The GPMemorandum

TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS

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

Quentin R. Wittrock, Editor of *The GPMemorandum*

Jason J. Stover, Assistant Editor

DATE: January 11, 2012—No. 151

In this issue of *The GPMemorandum*, we will begin with four articles of general interest to franchisors, followed by our summaries of recent case decisions. The first article is in celebration of our 15th year of publication, as mentioned last month.

RETROSPECTIVE

WHAT HAS FOLLOWED FROM *BROUSSARD v. MEINEKE*?

This is the first of our year-long series of articles reviewing the progeny of what we identified in our ten-year anniversary edition in December 2007 as the most significant franchise case decisions summarized in Issues 1 through 100 of *The GPMemorandum*, covering the period from late 1997 through 2007. The first of those cases was the groundbreaking decision on appeal in *Broussard v. Meineke Discount Muffler Shops*, 155 F.3d 331 (4th Cir. 1998). The decision issued by the Fourth Circuit in that case reversed a large judgment that had been entered against the franchisor, primarily based on its administration of the franchise system's advertising fund. That case was significant for two reasons. First, the court held that class action lawsuits are generally inappropriate in the franchise context because of the unique contracts and facts presented by individual franchisees' relationships with their franchisor. Second, the court determined that no fiduciary duty exists between franchisors and franchisees in the advertising fund situation in particular, or the franchise context in general.

The cases reported by *The GPMemorandum* over the past four years have followed the lead of the *Broussard* court. Since 2007, courts have repeatedly rejected franchisees' attempts to present their claims on a class basis. As reported in Issue 104, the court in *Good v. Ameriprise Financial, Inc.*, 2008 WL 185714 (D. Minn. 2008), found that franchisees' claims against their franchisor were limited by the terms of their individual agreements, which varied among members of the class. That variation prevented class certification because the proposed claims would require interpretation of those individual agreements. Many of the class action lawsuits in the franchise context over the past four years have been brought by third parties, such as patrons of franchised businesses. Other class action cases have been brought by janitorial franchisees, which some courts have held are more properly characterized as employees than franchisees. *See, e.g., De Giovanni v. Jani-King Int'l., Inc.*, 2009 WL 2993798 (D. Mass. 2009). In general, however, there has been a notable lack of successful class action claims brought by franchisees during the past four years.

The *Broussard* court's analysis of the advertising fund and fiduciary duty issues also has remained largely unchallenged. We have not reported on a single case involving a challenge to the manner in which a franchisor has administered its advertising fund during the past four years. While franchisees continue to plead claims for breach of fiduciary duty, we also have not reported a single case in which a court agreed with that theory.

The past fifty issues of *The GPMemorandum* have not seen any courts taking a significantly different approach than the *Broussard* court. Franchisee class action lawsuits have faced the same hurdles identified by the *Broussard* court, to the point where most reported decisions involving class action issues now arise in the third-party context. The lack of cases involving challenges to an advertising fund suggests that the *Broussard* court's analysis of that issue remains widely followed.

FRANCHISE SALES

NEW YORK ADOPTS "2012 FRANCHISE EXPO" REGISTRATION EXEMPTION

Franchisors who wish to exhibit at the June 2012 International Franchise Expo (IFE), being held for the first time this year in New York, may have the opportunity to do so without registering their franchises in the state. In October, the New York Office of the Attorney General published a unique franchise registration exemption under its "general" exemption powers pursuant to N.Y. Gen. Bus. L. § 684(1). Although the exemption will not allow franchisors to "sell" franchises or distribute Franchise Disclosure Documents, for $150 per day franchisors can attend the 3-day IFE, distribute promotional materials, and gauge interest in their franchises.

To take advantage of this 2012 IFE exemption, a franchisor must submit an exemption application form, which requires it to detail its litigation and bankruptcy history and answer general questions regarding its current and targeted franchise markets. Once a franchisor receives the exemption, it must display a prescribed sign at its booth alerting prospective franchisees that it is "not registered in New York, [and] is not lawfully permitted to sell franchises from or in New York."

The exemption application form may be found at:
http://www.ag.ny.gov/bureaus/investor_protection/franchise/NY%20Franchise%20Trade%20Show%20Application%20Final.pdf

FTC FRANCHISE RULE TO BE ENFORCED BY CONSUMER FINANCIAL PROTECTION BUREAU

The Consumer Financial Protection Bureau (CFPB) has announced that it will assume certain enforcement responsibilities for the FTC's Franchising Trade Regulation Rule. Details of how enforcement responsibilities will be shared with the FTC have been awaiting confirmation of a chair of the CFPB. Richard Cordray was named chair last week by President Obama.

Under Section 1063 (i) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the CFPB was required to publish in the Federal Register by July 21, 2011, a list of the rules and orders for which it would assume enforcement authority. The Franchise Rule was one of many over which the CFPB has been given enforcement authority.

The FTC remains responsible for amending, reviewing, and interpreting the Franchise Rule, and it will retain concurrent authority over enforcement. It remains unclear how decisions will be made about which cases to bring and how they will be resolved.

THE GPMemoradum INTERNATIONAL

CHINA'S MOFCOM AMENDS FRANCHISE MEASURES

On February 1, 2012, amendments to China's Commercial Franchise Registration Administrative Measures will become effective, clarifying the 2007 Measures. Among the clarifications in the 2011 Measures are:

1. Foreign franchisors must register with the Chinese Ministry of Commerce (MOFCOM) in Beijing, not one of the provincial Commerce Ministries.

2. Amendments to registrations must be filed when Chinese company registration information for the franchisor changes, when a change in the status of the

franchisor's intellectual property rights occurs, and when a change in the number, geographic distribution, territorial rights, gross sales, and profitability of franchised outlets occurs. The revised Measures do not articulate a materiality standard.

The two-plus-one rule, requiring franchisors to have at least two company-owned outlets in operation for at least one year before beginning franchising, has not been changed.

According to our colleagues at the Jun He law firm in Beijing, more substantive revisions to the Franchise Regulations are being prepared.

RECENT CASE DECISIONS

Here are summaries of recent case decisions of interest to franchisors.

POST-TERMINATION INJUNCTIONS: NONCOMPETE COVENANTS

COURT ENFORCES COVENANT AGAINST THIRD-PARTY NONSIGNATORIES AND AGAINST CONDUCT THROUGH A RELATED BUSINESS

The United States District Court for the District of New Jersey recently enforced a franchisor's noncompete agreement in two consolidated cases. In the first case, *Jackson Hewitt Inc. v. H.E.A.T. Enterprises, LLC*, 2011 U.S. Dist. LEXIS 144759 (D.N.J. Dec. 15, 2011), the court had previously issued an injunction against the corporate defendant and its owner. Jackson Hewitt then asked the court to apply the injunction against two individuals, Elter and Fournier, who were associated with the business but were not signatories to the franchise agreement. Jackson Hewitt alleged that Elter was the current owner of the corporate defendant. First, the court decided that if Elter was the owner of the corporate defendant, she could be bound by the injunction because an injunction may be enforced against successors-in-interest when there is a substantial continuity of identity between the organizations. Second, the court found that regardless of whether Elter was the new owner, she and Fournier were active in the operation of the corporate defendant, which allowed the court to enforce the injunction against them. Since Elter and Fournier handled customer service issues and marketing for the corporate defendant, and owned corporations that received deposits from the corporate defendant, they were in active concert with it and their competitive behavior could be enjoined.

The second case, *Jackson Hewitt Inc. v. G.A.L.T. Investments, LLC*, 2011 U.S. Dist. LEXIS 148546 (D.N.J. Dec. 21, 2011), also considered the reach of the noncompete agreement. In the *G.A.L.T.* case, the franchisee defendants sold their hard assets to, and

GRAY
PLANT
MOOTY

entered into a lease arrangement with, a new entity owned by a former employee, which operated a competing business at the same location as the former franchise. The parties disputed whether a preliminary injunction could apply to prevent Fournier from having an ownership interest in a business that provided services to the new entity. The court held that Jackson Hewitt was likely to succeed on its claim that Fournier was violating the noncompete due to his business relationship with the new entity. The court found it persuasive that the new entity was not sold to the former employee until after the lawsuit began and that Fournier's business was processing tax returns for the new entity. The mere fact that Fournier's business was located outside the restricted territory did not change the court's analysis because it was providing competitive services within the territory through its relationship with the new entity.

POST-TERMINATION INJUNCTIONS: TRADEMARK/SERVICE MARK VIOLATIONS

FORMER BUFFALO WILD WINGS FRANCHISEES ARE ENJOINED FROM USING FRANCHISOR'S TRADEMARKS

Buffalo Wild Wings (BWW) recently prevailed on its motion for a preliminary injunction to enjoin three franchisees from continuing to use BWW's trademarks after the termination of their franchise agreements. *Buffalo Wild Wings Int'l, Inc. v. Grand Canyon Equity Partners LLC*, 2011 U.S. Dist. LEXIS 141921 (D. Minn. Dec. 9, 2011). BWW terminated the franchisees for nonpayment, but allowed them to find a purchaser pursuant to a Limited Reinstatement Agreement. The Agreement would automatically expire and the franchisees would be required to immediately cease using the marks if they failed to sell their franchises by October 20, 2011. In the days leading up to the October 20 deadline, BWW notified the franchisees that they would have to discontinue their use of the marks. The deadline came and went, and BWW instituted a proceeding in two bankruptcy actions filed by the franchisees, and also filed for an injunction in Minnesota federal district court. During this time, the franchisees continued to operate using BWW's trademarks.

At the injunction hearing, the franchisees contended that BWW had waived its trademark claim because it acquiesced in their continued use of the marks. As support for their waiver argument, the franchisees pointed out that BWW had continued for a number of weeks following the termination of the Agreement to withdraw royalties and advertising fees from their bank accounts and provide them with system communications. The district court rejected this argument and awarded BWW the injunction it requested. The court noted that BWW repeatedly notified the franchisees that it did not consent to their use of the trademarks. In addition, the court found that BWW's decision to pursue legal remedies while simultaneously allowing the franchisees to operate did not undermine its likelihood of success or preclude it from obtaining injunctive relief. The court granted BWW's injunction motion and ordered the franchisees to deidentify and comply with the post-termination provisions of the franchise agreements.

TRADEMARKS AND TRADE ISSUES

COURT RULES HOLDOVER FRANCHISEE'S CONTINUED UNAUTHORIZED USE OF FRANCHISOR'S TRADEMARK CONSTITUTES "COUNTERFEIT" USE OF THE MARK AND ENTITLES FRANCHISOR TO ENHANCED DAMAGES

In *Century 21 Real Estate, LLC v. Destiny Real Estate Properties, et al.*, 2011 U.S. Dist. LEXIS 147075 (N.D. Ind. Dec. 19, 2011), the United States District Court for the Northern District of Indiana held that a holdover franchisee's continued unauthorized use of a franchisor's trademark constitutes use of a counterfeit mark, which allows the franchisor to seek additional damages and attorneys' fees and costs under the Lanham Act. To establish counterfeiting, a plaintiff must prove that the mark is identical with or substantially indistinguishable from a registered mark, that the mark is registered with the USPTO, that the defendant is not authorized to use the mark, and that the defendant acted with knowledge and intent.

Century 21 terminated the franchisee for nonpayment of fees and brought suit for trademark infringement after the franchisee continued using the mark following termination. The court noted a circuit split regarding whether holdover use constitutes counterfeiting, including the Sixth Circuit's express finding that such conduct is not counterfeit use and the Ninth Circuit's ruling that it is. Relying on the Seventh Circuit's guidance in a case involving deceptive packaging, the court found that a holdover franchisee is committing counterfeit use of a franchisor's trademark when it uses the mark after termination. It noted, "The Court can conceive of no reason why an ex-franchisee should escape liability for counterfeiting simply because that person had access to a franchisor's original marks because of the former relationship and therefore did not need to reproduce an identical or substantially similar mark."

COURT REJECTS EXTRATERRITORIAL APPLICATION OF LANHAM ACT

A United States District Court in California last month dismissed Pinkberry's case against parties who registered the trademark "Pinkberry" in Japan, concluding the Lanham Act did not extend to defendants' activities outside the United States. *Pinkberry, Inc., et al., v. JEC International Corp., et al.*, 2011 U.S. Dist. LEXIS 140669 (C.D. Cal. Dec. 7, 2011). The defendants registered the trademark at issue in Japan but never used it. After unsuccessfully attempting to purchase the right to the trademark from defendants, Pinkberry initiated a proceeding in Japan to cancel defendants' registration of the mark and, while that proceeding was still pending, it filed suit in California under the Lanham Act.

For the Lanham Act to apply extraterritorially, (1) the alleged violations must create some effect on American foreign commerce, (2) the plaintiff must suffer a cognizable injury, and (3) the interests of and links to U.S. foreign commerce must be sufficiently strong in relation to those of other nations to justify an assertion of extraterritorial authority. Pinkberry satisfied the first two elements because the defendants acted from within the United States and effectively precluded Pinkberry from entering the Japanese market, causing it harm. Pinkberry failed to satisfy the third element, however, primarily because the dispute between the parties had a relatively greater effect on foreign countries than on the United States.

COLORADO FEDERAL COURT DENIES FRANCHISOR'S MOTION FOR SUMMARY JUDGMENT ON ITS TRADEMARK CLAIM

In *Big O Tires, LLC v. Felix Bros. Inc.*, 2011 U.S. Dist. LEXIS 143087 (D. Colo. Dec. 13, 2011), a federal district court in Colorado denied a franchisor's motion for summary judgment on its trademark and trade dress claims against the owners of three Big O Tires franchises in California. The defendants had elected not to renew their franchise agreement for one of the units, and requested early termination of the remaining two units. After Big O, the franchisor, declined that request, the defendants continued to operate their remaining two franchises and changed the name of their third store to "Budget Tires and Automotive," but did not fully deidentify that location.

In denying Big O's motion for summary judgment, the court found that Big O was "sending mixed signals" to the defendants during the parties' negotiations regarding the post-termination obligations and whether Big O might take over the defendants' stores. Thus, the court found that there was a genuine dispute of material fact regarding whether Big O had acquiesced in the use of its marks during the parties' termination negotiations. The court concluded that to the extent that Big O was aware of the continued operation of the tire business, and was actively engaging in discussion regarding the possibility of that location remaining a Big O franchise in some form, a jury could conclude that Big O implied that it would not assert its trademark and trade dress rights until all negotiations over the termination of that location were complete.

GRAY PLANT MOOTY

FRAUD

COURT HOLDS THAT NEW JERSEY CONSUMER FRAUD ACT DOES NOT APPLY TO SALE OF FRANCHISES

The United States District Court for the Middle District of Florida recently dismissed a hotel franchisee group's claim against several hotel franchisor entities for violation of the New Jersey Consumer Fraud Act (NJCFA). *Amar Shakti Enters., et al. v. Wyndham Worldwide, Inc., et al.* , 2011 U.S. Dist. LEXIS 146903 (M.D. Fla. Dec. 21, 2011). The franchisee group brought a variety of claims against the franchisors of multiple hotel brands in connection with the franchisors' alleged practices of automatically enrolling hotel guests in brand loyalty programs and automatically matching guest stays with loyalty accounts (regardless of whether the guest requested it), thereby increasing loyalty program related fees to the franchisees. Although the court declined to dismiss the plaintiffs' claims for breach of contract, breach of the implied covenant of good faith and fair dealing, and violation of the Florida Unfair and Deceptive Trade Practices Act, the court did dismiss a claim for violation of the NJCFA. The NJCFA prohibits unconscionable and fraudulent conduct in connection with the sale of "merchandise," defined as "any objects, wares, goods, commodities, services or anything offered directly or indirectly to the public for sale." The court found that because franchise sales are "complex transactions entered into only after an extensive prequalification process," they are not the type of consumer sales that the NJCFA is designed to protect.

STATE FRANCHISE LAWS

NINTH CIRCUIT AFFIRMS SUMMARY JUDGMENT UNDER CFIL

In *Samica Enterprises, LLC v. Mail Boxes Etc., Inc.*, 2011 U.S. App. LEXIS 25530 (9th Cir. Dec. 1, 2011), the court affirmed a district court's grant of summary judgment in favor of two franchisors who were sued by a large number of their franchisees under California law relating to their initial investment in the franchises and the franchisors' administration of the franchise system. More than 200 franchisees of The UPS Store and Mail Boxes Etc. franchise systems brought various claims under the California Franchise Investment Act (CFIL) and common law against UPS and MBE. The franchisees' main complaint was that the franchisors had "duped" them into purchasing franchises with unfavorable pricing structures by stating that the franchisees' success would depend on their "efforts" and "customer service." The district court granted the franchisors' motion for summary judgment on all counts.

The Ninth Circuit affirmed. It held first that the CFIL, which imposes liability for misrepresentations in connection with the offer and sale of a franchise, required a showing of reasonable reliance by the franchisees and damages caused by the misrepresentations. The franchisees' claims failed because the franchisees had "presented no evidence that they had reasonably relied on any alleged untrue or misleading statement . . . ." The court also found that the franchisees' claim under the CFIL that the franchisors had failed to register an amendment to the franchise agreements in connection with the conversion to a new franchise model was barred by the statute's one-year limitations period. In addition, the Ninth Circuit concluded that MBE had not breached its duty to use "best efforts" to obtain incentives from UPS merely because MBE had used only oral, rather than written, requests for such incentives. Finally, the court affirmed the finding that the California choice of law provision in the franchise agreements applied because the claims would have failed even if other states' laws had applied.

INSURANCE

INSURER'S DUTY TO DEFEND FRANCHISEE TRIGGERED IN TRADEMARK INFRINGEMENT CASE

A federal court in California denied a commercial general liability insurance carrier's motion for summary judgment seeking a declaration that it had no duty to defend a former franchisee sued for trademark violations by the franchisor. *Tower Ins. Co. of New York v. Capurro Ent., Inc.*, 2011 U.S. Dist. LEXIS 144436 (N.D. Cal. Dec. 15, 2011). Certa Pro, a national franchisor of painting and decorating services franchises, had entered into a franchise agreement with defendant Capurro. After termination, Capurro began marketing a new business using Certa Pro's marks, including referring to itself as a former Certa Pro franchise and advertising its technicians as being trained by Certa Pro. Certa Pro sued Capurro for infringement and Capurro tendered defense to Tower under the Personal & Advertising Injury Liability coverage in its policy. Tower denied coverage and filed a declaratory judgment action. Tower argued that the underlying lawsuit complained of Capurro's use of Certa Pro's name and that simply using the name Certa Pro did not constitute use of Certa Pro's "advertising idea, trade dress, or slogan" under the policy.

The court rejected Tower's argument, relying on the allegations of the complaint asserting that Capurro wrongfully used Certa Pro's proprietary marks and trade dress. The court found the allegations in that complaint sufficient to allege an advertising injury under the policy, triggering Tower's duty to defend.

Minneapolis, MN Office

John W. Fitzgerald, cochair (612.632.3064)
Megan L. Anderson (612.632.3004)
Phillip W. Bohl (612.632.3019)
* Jennifer C. Debrow (612.632.3357)
* Elizabeth S. Dillon (612.632.3284)
* Ashley Bennett Ewald (612.632.3449)
* Michael R. Gray (612.632.3078)
Laura J. Hein (612.632.3097)
Kelly W. Hoversten (612.632.3203)
Franklin C. Jesse, Jr. (612.632.3205)
Cheryl L. Johnson (612.632.3271)
Jeremy L. Johnson (612.632.3035)
* Gaylen L. Knack (612.632.3217)
Craig P. Miller (612.632.3258)

Kirk W. Reilly, cochair (612.632.3305)
Bruce W. Mooty (612.632.3333)
John W. Mooty (612.632.3200)
* Kevin J. Moran (612.632.3269)
* Kate G. Nilan (612.632.3419)
* Matthew G. Plowman (612.632.3425)
Angela L. Rud (612.632.3281)
* Max J. Schott II (612.632.3327)
* Jason J. Stover (612.632.3348)
Michael P. Sullivan, Sr. (612.632.3351)
Michael P. Sullivan, Jr. (612.632.3350)
Henry Wang (612.632.3370)
Lori L. Wiese-Parks (612.632.3375)
* Quentin R. Wittrock (612.632.3382)

Washington, DC Office

* **Robert L. Zisk, cochair (202.295.2202)**
Julia Colarusso (202.295.2217)
* Maisa J. Frank (202.295.2209)
* Jeffrey L. Karlin (202.295.2207)
* Peter J. Klarfeld (202.295.2226)
Sheldon Klein (202.295.2215)
* Iris F. Rosario (202.295.2204)
* Stephen J. Vaughan (202.295.2208)
* Katherine L. Wallman (202.295.2223)
* David E. Worthen (202.295.2203)
Eric L. Yaffe (202.295.2222)
* Carl Zwisler (202.295.2225)

**** Wrote or edited articles for this issue.***

For more information on our Franchise and Distribution practice and for recent back issues of this publication, visit the **Franchise and Distribution** practice group at www.gpmlaw.com/practices/franchise-and-distribution.aspx.

GRAY PLANT MOOTY

500 IDS Center
80 South Eighth Street
Minneapolis, MN 55402-3796
Phone: 612.632.3000
Fax: 612.632.4444

Suite 700, The Watergate
600 New Hampshire Avenue, N.W.
Washington, DC 20037-1905
Phone: 202.295.2200
Fax: 202.295.2250

franchise@gpmlaw.com