Franchising (& Distribution) Currents

Diane Green-Kelly, Bethany L. Appleby, and Robert M. Einhorn

Diane Green-Kelly

Robert Einhorn

Bethany L. Appleby

Antitrust

***Jean Ann Mumford v. GNC Franchising LLC,* 437 F. Supp. 2d 344, Bus. Franchise Guide (CCH) ¶ 13,369 (W.D. Pa. June 29, 2006)**

Cases involving antitrust claims are being brought with increasing regularity in the franchise and distribution arena. In the first of many antitrust cases decided during the past several months, a federal district court in Pennsylvania held that the claims of two GNC franchisees, brought pursuant to Sections 1 and 2 of the Sherman Act and the Robinson-Patman Act, failed to state a claim and dismissed them pursuant to Federal Rule of Civil Procedure 12(b)(6).

The GNC franchise agreement required the franchisees to purchase only approved products for resale in their GNC stores and further required them to purchase inventory from the franchisor or its affiliates, or from an approved supplier, in categories and minimum quantities specified by GNC. The franchisees' claims arose from those purchase requirements in the franchise agreements; they alleged that franchisees were required to pay outrageous charges to the franchisor or its affiliates in connection with such purchases. The franchisees alleged that the purchase requirements were a restraint of trade in violation of the Sherman Act. Further, the franchisees alleged that they were required to pay higher prices than the franchisor's company-owned stores in violation of the Robinson-Patman Act.

As to the Sherman Act claims, the franchisees defined the relevant product market for a rule of reason analysis as the market for approved products sold to GNC franchisees. The court found that the restrictions challenged by the franchisees were imposed by the franchise agreement; and in *Queen City Pizza, Inc. v. Domino's Pizza, Inc.,* 124 F.3d 430 (3d Cir. 1997), the Third Circuit held that a relevant market cannot be defined by such contractual restraints as a matter of law. The court distinguished the decision in *Little Caesar Enterprises, Inc. v. Smith,* 34 F.Supp. 2d 459 (E.D. Mich. 1998), because, unlike the GNC franchise agreement, the Little Caesar franchise agreement did not disclose the challenged restriction. The court thus dismissed the franchisees' Sherman Act claims.

The district court also dismissed the Robinson-Patman Act claims. To state a claim under the Robinson-Patman Act, a plaintiff must allege two contemporaneous sales of the same commodity at different prices to different purchasers. The franchisees alleged that they were required to pay different prices to the franchisor than the prices paid by the franchisor's company-owned stores, which were owned by a subsidiary of the franchisor. Citing *Copperweld Corp. v. Independence Tube Corp.,* 467 U.S. 752 (1984), the court held that a parent and wholly owned subsidiary are considered to be a single economic unit for purposes of antitrust scrutiny. Although *Copperweld* involved claims under the Sherman Act, the court held that the "[c]oordinated activity of a parent and its wholly owned subsidiary in the form of transfers between them has been read to not support a price discrimination claim under the Robinson-Patman Act." Because one of the two sales alleged by the franchisees to support their Robinson-Patman Act claim was made between the franchisor and its wholly owned subsidiary, the court held that the franchisees failed to state a claim.

***F.F. Orthotics Inc. v. Joe Paul,* No. B-044226, 2006 WL 1980270, Bus. Franchise Guide (CCH) ¶ 13,389 (Cal. Ct. App. 2006)**

A California appellate court reversed a verdict against the supplier of Good Feet orthotic supports for alleged vertical resale price fixing and unlawful tying in violation of the California Cartwright Act, which is fashioned after Section 1 of the Sherman Act. The court noted that in *Copperweld Corp. v. Independence Tube Corp.,* 467 U.S. 752 (1984), the U.S. Supreme Court held that a parent and wholly owned subsidiary are considered to be a single economic unit and cannot conspire as a matter of law for purposes of antitrust scrutiny. In this case, the only conspiracy alleged by the plaintiffs was a conspiracy to fix wholesale prices between a supplier and its wholly owned subsidiaries. Further, there was no evidence of a conspiracy to fix retail prices. The plaintiffs had alleged that they were contractually prevented from using any broadcast advertising not prepared by the franchisor and were forced either to charge the

---

Diane Green-Kelly is a partner in the Chicago office of Mayer, Brown, Rowe & Maw LLP. Bethany L. Appleby is a partner in the New Haven office of Wiggin and Dana LLP. Robert M. Einhorn is a partner in the Miami office of Zarco Einhorn, Salkowski, & Brito PA.

prices in the franchisor-prepared ads or to pay additional amounts to the franchisor to customize the ads to include the prices they wanted to charge; alternatively, they were forced to forgo any broadcast advertising. However, the evidence showed that dealers set their own retail prices to consumers.

The court also held that the evidence did not support a vertical price-fixing conspiracy because the franchisor acted unilaterally in refusing to deal with dealers that failed to comply with the franchisor's minimum resale price policy.

The court also reversed the verdict against the franchisor on the tying claims. The plaintiffs claimed that they were required to purchase supplies from the franchisor's affiliate. However, the court held that such contractual restraints do not violate the antitrust laws where the supplier lacks market power. There was no evidence that the franchisor had market power in the market for the sale of orthotics, and therefore the verdict against the franchisor was reversed.

***U.S. Horticultural Supply, Inc. v. Scotts Co.,* No. 04-5182, 2006 WL 1531407, Bus. Franchise Guide (CCH) ¶ 13,371 (E.D. Pa. June 1, 2006)**

A Pennsylvania district court denied a motion to dismiss the Sherman Act claims brought by a former distributor of Scotts horticultural products. Although the court expressed doubt as to whether the plaintiff could later prove its claims, the court held that the complaint stated the elements of a per se violation of Section 1 of the Sherman Act, as well as a claim under a rule-of-reason analysis.

The plaintiff alleged that Scotts and another distributor, Griffin, conspired not only to drive the plaintiff out of one geographic market by inhibiting the plaintiff's ability to obtain a supply of Scotts products at a fair price, but also to block its entry into another market, eventually driving the plaintiff out of business and allowing Griffin to purchase the plaintiff's assets at a low price. The plaintiff alleged that Scotts and Griffin entered into the conspiracy to eliminate the plaintiff from the market because it charged lower prices, and thereafter they charged supracompetitive prices to consumers. The defendant, Scotts Co., a supplier of horticultural products, moved to dismiss, claiming that the plaintiff failed to allege facts establishing a conspiracy and that the facts that were alleged were consistent with lawful unilateral conduct.

The court held that the plaintiff's allegations were sufficient to allege a conspiracy. Further, the court held that a plaintiff is not required to allege facts that tend to exclude the possibility of unilateral conduct by the defendant, provided the facts alleged support an inference of an agreement between two or more coconspirators.

The court also held that the plaintiff alleged facts supporting a per se unlawful vertical agreement to fix prices. The plaintiff alleged that Scotts and Griffin conspired to eliminate the plaintiff, with its price-cutting activities and sales of non-Scotts-branded products, as a competitor for the purpose of raising prices to supracompetitive levels. Further, the plaintiff alleged that after it was driven from the market, Griffin in fact raised its prices to supracompetitive levels. Such allegations stated a per se violation of Section 1 of the Sherman Act.

***Worldhomecenter.com v. Thermasol, Ltd.,* Case. No. 05-CIV-3298 (DRH), 2006 WL 1896344, Bus. Franchise Guide (CCH) ¶ 13,391 (E.D.N.Y. July 10, 2006)**

A district court in New York denied a motion to dismiss a distributor's claims of vertical price fixing, pursuant to Federal Rule of Civil Procedure 12(b)(6). The plaintiff, a seller of home improvement products over the Internet, alleged that the manufacturer implemented a minimum advertising price (MAP) policy as a result of a conspiracy between the manufacturer and distributors of the home improvement products through traditional brick-and-mortar stores. The court held that under a notice pleading standing, the plaintiff stated a claim by alleging that the manufacturer implemented the MAP policy only after receiving complaints from the traditional distributors. The court held that the plaintiff was not required to plead "the details of secret conspiratorial conversations prior to discovery." Because the complaint alleged the existence of an agreement, it was adequate to survive a motion to dismiss.

***WaterCraft Mgmt LLC v. Mercury Marine*, 457 F.3d 484, Bus. Franchise Guide (CCH) ¶ 13,398 (5th Cir. 2006)**

The Fifth Circuit affirmed judgment in favor of a manufacturer on a Robinson-Patman Act claim following a bench trial in which the manufacturer of boat engines, Mercury Marine, established the meeting competition defense. There, the plaintiff was a boat dealer that sold Mercury motors, which went out of business after two years. The plaintiff alleged that Mercury Marine offered discriminatory pricing by offering deeply discounted pricing to a large, competing boat dealer.

To establish the meeting competition defense, a defendant must show that its lower price was made in a good-faith response to that of a competing low price. Here, the evidence showed that Mercury offered a lower price in an effort to obtain the dealer's business in competition with OMC, a competitor of Mercury Marine. The district court found that the defendant's lower price to a competing dealer was driven solely by its negotiations with the dealer, which, "like any savvy buyer, used its OMC price schedule to extract deep discounts from Mercury." Further, the district court rejected the plaintiff's argument that the defendant failed to establish the meeting competition defense because Mercury's final discriminatory price was not as low as OMC's price. The court held that a defendant establishes the meeting competition defense if it shows an intent to meet a competitor's price, which was demonstrated in this case.

***Glauser DCJB, LLC v. Porsche Cars N. Am., Inc.,* No. 05-CV-01493 (PSF), 2006 WL 1816458, Bus. Franchise Guide (CCH) ¶ 13,407 (D. Colo. June 30, 2006)**

The owner of a Mercedes-Benz automobile dealership sued the manufacturer of Porsche cars for refusing to approve the sale of a Porsche dealership in Boulder, Colorado, to the plaintiff and to permit it to relocate the Porsche dealership to another location in Boulder where the plaintiff operated its Mercedes-Benz dealership. The Porsche dealership agreement required Porsche's approval of a sale of a dealership, which could be withheld only due to specified criteria, including consideration of the purchaser's qualifications. The plaintiff alleged that Porsche's refusal to approve the transfer and relocation violated the Colorado Automobile Dealers Act and federal and Colorado antitrust laws because it was made based on complaints from two other Porsche dealers in the Denver area. The plaintiff alleged that Porsche and the dealers engaged in a conspiracy to allocate the Denver/Boulder market for the purpose of charging higher prices for Porsche cars and to boycott the plaintiff's purchase of the Porsche dealership in order to maintain the dealers' market allocation and high prices.

Porsche moved to dismiss, arguing that because the dealership agreement required Porsche's approval of any sale or transfer, it, as a matter of law, may refuse to approve such a transfer or sale. The court, however, held that on a motion to dismiss, the court must accept all allegations as true; if the evidence showed that Porsche acted unilaterally, it would not violate the antitrust laws, but the complaint alleged that Porsche acted in concert with two Porsche dealers.

Porsche then argued that the plaintiff failed to allege that Porsche had market power in a properly defined relevant market, to which the plaintiff responded that it was alleging only per se violations of the antitrust laws (price fixing and boycotting) and therefore need not allege market power because anticompetitive impact is presumed in a per se violation.

The court noted that although the complaint alleged a conspiracy between two Porsche dealers to allocate the market and fix prices, there was no allegation that Porsche was a party to that conspiracy. The court held that the allegations did not lead to a "reasonable inference" that Porsche was a participant in the dealers' price-fixing conspiracy and therefore dismissed that claim. Further, the court noted that a per se unlawful boycott can only exist between actors at the same level of distribution, and Porsche was not in a horizontal relationship with the two Porsche dealers. Although a violation of the antitrust laws can be stated by alleging that a manufacturer refused to deal with a price-cutting dealer in response to complaints from other dealers, such a violation requires that the plaintiff allege that the defendant has market power in a properly alleged relevant market. Because the plaintiff failed to do so, the court dismissed the plaintiff's antitrust claims.

***PSKS, Inc. v. Creative Leather Prods., Inc.*, 171 F. App. 464, Bus. Franchise Guide (CCH) ¶ 13,410 (5th Cir. 2006)**

The Fifth Circuit upheld a jury verdict in favor of a retailer of women's accessories, which alleged a per se unlawful price-fixing agreement between the manufacturer and its retailers. On appeal, the defendant did not challenge the jury's finding that the defendant entered into price-fixing agreements with retailers; rather, it appealed the application of the per se rule, claiming that the rule of reason should have applied. The defendant argued that the rule of reason applies to vertical restraints; however, the Fifth Circuit held that although the rule of reason applies to nonprice vertical restraints, the per se rule applies to vertical price-fixing agreements.

The defendant also appealed the district court's exclusion of the defendant's expert witness, who testified that the price-fixing agreement did not have anticompetitive effects. The Fifth Circuit, reviewing an abuse-of-discretion standard, upheld the district court ruling, holding that because anticompetitive impact is presumed in a per se violation, testimony regarding the question of whether the price-fixing agreement had anticompetitive effects was irrelevant.

***Champagne Metals, LLC v. Ken-Mac Metals, Inc.*, 458 F.3d 1073, Bus. Franchise Guide (CCH) ¶ 13,425 (10th Cir. 2006)**

The Tenth Circuit reversed summary judgment in favor of the defendants on group boycott claims brought by an aluminum distributor (service center). Service centers operate as middlemen, which purchase aluminum from mills and sell it to end users. There are six "leading" mills in North America, each of which specializes in one or more of five different types of aluminum. The plaintiff alleged that three of these types of aluminum were key to its operations, and access to more than one mill was critical to its ability to compete effectively. The plaintiff alleged that the defendants, older, more established service centers, threatened to move their business from mills that did business with the plaintiff in order to drive it out of business and to discourage other service centers generally from entering the market. The district granted summary judgment to the defendants, finding that the plaintiff had failed to establish the existence of a conspiracy by direct or circumstantial evidence.

The Tenth Circuit reversed, holding that the plaintiff had presented direct evidence of such a conspiracy, as well as a plausible economic theory to support such a conspiracy. The record included testimony of a mill representative that the mill was told by competitors that selling to the plaintiff would not be in the best interest of the industry and would cause other distributors in the area to source their metal from other mills. The court held that this evidence by itself was insufficient to raise a genuine issue of material fact; to defeat summary judgment, a plaintiff must present evidence that tends to exclude the possibility that the defendants acted independently. The Tenth Circuit disagreed with the district court that the plaintiff's economic theory was, at best, "plausible but weak." The court found plausible the plaintiff's argument that the defendants acted to keep a new, aggressive entrant out of the market in order to maintain current pricing, rather than fixing or raising prices. The court noted that the plaintiff had presented evidence that the defendants viewed the plaintiff as a price-cutting competitor that threatened their profit margins and market share, thus presenting an economically rational theory.

***Nicsand, Inc. v. 3M Co.*, 457 F.3d 534, Bus. Franchise Guide (CCH) ¶ 13,424 (6th Cir. 2006)**

The Sixth Circuit reversed the trial court's Rule 12(b)(6) dismissal of claims against 3M Company (3M), which alleged violation of Sections 1 and 2 of the Sherman Act. The trial court dismissed the lawsuit after concluding that the plaintiff, NicSand, Inc., (NicSand), failed to plead an injury that supported standing under the Sherman Act.

NicSand marketed materials used to prepare automotive surfaces for painting. 3M was NicSand's only competing supplier of certain products. In its lawsuit, NicSand alleged that 3M attempted to monopolize the market for certain products by giving large discounts to certain retailers in exchange for multiyear exclusive-dealing agreements. NicSand claimed that 3M's exclusive contracts locked up business with two-thirds of the retailers that together supplied 80 percent of the retail market.

The Sixth Circuit held that NicSand had sufficiently alleged a Section 2 violation to withstand a motion to dismiss because it alleged (1) "sufficient averments regarding monopoly power," (2) that 3M "had acquired and attempted to acquire its monopoly power through anticompetitive conduct," and (3) that 3M had the specific intent to monopolize the specified market. The court also rejected 3M's argument that NicSand lacked standing to bring an exclusive-dealing claim.

One judge dissented, agreeing with 3M that NicSand lacked standing as a competitor for its failure to allege "antitrust injury," commenting that its only alleged harm was "suffered in its capacity as a competitor, not as a defender of marketplace competition" (quoting *Indeck Energy Services v. Consumers Energy Co.,* 250 F.3d 972 (6th Cir. 2000)).

Arbitration

***T. Barry Stephens v. TES Franchising LLC,* No. 3:01-CV-2267, 2006 WL 1933094, Bus. Franchise Guide (CCH) ¶ 13,392 (D. Conn. July 12, 2006)**

A federal district court refused to vacate an arbitration award where the plaintiff that moved to vacate the award failed to show that the arbitrator was partial toward the franchisor. The franchisee alleged claims under the Connecticut little FTC Act and the Florida Franchise Act. The franchisee alleged that partiality was shown by the arbitrator's manifest disregard of the law and evidence, i.e., by requiring that the franchisee demonstrate that it reasonably relied on alleged misrepresentations when no such requirement is imposed by either the Connecticut or the Florida statute.

The district court found that the arbitrator did not add an element of individual reliance in evaluating the franchisee's claim. Rather, the arbitrator properly considered the misleading nature of the alleged statements, the reasonableness of their interpretation, and their materiality. The court further rejected the franchisee's argument of partiality where there was no claim that the arbitrator had a prior personal or business relationship with either party and had no personal interest in the outcome of the dispute.

***Timothy Gill v. World Inspection Network Int'l, Inc.,* No. 06-CV-3187 (JFB) (MLO), 2006 WL 2166821 (slip copy), Bus. Franchise Guide (CCH) ¶ 13,419 (E.D.N.Y. July 31, 2006)**

A New York federal court denied a former franchisee's motion for preliminary injunction to prevent a franchisor from prosecuting an arbitration against him in Seattle, Washington, and granted the franchisor's cross-motion to stay the lawsuit pending arbitration.

World Inspection Network Int'l, Inc., (WIN), is a franchisor that licenses a home property inspection system. WIN's franchise agreement contains a broad arbitration clause requiring arbitration "in or about King County, Washington." WIN commenced arbitration in Seattle against a former franchisee in New York for its alleged violation of a posttermination covenant not to compete. The former franchisee filed an action in New York seeking a preliminary injunction to enjoin the Seattle arbitration and to require the parties, if they chose to arbitrate, to do so in New York.

The former franchisee argued that the arbitral forum selection clause should not be enforced because it would impose a financial hardship and would be inconvenient for witnesses. He also claimed that the clause was unconscionable because, inter alia, it was "found at the end of a 'long and convoluted' paragraph of the" franchise agreement. The former franchisee also relied on a 2005 New Jersey Superior Court ruling that it claimed refused to enforce the same clause against another WIN franchisee.

Citing the U.S. Supreme Court decision in *Howsam v. Dean Witter Reynolds, Inc.,* 537 U.S. 79, 123 S. Ct. 588, 154 L.E.2d 491 (2002), the New York court refused to grant an injunction, concluding that the former franchisee was not likely to reach the issue of unconscionability because it could not prove that the issue was a "substantive gateway issue" for a court, rather than an arbitrator, to decide. In *Howsam,* the U.S. Supreme Court recognized that, even though federal policy favors enforcing agreements to arbitrate, "[t]he question whether the parties have submitted a particular dispute to arbitration, *i.e.,* the '*question of arbitrability*' is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise." The Supreme Court also noted, however, that questions of arbitrability appropriate for judicial determination exist only "in the narrow circumstance where contracting parties would likely have expected a court to have decided the gateway matter." The New York court cited decisions from other jurisdictions where courts had held that the validity or interpretation of an arbitral forum selection provision was a procedural, rather than substantive, matter and therefore appropriate for the arbitrator to decide. The court further noted that even if the former franchisee could convince the court that the issue was a substantive "question of arbitrability" for the court to decide, the parties explicitly provided otherwise in their franchise agreement, which stated that the arbitration clause applied to any claim that the franchise agreement "or any part thereof, is invalid, illegal or otherwise voidable or void."

The court recognized that substantive unconscionability alone can render a contract provision unenforceable in both Washington and New York. Relying on Second Circuit precedent, including cases involving Doctor's Associates, Inc., that enforced the arbitral forum selection clause in the Subway® franchise agreement, the court found that the clause at issue was not unconscionable and noted that the Second Circuit has specifically rejected franchisees' arguments that the cost of arbitrating in a distant forum is sufficient for a finding of unconscionability. Moreover, the former franchisee failed to introduce any evidence whatsoever concerning the alleged hardship of arbitrating in Washington as opposed to New York. The court also concluded that there was no procedural unconscionability because the contract language was not ambiguous or hidden, and there was no "unfair surprise." In addition, even though the franchise agreement was a standard form contract, the court could not find that this particular franchisee was "so vulnerable or that there was such unequal bargaining power that it was procedurally unconscionable, given the business nature of a franchisor/franchisee relationship."

***Diagnostic Imaging Supplies & Servs., Inc. v. Gen. Elec. Co.,* No. 04-2368, 2006 U.S. Dist. LEXIS 50792, Bus. Franchise Guide (CCH) ¶ 13,416 (D.P.R. July 24, 2006)**

This case is discussed under the topic heading "Declaratory Judgments."

Choice of Forum

DVDplay, Inc. v. DVD 123 LLC,* 930 So. 2d 816, Bus. Franchise Guide (CCH) ¶ 13,361 (Fla. Dist. Ct. App. 2006)

A Florida franchisee sued a California-based franchisor in Florida state court despite the franchise agreement's California forum selection clause. This occurred after (1) the franchisee invoked the franchise agreement's mandatory presuit mediation requirement for its claims against the franchisor; and (2) the franchisor sought mediation of its own claims against the franchisee, but the franchisee failed to respond, and the franchisor then terminated the franchise agreement and refused to mediate thereafter due to the termination.

The trial court declined to dismiss for improper forum. The court of appeals reversed on de novo review because (1) the parties intended the forum selection clause to survive termination, and (2) the franchisor's termination was not necessarily an anticipatory repudiation, but rather a termination based on the franchisee's claimed failure to cure its own breach. The court of appeals commented that although the trial court could have refused to dismiss if it had determined that enforcement of the forum selection clause was "unjust, as the result of unequal bargaining power, or unreasonable," the franchisee did not assert these arguments.

***In re Lathan Co. v. Soprema, Inc.,* No. 1050466, 2006 WL 2037179, Bus. Franchise Guide (CCH) ¶ 13,397 (Ala. July 21, 2006)**

The Alabama Supreme Court issued a writ of mandamus directing an Alabama trial court to enforce an Ohio forum selection clause in an agreement between an Ohio roofing materials manufacturer and an Alabama roofing company. The Alabama company had not claimed fraud in the inducement with regard to the clause, and there was no evidence that enforcement would be unfair on the basis that the agreement was affected by fraud, undue influence, or "overweening bargaining power." The court also found that both parties were reasonably sophisticated and had understood the agreement and that the clause did not appear to be unreasonable or pose undue difficulties for the roofing company. The court further rejected the Alabama company's contention that its claims were outside the scope of the clause because, as the court noted, the roofing company would have no claims against the manufacturer absent the parties' agreement.

***S&G Janitschke, Inc. v. Cottman Transmission Sys., LLC,* No. 05-2896 (DSD/SRN), 2006 WL 1662892 (slip copy), Bus. Franchise Guide (CCH) ¶ 13,409 (D. Minn. June 8, 2006)**

The U.S. District Court for the District of Minnesota addressed the enforceability of a forum selection clause designating Pennsylvania as the chosen forum as it related to franchisees from several different states.

Cottman Transmission Systems, LLC, is a Delaware franchisor with its principal place of business in Pennsylvania. The company's standard franchise agreement contains a Pennsylvania forum selection clause, which it sought to invoke by moving to dismiss or transfer the plaintiffs' Minnesota lawsuit. The magistrate recommended dismissing the claims against Cottman's CEO for lack of personal jurisdiction and then analyzed the law of certain franchisees' states to decide the motion with respect to their claims against the franchisor.

Minnesota. The court refused to enforce the forum selection clause against Minnesota franchisees and declined to transfer. Even though the Minnesota Franchise Act does not expressly prohibit venue selection provisions, the Minnesota Commissioner of Commerce has determined that it is "unfair" and "inequitable" to "require a franchisee to waive his or her rights to a jury trial or to waive rights to any procedure, forum, or remedies provided for by the laws of the jurisdiction."

Iowa. The court refused to enforce the forum selection clause against Iowa franchisees and declined to transfer because the Iowa Franchise Agreements Law expressly provides that franchise agreement provisions restricting jurisdiction to forums outside the state are void.

Illinois. The single Illinois plaintiff did not actually have a franchise agreement with a Pennsylvania forum selection clause. The magistrate concluded, however, that even if the franchise agreement had the clause, the Illinois Franchise Disclosure Act would void it.

Wisconsin. Unlike the other states discussed above, Wisconsin law does not prohibit out-of-state forum selection clauses. The court therefore transferred the Wisconsin franchisee's claims to the U.S. District Court for the Eastern District of Pennsylvania.

Remaining Plaintiffs. The magistrate concluded that "considerations of judicial economy and fairness weigh in favor of" dismissing the remaining plaintiffs' claims because there was litigation involving these plaintiffs already pending in other states.

***S.K.I. Beer Corp. v. Baltika Brewery,* 443 F. Supp. 2d 313, Bus. Franchise Guide (CCH) ¶ 13,393 (E.D.N.Y. 2006)**

A New York federal court dismissed claims against a Russian brewer that were brought by a New York wholesaler because a forum selection clause required that disputes be adjudicated in "the Arbitration Court in St. Petersburg and the Leningradskaya Oblast" under the laws of the Russian Federation. The wholesaler argued that the clause contravened New York public policy as set forth in the state's beer law. The court, however, concluded that the state's beer law did not apply because the brewer was not located in New York and did not sell beer in New York and that, in any event, the law did not constitute a strong public policy sufficient to overcome public policy favoring the enforcement of forum selection clauses. In addition, the wholesaler failed to present evidence that it would lose any rights or remedies it would otherwise have if it were able to sue in New York.

Choice of Law

Kevin Burgo v. Lady of Am. Franchise Corp.,* No. SA CV 05-518 DOC (RNBx), Bus. Franchise Guide (CCH) ¶ 13,367 (C.D. Cal. May 4, 2006)

This case is discussed under the topic heading "Procedure—Personal Jurisdiction."

***Gabana Gulf Distribution, Ltd. v. Gap Int'l Sales, Inc.,* No. C 06-02584 CRB, 2006 WL 2355092 (slip copy), Bus. Franchise Guide (CCH) ¶ 13,420 (N.D. Cal. Aug. 14, 2006)**

The U.S. District Court for the Northern District of California held that the California Franchise Relations Act (CFRA) applied to a distributor agreement between a European distributor and a Delaware clothing manufacturer (the Gap) whose principal place of business was in California, and refused to dismiss for failure to state a claim.

A European distributor sued the Gap for issues relating to "a distribution agreement gone awry," including alleged wrongful termination under the CFRA. The agreement between the parties contained a California choice of law provision.

The court noted that although simple choice of law clauses are insufficient to invoke the CFRA to out-of-state franchises, the particular language in the agreement raised an issue of first impression because it specifically selected California law "as applied to agreements entered into and to be performed entirely within California between California residents." The court held that, under the circumstances, the European distributor should "be treated as a California resident and that the contract shall effectively be deemed to have been entered into within California." The court therefore concluded that because the distributor was "a California resident" for purposes of the contract, it "satisfi[ed] the plain language of the jurisdictional limitation of the CFRA" even though the distributor was not suing for conduct concerning either party's conduct in California.

The Gap also argued that the distributor was not a franchisee under the CFRA but relied exclusively on language in the parties' agreement that provided that there was no franchise relationship. The plaintiff distributor alleged that it met the criteria for becoming a de facto franchisee under California law, and the Gap failed to dispute those allegations.

Civil Rights

***Warren DeLuca v. Allied Domecq Quick Serv. Rests.*, No. 03-CV-5142 (JFB), 2006 WL 1662611, Bus. Franchise Guide (CCH) ¶ 13,384 (E.D.N.Y. June 13, 2006)**

A federal district court in New York granted summary judgment to Dunkin' Donuts on a former employee's claims of age discrimination and denied summary judgment with respect to the plaintiff's claim of unlawful retaliation. The plaintiff, who was forty-five at the time of his employment termination, had been an employee of Dunkin' Donuts for a number of years. At the time of his termination, he had responsibilities for "A and B class" franchises; his sisters owned A and B class franchises in New York. The franchisor conducted an investigation after receiving complaints of nepotism in violation of the Dunkin' Donuts Code of Ethics with respect to the plaintiff's alleged favorable treatment of his sisters' franchises. Based on the investigation, Dunkin' Donuts terminated the plaintiff's employment. The investigation showed that the plaintiff had been warned of such conduct previously. At the same time, two other employees, both of whom were older than the plaintiff, were given warnings for alleged violations of the Code of Conduct, and their employments were not terminated. The plaintiff later applied to become a Dunkin' Donuts franchisee; however, his application was rejected.

On the franchisor's motion for summary judgment, the court held that there were no issues of material fact that there was age discrimination. It was indisputable that the individual who conducted the investigation and terminated the plaintiff's employment did not know the plaintiff's age. Further, the two older employees were not terminated because, unlike the plaintiff, they had not received any prior warnings. Therefore, the court held that there was no evidence of age discrimination.

The court denied summary judgment on the plaintiff's retaliation claim, however. The court held that the denial of a franchise application could constitute retaliatory adverse employment action as a form of "blacklisting." The court held that there was sufficient evidence from which a reasonable jury could find retaliation, notwithstanding the franchisor's claimed legitimate, nondiscriminatory reason for denying the plaintiff's franchise application (i.e., the circumstances under which he had been fired). The plaintiff showed that his application was handled in a different manner and by individuals who rarely are involved in such decisions, including the legal department. Therefore, there were issues of fact regarding the legitimacy of the defendants' denial of the franchise application.

Contracts

***DVDplay, Inc. v. DVD 123 LLC*, 930 So. 2d 816, Bus. Franchise Guide (CCH) ¶ 13,361 (Fla. Dist. Ct. App. 2006)**

This case is discussed under the topic heading "Choice of Forum."

Declaratory Judgments

***Diagnostic Imaging Supplies & Servs., Inc. v. Gen. Elec. Co.*, No. 04-2368, 2006 U.S. Dist. LEXIS 50792, Bus. Franchise Guide (CCH) ¶ 13,416 (D.P.R. July 24, 2006)**

The plaintiff entered into a distribution agreement with a manufacturer to become the exclusive distributor of the manufacturer's products in Puerto Rico and the Virgin Islands. The manufacturer was then acquired by the defendant. The distribution agreement contained choice of law and arbitration provisions, which provided that the distributorship agreement was governed by the laws of Finland and any disputes were to be settled by arbitration in Helsinki, Finland.

The plaintiff brought suit against the defendant, seeking a declaratory judgment that the choice of law provision was void under the Puerto Rico Dealer's Act (Law 75) (title 10, § 278 et seq. of the Laws of Puerto Rico Annotated), which provides that "any stipulation that obligates a dealer to . . . arbitrate or litigate any controversy . . . regarding his dealer's contract outside of Puerto Rico, or under foreign law or rule of law, shall be likewise considered as violating the public policy . . . and is therefore null and void." P.R. Laws Ann. Ann. tit. 10, § 278b-2 (1994).

The court granted the defendant's motion to dismiss and for summary judgment holding that there was no case or controversy presented in the complaint, as is required by Article III of the U.S. Constitution and the declaratory judgment statute, 28 U.S.C. § 2201. Significantly, the court found that even if a case or controversy had existed, the court was precluded from determining the choice of law issue pursuant to the Federal Arbitration Act (FAA), 9 U.S.C. § 1 et seq. (). The court held that the FAA prevails over any contrary state laws that impede the enforceability of arbitration agreements, and "under the FAA when an agreement contains arbitration and choice of law clauses, the determination of what law applies to the agreement is one that falls within the scope of the agreement and should be made by the arbitrator rather than the courts."

Disclosure

***F.F. Orthotics Inc. v. Joe Paul,* No. B-044226, 2006 WL 1980270, Bus. Franchise Guide (CCH) ¶ 13,389 (Cal. Ct. App. 2006)**
See the discussion under the topic heading "Antitrust" for a fuller discussion. The California appellate court reversed a verdict against the supplier of Good Feet orthotic supports for violations of the California Franchise Investment Law, holding that the claims of two out-of-state franchisees pursuant to the California Franchise Investment Law were time barred because they were brought more than four years after the franchisees purchased their franchises. Further, the court held that § 31110 did not apply to the sale of franchises outside of California. Finally, the court held that the common law fraud claims brought by the franchisees were barred because they were completely based on the franchisor's failure to register the franchise in violation of the California registration and disclosure statute.

Fraud

***Holiday Hospitality Franchising, Inc. v. 174 W. St. Corp.,* No. 5:05-CV-1419-TWT, 2006 U.S. Dist. LEXIS 49177, Bus. Franchise Guide (CCH) ¶ 13,399 (N.D. Ga. July 19, 2006)**
This case is discussed under the topic heading "State Law."

Injunctions

***Timothy Gill v. World Inspection Network Int'l, Inc.,* No. 06-CV-3187 (JFB) (MLO), 2006 WL 2166821 (slip copy), Bus. Franchise Guide (CCH) ¶ 13,419 (E.D.N.Y. July 31, 2006)**
This case is discussed under the topic heading "Arbitration."

***Rescuecom Corp. v. Mathews,* No. 5:05-CV-1330, 2006 U.S. Dist. LEXIS 41042, Bus. Franchise Guide (CCH) ¶ 13,382 (N.D.N.Y. June 20, 2006)**
The U.S. District Court for the Northern District of New York modified and granted a motion for preliminary injunction enforcing a noncompete provision of a franchise agreement between franchisor Rescuecom and former franchisee Mathews. Mathews purchased two separately issued computer sales and services franchises from Rescuecom. Rescuecom alleged that following the deterioration and eventual termination of Mathews's franchise agreements, Mathews solicited Rescuecom's customers and diverted new business from Rescuecom to Mathews's new business in violation of the noncompete provisions of the franchise agreements.

Rescuecom sought a preliminary injunction to enjoin Mathews from continuing to breach the noncompete provision. Rescuecom presented evidence of irreparable harm by showing that Mathews had successfully solicited at least five of Rescuecom's former customers and irreparably damaged Rescuecom's business relationship with those customers, and that Mathews had prevented Rescuecom from transferring the customer relationships that Mathews had developed with Rescuecom's assistance to one or more of its other franchisees in the same geographic area. Rescuecom argued that it provided Mathews with specialized training based on methods that Rescuecom had developed from its experience and that if the court declined to enforce the noncompete provisions, the increase in competition that would result would make it more difficult for Rescuecom to attract and keep franchisees.

Mathews responded by asserting that there were numerous similar businesses already competing in the same area, including Rescuecom's other franchisees. Mathews argued that a balancing of the harms favored him because Rescuecom's interest in protecting its business system and its ability to have other franchisees operate in the same area was outweighed by the harm to Mathews if he was unable to establish a computer service business within the same geographic area for a period of two years.

After weighing the parties' respective positions, the court held that Mathews' actions in successfully soliciting Rescuecom's former customers and attempting to solicit others threatened to cause Rescuecom irreparable harm. The court further found that there was a likelihood that Rescuecom would succeed on the merits because Mathews had violated at least some of the noncompete provisions. However, because of the early stage in the litigation, the court could not determine whether all of the noncompete provisions were reasonable. Therefore the court granted the preliminary injunction but limited the injunction to the terms "during the pendency of this action" by enjoining Mathews "from soliciting business from or providing computer-related sales and services to any of Plaintiff's current or former customers."

***Caring Senior Serv. Franchise P'ship v. Batson,* No. 1:06-CV-82, Bus. Franchise Guide (CCH) ¶ 13,388 (E.D. Tenn. 2006)**
The franchisor of a nonmedical, domestic care services franchise filed suit against a terminated franchisee, seeking a preliminary injunction to enforce a posttermination covenant not to compete. The franchisor had terminated the franchisee for failure to submit timely royalty reports and for failure to pay royalties. The terminated franchisee argued that the franchise agreement was illegal, and therefore void ab initio, because the royalty reports and records inspection provisions in the agreement required the disclosure of private patient information in violation of federal and state privacy laws, as well as federal labor laws. Further, because the agreement was void ab initio, the franchisee had no obligation to pay royalties as provided in the agreement. After analyzing the four requirements for a preliminary injunction, i.e.,(i) likelihood of success on the merits, (ii) irreparable injury, (iii) substantial harm to others, and (iv) public interest, the court found in favor of the franchisor and entered an order granting a preliminary injunction.

In evaluating the franchisor's likelihood of success on the merits, the court first considered whether the contract was illegal and therefore void ab initio. To prove that the agreement is illegal, the proponent must show that a part of the agreement requires an illegal act and that such part of the agreement is central, and not incidental, to the contract as a whole. Thus, the franchisee had to demonstrate that the franchise agreement required it to violate the Health Insurance

Portability and Accountability Act of 1996 (HIPAA), Tennessee Rule 0940-5-6, and the Fair Labor Standards Act of 1938 (FLSA), as it contended. The court found that the entity contemplated in the parties' franchise agreement was not an entity to which HIPAA's privacy regulations applied. Further, the court found that although the franchise agreement appeared to permit the franchisor to request the type of confidential information protected by Tennessee Rule 0940-5-6, the agreement did "not necessarily require disclosure of such confidential information." The court also noted that the agreement did not preclude the franchisee from obtaining client consent to release the confidential information to the franchisor, as allowed under the Tennessee Rule. The court further found that nothing in the agreement required the franchisee to calculate employees' hours in violation of the FLSA. Because the franchise agreement did not require an illegal act, the court rejected the franchisee's claim that the contact was void ab initio and concluded that the franchisor had a likelihood of success on the merits.

The court also found that the franchisor would suffer irreparable injury if an injunction was not entered. The court noted that the franchisee's continued violation of the noncompete provisions of the franchise agreement would impair the franchisor's goodwill, preventing it from fairly competing in the same geographic area. The court also noted that when a franchisee disregards its obligations under a franchise agreement, the franchisor suffers irreparable injury because of the message it may send to other franchisees that the noncompete provisions in their agreements have no effect.

In considering the substantial harm to others of granting a preliminary injunction, the court recognized that a preliminary injunction could leave the franchisee's clients without care. However, the franchisor had submitted a detailed plan for setting up temporary operations that would address this issue, and the court found the plan to sufficiently ameliorate any threat of substantial harm to others if it granted preliminary injunctive relief.

Finally, the court concluded that the public interest factors favored granting a preliminary injunction because public policy favors the enforcement of contracts in accordance with their terms.

***Merry Maids, L.P. v. WWJD Enters., Inc.,* No. 8:06-CV-36, 2006 U.S. Dist LEXIS 42029, Bus. Franchise Guide (CCH) ¶ 13,383 (D. Neb. June 20, 2006)**

The defendants, a former franchisee in the Merry Maids franchise system, its principle owners, and its successor entity, were enjoined from competing with the plaintiff franchisor, Merry Maids, L.P. The court held that a one-year, seventy-five-mile noncompete provision in the license agreement would likely be found reasonable by the courts of Tennessee and ordered the defendants and anyone acting in concert with them not to own, maintain, engage in, or have any interest in any type of services offered by Merry Maids.

Upon expiration of the defendants' franchise agreement, Merry Maids reminded the defendants by letter that it was time to renew and extended the term of the license to provide time to execute the new agreement. Rather than execute a new agreement, the defendants requested additional territory for their franchise. At about that same time, Merry Maids was receiving complaints that the defendants were operating outside of their designated territory and in a territory that belonged to the Merry Maids company-owned branch.

Merry Maids informed the defendants that their request for an extension of their territory had been denied and further rejected the defendants' application for an extension of the term of the franchise agreement because the defendants were operating outside of their designated territory. Following negotiations, Merry Maids initially offered the defendants a new franchise agreement containing conditions that were designed to protect Merry Maids from the defendants' infringement activities, but Merry Maids withdrew the offer upon receiving notice that the defendants had no intention of complying with the conditions.

Merry Maids commenced this action after the defendants created a competing entity using the same assets, employees, customer lists, and customer keys as were used under the Merry Maids franchise. In granting Merry Maids' request for a preliminary injunction, the court held that Merry Maids would be irreparably harmed absent an injunction because of the franchisor's inability to refranchise the area, which would be compromised by the former franchisee. The court also noted that the burden of not entering an injunction on Merry Maids would be greater than the burden on the defendants if no injunction were entered because the defendants were free to operate outside of the seventy-five-mile boundary. Finally, because Merry Maids was likely to succeed on the merits and because the enforcement of a reasonable covenant not to compete serves to confirm the legitimate expectations of parties to a franchise agreement, the court barred the defendants from engaging in the types of services offered by Merry Maids for one year from the date of the court's order.

Lanham Act

***Phoenix of Broward, Inc. v. McDonald's Corp.,* 441 F. Supp. 2d 1241, 1249, Bus. Franchise Guide (CCH) ¶ 13,421 (N.D. Ga. 2006)**

On a motion to dismiss, the district court in Georgia held that a Burger King franchisee lacked standing to pursue a Lanham Act § 43(a) claim of false advertising against McDonald's. The plaintiff alleged that McDonald's misrepresented that consumers had a fair and equal chance of winning prizes in McDonald's promotional games, such as "Monopoly Game at McDonald's," "Who Wants to Be a Millionaire Game," and others, but these games had been compromised by a third party's criminal diversion of $20 million in high-value prizes by embezzling game pieces and distributing them to a network of "winners." The plaintiff alleged that it competed with McDonald's, and consumers were diverted to McDonald's because of the promotions. The plaintiff alleged that the consumers were misled regarding whether they actually had a fair and equal chance of winning the games because of the criminal manipulation of the games by the third party.

McDonald's argued, inter alia, that the Burger King franchisee lacked prudential standing to bring the claims. The court noted that to have standing, a plaintiff must have "suffered an injury in fact, that there be a causal connection between the injury and the defendant's conduct, and that the injury be redressable by a favorable court decision." The court also noted that in addition to these constitutional requirements, federal courts determine whether the plaintiff is the proper party to invoke judicial resolution of the dispute. Noting that the Eleventh Circuit had not yet addressed the test for determining prudential standing to bring a Lanham Act case, the court looked to other circuits. The Seventh, Ninth, and Tenth Circuits have adopted a categorical approach, which holds that a competitor of the defendant has standing to assert a Lanham Act false advertising claim. The approach of the Third and Fifth Circuits has been to focus on the protection of commercial interests and the prevention of competitive harm.

The court adopted the five-factor approach of the Third and Fifth Circuits, as outlined in *Conte Bros. Automotive, Inc. v. Quaker State-Slick 50, Inc.,* 165 F.3d 221, 233–35 (3d Cir. 1998). Under that test, a court considers the following factors: (1) the nature of the plaintiff's alleged injury, (2) the directness or indirectness of the alleged injury, (3) the proximity or remoteness of the party to the alleged conduct, (4) the speculativeness of the damages claimed, and (5) the risk of duplicative damages or complexity in apportioning damages. Considering these factors, the court held that the Burger King franchisee lacked prudential standing.

The court held that the plaintiff and McDonald's were competitors, and thus the first factor favored a finding of standing, although it did so weakly because the advertisements did not tout McDonald's products and services and did not disparage Burger King's products or services. The court also found that the causal connection was complex and thus weighed only moderately in favor of prudential standing. The court concluded that there was a better identifiable group of plaintiffs to seek a remedy, i.e., consumers who were mislead, and that damages were highly speculative, especially given the number of fast food competitors of McDonald's as well as the difficulty in determining what portion of consumers would have gone to Burger King. The court also found that there was a risk of duplicative damages, and the totality of the *Conte Bros.* factors failed to support standing. Therefore, the case was dismissed.

Noncompete Agreements

***Rescuecom Corp. v. Mathews,* No. 5:05-CV-1330, 2006 U.S. Dist. LEXIS 41042, Bus. Franchise Guide (CCH) ¶ 13,382 (N.D.N.Y. June 20, 2006)**

This case is discussed under the topic heading "Injunctions."

***Papa John's Int'l Inc. v. Rezko,* No. 04-C-3131, 2006 U.S. Dist. LEXIS 43944, Bus. Franchise Guide (CCH) ¶ 13,386 (N.D. Ill. June 14, 2006)**

Papa John's brought an action against a terminated franchisee alleging trademark and copyright infringement, misappropriation of trade secrets, and breach of contract. The franchisee counterclaimed, inter alia, for declaratory judgment seeking invalidation of the noncompete covenants contained in its franchise agreements. The franchisor then moved to dismiss the franchisee's declaratory judgment counterclaim.

The parties entered multiple franchise agreements between 1998 and 2002 for the operation of franchised pizza stores in Illinois and Michigan. The franchise agreements, which were governed by Kentucky law, contained posttermination noncompete provisions barring the franchisee from conducting certain activities for two years within a ten-mile radius of franchisee's restaurants or any business location affiliated with or operated by Papa John's. During the dispute with the franchisor, the franchisee was forced to close all thirty-seven of its franchised pizza stores, thus activating the posttermination covenants not to compete. The franchisee sought a declaratory judgment that the covenants not to compete were invalid on grounds that they were nonnegotiable, overbroad, and unreasonable.

Pointing to the hybrid nature of franchise relationships, the court noted that courts addressing the validity of noncompete agreements have applied both an employment relationship standard and a sale of business standard; because Kentucky courts had not yet decided on the appropriate standard to apply to restrictive covenants in franchise agreements, the court adopted an employment standard.

The Kentucky Supreme Court's test for reasonableness of an employment covenant not to compete evaluates "whether the restraint, considering the particular situation and circumstances, is such only as to afford fair protection to the legitimate interests of the [employer] and not so extensive as to interfere with the interests of the public." Applying this test, the court found that the noncompete covenants could be overbroad and unenforceable. Specifically, the court stated that "while the duration may be reasonable, the extensive geographic restrictions, considered along with the prohibited activities may make the covenants unreasonable." As such, the court declined to dismiss the franchisee's counterclaim for a declaratory judgment seeking invalidation of those noncompete covenants.

This case is also discussed under the topic heading "Tortious Interference."

Pirtek USA LLC, v. Richard Wilcox & Wilcox LLC,* No. 6:06cv566, 2006 U.S. Dist. LEXIS 41569, Bus. Franchise Guide (CCH) ¶ 13,368 (M.D. Fla. June 21, 2006)

The franchisor of a hose installation and repair system sought a preliminary injunction prohibiting Wilcox, a former franchisee, from operating his hose installation and repair business in violation of a posttermination noncompete provision in its former franchise agreement with Pirtek. Pirtek terminated Wilcox's franchise on grounds that Wilcox was purchasing products from an unapproved supplier and had failed to provide the requisite monthly management reports. Wilcox claimed that the restrictive covenant was unenforceable and that Pirtek's termination of Wilcox's franchise agreement was a retaliatory response to an arbitration filing in which Wilcox and other franchisees alleged Pirtek was overcharging franchisees for the products it required to be stocked and sold. Subsequent to the termination, Wilcox continued to operate a hose installation and repair business with twenty-four-hour mobile support within the same New Orleans area.

Applying Florida law (which governed the agreement), the court held that the posttermination restrictive covenant was unlawful, void, and unenforceable. The court found that the franchisor had failed to establish (1) the existence of one or more legitimate business interests to justify the covenant and (2) that the covenant is reasonably necessary to protect the legitimate business interest justifying the restrictive covenant. In analyzing Pirtek's purported justifications for the noncompete covenant, the court rejected Pirtek's assertion that its business system is unique, holding that its techniques and information are commonly known in the industry and, therefore, were not entitled to protection. The court further held that there was not a substantial likelihood that Pirtek would prevail on the merits of the case because Pirtek had taken no action to refranchise the territory, operate any other franchise within 200 miles of the territory, or provide evidence of substantial customer relationships developed solely by Pirtek in the area. In closing, the court emphasized that the mere desire to avoid competition does not constitute a legitimate business interest. The court held that even if Pirtek could establish a legitimate business interest, the presumption of irreparable harm was rebuttable and not conclusive, and Pirtek's claim that it would suffer irreparable injury through loss of goodwill was merely speculative.

Procedure—Expedited Discovery

***Best W. Int'l, Inc. v. John Doe,* No. CV-06-1537-PHX-DGC, 2006 WL 2091695 (slip copy), Bus. Franchise Guide (CCH) ¶ 13,422 (D. Ariz. July 25, 2006)**

Best Western International, Inc., (BWI), a nonprofit membership corporation, established good cause for its motion for expedited discovery to serve subpoenas on various Internet service providers (ISPs) but the court, nonetheless, denied the motion without prejudice to renewal on First Amendment grounds.

BWI alleged that John Doe defendants had made anonymous postings on an Internet site that "defame BWI, breach contracts with BWI, breach fiduciary duties, reveal confidential information, infringe BWI trademarks, and constitute unfair competition," and BWI needed the requested information to determine the identities of the proper defendants. Although finding good cause for expedited discovery, the court also recognized the John Doe defendants' potential "right to anonymous speech" on the Internet.

The court discussed the "significant First Amendment interest at stake" and noted that different jurisdictions had adopted different standards under similar circumstances. BWI urged a low threshold "good faith" standard; however, the court followed the Delaware Supreme Court and required BWI to satisfy a summary judgment standard before discovering the identities of the John Doe defendants. Because BWI had not yet done so, the court denied the motion for expedited discovery without prejudice to renewal.

Procedure—Personal Jurisdiction

Kevin Burgo v. Lady of Am. Franchise Corp.,* No. SA CV 05-518 DOC (RNBx), Bus. Franchise Guide (CCH) ¶ 13,367 (C.D. Cal. May 4, 2006)

Applying Ninth Circuit law, a California federal court held that it lacked personal jurisdiction over the CEO of a Florida "women only" health club franchisor where the CEO's only California contacts were in his business capacity. In so doing, the court rejected the franchisee plaintiffs' argument that the California Franchise Investment Law's (CFIL) service of process provision and the CEO's status as a controlling person for purposes of joint and several liability under the CFIL were sufficient to confer jurisdiction. Even though the CEO executed the franchise agreements on behalf of the franchisor, he did not personally solicit the franchisees, and his conduct was otherwise "attenuated" and did not constitute "purposeful availment."

The court also addressed, sua sponte and after requesting briefing from the parties, whether California or Florida law would apply to the parties' dispute. The franchisees had asserted claims under both states' laws, and the defendants moved to dismiss for failure to state a claim; the court held that it could not decide the motion without determining which state's law applied. The court then concluded that California law applied because the state had a "materially greater interest" in the dispute than Florida, Florida franchise law conflicted with the CFIL because it provides "significantly less protection to franchisees," and application of Florida law pursuant to the franchise agreement's Florida choice of law clause would be contrary to California's fundamental public policy. The court also noted that the franchise agreements were executed in California and that they contained a California Addendum that acknowledged that the Florida franchisor was aware of California's "expansive regulation of the franchise industry." Having determined that California law should apply, the court denied the defendants' motion to dismiss for failure to state a claim without prejudice because the parties' briefing did not present the relevant state law on a number of substantive issues.

An earlier decision in the same case is discussed under the topic heading "Procedure—Subject Matter Jurisdiction."

***Rescuecom Corp. v. Jason Hyams,* No. 5:04-CV-93, 2006 U.S. Dist. LEXIS 45282, Bus. Franchise Guide (CCH) ¶ 13,394 (N.D.N.Y July 5, 2006)**

A New York computer services franchisor sued a former Texas franchisee in the U.S. District Court for the Northern District of New York for the former franchisee's Internet activities. The former franchisee moved to dismiss for lack of personal jurisdiction, and the court granted the motion. This case presents an interesting twist given the numerous other cases where plaintiffs try to establish jurisdiction over franchisors based on their Internet activities.

The franchisor, Rescuecom Corporation (Rescuecom), had previously terminated the former franchisee for breach of the franchise agreement. The former franchisee then registered Internet domain names apparently designed to attract potential Rescuecom franchisees and established websites at those addresses containing, among other things, "warnings" about Rescuecom. Rescuecom alleged that these activities violated the former franchisee's posttermination obligations and the Lanham Act and constituted tortious conduct under New York law.

Despite evidence that individuals in New York were registered users of one of the websites, the court found that the sites were informational rather than commercial in nature and that the former franchisee did not specifically target New York residents. It therefore concluded that the former franchisee did not purposefully avail himself of the privilege of conducting activities in New York and that the franchisor failed to make a prima facie showing that the franchisee had transacted business in the state.

The court further held that the franchisor could not invoke the franchise agreement's "consent to jurisdiction" provision because the franchisor's breach of contract claim arose from a posttermination covenant not to compete, which did not preclude to the former franchisee's alleged conduct.

***S&G Janitschke, Inc. v. Cottman Transmission Sys., LLC,* No. 05-2896 (DSD/SRN), 2006 WL 1662892 (slip copy), Bus. Franchise Guide (CCH) ¶ 13,409 (D. Minn. June 8, 2006)**

This case is discussed under the topic heading "Choice of Forum."

Procedure—Subject Matter Jurisdiction

Kevin Burgo v. Lady of Am. Franchise Corp.,* No. SA CV 05-518 DOC (RNBx), Bus. Franchise Guide (CCH) ¶ 13,366 (C.D. Cal. Apr. 19, 2006)

The U.S. District Court for the Central District of California denied, without hearing, a Florida "women only" health club franchisor's motion to dismiss for lack of subject matter jurisdiction and/or to sever the plaintiffs' claims for improper joinder.

Twenty-two California franchisees sued the franchisor, alleging numerous California and Florida statutory and common law causes of action for misrepresenting costs and returns and for stating that California permits single-sex health clubs when it does not. The franchisor argued that the franchisees, if successful, would be entitled only to return of their initial investment, which individually failed to meet the $75,000 jurisdictional minimum. The court disagreed, concluding that the franchisees also sought compensatory and punitive damages, rather than simply their initial investment, and that the plaintiffs' claimed damage amount was not "illusory."

The court also denied the franchisor's request to sever the franchisees' claims into separate lawsuits because the claims shared common factual allegations and questions of law, and, accordingly, trying them together would promote judicial efficiency.

A later decision in the same case is discussed under the topic heading "Procedure—Personal Jurisdiction."

State Law

***Cherrington v. Wild Noodles Franchise Co., LLC,* No. 04-4572, 2006 U.S. Dist. LEXIS 39981, Bus. Franchise Guide (CCH) ¶ 13,373 (D. Minn. June 15, 2006)**

The U.S. District Court for the District of Minnesota held that an individual who was neither a control person at the time of an alleged violation of the Minnesota Franchise Act (MFA) nor a material participant in the alleged violation could be held liable for a franchisor's violation of the MFA. This case arose out of the failure of two Wild Noodles franchises that were part of an Area Development Agreement (ADA), which contemplated the development of at least nine stores.

The failed franchisees alleged that the franchisor and its chief operating officer, Steve Leibsohn, violated the MFA by making false representations about the franchise and lacking the necessary authorization to offer or sell franchises in Minnesota. The franchisees filed suit arguing that Liebsohn "oversold" them on the franchise opportunity and induced them into the ADA by misrepresentations or omissions of material fact. The franchisees maintained that Leibsohn was a "control person" under the MFA by virtue of his status as chief operating officer and future franchise owner and asserted that Leibsohn, in his capacity as chief operating officer, was liable even if he did not "materially aid" in the violation.

Leibsohn responded by filing a motion for summary judgment asserting that (1) he was not a person covered by the MFA, (2) that he had no knowledge or reason to know of the alleged violations of the MFA, and (3) that there was no evidence that he materially aided in any act or transaction constituting the alleged violations.

The court held that the franchisees incorrectly interpreted the MFA. Specifically, the court noted that to have violated the MFA, Leibsohn had to be in a position of control at the time of the alleged violation or, in the alternative, an active participant in the violation. The court found that, at the time of the alleged violations, Leibsohn was at best a prospective lender with the hopes of becoming an owner, and, therefore, he had no control over any party that was liable under the MFA. The court further found that as chief operating officer of the franchisor, Liebsohn had very limited duties and no control over any of the franchisor's representatives, agents, or employees. Consequently, the court concluded that Liebsohn had no reason to know of any violation of the MFA and therefore could not have materially aided in any act constituting a violation. Because the plaintiffs could not produce any evidence to rebut these findings, the court granted Liebsohn's motion for summary judgment.

***Southeastern Distrib. Co. v. Miller Brewing Co.*, No. 05-969, 2006 Ark. LEXIS 357, Bus. Franchise Guide (CCH) ¶ 13,379 (Ark. June 15, 2006)**

The plaintiff, Southeastern Distributing Company, Inc., a wholesale beer distributing company, sued Miller Brewing Company, alleging claims for violations of the Arkansas Beer Wholesaler's Act and the Arkansas Franchise Practices Act, as well as for common law fraud and intentional interference with business expectancies. Southeastern alleged Miller's unlawful conduct interfered with Southeastern's ability to market its business freely, forcing it to sell for substantially less than fair market value to O'Connor, a buyer approved and supported by Miller. The circuit court granted Miller's motion for summary judgment, dismissing all of Southeastern's claims against Miller.

On appeal, Southeastern argued that there were material issues of fact regarding whether Miller refused to allow Southeastern to sell its business to a purchaser other than O'Connor. The Arkansas Franchise Practices Act prohibits a franchisor from refusing to deal with a franchise in a commercially reasonable manner and in good faith. *See* ARK. CODE ANN.. Code Ann. § 4-72-206 (Repl. 2001). Because Southeastern had provided the testimony of potential purchasers supporting its position, the court reversed the summary judgment on Southeastern's claims under the Arkansas Franchise Practices Act.

The court also reversed summary judgment on the Arkansas Beer Wholesaler's Act. That statute prohibits a beer manufacturer from causing a wholesaler to resign from an agreement or from withholding or unreasonably delaying consent to or approval of any assignment or transfer of a wholesaler's business without "paying the wholesaler reasonable compensation for the diminished value of the wholesaler's business including any ancillary business which has been negatively affected by the act of the supplier." *See* ARK. CODE ANN. § 3-5-1108 (Repl. 1996). Southeastern had argued that there were issues of fact regarding whether Miller caused Southeastern to involuntarily resign from its distributor agreement and whether Miller refused to consider or approve prospective purchasers other than O'Connor. Miller responded that Southeastern never notified Miller of any other prospective purchasers in writing, as required by the Arkansas Beer Wholesaler's Act, and therefore Miller had no duty under the act to approve a transfer. The court agreed with Miller regarding the need to provide written notice of intent to transfer but held that such requirement did not bar Southeastern's claim under the Arkansas statute with respect to its claim of involuntary resignation. Accordingly, the court reversed summary judgment with respect to that aspect of Southeastern's claim under the Arkansas Beer Wholesaler's Act.

The appellate court refused to reverse summary judgment with respect to Southeastern's fraud claims under the Franchise Act and common law. Southeastern had argued that Miller falsely stated that O'Connor would be the only approved purchaser of Southeastern's business; however, the court agreed with Miller that Southeastern failed to provide evidence of a false representation of fact or of Southeastern's actual or justifiable reliance on such representation and thus upheld the circuit court ruling.

Finally, the appellate court reversed the order granting summary judgment on Southeastern's claim that Miller tortiously interfered with Southeastern's expectancy that it could sell its business to the highest qualified purchaser and freely market its business for sale. Miller asserted that it could not be liable for tortiously interfering with Southeastern's expectancies because Miller was a party to the distributor contract with Southeastern, and a party cannot tortiously interfere with its own contract. However, the court held that there were issues of fact regarding whether Miller tortiously interfered with Southeastern's expectancies with respect to its ability to sell its business and thus reversed the circuit court's order granting summary judgment.

***Holiday Hospitality Franchising, Inc. v. 174 W. St. Corp.*, No. 1:05-CV-1419-TWT, 2006 WL 2038550, Bus. Franchise Guide (CCH) ¶ 13,399 (N.D. Ga. July 19, 2006)**

The franchisor brought this action for breach of contract against a hotel franchisee operating in Maryland. Shortly after the franchisee opened its Holiday Inn hotel, it notified the franchisor that it intended to breach the franchise agreement and discontinue operating as a Holiday Inn. After the franchisee stopped operating as a Holiday Inn, the franchisor terminated the franchise agreement and filed suit, demanding franchise fees and liquidated damages. On the parties' cross motions for summary judgment, the court entered judgment in favor of the franchisor.

The franchisee argued that its breach of contract was justified, and it asserted three alternative defenses: (i) that the franchisor fraudulently induced the franchisee to enter into the contract; (ii) that the franchisor's violation of Maryland law and the Federal Trade Commission (FTC) Rule (by making untrue earnings statements and failure to disclose actual earnings) act as a complete defense; and (iii) that the franchisor breached the contract, and, therefore, the franchisee's refusal to pay further royalties was justified.

The court rejected the franchisee's fraudulent inducement claim, pointing to a valid merger clause in the franchise agreement. The court noted that when such a clause is present in a contract, and where a claim of fraud is made, a party must rescind the contract, which under Georgia law (which governed the contract) requires that a request for rescission be made promptly and requires the franchisee to return any benefits received. Because the franchisee continued to operate as a Holiday Inn and accepted reservations through the Holiday Inn system for several months after it first notified the franchisor of its intent to breach the agreement and because the franchisee failed to offer the franchisor repayment of benefits received, the court found that the franchisee did not properly rescind the agreement. Therefore, the franchisee's claim for fraudulent inducement could not be sustained.

The court also rejected the franchisee's claim that the franchisor had violated Maryland law and the FTC Rule. The franchisee argued that because the franchisor violated Maryland's franchise law, the entire contract was unenforceable pursuant to public policy. However, the court noted that the Maryland statute provided for only two remedies: rescission and restitution. MD. CODE ANN., BUS. REG. § 14-227(c) (2001). The franchisee, however, had sought neither of these remedies. The court also held that the alleged violations of the FTC Rule did not serve as a complete defense to the breach of contract claim because there did not exist the requisite "close nexus" between the statutory or regulatory violation and the contract at issue.

Finally, the court rejected the franchisee's claim that the liquidated damages provision in the agreement at issue was a penalty and was therefore unenforceable. In determining whether the provision was enforceable, the court considered the following three factors: (i) whether the injury caused by the breach is difficult or impossible to estimate accurately, (ii) whether it was the intention of the parties to provide for damages rather than a penalty, and (iii) whether the stipulated sum is a reasonable estimate of the probable loss. As the first two factors were not in dispute, the court only addressed the third factor and concluded that the stipulated amount of liquidated damages was not unreasonable.

***Zeidler v. A&W Rests., Inc.*, No. 03-C-5063, 2006 U.S. Dist. LEXIS 49217, Bus. Franchise Guide (CCH) ¶ 13,406 (N.D. Ill. July 6, 2006)**

A failed A&W franchisee was unsuccessful in an action against the franchisor, in large part because the franchisee opened the franchise next to the proposed site for a Dairy Queen franchise over the franchisor's objections. Before the franchisee opened its location, A&W had cautioned that it never would have approved the franchise location had it known in advance of the plans for a Dairy Queen restaurant, and A&W offered to return the franchisee's money if it chose to abandon the project.

The franchisee's operations and profits struggled from the day the restaurant opened. The franchisee requested and received permission from A&W to close for portions of the year, even though the franchise agreement required that the restaurant operate for at least 360 days a year. When the franchisee eventually informed A&W that the restaurant could not reopen, A&W advised the franchisee by letter that it was in material breach of the franchise agreement. When the franchisee approached A&W for a franchise mailing list (allegedly seeking to contact other franchisees for participation in a questionnaire), A&W promptly reminded the franchisee that it was in breach of the franchise agreement, and A&W expressly reserved its right to terminate the agreement. The franchisee then abandoned the restaurant and commenced a lawsuit against A&W, alleging violations of the Illinois Franchise Disclosure Act (IFDA), breach of the license agreement, wrongful termination, and fraud. The parties filed cross motions for summary judgment.

The court found that the franchisee's lengthy closure of the restaurant and refusal to reopen constituted an abandonment of the franchise. Because Illinois law does not recognize a claim for wrongful termination when a franchisee abandons its restaurant, the franchisee's wrongful termination claim under the IFDA was inactionable. Similarly, the court held that the franchisee could not maintain a claim for breach of contract because it could not allege and prove that it had substantially complied with the material terms of the agreement.

Finally, the court rejected the franchisee's various claims of fraud. In support of those claims, the franchisee had alleged that at an investor relations meeting in 2002, the franchisor had indicated that when they "bought the company, they realized that they could not build free-standing buildings on corners because the unit economics simply wouldn't justify that." The franchisee contended that had it known that information, it would not have invested in an A&W restaurant. The court rejected the franchisee's claim because (1) the franchisor had urged the franchisee not to open in the chosen location and had offered to refund the franchisee's money, (2) the statement relied upon by the franchisee was made six years after the franchisee opened its franchised restaurant, and (3) seventeen of the nineteen free-standing A&W locations that were opened were still operating. Thus, the court reasoned, the franchisee could not establish that A&W intentionally made a false statement of material fact.

***S&S Sales Corp. v. Marvin Lumber & Cedar Co.,* 434 F. Supp. 2d 879, Bus. Franchise Guide (CCH) ¶ 13,375 (E.D. Wis. June 20, 2006)**

In 1987, the plaintiff, S&S Sales Corporation, entered into an oral, nonexclusive agreement to distribute windows manufactured by the defendant, Marvin Lumber & Cedar Company, in eastern Wisconsin. At the time, Marvin distributed its windows through a distribution system under which it sold to distributors, who resold to dealers, who further resold to retail customers. S&S exclusively sold Marvin windows, but it distributed various other products from other manufacturers. In the year preceding the lawsuit, nearly 28 percent of S&S's sales were attributable to Marvin products.

After some of Marvin's larger dealers began purchasing other brands of windows from manufacturers who sold directly to the dealers, Marvin decided to eliminate distributors, such as S&S, and sell directly to the dealers. Upon learning of Marvin's new business plan, S&S sued Marvin, seeking to enjoin it from selling directly to dealers within S&S's territory and alleging that Marvin had violated the Wisconsin Fair Dealership Law (WFDL), Wisconsin Statute § 135.01 et seq. (1993–94), by constructively terminating its distributorship without good cause. Marvin removed the action to federal court based on diversity jurisdiction, and S&S moved for a preliminary injunction.

In considering S&S's motion for preliminary injunction, the court addressed what it considered to be the principal interpretative issue raised by the WFDL: "whether, once a plaintiff establishes the likelihood of a WFDL violation, the statute creates a rebuttable or an irrebuttable presumption of irreparable harm." In support of its argument that it would suffer irreparable harm, S&S quoted a WFDL provision stating that "any violation of this chapter by the grantor is deemed an irreparable injury to the dealer for determining if a temporary injunction should be issued." Wis. Stat. §135.065. The court interpreted this language as creating a rebuttable presumption based on the legislative history and because holding otherwise arguably presented two constitutional violations: (1) if the presumption were irrebuttable, it would violate the separation of powers principle by usurping judicial authority to make the determination; and (2) creating an irrebuttable presumption would arguably violate due process of law, where the difficulty of permitting an individualized determination of irreparable harm was not so great as to justify the establishment of a conclusive and imprecise presumption of irreparable harm.

The court found that S&S failed to prove irreparable harm because S&S had failed to show that it would become insolvent, would be unable to finance the litigation, or would incur damages that are difficult to calculate; therefore, S&S was not entitled to a preliminary injunction,. The principal injury S&S was likely to incur prior to trial was loss of some sales, which the court found were easily calculable in light of the distributor's long history of selling to the dealers to which Marvin intended to begin selling directly.

***Gabana Gulf Distribution, Ltd. v. Gap Int'l Sales, Inc.,* No. C 06-02584 CRB, 2006 WL 2355092 (slip copy), Bus. Franchise Guide (CCH) ¶ 13,420 (N.D. Cal. Aug. 14, 2006)**

This case is discussed under the topic heading "Choice of Law."

***Maple Shade Motor Corp. v. Kia Motors Am., Inc.,* No. 04-2224 (JEI), 2006 WL 2320705 (slip copy), Bus. Franchise Guide (CCH) ¶ 13,418 (D.N.J. Aug. 8, 2006)**

This case is discussed under the topic heading "Transfer."

***S&G Janitschke, Inc. v. Cottman Transmission Sys., LLC,* No. 05-2896 (DSD/SRN), 2006 WL 1662892 (slip copy), Bus. Franchise Guide (CCH) ¶ 13,409 (D. Minn. June 8, 2006)**

This case is discussed under the topic heading "Choice of Forum."

***Timothy Gill v. World Inspection Network Int'l, Inc.,* No. 06-CV-3187 (JFB) (MLO), 2006 WL 2166821 (slip copy), Bus. Franchise Guide (CCH) ¶ 13,419 (E.D.N.Y. July 31, 2006)**

This case is discussed under the topic heading "Arbitration."

Tortious Interference

***Se. Distrib. Co. v. Miller Brewing Co.,* No. 05-969, 2006 Ark. LEXIS 357, Bus. Franchise Guide (CCH) ¶ 13,379 (Ark. June 15, 2006)**

This case is discussed under the topic heading "State Law."

***Papa John's Int'l Inc. v. Rezko,* No. 04-C-3131, 2006 U.S. Dist. LEXIS 43944, Bus. Franchise Guide (CCH) ¶ 13,386 (N.D. Ill. June 14, 2006)**

This case is also discussed under the topic heading "Noncompete Agreements." The dispute is based on multiple franchise agreements for pizza stores in Illinois and Michigan. Here, the Papa John's franchisor brought an action against the terminated franchisee, alleging breach of contract based on the defendant's nonperformance and default on a series of franchise agreements. The franchisee counterclaimed for breach of contract and intentional interference with prospective economic advantage. The court granted in part and denied in part the franchisor's motion to dismiss the franchisee's counterclaims.

During the course of this dispute, the defendant was forced to shut down all thirty-seven of its franchised pizza stores, which triggered the posttermination covenants not to compete. During the litigation, the parties engaged in settlement discussions. The parties entered into a settlement agreement and mutual release, which stipulated that the defendant would sell its interest in its former pizza franchises to a third party, Dr. Paul Ray. The agreement further released the defendant's liability contingent upon the receipt of certain payments and the sale to Ray, and it included a provision stating that the defendant acknowledged the postterm covenant not to compete contained in the franchise agreements as valid and enforceable. Due to the breakdown of the sale negotiations with Ray, however, the defendant was unable to sell its franchises and, therefore, never closed on the agreement to settle.

The defendant contended that the franchisor violated the implied duty of good faith and fair dealing under the settlement agreement. The defendant's counterclaim of tortious interference with prospective economic advantage alleged that the franchisor never intended to allow Ray to operate the franchises and, further, failed to engage in good faith negotiations with him. The court, however, agreed with the franchisor that there was no meeting of the minds because the settlement agreement did not mention any responsibility of the franchisor relating to the sale and was silent as to the terms of the franchise agreement to be formed with Ray. The court dismissed the franchisee's claim for breach of contract.

Transfer

***Maple Shade Motor Corp. v. Kia Motors Am., Inc.,* No. 04-2224 (JEI), 2006 WL 2320705 (slip copy), Bus. Franchise Guide (CCH) ¶ 13,418 (D.N.J. Aug. 8, 2006)**

The federal court in New Jersey granted a franchisor's motion for partial summary judgment on the franchisee's claim that the franchisor's refusal to approve a transfer of the franchise violated the New Jersey Franchise Practices Act (NJFPA).

The franchisor terminated the franchise agreement at issue. In an earlier opinion, the court held that Kia had good cause to do so and that termination did not violate the NJFPA. After that ruling, the (former) franchisee executed an asset sale agreement with a third party and forwarded a copy of the agreement to Kia. Kia responded that, for settlement purposes only, it would consider the proposed transaction but believed that it was under no obligation to do so given the court's earlier ruling. After reviewing the transaction, Kia refused to consent because the (former) franchisee had no rights to transfer and because the transferee did not have an exclusive showroom available, which the franchise agreement required. The franchisee then moved to amend its pending wrongful termination lawsuit to add a claim for illegal failure to approve transfer, and Kia moved for summary judgment on that claim.

The court granted Kia's motion, noting that the NJFPA "contains a specific provision both limiting and protecting the right of a franchisee to transfer its franchise rights." Under the circumstances, where Kia had already terminated the franchise agreement and the court had upheld the termination, the franchisee had "no franchise rights to transfer 'free and clear'" to the purported purchaser, and Kia therefore did not violate the NJFPA by refusing to consent to transfer.

Vicarious Liability

***Dana Vandemark v. McDonald's Corp.,* No. 2005-412, Bus. Franchise Guide (CCH) ¶ 13,396 (N.H. 2006)**

On a motion for summary judgment, the court found the franchisor not to be vicariously liable for injuries suffered by an employee of a franchisee during his employment. The employee, who worked as a night custodian, was beaten with a baseball bat by two intruders while taking a break at approximately 3:00 a.m. The employee alleged that the franchisor was vicariously liable for his injuries because the franchisor's operations manual for its franchised restaurants addressed a number of safety and security procedures. The evidence showed, however, that those procedures were recommended and were not mandatory, and there was no evidence that the franchisor could terminate a franchisee for failure to comply with such security procedures and standards.

The employee attempted to rely on the decision in *Martin v. McDonald's Corp.,* 572 N.E.2d 1073 (Ill. Ct. App. 1991), a case in which an Illinois state court found McDonald's to be vicariously liable. The court found, however, that case to be distinguishable because there, unlike in *Vandemark,* McDonald's employees conducted security checks of the franchisee that included changing locks and ordering new security windows and alarm systems.

*Robert Einhorn's firm (Zarco Einhorn, Salkowski & Brito, P.A.), represented the following parties: DVDplay, Inc. (DVDplay, Inc. v. DVD 123 LLC); Lady of America Franchise Corp. (Burgo v. Lady of America Franchise Corp.); and Richard Wilcox & Wilcox LLC (Pirtek USA LLC v. Richard Wilcox & Wilcox LLC).