



The GPMemorandum

TO: OUR FRANCHISE CLIENTS AND FRIENDS

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

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

ANTITRUST

ARBITRATORS RULE FOR FRANCHISOR IN SUPPLY CHAIN CHALLENGE

Franchisor American Dairy Queen Corporation and its corporate parent, International Dairy Queen, Inc., prevailed this month against the most recent challenges by a franchisee association and cooperative that represents some of its franchisees. An arbitration panel held that the franchisor and its parent's supply entity have not violated antitrust law or a prior settlement agreement with respect to the approval and distribution of products for use in franchisees' locations. *Dairy Queen Operators Association and Dairy Queen Operators Cooperative v. International Dairy Queen, Inc. and American Dairy Queen Corporation* (Arbitration Award, October 1, 2008). Gray Plant Mooty represented ADQ and IDQ in this matter, which was the third arbitration following the federal-court class action settlement in *Collins, et al. v. ADQ, et al.* (M.D. Ga. 2000), as reported in Issue 25 of *The GPMemorandum*.

In this most recent arbitration, the franchisee cooperative brought broad allegations under antitrust law. The panel rejected each claim brought by the cooperative, which competes for the sale of products to *Dairy Queen*® stores. First, the panel found that the franchisor's authorized warehouses have not engaged in below-cost pricing through product "bundling" and discount practices. The panel also found that ADQ and IDQ had legitimately enacted non-price restrictions such as the rationing of special limited-time-offer promotional products and the refusal to add "dual" warehouses that would carry the cooperative's products alongside the IDQ-sponsored line of products.

There has been no anticompetitive conduct by the franchisor or its approved supply chain, the panel found. For that reason, the arbitrators did not need to determine whether the claimants had set forth a cognizable “relevant market,” as also would have been necessary to prove an antitrust violation.

In addition to finding that the franchisor had not violated federal or state antitrust law, the panel rejected the breach of contract claims asserted by the association and cooperative. Nor did any of the claimants’ allegations on price or non-price issues establish breach of the covenant of good faith and fair dealing, the arbitrators held.

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In a non-antitrust case, the same franchisor also prevailed this June on associational standing grounds in *Michigan Dairy Queen Operators’ Association v. International Dairy Queen, Inc.*, 2008 WL 2566547 (W.D. Mich. June 9, 2008). In that case, the court granted the defendants’ motion and dismissed the plaintiffs’ claims, without prejudice, for lack of standing. The plaintiffs consisted of a group of four associations whose members are Dairy Queen® franchisees in various states. The associations claimed that the franchisor was breaching its franchise agreements by allegedly mandating conversion of outlets to DQ Grill & Chill® or Dairy Queen® Treat Center® units.

In reaching its conclusion that the state franchisee associations did not have standing to assert claims on behalf of their members, the court focused on whether the case would require the participation of individual members of the associations. Noting that this case involves “strictly contracts claims” based on the franchise agreements, the court could not fathom how those claims and the relief sought could be addressed without the franchisees. The court determined that the filing of individual contract actions by the franchisor or franchisees is better and more effective than the associations’ claims.

CHOICE OF FORUM

FRANCHISOR PREVAILS IN MOTION TO TRANSFER CASE TO TEXAS

In *Luv2bfit, Inc. v. Curves International, Inc.*, 2008 WL 4443961 (S.D.N.Y. Sept. 29, 2008), a federal court in New York enforced the Texas choice of venue clause in the franchise contracts of a Texas-based franchisor. Several New York franchisees alleged claims related to the purchase of their franchises and the franchisor’s compliance with its franchise agreements. They filed the case in New York, despite a Texas venue provision. The franchisor moved to dismiss for lack of venue or to transfer to Texas.

In granting the franchisor’s motion to transfer, the court first addressed whether the Texas venue clause was enforceable. The court rejected the franchisees’ argument that the New York Franchise Sales Act rendered the forum selection clause unenforceable. In

so doing, the court found that the anti-waiver provision of the NYFSA in no way limited the right of a New York franchisee to contractually agree to litigate disputes in a forum other than New York. The court also noted that forum selection clauses are given great deference and do not violate New York public policy.

The court then determined whether considerations of convenience and fairness weighed in favor of transferring the case to Texas. The court noted that there were witnesses in both New York and Texas, meaning that choosing one venue over the other would merely shift the inconvenience to the other party. Moreover, there were operative facts pertaining to both New York and Texas. The court recognized that New York courts would be more familiar with the franchisees' NYFSA claims, but that this was less important with respect to the franchisees' straightforward breach of contract claims. Finally, with an eye toward preserving judicial resources, the court noted there were similar cases already pending against the franchisor in federal court in Texas. Holding that the franchisees failed to demonstrate sufficient facts as to why New York was the better forum, the court concluded that because the parties agreed to a Texas forum in an enforceable contract provision, the case should be transferred.

JURISDICTION

KENTUCKY FEDERAL COURT DECLINES TO EXERCISE PERSONAL JURISDICTION OVER GUARANTORS

In *Fazoli's Franchising Systems, LLC v. JBB Investments, LLC*, 2008 WL 4525433 (E.D.Ky. Sept. 30, 2008), the United States District Court for the Eastern District of Kentucky addressed issues arising from the choice of law and venue provisions contained in the terms of several Fazoli's franchise agreements. Fazoli's claimed that the defendants, who were guarantors of the franchise agreements, were subject to personal jurisdiction in Kentucky by virtue of having signed their personal guaranty agreements in Kentucky.

In finding that no personal jurisdiction over the guarantors existed, the court found that minimum contacts with a forum state cannot be established solely on the basis of a contract between a resident and a nonresident of the state. The court held that execution of a guaranty with a Kentucky-based company did not mean that the signatories purposefully availed themselves of the privilege of transacting business in Kentucky. The court also found that the acts or omissions alleged to have occurred did not have a substantial enough connection with Kentucky to make the court's exercise of jurisdiction reasonable, as all acts involved in the case occurred in Arkansas or in other states except the signing of the personal guaranty agreements with a Kentucky company. Thus, the court found that there were inadequate minimum contacts between the defendants and Kentucky to provide personal jurisdiction over them.

Next, the court analyzed whether the requirement of personal jurisdiction was waived. The court stated that a party to a contract may waive its right to challenge personal jurisdiction by consenting to personal jurisdiction in a forum selection clause. Here, the court found that only the underlying franchise agreements contained an explicit waiver of any objection to the personal jurisdiction of the Kentucky courts and that the defendants were not a party to the franchise agreements. The court found that the guarantors did not waive the right to personal jurisdiction.

CONTRACTS

DISTRICT COURT REFUSES TO ISSUE INJUNCTION COMPELLING HOTEL FRANCHISOR TO TAKE RESERVATIONS FOR AFTER TERMINATION DATE

This month the United States District Court for the Western District of Michigan refused to grant a hotel franchisee's request for a preliminary injunction ordering its franchisor to take reservations for hotel stays occurring after June 30, 2009, the date that the parties agreed the franchise agreement between them would expire. *Lake Country Corp. v. Sheraton LLC*, 2008 WL 4534419 (W.D. Mich. Oct. 6, 2008).

Relations between the franchisee and Sheraton had begun to deteriorate after the franchisee refused to make required improvements to the hotel property. The franchisee brought suit, and the parties later settled, agreeing that the franchise agreement would expire on June 30, 2009. Thereafter, Sheraton refused to book guest reservations through its reservation system for stays occurring after the June 2009 termination date. The franchisee filed suit again, this time asserting that its rights to the use of the Sheraton reservation system did not expire until June 30, 2009, and that its customers should be allowed to make reservations using the system until June 30, regardless of the dates they would actually be staying at the hotel.

The court disagreed, finding that the franchisee had not made a showing of irreparable harm. First, the court found that the franchisee could use a third-party reservation system and simply pay Sheraton the usual fee for reservations booked for stays up to the termination date, June 30. After the termination date, however, the franchisee would become a Sheraton competitor, and the court held that the franchise agreement did not require Sheraton to assist the operator in such a situation. The court proceeded to rule in favor of Sheraton on the remaining three preliminary injunction prongs—likelihood of success on the merits, balance of harms, and public interest. As to the latter, the court noted that the public has interest in “avoiding the potential confusion and dissatisfaction which may result if guests call Sheraton’s reservation system to book a hotel only to find out later, perhaps even when they arrive, that the hotel is not a Sheraton.” The court also ordered the franchisee to state on its website and confirmation notices that it would not be operating as a Sheraton after June 30, 2009.



PROSPECTIVE PURCHASER OF DEALERSHIP IS NOT THIRD-PARTY BENEFICIARY OF AGREEMENT

The United States Court of Appeals for the Fifth Circuit recently concluded that a prospective purchaser of a vehicle dealership is not a third-party beneficiary of the seller's dealership agreement. In *K.P.'s Auto Sales, Inc. v. General Motors Corp.*, 2008 WL 4580087 (5th Cir. Oct. 15, 2008), K.P. offered to buy an existing Cadillac dealership, which submitted the proposed sale to GM for approval. K.P.'s lawsuit alleged that GM then improperly shared confidential information about K.P. and its principal with another dealer, who used that information to outbid K.P. In its case, K.P. argued that it was a third-party beneficiary of the selling dealer's contract with GM, which barred GM from disclosing confidential information submitted in the context of a proposed sale. The district court granted summary judgment to GM, concluding that K.P. was not a third-party beneficiary of the dealership agreement.

The Fifth Circuit affirmed. The court of appeals found that the dealership agreement between ADG and GM did not manifest a clear intent to benefit any other party. Accordingly, K.P. could not rely on that agreement to challenge GM's conduct.

TRADEMARKS

SENIOR TRADEMARK USER FAILS ON INFRINGEMENT AND CYBERSQUATTING CLAIMS AGAINST FRANCHISE SYSTEM

In *Dudley v. HealthSource Chiropractic, Inc.*, 2008 WL 4507714 (W.D.N.Y. Sept. 30, 2008), the owner of a chiropractic practice brought claims against a franchisor and local franchisee alleging trademark infringement and cybersquatting. The plaintiff had used the trademark HEALTHSOURCE in connection with a chiropractic practice in the Rochester, New York area prior to the defendant franchisor's adoption of the same mark. The franchisor's system expanded to over 170 franchisees, including one in the Rochester area. The plaintiff brought suit alleging that links to that franchisee as "HealthSource of Rochester" on the franchisor's website at www.healthsourcechiro.com and use of the mark HEALTHSOURCE on other promotional material constituted trademark infringement under the Lanham Act and cybersquatting under the Anticybersquatting Consumer Protection Act.

The court denied the plaintiff's motion for a preliminary injunction on the grounds that the plaintiff failed to show a likelihood of success on the merits. The court held that no likelihood of confusion as to the source of services existed, particularly since the website reference to the Rochester franchisee was changed to a different name and the franchisee had ceased using promotional material with the franchisor's mark.



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