LJN LAW JOURNAL NEWSLETTERS

LJN's

# Franchising Business & Law Alert®

An ALM Publication

Volume 17, Number 7 • April 2011

## Enjoining Unlicensed Trademark Use By Terminated Franchisees

**By Kevin Adler**

Franchisors struggle to stop terminated franchisees from using the system's trademarks. In a recent presentation to the Maryland State Bar Association's Franchise Law Committee, Stephen Vaughan and David Worthen, shareholders with Gray Plant Mooty, discussed how to obtain an injunction that will prevent unlicensed trademark use by a terminated franchisee, as well as strategies for fending off arguments commonly raised by franchisees when confronted with a motion for an injunction.

### Quick and Decisive Action

Quick and decisive action is crucial, starting with the termination of the franchise, said Worthen. "If there has been a breach of the franchise contract, my advice to a franchisor is to send notice of termination," he said. "If you then want to negotiate with the franchise, fine. … It gives you the stronger position if you go for a motion for a preliminary injunction."

If the franchisee continues to use the mark after the termination date, the franchisor again needs to act quickly. "Don't delay seeking the injunction," said Vaughan. "If you delay, you

*continued on page 4*

## Franchise Litigation in China: Are You Ready?

**By Paul Jones**

Although the cases are not yet being cited in the *ABA Annual Franchise and Distribution Law Developments*, there are now actually quite a few decisions annually from the Chinese courts. For 2010, there are more than 30 substantive decisions available — but, of course, in Chinese only. Perhaps that is why the ABA has not yet started reporting on them.

Despite the fact that China has a civil law system that does not use cases as precedents, the cases can be very helpful in interpreting franchise regulations and developing an understanding of Chinese law. Judges in China use the online versions of the cases to assist them in writing their decisions, and the courts have the power to decide whether a particular provision of a law is mandatory (a civil law concept meaning that it cannot be contracted out of, among other things). As an example, the Beijing No. 1 Intermediate Court has rendered decisions that the "2+1 Rule" in the second paragraph of Article 7 of the Franchise Regulations (Shangye Texujingying Guanli Tiaoli, Ordinance No. 485 adopted on Jan. 31, 2007 at 167th Regular Meeting of the State Council, in effect from May 1, 2007. 商业特许经营管理条例) has only an administrative remedy and cannot be the basis for the rescission of the franchise agreement.

Below are two cases decided in 2010 that should assist general counsel in understanding franchise disclosure in the Chinese legal system and in preparing for litigation in the Chinese courts.

### Implications of a Failure to Disclose

A recently released decision of the IP Bench of the Beijing No. 1 Intermediate People's Court, which upholds a decision of the Haidian District Court in Beijing, illustrates quite simply the importance of disclosing what the regulations require. (*See* 邹君 *(Zou Jun) v.* 艺彩国际企业管理（北京）有限公司 *(Yicai International Business Management (Beijing), Inc.*), 北京市第一中级人民法院 (Beijing No.1 Intermediate People's Court), (2010) 一中民终字第20113号. Available online at: http://bjgy.chinacourt.org/public/paperview.php?id=487970.)

*continued on page 2*

### In This Issue

## China

*continued from page 1*

The franchisee, Zou Jun, entered into a franchise agreement on April 24, 2010 with the franchisor, Yicai International Business Management (Beijing), Inc., to operate a shop selling Korean cosmetics. Under the agreement, the franchisee paid an initial fee in the amount of 39,800 RMB for the products and equipment provided by the franchisor. The location of the franchisee's shop had to be approved by the franchisor, the franchisee was not authorized to sell the franchised products outside the authorized area, and the franchisee could not purchase products from other sources. The selling price was to be fixed by the franchisor. The franchisor was to provide the construction specifications, brochures, uniform marks and logo, instructions on management, technical support, etc. The franchise contract was to be effective from April 24, 2010 to April 23, 2011.

However, the franchisee appears to have changed his mind about the arrangement and commenced an action against the franchisor for termination and rescission, claiming that the franchisor had failed to provide the audited financial statements for the previous two years as required by Article 22(9) of the 2007 Franchise Regulation (第二十二条 特许人应当向被特许人提供以下信息). Article 22(9) states that the franchisor shall disclose to the franchisee the information set out below: (9) summaries of the financial statements and audit reports, audited by an accounting firm, for the most recent two years (九）最近2年的经会计师事务所审计的财务会计报告摘要和审计报告摘要).

Based on the provisions of Article 23 of the Franchise Regulation, the Haidian District court agreed. Article 23 reads: The information provided by the franchisor to the franchisee shall be true, accurate and complete and shall not conceal any relevant information, or provide any false information. If there is a significant change in the information provided by the franchisor to the franchisee, the franchisor shall promptly inform the franchisee. If a franchisor conceals relevant information or provides false information, the franchisee may terminate the franchise agreement (第二十三条 特许人向被特许人提供的信息应当真实、准确、完整，不得隐瞒有关信息，或者提供虚假信息。特许人向被特许人提供的信息发生重大变更的，应当及时通知被特许人. 特许人隐瞒有关信息或者提供虚假信息的，被特许人可以解除特许经营合同。).

The franchisor appealed this decision, claiming that the franchisee did not request a copy of the audited financial statements. For disclosure based simply on the doctrine of *culpa in contrahendo*, which is common in civil law jurisdictions and requires that negotiations and the formation of a contract be in good faith, this is often a good defense. It provides a judicial limit on the scope of the disclosure required when negotiating in good faith. In China, this doctrine can be found in Article 42 of the Contract Law (合同法 — Hetong Fa), adopted at the Second Session of the Ninth National People's Congress on March 15, 1999, and in effect since Oct. 1, 1999.

However, the court also looked at the specific provisions of the franchise regulation. Beijing No. 1 Intermediate People's Court said that the regulations create an obligation to disclose the required items, whether the franchisee requests them or not. The missing audited financial statements provided sufficient grounds for rescission.

*continued on page 3*

**Paul Jones** (钟 保 禄 Пол Джоунс) is barrister, solicitor and trademark agent with Jones & Co. in Toronto, Canada. He can be contacted at pjones@jonesco-law.ca or 416-703-5716.



**FRANCHISING**

**BUSINESS & LAW ALERT®**



LJN'S Franchising Business & Law Alert® (ISSN 1079-6339)
is published by Law Journal Newsletters, a division of ALM.

Telephone: (877) 256-2472
Editorial e-mail: jgromer@alm.com
Circulation e-mail: customercare@alm.com
Reprints: www.almreprints.com

LJN's Franchising Business & Law Alert 023145
Periodicals Postage Paid at Philadelphia, PA
POSTMASTER: Send address changes to:
ALM
120 Broadway, New York, NY 10271

*Published Monthly by:*
Law Journal Newsletters
1617 JFK Boulevard, Suite 1750, Philadelphia, Pa 19103
www.ljnonline.com

An Integrated Media Company

# China

*continued from page 2*

## Preparing for Litigation in China

The first step in protecting your intellectual property in China is registration. But what is the second step? In my opinion, it is preparing the evidence properly in case you need to go to court. This is illustrated by a decision of the Beijing No. 1 Intermediate People's Court dated Dec. 10, 2010 and posted online in Chinese on Jan. 29, 2011 at http://bjgy.chinacourt.org/public/paperview.php?id=488168. (*See* 台湾农垦贸易有限公司 *(Taiwan Agricultural Trading Co., Ltd.) v.* 兰州正林农垦食品有限公司 *(Lanzhou Zhenglin Land Reclamation Products Co., Ltd.)*, 北京市第一中级人民法院 (Beijing No. 1 Intermediate People's Court), (2010) 一中民初字第7292号.)

The plaintiff was a Taiwanese company that had a trademark, ZHENGLIN & Design (正林及图), that it used in Taiwan. In the early 90s, the principal of the Taiwanese company, Lin Ken, incorporated a company called Lanzhou Zhenglin Land Reclamation Food Co., Ltd. (兰州正林农垦食品有限公司) ("Lanzhou Zhenglin") with some local partners in Gansu Province, a poor province in the northwest along the route of the old Silk Road, in order to develop supplies for export and for the People's Republic of China ("PRC") market. The PRC company registered the mark in China, and the mark became well-known in the PRC.

There was a falling out amongst the partners, and in August 2007, Lin Ken was removed as president. He disputed that decision and refused to hand over the corporate seal. In China, the corporate seal, or "chop," is a very important indicator of the authority of the corporation, unlike in North America.

The plaintiff then claimed that the PRC company, Lanzhou Zhenglin, should not continue to use the marks. The plaintiff claimed that the right of Lanzhou Zhenglin to register the marks in the PRC was based on an "Authorization Letter" and trademark license and renewal letters dated 1993, 1999, 2004 and 2008. He presented copies of the letters to the court. But he lost.

Article 49 of the Supreme People's Court rules on evidence of 2001 provides that the other party has the right to demand that the original documents be submitted. (Article 49 was adopted Dec. 6, 2001 at the meeting of the Judicial Committee of the Supreme People's Court, and it came into effect April 1, 2002. 最高人民法院关于民事诉讼证据的若干规定. It is available online in Chinese at: www.chinacourt.org/html/article/200206/12/4562.shtml.) But Lin Ken submitted only photocopies of the documents notarized by a law firm in Taiwan in 2008. The Taiwanese law firm carefully limited its authentication to the signature and seal on the documents. It did not say that it had compared the copy to the original and that they were the same. Nor did the law firm address the dates on the letters. Interestingly, the letters were also stamped with the seal of the Lanzhou Zhenglin company — the very corporate seal that Lin Ken had refused to hand over in 2007.

***The legal representative can be held personally responsible for the actions of the corporation.***

The plaintiff claimed that the originals of the letters were in the office of Lanzhou Zhenglin in Gansu Province, to which he had no access. In the PRC courts, the defendant was under no obligation to produce evidence to help the plaintiff; in other words, discovery actions that are familiar to attorneys in North America do not exist. The plaintiff also claimed that a copy was in the home of Lin Ken in Lanzhou (the capital of Gansu Province), but the documents at Ken's home had been seized by the police as part of an action against him regarding misappropriation of the assets of Lanzhou Zhenglin. Interestingly, the police records did not show that such letters were among the items seized.

Article 69(4) of the SPC rules on evidence states that photocopies may not be used as evidence if they cannot be verified against the original. Accordingly, Ken lost his claim for the trademarks in the PRC.

Were there ever such authorization letters? Certainly, it is not uncommon for business people to forget about such details when setting up a company that they control. But even if the letter existed, the plaintiff did not take the necessary steps at the time that the letters were written to ensure that they would be effective evidence in court. If you are operating without discovery in litigation, you have to collect your own evidence, usually before you start the lawsuit.

A few more lessons: First, when the agreements are entered into, the parties should have them notarized in China. Also, the parties should be careful to ensure that the "legal representative" (法定代表人 — fading daibiao ren) signs on behalf of the Chinese company. The legal representative can be held personally responsible for the actions of the corporation. There is no similar concept in North America.

Next, use a corporate seal (企业公章 — qiye gongzhang). If the company does not have one, then buy one.

Finally, trademark licenses and other IP licenses should be registered. That was not done in this case.

In China, litigation generally is all (or at least mostly) about the evidence. The courts rely more on documentary evidence than they do on oral testimony, and the rules of evidence and the courts are stricter about documentary evidence than in North America. Plus, there is no discovery to help you out.

So the rule in Chinese litigation is "Be Prepared."

—❖—

## *Trademark*

*continued from page 1*

undermine your claim that you are suffering harm."

Deciding which type of injunction to seek — preliminary or a permanent, or even a temporary restraining order — is important. The franchisor must assess the strength of the claims it can make to a judge without engaging in discovery. "Do you have enough evidence to make your case at this time?" asked Worthen. "Typically, you need to be able to establish a likelihood that your claim will succeed on the merits. A judge will be hesitant to take away a franchisee's business, his livelihood."

Judges will consider both the obvious harm to the franchisee, who will be enjoined from operating his business, with the franchisor's claims that its brand is being damaged by the unauthorized, out-of-compliance operation. The public interest also is factored into the equation, usually in the context of the franchisor's interest in protecting its intellectual property.

Different types of claims are much easier to make than others, said Vaughan. "If the franchisee has been terminated for nonpayment of royalties, a representative of the company can show the judge the contract and testify that payment was not made. Abandonment is easy to demonstrate, too," he said. But a franchisor that is making the case for a preliminary injunction by citing a termination based on an allegation by a third party that the franchisee made an unauthorized transfer of money will have a more difficult challenge.

In some jurisdictions, Worthen added, the bar for an injunction is higher: Courts might require "clear evidence" of the success of the case on its merits, rather than a likelihood of success.

Temporary restraining orders are not commonly used, but they can come into play in particularly high-profile situations. They have the merit of being issued very quickly, and sometimes without notice of the hearing even being given to the other party. But Worthen said that they are difficult to obtain unless public health or safety is affected, such as a restaurant that is in serious breach of health codes. Also, since the temporary restraining orders usually last 10 days to two weeks, the franchisor will still need to follow up with a request for an injunction.

***The franchisor has two decisions to make: where to seek an injunction, and which court to approach.***

### Selecting a Venue

Selecting a venue is another important decision. The franchisor has two decisions to make: where to seek an injunction, and which court to approach. Worthen and Vaughan recommended that franchisors seek injunctions in the franchisee's jurisdiction and that they use federal courts, not state courts. "Many franchise contracts allow franchisors to bring disputes to the jurisdiction where they are headquartered, but we do not think this is necessarily a good idea in these termination-and-trademark cases," said Worthen. "If you consistently bring them in your home area, the judges might feel as if you're doing nothing but terminating mom-and-pop franchises, and you might be getting the attention of an enterprising young lawyer who decides to specialize in defending the franchisees. Also, you can get caught in a venue dispute that slows down the injunction you are seeking."

As for selecting federal courts over state courts, Vaughan observed, "The process in federal court tends to be more established and consistent, and federal judges often are familiar with franchise trademark cases."

### Pulling on Heartstings

Terminations are contentious, so it's not surprising that hearings about injunctions are contentious, too. "You tend to see [attempts to pull on] the heartstrings of the judge, to hear claims that the injunction will destroy a family business and life savings and throw all the employees out of work," said Vaughan. "These are real issues, but courts recognize when the franchisee's harm is self-inflicted through actions that resulted in termination."

Franchisees will raise a number of defenses, but Worthen said that franchisors can respond effectively by sticking to the facts of the case and the language of the franchise contract. Typical defenses include:

- Termination is a pretext for taking the franchise. Franchisees will argue that a franchisor wants to terminate a store location because it wants to resell the franchise to another operator or encroach on the franchisee's territory. "Judges tend to stick to the facts on whether the termination is valid, rather than on the motivation, or alleged motivation, for the termination," Worthen said.
- The franchisor is discriminating. Franchisees will argue that they are being discriminated against. "None of those allegations should matter when you are seeking an injunction," said Worthen. "Either you can make your case for termination, or you can't."
- The franchisor caused the breach. Franchisees will argue that inadequate training, provision of poor equipment or overpriced supplies, or other such actions by the franchisor led to the breach of the contract and termination. "Franchisees can bring up almost limitless rationales for why the franchisor breached its obligation," said Worthen. "Again, the law is pretty well established in this area. But

*continued on page 6*

**Kevin Adler** is associate editor of this newsletter.

# COURT WATCH

**By Darryl A. Hart**
**and Charles G. Miller**

## Court Confirms Power of KFC Advertising Cooperative To Modify Corporate Advertising Plans

In 1997, as part of the settlement of a class action lawsuit between Kentucky Fried Chicken Corporation ("KFCC") and its franchisee association, a new Certificate of Incorporation dealing with the governance of the KFC National Council and Advertising Cooperative ("NCAC") was filed. The NCAC is a Delaware non-stock corporation that was founded more than 40 years ago to oversee the spending of the $150-million-plus in advertising funds collected annually from both company-owned and franchised KFC stores. The new Certificate of Incorporation divided various advertising duties and responsibilities between KFCC and the NCAC. The NCAC governing Committee has 13 franchisee members and four KFCC-appointed members. Under the agreement represented by the new Certificate, KFCC has the right to hire and fire the national advertising agency that develops and implements the annual KFC advertising program. KFCC also has the right under the Certificate to "develop national advertising, public relations and media plans and strategy." However, among the powers of the governing committee of the NCAC is the power "to plan and approve each ensuing year's advertising program." Over the years, KFC's advertising agency developed each year's advertising plan, the NCAC would approve or disapprove it, and then the agency would implement it. On occasion, prior to the system specified in the new Certificate, the NCAC would modify the plan before approving it.

In 2009, KFCC presented an advertising plan that the NCAC substantially modified to redirect the amount of advertising money to be devoted to the company's newer products back to its traditional fried specialties. KFCC claimed that the NCAC was not empowered by its Certificate of Incorporation to modify KFCC's annual advertising plan, but could only approve or disapprove it. KFCC maintained that if the plan were not approved, and if KFCC could not modify it to satisfy the NCAC governing committee, brand advertising would come to a halt — to the great detriment of both KFCC and its franchisees. The NCAC maintained that its powers under the Certificate authorized it to plan and approve each year's advertising program, impliedly authorizing it to modify the plan proposed by KFCC. Since neither party would agree to the other's position, a suit for declaratory relief was filed in which the NCAC sought a declaration that it could modify the annual advertising plan proposed by KFCC, and KFCC sought to have the court declare that it alone could modify the plan it proposed.

In *KFC National Council and Advertising Cooperative, Inc. v. KFC Corporation*, Bus. Franchise Guide (CCH) ¶14,542 (Del. Ct. of Chancery, Jan. 31, 2011), the court examined the words of the Certificate of Incorporation, the history of the parties' relationship, and parol evidence as to the intention of the parties in determining that the NCAC did, indeed, have the power to revise KFC's advertising proposals before approving them. The seemingly contradictory terms of the Certificate giving both KFCC and the NCAC the power to "plan" advertising programs allowed the court to examine the circumstances giving rise to the disputed terms in order to determine the intent of the parties in arriving at the agreed-upon provisions.

The court partially relied on the general corporate principle that, in the absence of specific language to the contrary, a corporate instrument should not be interpreted to give certain board members preferential powers or rights over other board members. Here, the franchisee board members greatly outnumbered the KFCC board members. As such, to allow the KFCC board members to veto the will of the majority of the board could not be permitted without specific authority in the governing documents.

In discussing the history of the development of the NCAC Certificate, the court pointed out that language suggested by KFCC that would have given it the control it sought was removed from the Certificate as part of the negotiations that settled the class action lawsuit. Also, the NCAC's operating history contained examples of changes made by the NCAC that were implemented by KFCC, which showed a "course of performance" in the relations between the parties.

KFCC did retain some control over the final advertising output, however, since the agreement between KFCC and the NCAC that allowed the use of the KFC names and marks in advertising requires that all advertising be in good taste. Also, since franchisees can only sell products approved by KFCC and KFCC retains control of the national advertising agency, the court felt KFCC still had the power to protect its brand and its positioning in the market.

The powers retained by each party make KFC advertising a virtual partnership between KFCC and the NCAC, and partnership relations can be difficult. However, cooperation between KFCC and the NCAC is essential to keep the flow of KFC advertising going. One wonders about the consequences if KFCC and the NCAC became seriously estranged and each side wanted to

*continued on page 6*

**Darryl A. Hart** is an attorney with Bartko, Zankel, Tarrant & Miller in San Francisco. **Charles G. Miller** is a shareholder and director of the firm. Hart and Miller can be reached by phone at 415-956-1900.

## Court Watch

*continued from page 5*

play "chicken" with the other. Why did KFCC agree to the overlapping terms of the Certificate of Incorporation? Probably because the settlement of the long-running class action lawsuit, which contained issues in addition to advertising, was paramount. As so often happens, there is a price to pay for expediency, and this may be it as far as KFC advertising is concerned.

### Court Finds That Rebates From Affiliates Need Not Be Separately Disclosed in Item 8

An issue raised in a continuing battle of motions to dismiss between a Maryland-based home cleaning franchisor and two of its South Carolina franchisees was decided in the franchisor's favor in *The Cleaning Authority, Inc. v. Joanna Neubert, et al.* (2011 WL 666892, D.Md.). Earlier issues were discussed at *The Cleaning Authority, Inc. v. Joanna Neubert, et al.*, 739 F.Supp.2d 807; Bus. Franchise Guide (CCH) ¶14,465, (USDC Maryland, Sept. 7, 2010).

The franchisees unilaterally terminated their franchise agreements without the franchisor's consent. Litigation followed with a variety of claims and counterclaims. One of the claims made by the franchisees was that the franchisor did not comply with the requirements of Item 8 of the UFOC in effect at the time — specifically, that it did not disclose that its affiliate, with which the franchisees were required to do business, paid over some of its proceeds to the franchisor. Since the pertinent requirements of Item 8 are the same under the UFOC and the current FDD disclosure format, the review and findings by the court are of present interest.

The franchisor did disclose that S&T Management, Inc. ("S&T") was its affiliate and in Item 8 disclosed that its franchisees had to sign a Mailer Services Agreement with S&T to send advertising brochures to prospective customers in the franchisees' territory. The amounts that the franchisees had to pay S&T also were disclosed. The franchisees argued that since there was no disclosure that S&T made payments to the franchisor, the franchisor's statement in Item 8 that "we do not currently receive rebates from any of our approved suppliers" was in error and had the franchisees known the truth, they would not have purchased the franchise.

The court quickly dismissed the franchisees' claim that, at least based on their pleadings, the nature of the financial relationship between the franchisor and its affiliate was material to the franchisees' decision whether to purchase the franchise. It also found that there was a distinction between what was required to be disclosed concerning payments to a franchisor from approved third-party suppliers and those made by affiliated suppliers. The court concluded that as far as the Item 8 disclosure about payments to a franchisor by its affiliates was concerned, only the receipt of revenues from franchisee purchases by the affiliate is called for, not what the affiliate does with the money it receives from franchisees. The court cited the FTC's "Statement of Basis and Purpose" issued in connection with the UFOC, which lumped a franchisor and its affiliates together for purposes of the disclosure of rebates or kickbacks, distinguishing them from third-party suppliers and the payments they make to the franchisor or its affiliates.

Disclosure requirements in the UFOC, and now the FDD, are long and complex. Often minor, relatively immaterial, errors are made in compliance — so-called "technical violations" — which, as a practical matter, do not disadvantage a franchisee or which should not influence the decision of a reasonable franchisee whether to purchase the franchise. It can be argued that the court in this case took a practical view of the facts and disallowed a claim based on what may have been a technical violation, depending on one's view of the concerned Item 8 requirement at issue, of the disclosure requirements. There are real issues in this dispute. The court was wise to disregard the minutiae so that the basic contract issues could be dealt with.

—❖—

## Trademark

*continued from page 4*

> the franchisee still can seek damages after termination, if the franchisor did breach its obligations."

### Challenges Raised By the Internet

As with so many areas of law and business, the Internet is raising new questions and challenges, especially because terminations usually include non-compete provisions. Enforcing non-competes in the online environment is complex and remains full of uncertainty. Worthen said that he has worked with franchisors who got injunctions against former franchisees who created their own Web sites that incorporated the franchisor's brand in them (*e.g.*, Joe'sDunkinDonuts.com). "Those are fairly easy to shut down," he said.

Other situations require more creativity to solve satisfactorily. "We had a case recently where a former franchisee was … selling competing products on the Internet," said Worthen. "The judge came up with what I felt was a pretty ingenious solution. The judge said that the former franchisee could not accept business from customers within a defined radius of any existing franchise location. Basically, he created a bubble around each existing store." The former franchisee's Web site had a standardized message that would reject orders from addresses within those non-compete areas.

### Beware of Self-Help

As a final note, Worthen and Vaughan counseled franchisors against "self-help," that is, taking matters into their own hands by going to the site of the terminated franchisee and trying to take

*continued on page 8*

## NEWS BRIEFS

### Dairy Queen Claims Franchisee Extortion

A dispute with an Iowa franchisee has taken an unusual turn as American Dairy Queen Corp. ("ADQ") is suing the franchisee for "implicit … threat of violence" and "claims and name-calling [that] have had as their ultimate objective the extortion of huge sums of money from ADQ." ADQ is seeking to immediately terminate its franchise agreements with the franchisee, permanently enjoin alleged acts of extortion and defamation, enforce post-termination covenants, and obtain payments of royalty and promotional funds it says it is owed, and damages. The lawsuit is *American Dairy Queen Corporation v. Guy A. Blume, et al.*, District of Minnesota, No. 0:11-cv-00358.

The franchisee, Guy A. Blume, "has threatened to inflict physical harm on ADQ representatives; has threatened to accuse ADQ of criminal conduct, a public offense; has threatened to expose ADQ to hatred, contempt, and ridicule; and has threatened to harm the business and professional reputation of ADQ and its representatives — all unless ADQ paid him huge sums of money to buy his silence," the complaint states.

According to the lawsuit, Blume became an operator of three Dairy Queen franchises in 2008 and 2009 by purchasing assignments from other franchise operators. While a small problem with royalty payments surfaced at one of the franchises in 2009, the lawsuit states that the problems escalated significantly in July 2010, when Blume stopped reporting gross sales figures and making any required royalty or sales promotion payments for any of the three franchise units.

As ADQ sought to enforce its agreements, tensions with Blume increased. For example, Blume allegedly sent a letter to ADQ on Oct. 31, 2010, accusing ADQ of engaging in "personal attacks [that] have hurt me emotionally as well as financially." Blume allegedly claimed that ADQ was "slandering me to other operators to be destructive to my business." The lawsuit also claims that Blume demanded $495,000 for the alleged harm done to him by ADQ.

According to the lawsuit, in November, Blume claimed that ADQ did not provide him with franchise disclosure documents prior to his becoming the assignee of the three franchises and later filed complaints with the Federal Trade Commission. While Blume's statement is accurate, ADQ's filing notes that "ADQ had no legal obligation to give Blume an FDD." ADQ also stated in the lawsuit filing that "the applicable law does not require such a disclosure where, as here, ADQ was not involved in the sale of the franchise opportunity, but the sale was by a third party to the franchisee."

Then, in a letter dated Dec. 24, Blume claimed that "I am putting you on notice that I will show your organization no mercy if these issues are not resolved in due time," according to the lawsuit, and a week later he allegedly wrote a lengthy letter indicating that he would utilize electronic media outlets to publicize his complaints. In February 2011, he allegedly dressed in a clown suit and appeared at a meeting of area DQ franchisees and then at the headquarters of Berkshire Hathaway in Omaha, NE (Berkshire Hathaway owns ADQ) to indicate his displeasure with the company. After those alleged incidents, ADQ filed the lawsuit.

In an e-mail interview with *FBLA*, Dairy Queen issued the following statement: "ADQ's primary objective is to protect the Dairy Queen® brand. ADQ has attempted, and will continue to pursue, a mutually acceptable resolution that meets that objective. Ideally, that solution would minimize impact on the local marketing area."

Blume could not be reached for comment. He must file an answer to the complaint by April 21.

### Taco Bell Aggressively Challenges Food Content Lawsuit

Yum! Brands, owner of the Taco Bell franchise, has asked the U.S. District Court, Central District of California, to dismiss a class action lawsuit that challenges Taco Bell's advertisements and claims that the franchise's "seasoned beef" does not meet the federal definition for beef. The lawsuit is *Obney v. Taco Bell Corp.*, U.S. District Court, Central District of California, No. 11-00101.

"This is a consumer rights class action challenging Taco Bell's practice of representing to consumers that the filling in many of its 'beef' food items is 'seasoned ground beef' or 'seasoned beef,' when in fact a substantial amount of the filling contains substances other than beef," the lawsuit states. "Rather than beef, these food items are actually made with a substance known as 'taco meat filling.' Taco meat filling consists of 'extenders' and other non-meat substances. Taco meat filling is not beef."

A hearing on the dismissal will be held on April 25, confirmed Helen Taylor, public relations coordinator for the law firm that is representing plaintiff Amanda Obney, the Montgomery, AL-based Beasley, Allen, Crow, Methvin, Portis & Miles, PC. The lawsuit seeks changes in Taco Bell's advertising claims or content of its ground beef. It does not state the monetary damages that are being sought, and a representative of the law firm would not comment to *FBLA* beyond supplying a copy of the lawsuit filing.

*continued on page 8*

## Movers & Shakers

**David Cahn** returned to **Whiteford, Taylor & Preston** in Baltimore, after dissolving the **Franchise & Business Law Group**, which he had founded in 2004. **Harry Rifkin**, who was a partner with Cahn, has opened his own firm, **Law Offices of Harry M. Rifkin, LLC** (Towson, MD), where he will focus on litigation in franchising, construction, and other industries.

**Robert W. Dickerson** joined the Los Angeles office of **Dickstein Shapiro LLP** and is the deputy practice leader of the firm's intellectual property practice. Dickerson brings more than 30 years' experience in patent, trademark, copyright, trade secrets, and franchise cases. Dickerson had been the leader of the IP practice at **Orrick, Herrington & Sutcliffe LLP**, also in Los Angeles, and **Lyon & Lyon**.

Chicago trial lawyers **Carmen D. Caruso** and **Daniel S. Kaplan** have joined forces to start a new firm, **CarusoKaplan**. They are being joined by **Sarah J. Isaacson**. In the franchise, distribution and dealership industries, they defended numerous franchisors from allegations of fraud, breach of contract, bad faith, breach of fiduciary duty, statutory violations, business torts and professional liability. Among his professional affiliations, Caruso was a litigation partner at **Schwartz Cooper Chartered** from 2001 to 2008, where he established and served as chair of the firm's franchise and distribution practice. Kaplan was most recently a shareholder in **Kaplan & Greenswag LLC**.

—❖—

## *News Briefs*

*continued from page 7*

So far, the impact has been to change Taco Bell's ads — but not in the way that the plaintiff would have anticipated. Taco Bell came out swinging against the allegations, first with national ads that stated: "Thank you for suing us." Then, in late-January, Taco Bell President Greg Creed released a statement in which he said that Taco Bell's ground beef is 88% USDA-certified beef and 12% fillers (water, spices, and oats). He added that the spice mixture is proprietary.

Subsequently, the company has aired ads in which employees state that the ingredients are "right there" on the Web site and taco giveaways and discounts. One discount was for premium tacos, typically priced at $2.39-$2.49, for 88 cents, referencing the company's claim of its percentage of USDA-certified meat in its ground beef.

The lawsuit notes that the USDA's definition states that ground beef "shall not contain added water, phosphates, binders, or extenders." But Taco Bell's mandatory nutrition label lists water as a primary ingredient in its "taco meat filling," topped only by beef, according to the lawsuit.

### NASAA Project Group Seeks Input on Multi-Unit Franchising

The Franchise and Business Opportunities Project Group ("Project Group") of the North American Securities Administrators Association ("NASAA") is beginning work on a new Commentary that will address a wide range of issues on multi-unit franchising and provide practical guidance about the disclosure obligations of all involved parties. The Project Group is seeking input on issues, ambiguities, or problems that franchisors, franchisees, and franchise attorneys believe should be addressed in the new Commentary. Input can include proposed resolutions or solutions and any relevant cases, statutory provisions, regulations, papers, or other information that could be relevant.

Some multi-unit franchising issues already have been addressed by the Federal Trade Commission in FAQs 9 and 13, by NASAA in Sections 20.2, 20.3 and 20.4 of NASAA's 2009 Commentary on the 2008 Franchise Registration and Disclosure Guidelines, and by California in its Release 18-F. The Project Group, in consultation with the staff of the FTC and state franchise examiners, intends to give expanded guidance on those and other issues in this new commentary.

The deadline for providing input is April 22. Responses can be sent to Dale Cantone at dcantone@oag.state.md.us and Theresa Leets at tleets@corp.ca.gov — "if you are comfortable sharing your ideas with attribution," Cantone noted. "If you would prefer to share your ideas on a confidential basis without attribution, please send your input to Warren Lewis at warren.lewis@akerman.com, Ron Gardner at rkgardner@dadygardner.com, or Chuck Modell at cmodell@larkinhoffman.com."

—❖—

## *Trademark*

*continued from page 6*

down signs and remove equipment. "Self-help isn't a good idea. … I've seen it attempted, and guns have been drawn, knives pulled, and tires slashed. There's no reason to put a franchisor's employees in danger," Worthen said.

"The only exception might be in an abandonment situation, when you want to check on the facility and make sure it's secure," said Vaughan.

—❖—