The GPMemorandum

TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS

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

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DATE: September 17, 2012—No. 159

Here are summaries of recent decisions and laws of interest to franchisors.

JURISDICTION AND PROCEDURE

ILLINOIS STATE COURT DISMISSES PLAINTIFF'S CLAIMS AGAINST HOTEL FRANCHISOR ON *FORUM NON CONVENIENS* GROUNDS

An Illinois court recently dismissed a case brought by a celebrity sports journalist against a hotel franchisor arising out of alleged privacy violations. *Erin Andrews v. Marriot International, Inc.,* No. 10-L-8186 (Cook County Circuit Court, state of Illinois, August 10, 2012). In a case defended by Gray Plant Mooty, Erin Andrews filed a lawsuit in Illinois against Radisson Hotels International, Inc. (and other hotel companies) alleging that she was illegally viewed in the nude by an individual who stalked her and altered the peephole in her guest room door at various hotels in Milwaukee, Nashville, and Columbus. Plaintiff sought to have all her claims against all defendants tried in one lawsuit in Cook County Circuit Court.

Radisson moved to dismiss the plaintiff's lawsuit pursuant to the doctrine of *forum non conveniens*, arguing that the Radisson® hotel at issue was located in Wisconsin. In dismissing the action, the Cook County Circuit Court noted that in weighing both the private and public interest factors that Illinois courts must consider in determining *forum non conveniens* motions, all the relevant factors strongly favored Radisson's suggested forum of Milwaukee County, Wisconsin. The court specifically noted that the franchised Radisson hotel at issue was located in Wisconsin, the individuals with the most knowledge of the alleged incident were located in Wisconsin, compulsory process for the attendance of unwilling witnesses would not be available in Cook County, and the perpetrator was no longer a resident of the state of Illinois. In addition, the court stated that because the plaintiff did not reside in Cook County, her choice of forum was given less deference. Accordingly, the court held that a Wisconsin court had a much greater interest in resolving the matter and dismissed the action against Radisson. The court also dismissed the other defendants from the action on grounds specific to each of them, including lack of *in personam* jurisdiction, sovereign immunity, and the existence of another action pending in Tennessee.

LIMITATIONS OF ACTIONS

COURT APPLIES STATUTE OF LIMITATIONS TO BAR FRANCHISEE'S CLAIM

In a case litigated by Gray Plant Mooty, the United States Court of Appeals for the Sixth Circuit recently reversed a federal trial court's judgment in favor of a franchisee in a dispute over a development contract on the grounds that its claims were barred by the agreement's two-year limitations provision. The franchisee in *Progressive Foods, LLC v. Dunkin' Donuts, Inc.*, 2012 WL 3241696 (6th Cir., Aug. 9, 2012), had opened three stores under a six-store development contract before Dunkin' terminated the deal for nonpayment of fees associated with the agreement. The franchisee then sued Dunkin' for alleged wrongdoing associated with the development process, seeking more than $6 million in damages and the right to develop the three remaining stores. Dunkin' brought a counterclaim to enforce the termination of the development agreement and to obtain payment of the required fees. The development agreement contained a limitations provision which required any claims to be brought "within two years after the discovery of facts giving rise to such claim and action." The franchisee, however, claimed that it had notified Dunkin' of "all of the issues and problems and their claims" on a date that was more than two years before the filing of the franchisee's initial complaint. Although Dunkin' had repeatedly raised the limitations issue both before and during trial, the district court ignored the issue entirely. Instead, it awarded the franchisee $336,000 in damages and an injunction to allow the franchisee to develop three additional stores. The court also ordered the franchisee to pay the $100,000 in fees it owed Dunkin' under the development contract.

The Sixth Circuit reversed the judgment, holding that the franchisee's claims were completely barred by the limitations provision. The court found that the franchisee's allegation that it had notified Dunkin' about all of the facts and issues in the case by a particular date was not factually correct. The statements parties make in their pleadings, the panel noted, are "judicial admissions." The court commented that although such admissions must be shown to have been deliberate, clear, and unambiguous, "they do not also have to be true" since a "judicial admission trumps the evidence." It concluded that there was "no doubt" that the franchisee's admissions in this case were deliberate since it had repeated the same statement multiple times in its pleadings. Moreover, the franchisee had not sought to amend its complaint to correct any alleged errors despite the fact that Dunkin' had highlighted the limitations issue in its answer, its motion for summary judgment, and its post-trial proposed findings of facts and conclusion of law. Thus, the panel concluded that the franchisee's statement was "a binding admission as to when it discovered the factual basis for all of its claims against [Dunkin']." On that basis, the district court's award of damages and injunctive relief was reversed in its entirety and judgment was entered in Dunkin's favor.

RENEWALS

EIGHTH CIRCUIT REVERSES DISTRICT COURT FINDING THAT FRANCHISE AGREEMENT WAS RENEWABLE IN PERPETUITY

In a case in which Gray Plant Mooty represented H&R Block, the United States Court of Appeals for the Eighth Circuit reversed a district court holding that Block was required to continue performing its obligations under certain franchise agreements in perpetuity. *H&R Block Tax Services LLC v. Franklin*, 2012 WL 3870574 (8th Cir. Sept. 7, 2012). The franchise agreements at issue provided that they would "automatically renew" for successive five-year terms, but that the franchisee could elect not to renew if it gave 120 days' notice. After the agreements had remained in force for 30 years, Block gave the franchisee notice that it would decline to renew the agreements again.

On cross-motions for summary judgment, the district court held that Block had "clearly implicated" that it intended to remain in the franchise relationship until the franchisee elected to end it, no matter how long that might be. The court of appeals reversed, finding that "the Missouri Supreme Court has set the bar high" with regard to construing a contract to allow one party to coerce the other to continue performing in perpetuity. To support such a holding under Missouri law, the Eighth Circuit held, "there must be an <u>unequivocal</u> expression that the contract last forever." While acknowledging that the practical effect of the contract language at issue would be to create agreements that continued in perpetuity, the court held that the language was insufficient under Missouri law to create an enforceable perpetual agreement. Instead, the agreements were construed to allow Block, as well as the franchisee, to elect not to renew the relationship.

TERMINATIONS

SEVENTH CIRCUIT DENIES FRANCHISOR RIGHT TO TERMINATE FRANCHISEE FOR FAILING TO FOLLOW NEW PRICING POLICY

Affirming a preliminary injunction reported in Issue 144 of *The GPMemorandum*, the United States Court of Appeals for the Seventh Circuit has found that a five-unit Steak N Shake franchisee would suffer "irreparable harm" if terminated for failing to comply with new policies governing pricing. *Stuller, Inc. v. Steak N Shake Enterprises, Inc.*, 2012 U.S. App. LEXIS 17921 (7th Cir. August 24, 2012). The court based its ruling on evidence submitted by the franchisee that the pricing policy "would be a significant change to its business model and it would negatively affect its revenue, possibly even to a considerable extent." Given that prospect, the court agreed with the district court that the franchisee's failure to follow the new policy would not cause "self-inflicted" harm. The court noted that the franchisee's subsequent victory on summary judgment on July 12, 2012, as summarized in our last issue of *The GPMemorandum*, also supported affirmance of the preliminary injunction, because that ruling increased the plaintiff's ultimate likelihood of success on the merits of the case.

STATE FRANCHISE LAWS

CONNECTICUT FRANCHISE ACT DOES NOT EXTEND PROTECTION TO TERMINATED INSURANCE AGENT

The United States District Court for the District of Connecticut recently held that a terminated insurance agent could not claim the protection of the Connecticut Franchise Act (CFA). In *Garbinski v. Nationwide Mut. Ins. Co.*, Bus. Franchise Guide (CCH) ¶ 14,872 (D. Conn. July 24, 2012), Garbinski entered into an Independent Contractor Agent's Agreement with Nationwide. Under that agreement, Garbinski had the right to sell Nationwide insurance products to his customers, but also the right to sell products offered by other insurers. After Garbinski was charged in connection with a highly publicized domestic incident with his wife, Nationwide terminated his independent contractor agreement. Garbinski brought suit, claiming that Nationwide had terminated him in violation of the CFA.

In siding with Nationwide, the court found that an independent insurance agency is not a franchise within the meaning of the CFA. The court found it persuasive that Nationwide did not prescribe a marketing plan for Garbinski's agency and Garbinski retained the right to sell insurance products offered by other insurance companies. Even if Garbinski's independent insurance agency could be considered a franchise, the court found that Nationwide had good cause under the CFA to terminate Garbinski because his domestic incident breached the terms of his agreement. The court found that Nationwide could reasonably conclude that Garbinski's conduct breached his obligation to maintain a positive reputation in the community. The court thus granted Nationwide summary judgment on Garbinski's wrongful termination claim.

FRANCHISEE ABLE TO PURSUE WRONGFUL TERMINATION CLAIM BASED UNDER INDIANA ACT DESPITE TIME-BARRED CLAIM UNDER DISTRIBUTOR AGREEMENT

An Indiana district court recently allowed a terminated distributor to allege that a manufacturer had violated a state deceptive franchise practices act by terminating its distributor agreement without good cause, even though the distributor's challenge to the agreement's unilateral termination provision was time-barred under the terms of the agreement itself. *Irvin Kahn & Son, Inc. v. Mannington Mills, Inc.*, 2012 U.S. Dist. LEXIS 116308 (S.D. Ind. Aug. 17, 2012). The plaintiff, a wholesale distributor of floor coverings, entered into a 1999 distributor agreement, which the manufacturer could terminate unilaterally for any reason with thirty days' notice. The manufacturer terminated the agreement in 2011. After suit was filed, the manufacturer prevailed on a theory that the distributor was not challenging the termination itself, but rather claiming that the distribution agreement contained a unilateral termination provision in violation of the Indiana Deceptive Franchise Practices Act. The court held that claims under the Act must be brought within two years of the date on which the parties entered into the agreement at issue. Since the distributor had filed suit more than two years after that date, the court found that its statutory claim was time-barred.

The distributor moved to amend its complaint to clarify that its DFPA claim challenged the actual termination of its agreement. The manufacturer argued that the Indiana statute's list of unlawful practices did not include termination. The court, however, determined that the act did allow a distributor to challenge the actual termination of an agreement without good cause as a separate cause of action. Because the statute of limitations under the DFPA did not start to run until termination, the court held, the distributor was allowed to amend.

CONTRACTS

FRANCHISOR AWARDED DAMAGES; FRANCHISEE'S CLAIMS BASED ON FRANCHISOR DUTIES DISMISSED ON SUMMARY JUDGMENT

The United States District Court for the Eastern District of California recently granted summary judgment to a franchisor on a franchisee's claim that it had breached the franchise agreement, thus relieving the franchisee of the obligation to pay fees. In *Century 21 Real Estate LLC v. All Professional Realty, Inc.,* 2012 U.S. Dist. LEXIS 111744 (E.D. Ca. August 7, 2012), All Professional Realty, Inc. owned and operated several

Century 21 franchises in California and Hawaii. After several years of operation, All Professional closed one of its California locations and stopped paying franchise fees for its other locations. As a result, Century 21 terminated All Professional's franchise agreements.

All Professional filed a lawsuit in California state court against Century 21 for breach of contract, fraud, and various other claims. Century 21 filed suit against All Professional in California federal court and New Jersey state court (based on a forum selection clause in one of the franchise agreements), bringing claims for trademark infringement, federal unfair competition, breach of contract, breach of guaranty, and related claims. All cases were removed or transferred to the U.S. District Court for the Eastern District of California. Century 21 then filed a motion for summary judgment on its claims for trademark infringement, breach of contract, and breach of guaranty, as well as on All Professional's claims.

In granting Century 21's motion for summary judgment on all claims except a single minor contract claim, the court found that the claim that Century 21 had breached the franchise agreements was without merit. All Professional argued that Century 21 breached the franchise agreements when it failed to stop other franchisees from recruiting its agents. All Professional also alleged that Century 21 released confidential information regarding its finances that undermined its agents' confidence in the franchised business. All Professional further alleged that Century 21's failure to protect its name and trademarks from third party infringement violated the franchise agreements. The court concluded that Century 21 had no duty to (1) prevent other franchisees from recruiting All Professional's agents; (2) protect All Professional's financial information from disclosure; or (3) prosecute entities that infringed upon the Century 21 name and trademarks. Accordingly, those alleged inactions could not serve as an excuse for All Professional to stop paying its franchise fees. The court awarded Century 21 over $195,000 in actual damages, over $575,000 in lost future profits, and over $86,000 as treble damages for willful trademark infringement. The court also enjoined All Professional and its owners from further use of Century 21's marks.

JURY DEMAND AND WAIVER

WISCONSIN COURT FINDS FRANCHISEE WAIVED ITS RIGHT TO TRIAL BY JURY

The United States District Court for the Western District of Wisconsin recently upheld the jury waiver provision in a franchise agreement under the Wisconsin Fair Dealership Law (WFDL). In *Novus Franchising, Inc. v. Superior Entrance Systems, Inc., et al.*, 2012 U.S. Dist. LEXIS 115640 (W.D. Wis. August 15, 2012), Novus Franchising and defendants Superior Entrance Systems, Inc. (SES) and Knute Pedersen were parties to a franchise agreement for the operation of a Novus business. Although SES's affiliate, defendant Superior Glass, Inc. (SGI), did not sign the franchise agreement, SGI actually operated the Novus business, paid Novus the royalty fees, and used Novus's trademarks.

The franchise agreement contained a provision under which the parties waived their right to trial by jury. The court found that the WFDL did not invalidate jury waivers, Defendants argued that the jury trial waiver should not extend to SGI because it did not sign the franchise agreement. The court rejected that argument, finding that because SGI was the principal beneficiary of the franchise agreement, it was equitably estopped from arguing that the franchise agreement did not apply to it.

TRADEMARKS

COURT DISMISSES CLAIMS AGAINST WEBSITE AND LANHAM ACT CLAIMS PERTAINING ONLY TO REGISTERED MARKS

Wine & Canvas, an Indiana franchisor whose franchisees organize parties where guests can enjoy cocktails during painting classes, sued YN Canvas, which operated a Wine & Canvas location in San Francisco. *Wine & Canvas Development, LLC v. YN Canvas CA, LLC, et al.*, 2012 U.S. Dist. LEXIS 111273 (S.D. Ind. Aug. 7, 2012). The nature of the parties' relationship was in dispute, including whether the arrangement was a license or a franchise. The suit alleged trademark infringement, unfair competition, breach of contract, and a number of other claims. The complaint named several defendants, including an officer of YN Canvas and YN Canvas' website, www.art-uncorked.com. The defendants brought a motion to dismiss for lack of personal jurisdiction and failure to state a claim.

The court held that sufficient minimum contacts existed to exercise personal jurisdiction over the corporate and individual defendants. However, with regard to the website, the court granted the motion to dismiss, as a website "is not an entity capable of being sued." The court also granted the motion to dismiss the Lanham Act claims under Sections 1114(1)(a) and 1116(d), as those sections apply only to registered marks and Wine & Canvas's federal trademark applications were still pending. The court dismissed those claims without prejudice, indicating that the plaintiff could bring them again once its marks were properly registered. [The proper section of the Lanham Act for claims involving unregistered marks is 15 U.S.C. § 1125(a).]

GRAY PLANT MOOTY

POST-TERMINATION OBLIGATIONS: COVENANT AGAINST COMPETITION

FEDERAL COURT ENTERS PRELIMINARY INJUNCTION TO ENFORCE COVENANT AGAINST COMPETITION

In *Allegra Network LLC v. Cormack*, 2012 U.S. Dist. LEXIS 117014 (E.D. Mich. Aug. 20, 2012), the court granted a preliminary injunction enforcing a post-termination covenant against competition. The franchisor terminated the franchise rights of an Insty-Prints Center based on its failure to pay royalty and advertising fees, report royalty figures, and use only the franchisor's marks. When the franchisees began operating a competing business in the same location as their terminated franchise, the franchisor sought a preliminary injunction to enforce the noncompetition provision, which prevented the franchisees from having any direct or indirect interest in a competitive business within a ten-mile radius of their terminated franchise, or a five-mile radius of any other Insty-Prints Center for a period of two years. The franchisor also sought compliance with other post-termination obligations, including deidentification of the terminated franchise.

In considering whether to grant the franchisor's motion, the court evaluated the four familiar elements of: likelihood of success on the merits, irreparable harm to the franchisor, harm to others, and the public interest. To determine whether the franchisor was likely to succeed on the merits, the court applied a Michigan statute which provides that noncompetition provisions in employment agreements will be upheld when they are reasonable in duration, geographic scope, and scope of the activities restrained. The court decided that both the duration and the geographic scope were reasonable. It also concluded that the franchisor had a reasonable interest in protecting its customer base, goodwill, and confidential information. Since the noncompetition provision was intended to protect those things, its scope was reasonable and the franchisor was likely to succeed in enforcing it. Next, the court found that the loss of customer goodwill would likely cause irreparable harm to the franchisor, that granting an injunction would not cause harm to third parties, and that an injunction would serve the public interest. Although the franchisees attempted to argue that they would suffer harm because they were not in a financial position to comply with the noncompetition provision, the court held that any harm to the franchisees was self-inflicted because they intentionally breached their franchise agreement.

COURT HOLDS NONCOMPETE AGREEMENT ENFORCEABLE ONLY WHERE FRANCHISE AGREEMENT IS TERMINATED, NOT WHEN IT EXPIRES

In *Hamden v. Total Car Franchising Corp.*, 2012 U.S. Dist. LEXIS 111432 (W.D. Va. Aug. 7, 2012), a Virginia federal district court held that where a franchise agreement expired at the end of its term, the post-termination non-compete clause was unenforceable because the clause only applied in situations where the agreement was terminated prior to expiration. The parties' franchise agreement expired in May 2011, but the franchisee continued operating as a franchisee because he did not realize the term had ended. After receiving a reminder from the franchisor of his right to renew the agreement, the franchisee notified the franchisor that he would not renew his franchise and ceased operations. The franchisee then filed a lawsuit seeking a declaration that the non-compete agreement was unenforceable because it only applied when the franchise agreement was terminated, and not when it simply expired. In response, the franchisor argued that expiration is a form of termination and that the post-termination restrictive covenant was therefore enforceable. The court disagreed, finding that the language of the non-compete agreement confirmed that "termination" is distinct from and does not encompass "expiration."

DAMAGES

LIQUIDATED DAMAGES PROVISION UPHELD IN FACE OF ALLEGED ORAL PROMISE

The United States District Court for the District of New Jersey recently granted summary judgment in favor of the franchisor of the Wingate Hotels system on its claim for damages (including liquidated damages) arising from the early termination of a franchise agreement by a franchisee. In *Wingate Inns International, Inc. v. P.G.S, LLC,* 2012 U.S. Dist. LEXIS 115745 (D.N.J. Aug. 16, 2012), the franchisee entered into a franchise agreement for a ten-year term. The agreement stated that the franchisee would pay liquidated damages capped at $250,000 if it terminated the franchise agreement prior to its expiration. Later, the franchisee signed a promissory note in favor of Wingate for $250,000, in exchange for which the franchisee received the same amount to be used toward building and later expanding the hotel. After opening its hotel, but several years before expiration of the term, the franchisee notified Wingate that it was terminating the franchise agreement. Wingate acknowledged the termination, then sought damages from the franchisee for royalties and other amounts due under the agreement, the remaining amounts due under the promissory note, and the $250,000 in agreed-upon liquidated damages.

In response, the franchisee claimed that it had been fraudulently induced to enter into the franchise agreement by statements by Wingate representatives that: (a) *all* damages arising from termination by the franchisee (not merely the liquidated damages) would be capped at $250,000 and (b) 30% of franchisee's reservations would come from Wingate's reservation system. The court rejected both of these arguments. With respect to the claim that Wingate fraudulently concealed the real meaning of the damages cap, the court found that the franchisee's testimony was barred by the parol evidence rule and that the franchise agreement and note unambiguously provided for all three categories of damages. With respect to Wingate's alleged representations regarding the percentage of reservations the franchisee could expect from the reservation system, the court noted that a promise regarding future events that are outside the promisor's control may not form the basis of a fraud claim. The court also held that under Third Circuit precedent, the New Jersey Consumer Fraud Act does not apply to the sale of franchises.

VICARIOUS LIABILITY

CALIFORNIA COURT FINDS THAT FRANCHISOR COULD BE HELD LIABLE FOR RESTAURANT PATRON'S INJURIES BASED ON AGENCY RELATIONSHIP

In *Ford v. Palmden Restaurants, LLC*, Bus. Franchise Guide ¶ 14,877 (Cal. Ct. App. July 31, 2012), a California Court of Appeal held that the plaintiff had raised a triable issue of fact as to whether Denny's and several of its affiliated corporate entities could be held jointly liable for the injuries he sustained at a franchised restaurant. The plaintiff brought a negligence action against the franchisee and the Denny's entities after being attacked by members of a street gang who were known to frequent the premises. The lower court granted summary judgment in favor of Denny's, finding that it could not be held liable for the franchisee's acts or omissions with respect to instituting appropriate security measures at the restaurant because the franchisee was not its agent. The plaintiff appealed the judgment on the grounds that there was a genuine issue of fact as to the existence of an agency relationship between Denny's and the franchisee.

In reversing the lower court's ruling, the Court of Appeal held that the plaintiff had set forth facts sufficient to allege that the franchisee was Denny's ostensible agent. The court stated that in order to prevail on an ostensible agency theory, the plaintiff would need to allege that (1) he reasonably believed that the franchisee had the authority to act on behalf of Denny's, (2) his belief was generated by some act or omission on the part of Denny's, and (3) he relied on the franchisee's apparent authority. The court determined that the plaintiff had satisfied these elements because the franchisee used Denny's name, logo, and other trademarks in the operation of its business without indicating its franchisee status. The court found that the public could not easily know whether particular restaurants were owned by Denny's or by franchisees. The court further found that the plaintiff had reasonably relied on advertisements identifying Denny's as a family restaurant in which patrons could enjoy their meal in a safe and secure environment. Denny's did not challenge the applicability of the ostensible agency theory and instead argued that holding franchisors liable for the wrongful acts of its franchisees would endanger the franchise business model. The court had previously rejected a similar argument and suggested that Denny's could have protected itself by requiring that its franchisees inform the public of their franchisee status. Finally, the court concluded that Denny's had waived any challenge to the plaintiff's argument that the affiliated entities should be treated as alter egos for purposes of the appeal.

CLASS ACTIONS

COURT APPROVES SETTLEMENT OF FRANCHISEES' CLASS ACTION FLSA CLAIMS

In 2008, a group of over 300 current and former franchisees of SuperShuttle International, Inc., a shared-ride airport taxi shuttle service, commenced an action against the franchisor. The franchisees claimed that they were employees of the franchisor and were improperly denied a minimum wage and overtime compensation under the New York Labor Law and the Fair Labor Standards Act. In *Reid v. SuperShuttle Int'l, Inc.*, 2012 U.S. Dist. LEXIS 113117 (E.D.N.Y. Aug. 10, 2012), the United States District Court for the Eastern District of New York granted the plaintiffs' motion to approve a settlement of the case. The settlement consisted primarily of a nominal monetary award to class members who are not current SuperShuttle franchisees, creation of a new "Franchise Resale Opportunity Program," and the inception of certain "procedural safeguards" relating to decisions to suspend or terminate a franchisee.

While acknowledging that the "settlement is modest," the court stated that it still benefitted the franchisees because they faced significant challenges in establishing liability. In particular, the court noted that plaintiffs could have a hard time proving they were employees rather than independent contractors. Similar claims brought by drivers for other companies had failed, and several SuperShuttle drivers were unable to establish their status as employees in arbitration proceedings. Plaintiffs also faced arguments that they were not entitled to overtime pay under the FLSA or NYLL because of the "Motor Carrier Exception," and that most of them could not recover for any violation of the minimum wage laws because their gross income exceeded the applicable minimum wage. Based in large part on its conclusion that the franchisees "face[d] a real and substantial risk of obtaining nothing if [the] case were to proceed," the court approved the proposed settlement.

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