The GPMemorandum

TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS

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

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CASE SUMMARIES

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

ARBITRATION

FOURTH CIRCUIT REVERSES DISTRICT COURT'S RULING THAT FRANCHISE ARBITRATION CLAUSE WAS UNCONSCIONABLE

The Fourth Circuit overturned a district court's decision not to enforce a franchise agreement's arbitration clause in *Muriithi v. Shuttle Express, Inc.*, 712 F.3d 173 (4th Cir. Apr. 1, 2013). The lower court had denied Shuttle Express's motion to compel arbitration after concluding that the arbitration clause was unconscionable because of (1) a class action waiver; (2) a requirement that the parties split arbitration fees; and (3) a one-year limitation on claims arising under the agreement. The Fourth Circuit concluded that the district court's first rationale was not sound in light of the controlling Supreme Court precedent in *AT&T Mobility LLC v. Concepcion*, 563 U.S. ___, 131 S. Ct. 1740 (2011). Under *Concepcion*, courts are prohibited from altering an otherwise valid arbitration agreement by applying the doctrine of unconscionability to eliminate a class action waiver. Therefore, the Fourth Circuit found that the district court had erred in holding that the class action waiver was unconscionable.

The Fourth Circuit next decided that the lower court erred in finding the fee-splitting provision in the arbitration clause to be unconscionable. The appellate court agreed that an arbitration clause could be unconscionable where it imposed on an aggrieved party fees that are so prohibitive as to effectively deny access to the arbitral forum. However, the court noted that it is the plaintiff's burden to prove that the actual costs were prohibitive. Although Muriithi claimed that the cost of arbitration would far exceed the value of his claim, the Fourth Circuit decided that he had not provided evidence of the value of his claim and provided insufficient evidence of the actual cost of arbitrating. Finally, the Fourth Circuit held that the district court had erred in finding the franchise agreement's one-year limitation on claims to be unconscionable. Because the limitation was part of the general terms of the parties' contract, and not part of the arbitration clause itself, it was improper for the district court to consider the provision while analyzing the enforceability of the arbitration clause. The court stated that arguments about the general terms of the contract, as opposed to specific arguments about the arbitration clause, should be left for the arbitrator to decide. Therefore, the Fourth Circuit vacated the district court's judgment and remanded with instructions to compel arbitration.

JURY DEMAND AND WAIVER

EASTERN DISTRICT OF MISSOURI ENFORCES PROVISIONS WAIVING THE RIGHT TO A JURY TRIAL, PUNITIVE DAMAGES, AND LOST FUTURE PROFITS

In *Dunkin' Donuts Franchising, LLC, v. SAI Food and Hospitality, LLC,* 2013 U.S. Dist. LEXIS 359472 (E.D. Mo. Mar. 15, 2013), the United States District Court for the Eastern District of Missouri granted Dunkin's motion to strike the franchisees' jury demand, and their request for punitive damages and lost profits. Gray Plant Mooty represents the franchisor in this case. The court enforced the mutual jury trial waiver contained in the parties' contracts on the basis that it was unambiguous and conspicuous. In addition, the court noted that the franchisees were experienced business people, there were no allegations of fraud, and the franchisees had the assistance of counsel in their contractual dealings.

The court also enforced franchise agreement provisions waiving punitive damages and lost future profits. Because such damages are not fundamental rights, they can be waived in commercial contracts, particularly where the waiver provisions are mutual. Accordingly, the court granted Dunkin's motion to strike the claim for damages.

INSURANCE

FRANCHISOR'S CLAIM FOR INSURANCE COVERAGE DISMISSED BASED ON CONTRACTUAL EXCLUSION

A federal court in Michigan granted summary judgment to an insurance carrier following its denial of liability coverage and refusal to defend a franchisor based on the policy's contractual liability exclusion. In *Certified Restoration Drycleaning Network, LLC v. Federal Ins. Co.*, 2013 U.S. Dist. LEXIS 54457 (E.D. Mich. Apr. 16, 2013), the franchisor (CRDN) sought defense coverage under its general liability insurance policy for an underlying lawsuit by a franchisee. The lawsuit arose after CRDN sold a franchise to a company named East Coast Garment Restoration and then unilaterally discontinued the franchise relationship eleven days later based on information it learned in a background check on East Coast's owner. East Coast sued CRDN for breach of contract and breach of the covenant of good faith and fair dealing. CRDN notified Federal Insurance Company of the lawsuit, but Federal denied coverage under an exclusion in the policy for any claim "based upon, arising from, or in consequence of" any actual or alleged liability under "any contract or agreement" (except to the extent that an insured would have been liable without the agreement). CRDN ultimately settled with East Coast after mandatory arbitration. CRDN then filed a lawsuit against Federal resulting in cross-motions for summary judgment on the meaning of the policy language.

CRDN argued that the contractual exclusion should not apply because the substance of East Coast's complaint alleged pre-sale misrepresentation. The court disagreed finding that the complaint detailed a story of the alleged execution and breach of the franchise agreement. The form and substance of the complaint all supported the conclusion that East Coast's claims against CRDN "arose out of" its alleged breach. Contrary to CRDN's position, the court determined that misrepresentation allegations only constituted a small part of the background story. The court granted Federal's motion for summary judgment and dismissed CRDN's claim.

DAMAGES TO FRANCHISOR

FRANCHISOR RECOVERS LANHAM ACT AND ACTUAL DAMAGES FROM HOLDOVER FRANCHISEE

A federal court in Texas awarded a hotel franchisor statutory damages consisting of profits, additional damages and costs, plus actual damages measured by lost royalties. *Choice Hotels Int'l, Inc. v. Bhakta*, 2013 U.S. Dist. LEXIS 49863 (S.D. Tex. Apr. 5, 2013). The lawsuit arose after Choice Hotels terminated a franchisee for its failure to comply with remodel requirements and to timely pay fees. Although the franchisee received a notice of termination in which Choice Hotels specifically demanded that the franchisee cease using its trademarks, the franchisee continued operating under the marks for sixteen months.

The court first awarded Choice Hotels damages authorized by the Lanham Act in the form of the franchisee's "profits" during the relevant time period. Although the franchisee protested that over the sixteen-month period it posted a net loss, the court followed the rule that when intellectual property is infringed, the owner "is not treated as a 'partner' subject to both profits and losses," but rather "is permitted to pick and choose the transactions on which it will recover." Thus, Choice Hotels was entitled to $105,453.29, the net income from the franchisee's profitable months. Choice Hotels also recovered actual damages of $39,521.28, representing the royalties it would have received during the applicable time period. Finally, the court held that the franchisee's conduct was intentional and knowing since it continued to operate after receiving the termination letter with the cease and desist language, and acknowledged that under the Lanham Act, such conduct may entitle Choice Hotels to treble damages. In the interest of equity, the court awarded Choice Hotels $75,000 in additional damages plus costs, but declined to award attorneys' fees, which are only available under the Lanham Act for willful or malicious conduct.

NORTHERN DISTRICT OF ILLINOIS GRANTS ATTORNEYS' FEES AGAINST FRANCHISEE AND *PRO SE* GUARANTOR IN TERMINATION CASE

In *7-Eleven, Inc. v. Spear,* 2013 U.S. Dist. LEXIS 59392 (N.D. Ill. Apr. 25, 2013), the convenience store franchisor had previously prevailed in an action against a franchisee to enforce the termination of the franchise agreement. Because it had prevailed in the underlying matter, 7-Eleven was entitled to an award of its reasonable attorneys' fees incurred in enforcing the franchise agreement. Having previously parted ways with her attorney, the franchisee's primary owner and personal guarantor of the franchise agreement defended against 7-Eleven's motion for fees on a *pro se* basis. (The franchisee entity was unrepresented on the motion, as corporations in federal court must be represented, if at all, by licensed counsel.) In her submissions, the guarantor did not dispute the validity of the personal guaranty and did not dispute that the fees requested had been incurred by 7-Eleven. Nor did she challenge the reasonableness of the fees charged by 7-Eleven's lawyers, except to argue that 7-Eleven should not have needed to incur extensive legal fees when litigating against an unrepresented opponent. The court disagreed with this reasoning. The franchisee had parted ways with her counsel in the midst of the litigation, and then declined to avail itself of multiple opportunities provided by the judge and magistrate to secure new counsel. Acting *pro se*, the guarantor then missed court hearings or was permitted to reschedule them in order to attempt to secure new counsel. All of this, the court found, delayed the proceedings and actually *increased* the amount of fees that 7-Eleven was required to incur. Noting that the fee-shifting provision and the personal guaranty were

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enforceable under Illinois law, the court entered an award for attorneys' fees, in the amount requested.

MINNESOTA FEDERAL COURT DENIES FRANCHISOR LOST FUTURE ROYALTIES

In *Novus Franchising, Inc. v. AZ Glassworks, LLC et al.*, 2013 U.S. Dist. LEXIS 36830 (D. Minn. Mar. 18, 2013), a federal district court denied Novus Franchising's claim for lost future royalties stemming from the franchisees' abandonment of two windshield replacement franchises. Novus calculated its lost future royalties based on the minimum monthly royalty and maintenance fees that the franchisee would have had to pay during the last six years of the franchise agreements. The court recognized that Minnesota law allows a franchisor to recover lost future royalties as long as they can be proven to "a reasonable certainty." In this case, however, the court determined that the franchisor did not provide enough specific information to meet the reasonable-certainty standard. The proposed damages amount failed to take into account the costs that Novus would save as a result of the franchisee's abandonment of the franchises. In addition, the court found that six years' worth of future royalties were not justified because Novus had not shown that it would take that long to find a replacement franchisee. Since considering these factors eliminated or reduced the lost royalties at issue, the court concluded, "an award of future damages is not warranted."

CONTRACTS

NEW JERSEY COURT FINDS NO EVIDENCE THAT FRANCHISE AGREEMENT WAS "UNCONSCIONABLE" WHERE PARTIES NEGOTIATED TERMS

The United States District Court for the District of New Jersey recently granted a hotel franchisor summary judgment on its Lanham Act and breach of contract claims, and dismissed the franchisee's claims that the franchise agreement was unconscionable and the product of negligent misrepresentation. *Wyndham Hotels and Resorts, LLC v. Northstar Mt. Olive, LLC, et al.*, 2013 U.S. Dist. LEXIS 44468 (D.N.J. Mar. 28, 2013). Wyndham, after terminating its franchise agreement with Northstar for Northstar's failure to pay royalties, sued Northstar to enforce the post-termination provisions of the franchise agreement, including Northstar's obligation to cease using Wyndham's trademarks and pay past-due royalty fees. Northstar counterclaimed, alleging, among other things, that the franchise agreement was unconscionable, and therefore void, and that Wyndham negligently misrepresented the agreement.

The district court found for Wyndham on its Lanham Act and breach of contract claims, finding Northstar's continued use of the trademark while failing to pay its royalty fees dispositive, noting that even if Wyndham had failed to perform some of its obligations under the franchise agreement (as Northstar claimed), Northstar could not continue to take advantage of the terms of the franchise agreement while using Wyndham's trademark without paying fees. On the issue of unconscionability the district court noted that New Jersey law requires the analysis of two factors: (1) whether there was unfairness in the formation of the contract ("procedural" unconsionability), and (2) whether the contract contained excessively disproportionate terms ("substantive" unconscionability). The district court found that the parties' inclusion of "special stipulations" in the franchise agreement was "exactly the sort of [negotiation] that preclude[s] a finding of procedural unconscionability." Additionally, the fact that the owners of Northstar could not identify a single provision as "unconscionable" during their depositions further supported a finding of no substantive unconscionability. Finally, in dismissing Northstar's negligent misrepresentation claims, the district court found that Northstar failed to show that Wyndham made any specific statements, and did not demonstrate that it justifiably relied on any statements. Further, Northstar failed to identify any duty of disclosure owed by Wyndham that might give rise to negligent misrepresentation by omission.

GEORGIA FEDERAL COURT DISMISSES FRANCHISOR'S CLAIMS FOR UNJUST ENRICHMENT, NEGLIGENCE, AND PUNITIVE DAMAGES

In an action stemming from a franchisee's alleged continued operation of a franchised restaurant after the termination of the franchise agreement, a federal district court in Georgia dismissed the franchisor's claims for unjust enrichment, negligence, and punitive damages. *Huddle House, Inc. v. Two Views, Inc.*, 2013 U.S. Dist. LEXIS 48754 (N.D. Ga. Apr. 4, 2013). The court stated that Georgia law precludes an unjust enrichment claim arising from a contract when the validity of the contract is undisputed. The court noted that although a party may plead an unjust enrichment claim in the alternative to a breach of contract claim, the existence of a contract cannot be conceded in a count alleging unjust enrichment. Because neither party disputed the existence or validity of the franchise agreement between them, and because the franchisor, Huddle House, acknowledged the existence of the agreement in its unjust enrichment claim, the court dismissed that claim as a matter of law. The court also found that Huddle House's negligence claim was barred by the economic loss doctrine, which generally precludes tort claims for purely economic loss, as opposed to personal injury or property damage, when the parties' relationship is governed by a contract. In so holding, the court rebuffed Huddle House's argument that trademark infringement constitutes "property damage" that is actionable in tort. Finally, the court concluded that Huddle House could not recover punitive damages because the franchise agreement contained a provision waiving punitive damages and, in any event, none of Huddle House's substantive claims supported such an award.

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INTERNET

THE TRADEMARK CLEARINGHOUSE IS NOW ACCEPTING REGISTRATIONS

As Gray Plant Mooty reported in Issue 157 of *The GPMemorandum*, the international corporation that controls internet domain names, ICANN, will soon allow companies to operate hundreds of new Generic Top-Level Domains (gTLDs)—URL extensions to the right of the "dot." Examples include product and service groups such as .coffee, .food, and .restaurant, and geographic locations such as .boston and .nyc. A few hundred of the gTLDs that are expected to be approved are "open," as opposed to being restricted to certain companies (e.g., .google) or other groups. The first group of approved gTLDs may begin accepting priority registrations for second-level domain names (which appear to the left of the "dot") as early as July or August 2013. As part of this program, brand owners can register their marks for inclusion in the Trademark Clearinghouse, a global repository for registered trademarks (or those validated by a court) intended to enhance trademark protection and facilitate dispute resolution in every new gTLD.

Registration with the Clearinghouse will be available on an ongoing basis as new gTLDs are individually approved and rolled out. The Clearinghouse will support two programs designed to help trademark owners protect their marks as the gTLD program progresses: Sunrise registration periods and Trademark Claims notifications. First, each new gTLD operator will open a Sunrise registration period that will last thirty or sixty days, during which time registrants with the Clearinghouse will have the opportunity to register their trademarks as second-level domain names in advance of the general public. This mechanism is designed for those brand owners that like to be proactive in acquiring domain names matching their brands, and in preventing others from doing so. Second, the Trademark Claims Service will operate for the first ninety days of open registration as a notification system, whereby a third party that seeks to obtain a domain name that matches a brand that is registered in the Clearinghouse will be warned of the potential conflict. If the domain name is nevertheless registered, the trademark owner will be notified.

The ability to initiate a challenge to a legally infringing domain name will remain even if one does not register with the Clearinghouse before infringement arises. While early registration in the Clearinghouse will have benefits, traditional remedies against infringing domain names, such as Uniform Domain-Name Dispute-Resolution proceedings and court actions, will continue to be available if a brand owner chooses to forgo Clearinghouse registration at this time. However, trademark rights holders should familiarize themselves with the benefits and requirements of a Clearinghouse registration, and should consider registering at least their primary brands. For more information about the Clearinghouse, or the new gTLD program, please click here.

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