Retaining and Improving Brand Equity by Enforcing System Standards

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In an age where there's so much information, a brand is a shorthand for the quality and service you're going to get.[1]

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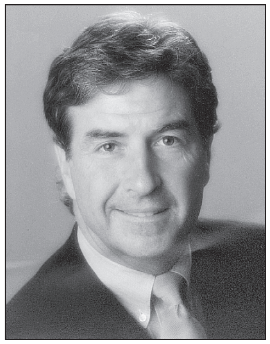

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Brand development is the process of creating in consumers' minds an image, an awareness, and a preference for a product or service. A franchisor typically invests enormous sums in its trademark or service mark and accompanying system, which guide the public to a particular product and service experience and assist franchisees with delivering that experience. Brand development will not be successful, however, until a franchisor ensures consistency across its system. As Barry S. Sternlicht, former Chairman and CEO of Starwood Hotels & Resorts Worldwide, Inc., has said, "[a] brand is nothing if it is not consistent in its product and service."[2] For every franchise system, "[c]onsistency is [the] challenge. Providing a great guest experience day after day is [the] solution. Consistency is the only way to keep the consumer's trust, and the key to trust is consistency."[3]

By enforcing system standards, a franchisor can achieve product and service consistency and ensure the continued viability of its mark and the attendant economic benefits from "a network of stores whose very uniformity and predictability attracts customers."[4] Generally, courts will not hesitate to enforce a franchisor's right to control its brand, goodwill, and integrity, particularly if a threat to public health or safety exists.[5] Among other interests, a franchisor has a protectable interest in ensuring that the public does not purchase inferior products from a noncompliant franchisee in the mistaken belief that these products meet the franchisor's standards.[6] This article reviews the legal rationale and sound business reasons for enforcing system standards, discusses methods that a franchisor can use to enhance compliance efforts, and evaluates the types of suits that can be brought to enforce compliance.[7]

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Legal Importance of Enforcing System Standards

Under the Lanham Act,[8] a trademark exists only as a symbol of goodwill and has no independent significance without it.[9] The U.S. Court of Appeals for the Second Circuit has explained that "[t]his creation and perpetuation of goodwill depends on customer recognition. The nature of goodwill is dictated by the consumer's desire to do business with the same seller. The buyer expects the same experience with each purchase—this is the *reason d'etre* [sic] for the sale."[10] A franchisor, therefore, has a legal duty to control the quality of goods and services under its mark or risk abandonment of its trademark.[11]

The danger of the trademark owner's failing to take on this affirmative duty is that products with the same trademark will have diverse characteristics. "If a trademark owner allows licensees to depart from its quality [or other] standards, the public will be misled, and the trademark will cease to have utility as an informational device."[12]

For franchisor, this duty typically includes establishing and enforcing system standards.[13] The failure to establish and enforce standards may also expose the franchisor to liability from third parties injured by the franchisee's actions or omissions and from franchisees claiming that the franchisor either is not doing enough to uphold system standards or has selectively pursued an action against them.

The Risks of a Naked License

Under the Lanham Act, a trademark owner may license its mark if it maintains sufficient control of the licensee's use of the mark to assure the nature and quality of goods or services that the licensee distributes under the mark.[14] A licensor engages in naked licensing, and risks cancellation of its federal registration, by failing to exercise an appropriate level of control.[15] To control the nature, or kind, of goods or services, a licensor must specify the products or services with which the licensed mark is to be used. The issue of quality control is more difficult because the Act does not define the means or degree of control that will qualify. This is a fact-intensive inquiry and courts generally require a licensor to use reasonable methods, such as contractual quality control provisions and review by the licensor of the licensee's conduct, to ensure that quality standards are being met.[16]

Because uniformity and consistency are so critical, franchise agreements generally specify the product or services with which the licensed mark is to be used, require the franchisee to comply with system standards, and provide the franchisor the right to inspect and evaluate whether the franchisee is complying (and to take action if the franchisee is not). Having the right to control quality is one thing. Doing it is another, and trademark law demands some level of actual control[17] —actual enforcement of franchise system standards. Courts generally permit a licensor to respect the licensee's right to manage its own business, and thus will not conclude that a licensor possesses insufficient quality control power because it agrees not to interfere with the internal management or day-to-day operation of the licensee's business.[18]

Vicarious Liability Claims

There is tension between trademark law requirements for franchisor controls and the franchisor's desire to avoid vicarious liability for franchisee conduct.[19] Vicarious liability claims range from third-party claims for personal injury, products liability, and violations of statutes such as the Americans with Disabilities Act, to claims by the franchisee's employees for an unsafe work environment, sexual harassment, and discrimination.[20]

Most courts evaluate vicarious liability claims under the *Restatement (Second) of Agency*, which addresses "the extent of control which, by the agreement, the master may exercise over the details of the work,"[21] i.e., a franchisor's right to control a franchisee's day-to-day business.[22] Other courts have held "that the relevant inquiry is control over the instrumentality resulting in the harm,"[23] which focuses on whether the franchisor controlled the injury-causing activity.[24]

There is no bright line test for determining when a franchisor has gone beyond the control needed to avoid a naked trademark license, and exercised enough control to expose it to significant vicarious liability.[25] Whichever test a particular court applies, vicarious liability cases are fact intensive and require a franchisor to educate its counsel regarding each control retained, the importance of that control to the welfare of the system, and how this control does not amount to control over the franchisee's day-to-day operations.[26] This costly and time-consuming process is distracting and expensive. A franchisor may also face a significant deductible, a loss-sharing arrangement, or both under its insurance policy.

Failure to Uphold System Standards Claims

System standards enforcement reduces a franchisor's exposure to franchisee claims that business is suffering because other franchisees are not operating their units properly.[27] These cases generally turn on whether the franchise agreement either makes the plaintiff-franchisee a third-party beneficiary of the franchisor's contractual right to demand another franchisee's compliance with system standards or commits the franchisor to upholding system standards at all outlets.

In *Creel Enterprises, Ltd. v. Mr. Gatti's, Inc.*,[28] a Mr. Gatti's pizza restaurant franchisee claimed that the franchisor's failure to force another franchisee to remove the trademark from two closed stores and resolve a bug infestation at a third caused the plaintiff lost business, reduced its ability to compete in the marketplace, and led to emotional distress.[29] The court held that the plaintiff-franchisee "was not a party to the contracts complained about and thus has standing to enforce [the standards] only if it is a third-party beneficiary, not indirectly by suing on its own contract with Mr. Gatti's."[30] The mere existence of quality standards provisions in a franchise agreement did not create a duty to enforce them.[31] The court granted the defendant's summary judgment motion because the plaintiff "failed to point to any provision in their [sic] franchise agreements which obligates Mr. Gatti's to enforce the quality standards provisions in the contracts signed by another franchisee."[32]

In *Yankee Enterprises, Inc. v. Dunkin' Donuts, Inc.*,[33] a jury returned a verdict (later reversed on appeal) for the plaintiff-franchisee on a breach-of-contract claim for failure to uphold system standards based on its franchise agreement language. The franchisee alleged that Dunkin' Dounuts failed to staff properly its operations unit and to enforce system standards in its West zone, in favor of its Northeast zone.[34] The franchise agreement provided that Dunkin' Donuts would "continue its efforts to maintain high and uniform standards of quality, cleanliness, appearance and service at all Dunkin' Donuts shops."[35] The U.S. Court of Appeals for the Fifth Circuit overturned the verdict because the franchisee had failed to prove that Dunkin' Donuts's conduct caused it damage, but the court did not question the validity of the breach-of-contract claim.[36] It focused instead on the franchisee's causation theory that "[t]he reduced standards of cleanliness in the other stores in the West zone damaged [the plaintiff's] sales even though [the plaintiff's] store met or exceeded the high standards in place prior to the alleged breach."[37] The court held that the testimony of the franchisee's financial expert regarding differences in sales between the plaintiff's shop and those in the Northeast was "nothing more than conjecture and surmise," because he admitted on cross-examination that the alleged diminution in sales predated Dunkin' Donuts's alleged breach and that he had not considered other potential causes, including management skill, market penetration, and advertising volume.[38]

Quality Control Is Also Good Business

Enforcing system standards is also good business. Standards are designed to ensure that the system retains and increases its customer base, provides a franchisee the best opportunity to earn a profit, and, by addressing these objectives, attracts new franchisee-prospects to help the system grow. A standards enforcement program delivers a strong message that system standards are important and that failure to comply will not be tolerated.

In a business format franchise, standards typically address factors that both affect sales and help control expenses. Uniformity of product and its delivery in a wholesome, healthy environment is the hallmark of a franchise business and increases sales by attracting customers, while strong operations management (e.g., inventory tracking and product ordering) addresses expense control. System standards help franchisees achieve this uniformity and operational control by simplifying their businesses—they must do certain things at certain times as presented in an operations manual. By enforcing system standards, a franchisor keeps a franchisee focused on the system and executing the many details that help a business succeed. This also encourages system growth because prospects will be attracted to a system full of franchisees making money by delivering a consistent quality of product and achieving strong sales with controlled expenses.

There is also a more subtle, but equally important, system morale component to enforcing standards. Failing to enforce system standards sends a dangerous message to both poor and good franchisees. Poor franchisees learn that they can get away with ever-increasing standards violations. Good franchisees may eventually conclude that their efforts to uphold standards are futile because other franchisees are not required to meet these standards. Each of these messages travels rapidly throughout a system to equally ill effects.

Seven Ways to Enhance Compliance Efforts

To create an effective standards compliance program, a franchisor should start with its franchise agreement, which should address, at a minimum, seven issues:

- The franchisor's system and the need for uniformity and consistency;
- The operations manual;
- Acts or omissions warranting termination;
- Notice and cure provisions;
- A nonwaiver clause;
- The franchisor's right to injunctive relief; and
- An attorney fees clause.

The franchise agreement should describe the franchisor's system and state unequivocally that the franchisee applied for a license to operate under the system and must adhere to that system to create the uniformity and consistency necessary to enhance the mark's goodwill. The agreement should also specifically mention any standards program, such as (in the restaurant industry) quality, service, and cleanliness standards.

The franchise agreement should require the franchisee to adopt and comply with the franchisor's operations manual as it may be modified from time to time, and incorporate the manual into the agreement by reference. Some franchisor use a separate section of their agreement specifically to address system changes, including the use of manual changes to allow the system to evolve. The franchisee's continuing obligation to comply with these modifications is also addressed expressly.[39]

The franchise agreement should describe in simple, straightforward language the acts or omissions that would permit the franchisor to terminate the agreement for standards violations. These items should be described as "material breaches of this agreement" and allow termination after no cure period, or a short cure period commensurate with the seriousness of the breach. For example, health, safety, or sanitation issues may authorize termination upon notice without a cure period, while the franchisee has seven days to cure standards violations relating to the use of the marks or affecting the goodwill associated with them and fifteen days to cure any other standards violations.

The franchise agreement's notice provision should authorize notice to the franchisee (e.g., regarding a system change or default notice) by a writing delivered to the store address. Some franchise agreements allow the franchisee to change the notice address, which could jeopardize a future standards enforcement action if the franchisor fails to process and file an address change and sends a system change or default notice to the old address.

Franchisor are also turning to Intranets, accessed via the Internet, to provide their franchisees with current operational materials and requirements, including updates to the operations manual and other changes to the system. Exclusive reliance on an Intranet to communicate system changes, however, may undermine a standards enforcement action unless the franchise agreement notice provision permits its use.[40] If not, a franchisor should issue a system change notice that requires its franchisees to connect to and monitor the Intranet; implement a process to confirm that each franchisee has purchased the necessary computer equipment and Internet service to connect to the Intranet (similar to its process for obtaining franchisee insurance certificates); and design the Intranet so that franchisees can easily locate, access, and print the operations-related materials.

A nonwaiver clause is essential because franchisor often do not respond to every breach of the franchise agreement by the franchisee.[41]

As discussed below, a federal trademark action for injunctive relief is a central component of an effective standards compliance program. A franchisor must keep its right to injunctive relief free from any contractual hurdles, particularly arbitration and forum selection clauses, at its option. For example, "Nothing in this Agreement shall prevent us from obtaining injunctive relief against actual or threatened conduct that will cause us loss or damages, in any appropriate forum under the usual equity rules, including rules for obtaining restraining orders and temporary injunctions."

Finally, the agreement should include a provision that entitles the franchisor to collect its attorney fees, costs, and litigation expenses from the franchisee in any action to enforce the franchise agreement. This may be the most important and effective tool to deliver a systemwide message about the importance of standards compliance.

Communications with Franchisees

Communication about a standards compliance program—the process, its benefits, and the ramifications of failure—is necessary to achieve franchisees' understanding and commitment. An excellent program description is check, coach, check, and enforce (if necessary).[42] These four short words communicate the essence of what franchisees can expect from the program and enable the franchisor to deliver this message consistently and inexpensively via system updates, at franchisee meetings, and in franchisee training.

Check, Coach, Check, and Enforce

Check, coach, check, and enforce is a compelling message for a franchisee. The franchisee realizes that the franchisor has invested in the program, both operationally and financially, by hiring the people and developing the processes required to conduct quality and service inspections and training. It will be a collaborative approach. The first reaction to noncompliance will be further training. The franchisor obviously expects results from this investment of time and effort in training, and a reinspection will be done to ensure that the franchisee has resolved the problems. If not, the franchisor will enforce the standards by providing an opportunity to cure followed by swift legal action if the problems are not cured. After a few enforcement actions that require franchisees to pay the franchisor's attorney fees and costs, a message will spread through the system: the franchisor is serious about system standards enforcement and writing a check for those attorney fees is very painful.

A franchisor can use its inspection process both to help its franchisees improve operations and to assist its operations personnel in developing evidence for a successful standards enforcement or termination lawsuit, if appropriate. There are four areas on which a franchisor should focus—initiating a compliance program, the inspection process, its inspection-related records and notices, and developing third-party evidence for an enforcement or termination action.

Initiating a Compliance Program

Speed and early success are critical to implementing an effective standards compliance program. A franchisor should involve its counsel to prepare model complaints to minimize both the time between a franchisee's failure to cure defaults and commencement of an enforcement or termination action (no more than two weeks) and the cost of that action. The franchisor must carefully select and consider starting with franchisees that have a history of, or have severe, compliance issues. The process can begin with a "new day" letter to selected franchisees to notify them that, regardless of past practices, failing scores on operational reviews may subject them to standards enforcement actions, payment of attorney fees, and termination of their franchise agreements. Unless there is the organizational commitment and financial ability to implement the program systemwide, a franchisor should not send the "new day" letter to all franchisees. Success in the enforcement actions pursued will deliver a very effective systemwide message, particularly if franchisees are forced to pay the franchisor's attorney fees and costs of suit.

Implementing the Procedure

Franchisor should train their operations consultants to provide detailed and objective descriptions of the conditions of a franchisee's outlet to give an accurate picture of the business. When the conditions may affect health, safety, or sanitation, the consultant should record the conditions in a way that provides the court with compelling examples of the extent of the problems and the dangers presented. Regarding other significant defaults, the consultant should describe the consequences of the violations (e.g., customer complaints).

The consultant should take digital pictures of any defaults, particularly those that document product safety or public health risk.[43] Because the condition of a franchisee's business can sometimes be a matter of subjective interpretation, courts consistently emphasize this compelling evidence in granting preliminary injunctions against franchisees' standards violations.[44] The consultant should label the pictures with the date, time, store number, and a cross-reference to the standard violated.

Either during or at the end of the inspection, the consultant should review the report with the franchisee (or store manager if the franchisee is unavailable) and have that person sign it when completed. The consultant should copy the report immediately and provide a copy to the franchisee or manager that same day. This process will effectively refute a franchisee's claim that it was unaware of the violations or that the violations did not exist.

After the franchisee has received a default notice (see below) and the cure period has expired, the franchisor should reinspect, if possible with a different operations consultant to avoid any argument about the consultant's subjectivity or personal bias toward the franchisee. If the franchisee has not cured the violations, the franchisor should send a copy of the report to counsel immediately so that an enforcement action can be brought. Failure to sue promptly risks the defense that the defaults were cured and did not exist when the complaint was filed. Compliance is the goal of any standards enforcement action, but the franchisor's success in proving its underlying claims will determine whether it can recover its attorney fees and costs.

Standardizing the Process

The inspection form should be standardized and focus on the central aspects of the franchise, and, perhaps most important, contain a section for the franchisee's signature stating that the operations consultant reviewed the inspection results with the franchisee. The form will be perceived as more understandable, by the operations consultants, franchisees, and any court holding a preliminary injunction hearing, if it is fairly short and addresses the system's core components. If defaults are present on inspection, a franchisor should develop some standard language for a default notice with a cure period[45] to avoid a franchisee's waiver argument and increase the consistency of enforcement efforts.

In an interesting approach, Dunkin' Donuts created a standardized inspection form that addressed these issues.[46] The form is entitled "Critical Food Safety and Sanitation Inspection," which tells the reader that Dunkin' Donuts is focusing on the areas in which its restaurant system is at greatest risk from a franchisee's noncompliance. It contains the subheadings "NOTICE OF DEFAULT" and "NOTICE

TO CURE" and, in four short sentences, demands that the franchisee correct the standards violations identified or risk termination.

The form also has two reference columns for each standard: the manual page number from which the standard is derived, and a "Photo ID Key" that provides the operations consultant a shorthand method to cross-reference to the form and applicable standard with photographs of any deficiencies (taken by the consultant). The form provides two columns headed "Inspection" and "Reinspection" for inspection results, which tells the franchisee that the consultant will return and evaluate whether the deficiencies have been cured. If the reinspection reveals the same problems, the form creates a very easy visual reference for the judge to see what standards were at issue and were not corrected. Finally, at the end of the form, there is a section for the franchisee and operations consultant to sign the form.

In *Dunkin' Donuts Inc. v. Albireh Donuts, Inc.,*[47] this form clearly helped the franchisor obtain an injunction, as the court ordered the franchisee to "cease violating [Dunkin' Donuts's] standards for health, sanitation, and safety, and, specifically, those identified on the February 24, 2000 Critical Food Safety Inspection form, which is annexed hereto and incorporated herein as Appendix 1."[48]

Alternatively, the inspection form could contain a separate section or page entitled "Requires Immediate Action," which can be used to identify any areas that should be immediately addressed, such as product safety, health, or sanitation issues. If an immediate real threat to health or safety exists, the franchisor should consider having the operations consultant remain at the outlet until the threat is abated. Again, the goal is to emphasize the core concerns to the franchisee and, by extension, to the fact finder if the franchisee does not cure the problems.

Building a Case

Third-party witnesses with no stake in the outcome can add substantial credibility to a franchisor's case. These include health inspectors, fire marshals, other government officials, former employees of the franchisee, and mystery shoppers. In *Carousel Systems, Inc. v. Ordway,*[49] the franchisor of Goddard Schools sought to terminate immediately the franchise agreement after a state agency revoked the franchisee's state license to operate a school, despite the potential applicability of the New Jersey Franchise Practices Act, which mandates sixty days notice before termination is effective.[50] The franchisee had used an unsafe trailer as a classroom and failed to evacuate the school on three separate occasions when sparks and smoke came out of baseboard heaters.[51] The court found the testimony of a local fire official, representatives of the state licensing agency, and a former employee of the franchisee compelling, and held that the state agency's action "was based on convincing sources, and that Carousel's reliance on the [state agency's] action as a predicate for the termination was entirely well-founded."[52]

Compliance Failures

When a franchisee fails to comply with operational standards, a franchisor can sue to enjoin continued noncompliance (i.e., have the existing standards violations corrected) under trademark theories, including infringement, dilution, and use in an unauthorized manner. A standards enforcement action works well where a franchisee that is otherwise complying with the franchise agreement (e.g., paying royalties) can respond to a clean-up order and pay a franchisor's attorney fees and costs. A franchisor can also terminate the franchise agreement and file a breach-of-contract and trademark infringement action (if the franchisee continues using the marks after termination) seeking damages for any past due amounts, estimated lost future royalties, attorney fees, and costs plus injunctive relief to prevent the franchisee from using the franchisor's trademarks and to enforce any covenant not to compete. A termination and enforcement action is best used when the franchisee's problems extend beyond operational defaults.

Arbitration Clause

If the franchise agreement includes an arbitration clause, counsel must evaluate whether the clause captures the dispute or there is an exception for actions seeking injunctive relief. Generally speaking, arbitration agreements that limit the parties to one arbitrator and place the forum in an advantageous location for the franchisor (i.e., the city of its principal place of business) can be very effective at resolving nonurgent standards actions. In particular, arbitral forum selection clauses in franchise agreements are enforceable[53] and require the noncompliant franchisee, to consider hiring counsel in the franchisor's home state traveling there for hearings. In urgent situations involving things like health, safety, or sanitation violations, however, a franchisor should sue the franchisee for injunctive relief (discussed below) to avoid any perceived or real uncertainty about an arbitrator's authority to order that relief.

Bringing Suit

If there is no arbitration clause or there is an exception to the arbitration clause for injunction actions and the franchisor decides to avail itself of that exception, counsel must next determine whether: (1) the franchise agreement contains a judicial forum selection clause, (2) a state franchise relationship statute governs, and (3) the franchise agreement includes a choice-of-law clause.

The enforceability of a judicial forum selection clause is beyond the scope of this article.[54] Because judicial forum selection clauses are enforced inconsistently,[55] a franchisor first should sue in the federal court with jurisdiction over the franchisee's business, given the type of relief that a franchisor would seek in a standards enforcement or termination action, particularly if quick relief is needed. Although some state courts have efficient procedures for obtaining injunctive relief, franchisor are generally better served in the federal system, which has recognized the importance of a franchisor's right to protect its trademarks and police its franchisee's compliance with system standards, especially those governing health, safety, and sanitation. Additionally, suing in the franchisee's forum, while increasing the initial costs of suit somewhat, ultimately expedites resolution. The parties avoid costly motion practice over jurisdiction and venue issues, and judges can be confident about their authority to issue enforceable orders granting the relief requested.

Second, the franchisor must determine whether a franchise relationship statute governs notices of default, opportunities to cure, the standards for termination of a franchise agreement, discriminatory treatment (i.e., requiring uniformity among franchisees in the franchisor's enforcement of system standards), or all of the above. Of these, franchisors are often most concerned about franchisee selective enforcement claims.[56] Under the common law, franchisor are generally allowed to be selective among franchisees when terminating a franchise agreement for the franchisee's failure to comply with system standards.[57] Whether disparate treatment is a defense to a standards enforcement action appears to be based on the language of the franchise agreement.[58] Seven states—Arkansas, Hawaii, Illinois, Indiana, Minnesota, Washington, and Wisconsin—have franchise relationship statutes that expressly address discriminatory treatment, and case law in three other states with franchise statutes—California, Connecticut, and Michigan—touches on franchisee claims of disparate treatment and indicates that care is warranted there as well. Accordingly, if the franchisee is located in a state with a franchise relationship statute, particularly one of the above ten states, counsel should analyze the applicable statute's requirements to treat similarly situated franchisees similarly before taking legal action.

Third, if the franchise agreement contains a choice-of-law clause, that law should apply to any contract issues, such as the right to recover attorney fees or enforceability of any covenant not to compete, that arise in litigation. Also, if the chosen state has a franchise relationship statute but the franchisee is in another state without such a statute, counsel must determine whether the relationship statute applies extraterritorially.

The Federal Injunction Standard

Federal law (i.e., the Lanham Act) governs most trademark claims. In a standards enforcement action, these claims are generally for infringement,[59] false designation and misrepresentation of origin,[60] and dilution.[61] Rule 65(a) of the Federal Rules of Civil Procedure governs preliminary injunction requests in federal courts.[62] This federal standard may vary slightly from circuit to circuit, but, generally speaking, a federal court will grant a preliminary injunction only if the plaintiff demonstrates a substantial likelihood that it will succeed on the ultimate merits of its claim, that it will suffer irreparable injury if the injunction is not entered, that the harm to plaintiff if the injunction is denied is greater than the harm to defendant if the injunction is granted, and that the injunction will not adversely affect the public interest.[63] Franchisor counsel must review this federal standard circuit by circuit to determine specifically how the court will balance these factors and whether any additional or different factors will be considered.

Likelihood of Success and Irreparable Harm

Franchisor are generally able to establish a likelihood of success on the merits with case law demonstrating their right to ensure the nature and quality of products and service associated with their trademarks. In *Burger King Corp. v. Stephens*, the court held that: "[i]f [Burger King] is unable to control the nature and quality of the goods and services defendants provide at Burger King franchised restaurants, activities not meeting [Burger King's] standards at those restaurants could irreparably harm the goodwill associated with [Burger King's] marks and [Burger King's] reputation."[64]

Federal courts typically have held that a franchisee's violation of health, safety, and sanitation standards causes irreparable harm to the franchisor, warranting a preliminary injunction. As the court said in *Dunkin' Donuts Inc. v. Kashi Enterprises, Inc.*:

> The possibility of irreparable injury arises because the record evidence indicates that the unsanitary conditions at the defendant's store may result in illness to the plaintiff's customers. To this end, the court notes that the plaintiff has an important interest in the uniformity of food specifications, preparation methods, quality and appearance, facilities and service of its franchisees. No[t] only does the defendant's conduct place the plaintiff's trademarks and trade name at risk, but more importantly, it puts the public in danger of food contamination. Further, the plaintiff has a strong legal interest in avoiding disputes stemming from the cleanliness and safety of its products. Accordingly, if customers become ill due to the defendant's franchises' unsanitary conditions, the plaintiff's national reputation, goodwill, and business will be harmed.[65]

Balance of Harms and the Public Interest

A franchisee generally cannot be harmed by the requested injunction because it will only be required to fulfill its obligations under the franchise agreement:

> All that is being asked of [the franchisees] is that they comply with the terms of the franchise agreement and the operating manuals and operate a clean, safe, and healthy donut shop. Requiring them to do so should not cause them any unnecessary expense or loss and certainly not subject them to any costs beyond that which they seemingly should now be spending to safely operate their shop.[66]

Moreover, the public and even the franchisee will likely benefit:

> The instant injunction would only require that the defendant comply with the Franchise Agreement, [into] which it freely entered. While no harm would befall the defendant by its compliance with the sanitation standards, the court notes that its business and public safety would at worst improve. Accordingly, the court finds that threatened injury to the plaintiff outweighs any conceivable injury to the defendant.[67]

In a termination action, these considerations are even more pronounced.[68] If the franchisor provides the franchisee with notice and an opportunity to cure before terminating the franchise agreement, the franchisee's arguments about its loss will ring hollow. In *The Original Great American Cookie Co. v. River Valley Cookies, Ltd.*,[69] the court balanced the hardship to the franchisee (loss of income and potentially significant assets) against the franchisor's harm in being forced to deal with a franchisee who committed egregious violations of the franchise agreement and who infringed on its trademarks. Specifically noting that the franchisee had received the opportunity to assign its franchise and avoid the harm, the court held that the balance of the hardships weighed in the franchisor's favor.[70]

Finally, the franchisor should emphasize (with testimony from other franchisees, if possible) the harm to other franchisees because the public views the franchisor's mark, and stores bearing it, as a unified business system; when one franchisee fails to uphold the franchisor's standards, it threatens the brand and the reputation and goodwill of all franchisees.

Speed Is Essential

Finally, if the franchisor decides to sue, it should do so quickly. "Significant delay in applying for injunctive relief in a trademark case tends to neutralize any presumption that infringement alone will cause irreparable harm pending trial, and such delay alone may justify denial of a preliminary injunction for trademark infringement."[71] Courts have found a presumption of irreparable harm rebutted in the face of periods shorter than four months.[72] Thus, franchisor should aim to have the standards action brought within one to two weeks of the last inspection of the franchisee business.

Enforcing system standards is necessary to protect a franchisor's marks and simply makes good business sense. By following the guides in this article, a franchisor should be able to increase the effectiveness of its enforcement program, benefiting the franchisor itself and its franchisees as well.

Endnotes

1. Robert W. Lane, Chairman, President, and CEO of Deere & Co., quoted in Alby Gallun, *In an Era of Corporate Scandals, Accounting Frauds and Rising Bankruptcies, Crain's Asks: Whom Do You Trust?: An Exclusive Survey of the Public's Confidence in Local Companies*, 25 Crain's Chi. Bus. 23, 2002 WL 9497726, at *2 (June 10, 2002).

2. *Starwood Announces Big Changes in the Works At Sheraton; New Beds, Room Design, and Tougher Standards Checking in to Starwood's Largest Brand,* Bus. Wire, at *2 (Apr. 18, 2002).

3. John P. Walsh, *Days Inns Focuses on Consistency,* 218 Hotel & Motel Mgmt. 3, 2003 WL 13359843, at *1 (Feb. 17, 2003) (quoting Joe Kane, President and CEO of Days Inn).

4. Principe v. McDonald's Corp., 631 F.2d 303, 309 (4th Cir. 1980).

5. *See, e.g.,* Dunkin' Donuts, Inc. v. Patel, 174 F. Supp. 2d 202, 212 (D.N.J. 2001) ("Dunkin's motives in conducting its inspections have no bearing on whether [the franchisees] breached their Franchise Agreement with [Dunkin' Donuts] by failing to properly maintain the three shops.").

6. *See, e.g.,* Power Test Petroleum Distribs., Inc. v. Calcu Gas, Inc., 754 F.2d 91, 96–97 (2d Cir. 1985) ("The 'metes and bounds' of a trademark are defined by the perceptions that exist in the minds of the relevant buying public. It is this customer perception which decides what property rights the trademark owner has. These property rights are often infringed; and what may be thereby impaired is both the consumer's right to be free from confusion and the trademark owner's right to a non-confused consumer and to control of his product's reputation.").

7. This article does not address enforcing franchise agreement provisions on royalties and advertising contributions or other monetary issues between franchisor and franchisees.

8. 15 U.S.C. §§ 1051 *et seq.*(2004).

9. *See* 2 J. Thomas McCarthy, McCarthy on Trademarks and Unfair Competition § 18:2 (4th ed. 2004).

10. *Power Test,* 754 F.2d at 97.

11. *See* McCarthy, *supra* note 9, § 18:48; *see also* Church of Scientology Int'l v. Elmira Mission of the Church of Scientology, 794 F.2d 38, 43 (2d Cir. 1986) ("Control of the trademark is crucial in the licensing context because a licensor who fails to monitor its mark risks a later determination that it has been abandoned.").

12. *Power Test,* 754 F.2d at 97 (quoting Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368, 387 (5th Cir. 1977)).

13. *See* Ann E. Doll, *Trademark Licensing: Quality Control,* 12 J. Contemp. Legal Issues 203, 205–06 (Mar. 2000); *see generally* Shred-It Am., Inc. v. Haley Sales, Inc., No. 01-CV-0041E(SR), 2001 WL 209906, at *1–3 (W.D.N.Y. Feb. 26, 2001).

14. *See* McCarthy, *supra* note 9, §§ 18:40 (citing 15 U.S.C. §§ 1055 and 1127), 18:49–18:54; *see also* 15 U.S.C. §§ 1055 (referring to the use of a mark by "related companies") and 1127 (defining a "related company" as "any person whose use of a mark is controlled by the owner of the mark with respect to the nature and quality of the goods or services on or in connection with which the mark is used").

15. Dawn Donut Co. v. Hart's Food Stores, Inc., 267 F.2d 358, 366–67 (2d Cir. 1959) ("[T]he Lanham Act places an affirmative duty upon a licensor of a registered trademark to take reasonable measures to detect and prevent misleading uses of his mark by his licensees or suffer cancellation of his federal registration. . . . The Lanham Act clearly carries forward the view . . . that controlled licensing does not work an abandonment of the licensor's registration, while a system of naked licensing does.").

16. Because a finding of inadequate control may result in a forfeiture of trademark rights, courts generally require a high degree of proof before declaring that all rights in the mark are lost. *See, e.g.,* Transgo, Inc. v. Ajac Transmission Parts Corp., 768 F.2d 1001, 1017 (9th Cir. 1985) ("[A] person who asserts insufficient control must meet a high burden of proof."); Kevin Parks, *"Naked"Is Not a Four Letter Word: Debunking the Myth of the "Quality Control Requirement" in Trademark Licensing,* 82 Trademark Rep. 531, 541 (1992) (describing this burden as "nearly insurmountable").

17. "The critical question in determining whether a licensing program is controlled sufficiently by the licensor to protect his mark is whether the licensees' operations are policed adequately to guarantee the quality of the products sold under the mark." Gen. Motors Corp. v. Gibson Chem. & Oil Corp., 786 F.2d 105, 110 (2d Cir. 1986) (internal quotations and citations omitted). A quality control provision in the license agreement does not save a trademark from abandonment if there is no actual control. *See, e.g., Dawn Donut Co.,* 267 F.2d at 367–68 (distinguishing between the Lanham Act's requirement of actual control and the presence of a mere right to control).

18. Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368, 387 (5th Cir. 1977) ("Retention of a trademark requires only minimal quality control, for in this context we do not sit to assess the quality of products sold on the open market. We must determine whether Kentucky Fried has abandoned quality control; the consuming public must be the judge of whether quality control efforts have been ineffectual.").

19. This subject is beyond the scope of this article. For a thorough discussion of vicarious liability law and litigation, see Michael D. Joblove & William L. Killion, *Defending Your Life: Protecting Your Unit and Your System in Vicarious Liability Litigation,* Amer. Bar Assoc., 26th Annual Forum on Franchising (2003).

20. *See id.* at 11–20.

21. Restatement (Second) of Agency § 220(2)(a) (2000).

22. *See* Joblove & Killion, *supra* note 19, at 3.

23. *Id.* at 7 (citing Exxon Corp. v. Tidwell, 867 S.W.2d 19 (Tex. 1993) for the rule's genesis).

24. *See id.* (citing Wu v. Dunkin' Donuts, Inc., 105 F. Supp.2d 83, 90 (E.D.N.Y. 2000) (holding that Dunkin' Donuts was not liable for a brutal

rape and assault of a franchisee's employee by third parties "absent a showing of actual control over the security measures employed by the franchisee" because Dunkin' Donuts had presented recommendations, not established requirements, regarding safety and security at franchised locations) and Ely v. Gen. Motors Corp., 927 S.W.2d 774 (Tex. App. – Texarkana 1996) (holding that General Motors had no liability to the estate of a mechanic who died when he lost control of the car during a test-drive, because it had no right to control the test-drive conducted at the dealership)).

25. Messrs. Joblove and Killion recommend that a franchisor think very carefully before requiring, versus recommending, a policy or procedure, particularly regarding employee relationships and safety and security, because of the continuing use of the Restatement's agency test by most courts. *See id.* at 30–34.

26. *See id.* at 2, 26–29 (stating that this problem is particularly acute with insurance defense counsel not schooled in franchise law).

27. *See, e.g.,* Creel Enters., Ltd. v. Mr. Gatti's, Inc., Bus. Franchise Guide (CCH) ¶ 9,825, at 22,237 (N.D. Ala. 1990), *aff'd,* 933 F.2d 1022 (11th Cir. 1991).

28. *Id.*

29. *Id.* at 22,239.

30. *Id.*

31. *Id.* (citing and quoting Kilday v. Econo-Travel Motor Hotel Corp., 516 F. Supp. 162 (E.D. Tenn. 1981) for the holding "that such quality standards provisions do not 'obligate the [franchisor] to require all its franchisees to conform to the standards required of the [franchisees]'").

32. *Id.*

33. Bus. Franchise Guide (CCH) ¶ 11,211 (5th Cir. 1997).

34. *Id.* at 29,691.

35. *Id.*

36. *Id.* at 29,693. Accordingly, the court did not address whether the plaintiff had presented sufficient evidence to support the jury's conclusion that Dunkin' Donuts had breached the franchise agreement. *Id.* at 29,692 n. 2.

37. *Id.* at 29,692–93. The court seemed to discount this theory because the franchisee only presented another franchisee's testimony to explain it. *See id.* at 29,693 n. 3.

38. *Id.* at 29,693.

39. When drafting the operations manual, franchisor need to keep in mind the vicarious liability conundrum of control leading to a possible finding of agency and *require* the essential components of the system (e.g., those that the franchisor will enforce) and *recommend* that the franchisee follow the rest of the concepts and policies. *See* Joblove and Killion, *supra* note 19, at 32. Also, to protect against those times when a franchisee causes injury despite systems standard training and enforcement, franchisor should include an indemnity provision and insurance requirements in the franchise agreement. *See id.* at 31–32. The franchise agreement should require the franchisee to maintain the types and amounts of insurance coverage specified by the franchisor with companies approved by the franchisor. The franchisor should be a named insured and must receive adequate notice before coverage is terminated. A franchisor's risk management department should be involved to ensure that the franchisees submit certificates of insurance reflecting this coverage, the franchisor's named insured status, and the insurer's agreement to provide notice of coverage termination.

40. A franchisor should confirm that all outstanding franchise agreements have the same notice provision or review each version to confirm that Intranet use is allowed.

41. For example, "No waiver by franchisor of any breach or series of breaches of this Agreement shall constitute either a waiver of any subsequent breach or a waiver of the terms of this Agreement."

42. This description is based on Mr. Schweickert's notes from a presentation by Steven Horn and David Worthen at the International Franchise Association's 36th Annual Legal Symposium. *See* Steven Horn & David Worthen, *System Standards Enforcement,* INT'L FRANCHISE ASSOC., 36th ANNUAL LEGAL SYMPOSIUM (2003).

43. Digital pictures are preferred because they can be reviewed immediately to determine if they adequately capture the scene and can be easily stored and transmitted to counsel for use in a standards enforcement action. Polaroid pictures are a reasonable alternative (again, they allow immediate review for completeness) and regular pictures developed quickly are a distant third option.

44. *See* Dunkin' Donuts, Inc. v. Barr Donut, LLC, 242 F. Supp.2d 296, 307 (S.D.N.Y. 2003) ("[T]he photographs . . . that have been admitted into evidence—depicting, *inter alia,* mold, flies, food stored on filthy surfaces, open flour bags, stagnant water, and mouse droppings—indisputably reveal a store with serious sanitation problems."); Dayan v. McDonald's Corp., 466 N.E.2d 945, 950–52 (Ill. App. Ct. 1984) (finding that McDonald's photographic evidence supported the trial court's finding that the franchisee's allegations and witnesses' testimony regarding compliance with McDonald's quality, service, and cleanliness standards were false and made without reasonable cause).

45. The notice and cure period may also be governed by a franchise relationship statute if the franchisor elects to terminate the franchise agreement. Because a standards enforcement action may evolve into a termination action if the standards violations continue and are serious enough, the applicability of these statutes must be considered regarding the notice and cure period.

46. *See* Dunkin' Donuts Inc. v. Albireh Donuts, Inc., 96 F. Supp. 2d 146, 152–54 (N.D.N.Y. 2000) (reproducing the form).

47. *Id.*

48. *See id.* at 151.

49. Civ. No. 96–2558, 1996 WL 208359 (E.D. Pa. Apr. 26, 1996). Mr. Schumacher represented Carousel Systems, Inc., in this case.

50. *Id.* at *4.

51. *Id.* at *2–4.

52. *Id.* at *1; *see id.* at *1–6.

53. Section 3 of the Federal Arbitration Act (FAA) requires a stay of litigation until "arbitration has been had in accordance with the terms of the agreement," and the choice of arbitral forum is one of those terms. Doctor's Assocs., Inc. v. Hamilton, 150 F.3d 157, 163 (2d Cir. 1998) (holding that a New Jersey Supreme Court opinion applying the New Jersey Franchise Practices Act is preempted by the FAA "to the extent that [it] can be read to invalidate arbitral forum selection clauses in franchise agreements"), *cert. denied,* 525 U.S. 1103 (1999); *see* Mgmt. Recruiters Int'l, Inc. v. Bloor, 129 F.3d 851, 856 (6th Cir. 1997) (stating that the validity of the Washington Franchise Investment Protection Act (Act) "would be in serious doubt as a result of the preemptive effect of the FAA" if the Act were interpreted to "impose[] an absolute requirement of in-state arbitration notwithstanding the parties' agreement to arbitrate [elsewhere]"). Mr. Dunham represented Doctor's Associates in *Hamilton.*

54. For a discussion exploring this subject, *see* Edward Wood Dunham, et al., *Franchisor Attempts to Control the Dispute Resolution Forum: Why the Federal Arbitration Act Trumps the New Jersey Supreme Court's Decisions in* Kubis, 29 RUTGERS L.J. 237, 239–52 (1998).

55. *See id.*

56. For a thorough review of this topic, *see* Mark J. Burzych & Emily L. Matthews, *Vive la Difference? Selective Enforcement of Franchise Agreement Terms and System Standards,* 23 FRANCHISE L.J. No. 2, at 110–19 (Fall 2003).

57. *See id.* at 110, 116–17; *see also* The Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd., 970 F.2d 273, 279 (7th Cir. 1992) ("The fact that the Cookie Company may . . . have treated other franchisees more leniently is no more a defense to a breach of contract than laxity in enforcing the speed limit is a defense to a speeding ticket."); *see also* McDonald's Corp. v. Robertson, 147 F.3d 1301, 1309 (11th Cir. 1998) ("[W]e find that the Robertsons' failure to comply with McDonald's [quality, safety, and cleanliness] and food safety standards constituted a material breach of the franchise agreement sufficient to justify termination, and thus, it does not matter whether McDonald's also possessed an ulterior, improper motive for terminating the Robertsons' franchise agreement. Indeed, a franchisor's right to terminate a franchisee exists independently of any claims the franchisee might have against the franchisor. The franchisor has the power to terminate the relationship where the terms of the franchise agreement are violated.") (citations

and quotation marks omitted).

58. Burzych & Matthews, *supra* note 56, at 117 (discussing Kilday v. Econo-Travel Motor Hotel Corp., 516 F. Supp. 162, 163 (E.D. Tenn. 1981); *see* discussion *supra*.

59. *See* 15 U.S.C. § 1114(1) (2004).

60. *See* 15 U.S.C. § 1125(a) (2004).

61. *See* 15 U.S.C. § 1125(c)(1) (2004).

62. *See* Campbell Soup Co. v. Giles, 47 F.3d 467, 469 (1st Cir. 1995) (applying federal standard).

63. *See, e.g.,* Pappan Enters., Inc. v. Hardee's Food Sys., Inc., 143 F.3d 800, 803 (3d Cir. 1998).

64. Burger King Corp. v. Stephens, Civ. No. 89–7691, 1989 WL 147557, at *11 (E.D. Pa. Dec. 6, 1989); *see* Dunkin Donuts, Inc. v. Patel, 174 F. Supp. 2d 202, 204–07, 211–12 (D.N.J. 2001) (awarding attorney fees and costs for breach of franchise agreement standards).

65. Dunkin' Donuts's Inc. v. Kashi Enters., Inc., 106 F. Supp. 2d 1325, 1327 (N.D. Ga. 2000); *see* Dunkin' Donuts Inc. v. Albireh Donuts, Inc., 96 F. Supp. 2d 146, 149 (N.D.N.Y. 2000) (restaurant's operation serving "inferior, non-conforming products under [Dunkin' Donuts] name could have a detrimental impact on [Dunkins's] name and goodwill, devalue [Dunkin' Donuts] trademark, and subject [Dunkin' Donuts's] to a loss of business and exposure to substantial tort liability"). Moreover, such harm is unquantifiable and cannot be addressed by money damages. *See* Warner-Lambert Co. v. Northside Dev. Corp., 86 F.3d 3, 8 (2d Cir. 1996) ("The extent of loss of consumer goodwill that Warner-Lambert may suffer from the sale of some 300,000 bags of non-conforming cough drops will be unquantifiable at trial. It is thus not accurately compensable by monetary damages. This satisfies the irreparable injury requirement.").

66. *Albireh Donuts,* 96 F. Supp. 2d at 151.

67. *Kashi Enters.*, 106 F. Supp. 2d at 1327.

68. *See, e.g.,* McDonald's Corp. v. Robertson, 147 F.3d 1301, 1309 ("'The franchisor has the power to terminate the relationship where the terms of the franchise agreement are violated.'") (quoting S & R Corp. v. Jiffy Lube Int'l, Inc., 968 F.2d 371, 375 (3d Cir. 1992)).

69. 970 F.2d 273 (7th Cir. 1992).

70. *Id.* at 276–77; *see* Carousel Sys., Inc. v. Ordway, Civ. No. 96–2558, 1996 WL 208359, at *5 (E.D. Pa. Apr. 26, 1996) ("[D]efendants cannot seriously contest the extent of the great harm plaintiff's reputation will suffer absent relief. While defendants' harm is also great, it has been brought about entirely of their own making. The balance of harms thus tips in plaintiff's favor.").

71. Citibank, N.A. v. Citytrust And Citytrust Bancorp, Inc., 756 F.2d 273, 276 (2d Cir. 1985).

72. Christopher Norman Chocolates, Ltd. v. Schokinag Chocolates N. Am., Inc., 270 F. Supp. 2d 432, 439 (S.D.N.Y. 2003) (citing cases).