

FRANCHISE LAW JOURNAL

2022–2023 EDITORIAL BOARD

EDITOR-IN-CHIEF

John M. Doroghazi (2024)
Wiggin and Dana LLP
jdoroghazi@wiggin.com

ASSOCIATE EDITORS

Emily I. Bridges (2023)
Parker Poe Adams & Bernstein LLP
emilybridges@parkerpoe.com

Maisa Jean Frank (2025)
Latbrop GPM LLP
maisa.frank@latbropgpm.com

Matthew Gruenberg (2023)
DLA Piper LLP (US)
matthew.gruenberg@dlapiper.com

David A. Harford (2024)
Bryan Cave Leighton Paisner LLP
david.harford@bclplaw.com

Andrew M. Malzahn (2024)
Dady & Gardner, P.A.
amalzahn@dadygardner.com

TOPIC & ARTICLE EDITORS

Matthew S. DeAntonio (2023)
Bradley Arant Boult Cummings LLP
mdeantonio@bradley.com

Jared C. Miller (2022)
Parker, Hudson, Rainer & Dobbs LLP
jmiller@pbrd.com

Sawan S. Patel (2023)
Larkin, Hoffman, Daly & Lindgren, Ltd.
spatel@larkinhoffman.com

Aaron-Michael Sapp (2023)
Cheng Cohen LLC
asapp@chengcohen.com

Briar Siljander (2023)
Trio Law PLC
briar@triolawplc.com

Vanessa Wheeler (2023)
Miller Nash Graham & Dunn LLP
vanessa.wheeler@millernash.com

MANAGING EDITOR

Julie Roberts Furgerson
ABA Publishing
American Bar Association
julie.furgerson@americanbar.org

STATEMENT OF IDENTIFICATION

Franchise Law Journal (ISSN: 8756-7962 (print); 2163-2154 (online)) is published quarterly, by season, by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, Illinois 60654-7598. *Franchise Law Journal* seeks to inform and educate members of the bar by publishing articles, columns, and reviews concerning legal developments relevant to franchising as a method of distributing products and services. *Franchise Law Journal* is indexed in the *Current Law Index* under the citation Franchising.

Requests for permission to reproduce or republish any material from the *Franchise Law Journal* should be sent to copyright@americanbar.org. Address corrections should be sent to coa@americanbar.org. The opinions expressed in the articles presented in *Franchise Law Journal* are those of the authors and shall not be construed to represent the policies of the American Bar Association or the Forum on Franchising. Copyright © 2022 American Bar Association. Produced by ABA Publishing.

FRANCHISE LAW JOURNAL

VOLUME 42, NUMBER 2

FALL 2022

TABLE OF CONTENTS

From the Editor-in-Chief <i>John M. Doroghazi</i>	v
--	---

ARTICLES

The Wisconsin Fair Dealership Law: Understanding the Interplay Between Forum-Selection and Choice-of-Law Clauses <i>Kerry L. Bundy & Joshua N. Turner</i>	123
Educating Courts: Using Franchise Lawyers and Consultants as Expert Witnesses in Franchise Cases and Avoiding Exclusion of Testimony as “Legal Opinion” <i>Glenn Plattner, David Harford & Makaela O’Connell</i>	135
An Overview of the Franchise Advertising Rules and New Forms of Advertisements <i>Cindy Kaneko</i>	153
A Crash Course on Interpretation of the “Marketing Plan or System” Element of State Franchise Statutes <i>Michael D. Braunstein & Megan B. Center</i>	173

FEATURE

LADR Case Note (May 2022) and FLJ Currents (Fall 2022) <i>Emily I. Bridges & Jared C. Miller</i>	191
---	-----



From the Editor-in-Chief

John M. Doroghazi*

It was great seeing everyone in San Diego at the 2022 Annual Forum. Following two years of COVID-impaired forums, San Diego was a true return to form. Among other things, it gave me an opportunity to harass many of you in person (and to otherwise shamelessly plug at every moment) about writing an article for the *Journal*. I am sure some of you were thinking: “Enough about the *Journal* Doroghazi! Why do you and the rest of Forum leadership mention it at every chance they get?” We would all¹ rather talk about something other than law review articles.² But it is a necessary evil. A sizable portion of the *Journal*’s pipeline of future content comes from individuals who volunteer to write articles at the Forum. But the socially distanced and largely virtual world of 2020 and 2021 caused supply chain disruptions for the *Journal* too, with this issue only having four articles and one Currents as a result. So this editorial is a call once again to readers to please write for the *Journal*.



Mr. Doroghazi

So what are the arguments against spending your free time drafting a law review article? As I spoke to a Forum member in San Diego about writing for the *Journal*, I received a very a pretty direct answer. The commenter³

1. Ok, maybe not *all*. I am positive there are some ride-or-die law review article nerds out there. It takes all kinds.

2. And, more importantly, some of you heeded my call from the last editorial to discuss music at the Forum. John Doroghazi, *From the Editor-in-Chief*, 42 FRANCHISE L.J. v n.7 (2022). One of my favorite discussions was with a group about if they have a song that is their family’s anthem (i.e., the song that everyone in the family loves). I also learned that Dan Oates, my predecessor and whose excellent Annual Developments presentation with Susan Tegt was built around pop culture references to various movies and televisions shows, has no knowledge of essentially any popular music in the last twenty years. Like he was literally in a bubble where the only music he heard was from the 1960s or written by John Williams. I find this fact so insane that it warrants permanent enshrinement in a scholarly publication.

3. He-who-shall-not-be-named. I only call you out by name if you cannot, with a straight face, name a single song by Taylor Swift. See, e.g., discussion *supra* note 2.

*John M. Doroghazi (jdoroghazi@wiggin) is a partner in the New Haven office of Wiggin and Dana LLP, where he focuses on franchise, class action, and complex commercial and business litigation. Feel free to reach out to John directly for comments on this editorial or any other matters related to the Franchise Law Journal.

said the Forum has always emphasized that writing for the *Journal* or the *Franchise Lawyer* is the first step to the pathway to leadership, but no one has ever explained why that matters. As this person put it, “Why should I choose to work on a Forum article at 2:00 am, or to prioritize finishing an article on a weekend, when I could be spending time with my children? How does it actually advance my career?”

This is a fair question.

We have perhaps made the vainglorious assumption that the benefits of Forum involvement and leadership are self-evident. I’ll do my best to articulate here why writing for the *Journal*, and by extension being an active participant in the Forum, is a pathway to career success.

Lawyers are service professionals. Whether we are in-house or outside counsel, we make our living by convincing clients to hire us. In my experience, people hire lawyers who (1) they know (or someone they know vouches for), (2) they like to interact with, (3) have the right experience, and (4) they respect. Writing for the *Journal* helps improve each of these four qualities for its authors.⁴

An article is a platform for showing the world that you are a knowledge leader and have writing chops. If you write a thoughtful article on a useful topic, people will read it and will respect you for it. For example, I wrote an article five years ago in the *Journal* on how forum selection clauses are applied after *Atlantic Marine Construction Co. v. United States District Court for the Western District of Texas*.⁵ The topic is technical, but it is something that all litigators need to understand. An associate and I worked hard on the article, and we turned in a quality work product. I have since learned that the article is read quite often by lawyers across industries to understand how federal courts apply forum selection clauses and how clauses can be vulnerable to attack. I was called by a high school classmate and law school classmate after they each read the article. Both are partners at major firms, and the article served as a point for reconnection. That reconnection led to at least one referral.⁶

Second, writing for the *Journal* does lead to speaking opportunities at the Forum. Speaking at the Forum forces you to work closely with members of the Forum that you often don’t know. It creates connections you did not have, and opportunities to make those connections. It puts you in front of potentially hundreds of people to show how knowledgeable and dynamic you are on your feet. It gives you something to talk about when mingling between sessions or at the networking events.

4. No amount of writing for the *Journal* or any other publication will make you more likeable as a person.

5. John M. Doroghazi & David Norman, *What’s Left to Litigate About Forum Selection Clauses? Atlantic Marine Turns Four*, 36 FRANCHISE L.J. 581 (2017).

6. It has also been cited by a federal district court as an authoritative source on forum selection clauses. *Polaris Eng’g Inc. v. Texas Int’l Terminals, Ltd.*, 2021 WL 5155691, at *10 (S.D. Tex. Apr. 16, 2021). The tangible benefits of being cited by a court are less clear, but I mainly just wanted to brag about it. And since I am the Editor-in-Chief, I can get away with it.

Third, writing articles builds your personal bio for your firm website or LinkedIn. This matters. Potential clients do their homework. They check those bios for the right experience. If there is a list of publications in the *Franchise Law Journal* on your bio, potential clients are more likely to believe that you know what you are doing in franchising. Will someone hire you just because you wrote an article in *Journal*? Not usually, but it does happen. A partner in my firm spent the time to write a lengthy article about a new kind of insurance coverage claim that class action plaintiffs were asserting. At least one insurer gave him the opportunity to pitch a case on that type of claim because of his article. My partner made the most of it and has now handled multiple cases for various insurance companies. A few years ago, counsel in a franchise dispute hired one of our attorneys as an expert witness about an esoteric arbitration question because of an article published in the *Journal* fifteen years ago on that topic.

Similarly, I was retained earlier this year by a distributor in a significant dispute with a manufacturer. We were referred this matter after the client's usual lawyers and the clients themselves researched firms in our region that had franchising and distribution experience. When I asked why they contacted me, they said that all of the sources and information kept pointing to our firm. That reputation wasn't just given to the firm. It was built by many of the firm's lawyers over many years, if not decades. And it was built, in part, by our lawyers consistently writing in the *Journal* and speaking at the Forum.

I cannot promise you that writing an article in the *Journal* (or participating in Forum leadership) will immediately translate into dollars in the next six months. But I can promise you that it is part of the long game. It is one ingredient in the recipe to becoming prominent in the national franchising bar and to creating opportunities to succeed. You cannot collect a harvest without planting some seeds. So please, pick up the pen and write. You will thank yourself in five years that you did it.⁷

7. I will thank you tomorrow.



The Wisconsin Fair Dealership Law: Understanding the Interplay Between Forum-Selection and Choice-of-Law Clauses

Kerry L. Bundy & Joshua N. Turner*

Wisconsin is known as having one of the broadest and most favorable dealer-protection statutes in the country, the Wisconsin Fair Dealership Law (WFDL).¹ Unlike many state franchise statutes, the WFDL “does not require a marketing plan or system prescribed by the franchisor/grantor, a business substantially associated with the grantor’s business and trademark or a franchise fee.”² If an entity can show that it has a dealership that is situated in Wisconsin, it will be afforded protection under the WFDL.³ These protections include prohibiting a manufacturer/franchisor from terminating a franchisee or making substantial changes to the dealership agreement without “good cause.”⁴ In short, the sweep of the WFDL is broader than most state laws protecting franchise relationships⁵ (even including not-so-typical



Ms. Bundy



Mr. Turner

1. WIS. STAT. § 135.01 *et seq.*; see also Eric Goldberg & Justin Csik, *Unintended Legal and Business Consequences of Termination of a Franchisee*, 34 FRANCHISE L.J. 53, 58 (2014) (noting that the WFDL is “one of the most protective” state franchise statutes).

2. *Bush v. Nat’l Sch. Studios, Inc.*, 407 N.W.2d 883, 889 (Wis. 1987).

3. See WIS. STAT. § 135.02(2), (3).

4. See *id.* § 135.03; see also Joseph P. Wright & Thomas B. Aquino, *Understanding the Wisconsin Fair Dealership Law*, WIS. LAW., Nov. 2009, at 14 (“The WFDL greatly circumscribes the ability of a grantor (as the WFDL terms it) to alter its relationship with a dealer, even in difficult economic times.”).

5. *Bush*, 407 N.W.2d at 890 (“The legislative intent reflected in the statute’s statement of purposes, . . . coupled with the legislature’s refusal to accept a narrow definition of dealership

*Kerry L. Bundy (Kerry.Bundy@FaegreDrinker.com) is a litigation partner at Faegre Drinker Biddle & Reath LLP. Her practice focuses primarily on franchise and distribution litigation and counseling, trade secret litigation, international arbitration, and other complex commercial litigation. Joshua N. Turner (Josh.Turner@FaegreDrinker.com) is a litigation associate at Faegre Drinker Biddle & Reath LLP and practices in the firm’s business litigation group. Josh’s practice focuses on distribution compliance and litigation, corporate and transactional litigation, and appellate litigation.

relationships within its ambit⁶), and the protections afforded to covered dealers are formidable.⁷

Since its enactment in 1974, courts have almost universally applied the WFDL to relationships that meet its definition, regardless of the parties' contractual choice of law.⁸ So long as the dealer was able to show that it had a "dealership" that was "situated in" Wisconsin, the WFDL has applied.⁹ But at least one federal circuit has broken step recently and signaled that reflexive rejection of choice-of-law clauses and application of the WFDL may not always be appropriate. In September 2021, the Ninth Circuit held that an agreement by the parties that a different state's law would govern their relationship was enforceable and displaced application of the WFDL.¹⁰ This result was likely only possible, however, due to another contractual provision: a mandatory forum-selection clause requiring suit to be brought in Washington State.¹¹

This article explores the interplay between forum-selection clauses and choice-of-law clauses and what they can mean for franchisors and franchisees whose relationships may otherwise be governed by the WFDL. The article begins with a brief lay of the landscape in two parts—the first addressing

convinces us that in determining whether a dealership exists, courts should not focus solely on identifying the telltale trappings of the traditional franchise. Rather courts should consider the overriding principle of whether the business' status is dependent upon the relationship with the grantor for its economic livelihood.”).

6. *Benson v. City of Madison*, 897 N.W.2d 16, 20 (Wis. 2017) (concluding that the WFDL applied to a relationship between the City of Madison and golf professionals who operated publicly owned golf courses and that the golf professionals were “dealers” under the WFDL); *Girl Scouts of Manitou Council, Inc. v. Girl Scouts of United States of Am., Inc.*, 549 F.3d 1079, 1094 (7th Cir. 2008) (holding that a local Girl Scouts council was a dealer protected under the WFDL).

7. WIS. STAT. §§ 135.03 (requiring “good cause” for termination, cancellation, failure to renew, or substantially changing the competitive circumstances of a dealership agreement), 135.04 (requiring proper notice before terminating, cancelling, failing to renew, or substantially changing the competitive circumstances of a dealership agreement), 135.045 (requiring grantor to repurchase dealership inventory upon termination), 135.06 (providing one-way attorney fees to prevailing dealers), and 135.065 (providing a presumption of irreparable harm to dealer when a grantor violates the WFDL); *see also* *Heat & Power Prod., Inc. v. Camus Hydronics Ltd.*, 2007 WL 2751862, at *8 (E.D. Wis. Sept. 18, 2007) (noting that the Wisconsin legislature enacted the WFDL to provide “strong protection for its dealers”).

8. *See, e.g., Generac Corp. v. Caterpillar Inc.*, 172 F.3d 971, 976 (7th Cir. 1999); *Morley-Murphy Co. v. Zenith Elecs. Corp.*, 142 F.3d 373, 381 (7th Cir. 1998); *Ferguson-Kubly Indus. Servs., Inc. v. Circle Env't, Inc.*, 409 F. Supp. 2d 1072, 1076 (E.D. Wis. 2006); *Bowen Med. Co. v. Nicolet Biomedical Inc.*, 2002 WL 32340885, at *5 (W.D. Wis. Nov. 14, 2002); *Bush v. Nat'l Sch. Studios, Inc.*, 407 N.W.2d 883, 887–88 (Wis. 1987).

9. *See, e.g., Bush*, 407 N.W.2d at 887–88 (refusing to “honor the parties’ choice of law clause” selecting Minnesota law and instead applying the WFDL); *Generac Corp.*, 172 F.3d at 976 (“The WFDL specifies who can take advantage of its protections through its definitions of the terms ‘dealer’ and ‘dealership,’ and thus obviates the need to resort to general choice of law principles.”); *Morley-Murphy*, 142 F.3d at 381 (“There is no way that Zenith and Morley-Murphy could have avoided the WFDL without deciding to forego a contract altogether.”).

10. *ACD Distrib. LLC v. Wizards of the Coast LLC*, 2021 WL 4027805, at *1 (9th Cir. Sept. 3, 2021). Ms. Bundy was one of the counsel to Wizards of the Coast LLC in this matter in the district court proceedings.

11. *Id.*

when and to whom the WFDL applies and the second addressing what the WFDL says about choice-of-law clauses and what courts have said about them in the context of the WFDL. In the third part, the article addresses the Ninth Circuit's recent decision and its implications and then closes with a discussion of factors that may limit the decision's impact.

I. The Scope of the Wisconsin Fair Dealership Law

The WFDL's protections apply to a "dealer,"¹² a statutorily defined term that means "a person who is a grantee of a dealership situated in this state."¹³ The WFDL provides a "dealer" with a cause of action against a "grantor" for damages, injunctive relief, and reasonable attorneys' fees for an unlawful termination, cancellation, nonrenewal, or substantial change in competitive circumstances.¹⁴ An unlawful termination, nonrenewal, or substantial change in competitive circumstances occurs when the grantor lacks "good cause" to take such action.¹⁵ Even when a grantor has good cause to take such action, it is still unlawful for a grantor to fail to provide at least ninety days' written notice of termination, nonrenewal, or a substantial change in competitive circumstances.¹⁶ Finally, it is unlawful for a grantor's written notice to fail to state the reasons for the termination, nonrenewal, or the substantial change in competitive circumstances or to fail to provide the dealer with sixty days to cure any claimed deficiency.¹⁷

Examining one of the threshold requirements—that the dealer is "situated in" the state of Wisconsin—is a factually intensive analysis and one that has evolved over time. The original version of the statute did not contain the requirement, which resulted in courts permitting dealers who were neither residents of Wisconsin nor had a presence in Wisconsin to take advantage of the WFDL.¹⁸ In 1977, the Wisconsin legislature added the "situated in this state" requirement "specifically to reverse the effect of decisions in *C.A. May Marine Supply Co. v. Brunswick Corp.* and *Boatland, Inc. v. Brunswick Corp.*, which held that a dealer in another state, who had a contract with a Wisconsin supplier specifying the application of Wisconsin law, could claim the protection of the WFDL."¹⁹ In reviewing the legislative history of the addition, the Wisconsin Court of Appeals explained that the legislature intended "to make the WFDL apply exclusively to dealerships that do business within

12. WIS. STAT. § 135.02(2).

13. *Id.*

14. *Id.* § 135.06.

15. *Id.* § 135.03.

16. *Id.* § 135.04.

17. *Id.*

18. See, e.g., *Boatland, Inc. v. Brunswick Corp.*, 558 F.2d 818 (6th Cir. 1977); *C.A. May Marine Supply Co. v. Brunswick Corp.*, 557 F.2d 1163 (5th Cir. 1977).

19. *Diesel Serv. Co. v. AMBAC Int'l Corp.*, 961 F.2d 635, 638 (7th Cir. 1992) (full internal case citations omitted), *overruled by* *Generac Corp. v. Caterpillar Inc.*, 172 F.3d 971 (7th Cir. 1999).

the geographic confines of the state of Wisconsin.²⁰ As such, not even an agreement by the parties that Wisconsin law applies is enough to trigger application of the WFDL.²¹

Instead, whether a dealership is situated in Wisconsin depends on the outcome of a non-exhaustive set of factors that are examined case-by-case.²² Under the decision of the Wisconsin Supreme Court in *Baldewein Co. v. Tri-Clover, Inc.*,²³ whether a dealership is situated in Wisconsin depends on the following factors (again, these are a starting point and non-exhaustive):

- Percentage of total sales in Wisconsin (and/or percentage of total revenue or profits derived from Wisconsin);
- How long the parties have dealt with each other in Wisconsin;
- The extent and nature of the obligations imposed on the dealer regarding operations in Wisconsin;
- The extent and nature of the grant of territory in the state;
- The extent and nature of the use of the grantor's proprietary marks in the state;
- The extent and nature of the dealer's financial investment in inventory, facilities, and good will of the dealership in the state;
- The personnel devoted to the Wisconsin market;
- The level of advertising and/or promotional expenditures in Wisconsin; and
- The extent and nature of any supplementary services provided in Wisconsin.²⁴

Although the intent of the legislature in amending the statute may have been to narrow the WFDL's applicability, it remains unclear how much, in practice, application of the statute has been narrowed. Sometimes, it will be easy to determine whether a dealership is situated in Wisconsin. For example, dealerships that are located in Wisconsin and whose operations are confined to Wisconsin are plainly situated in Wisconsin.²⁵ But dealers

20. *Swan Sales Corp. v. Joseph Schlitz Brewing Co.*, 374 N.W.2d 640, 644 (Wis. Ct. App. 1985).

21. *Baldewein Co. v. Tri-Clover, Inc.*, 606 N.W.2d 145, 149 (Wis. 2000), *opinion after certified question answered*, 221 F.3d 1338 (7th Cir. 2000) (explaining that the "situated in this state" amendment "was a legislative response to two federal cases, *C.A. May Marine Supply Co. v. Brunswick Corp.*, 557 F.2d 1163 (5th Cir. 1977) and *Boatland, Inc. v. Brunswick Corp.*, 558 F.2d 818 (6th Cir. 1977), which had applied the WFDL to non-Wisconsin dealers operating under agreements containing Wisconsin choice-of-law provisions"); *Dennehy v. Cousins Subs Sys., Inc.*, 2002 WL 31571149, at *2 (D. Minn. Nov. 18, 2002) ("Courts have routinely rejected attempts by out-of-state plaintiffs to bring claims under the WFDL based on Wisconsin choice-of-law provisions.").

22. *Baldewein*, 606 N.W.2d at 149 (adapting "[t]he multiple factor 'community of interest' test in *Ziegler*" to the "situated in this state" inquiry).

23. *Id.*, *opinion after certified question answered*, 221 F.3d 1338 (7th Cir. 2000).

24. *Id.* at 152–53.

25. See, e.g., *Benson v. City of Madison*, 897 N.W.2d 16, 20 (Wis. 2017) (applying WFDL to golf professionals who operated publicly owned golf courses for the City of Madison).

sometimes do business in Wisconsin from out-of-state headquarters or have in-state headquarters but operate entirely, or almost entirely, out of state.²⁶ In those situations, application of the WFDL is less clear. For example, in *Brio Corp. v. Meccano S.N.*,²⁷ a federal district court held that the plaintiff was a dealership situated in Wisconsin, even though the plaintiff operated in many states other than Wisconsin and its sales in Wisconsin only accounted for 4.8% of its business.²⁸ As the *Brio* case demonstrates, the percentage of sales factor is not outcome determinative, and a dealer that makes a strong showing on other factors need not demonstrate a large percentage of Wisconsin sales to obtain protection under the WFDL.²⁹

The WFDL has an extensive, and sometimes uncertain, reach. As a general practice and in an attempt to mitigate some uncertainty, parties often resort to choice-of-law clauses to provide certainty at least about the law governing their relationship. As to the WFDL, the cases are fairly clear that parties cannot use a Wisconsin choice-of-law clause to trigger application of the WFDL.³⁰ But it is less clear, especially as of late, whether parties can use a choice-of-law clause to avoid application of the WFDL.³¹

II. Courts Have Historically Refused to Enforce Choice-of-Law Clauses to Displace the Wisconsin Fair Dealership Law

The WFDL provides that its protections “may not be varied by contract or agreement” and that “[a]ny contract or agreement purporting to do so is void and unenforceable to that extent only.”³² While this provision is not as explicit as some state franchise statutes regarding choice-of-law clauses,³³ both the Wisconsin Supreme Court and the federal courts within the Seventh Circuit have interpreted that provision to foreclose choice-of-law

26. *Crown Operations Int’l, Ltd. v. Solutia, Inc.*, 2000 WL 33906466, at *7 (W.D. Wis. Aug. 22, 2000) (finding that plaintiff, whose “only connection with Wisconsin [was] its location,” not situated in Wisconsin because it could “not show investment in the Wisconsin market nor revenue derived from it”).

27. *Brio Corp. v. Meccano S.N.*, 690 F. Supp. 2d 731 (E.D. Wis. 2010).

28. *Id.* at 755.

29. *Baldewein Co. v. Tri-Clover, Inc.*, 606 N.W.2d 145, 152 (Wis. 2000), (declining “to create a minimum percent-of-sales test for determining whether a dealership is situated in this state” but recognizing that “Wisconsin sales percentages are highly significant to the analysis”).

30. *Id.* at 149; *Dennehy v. Cousins Subs Sys., Inc.*, 2002 WL 31571149, at *2 (D. Minn. Nov. 18, 2002) (“Courts have routinely rejected attempts by out-of-state plaintiffs to bring claims under the WFDL based on Wisconsin choice-of-law provisions.”).

31. See *infra* Section III.

32. WIS. STAT. § 135.025(3).

33. See, e.g., MINN. STAT. § 80C.21 (Any condition, stipulation or provision, including any choice of law provision, purporting to bind any person who, at the time of acquiring a franchise is a resident of this state, or, in the case of a partnership or corporation, organized or incorporated under the laws of this state, or purporting to bind a person acquiring any franchise to be operated in this state to waive compliance or which has the effect of waiving compliance with any provision of sections 80C.01 to 80C.22 or any rule or order thereunder is void.” (emphasis added)).

clauses that would have the effect of avoiding application of the WFDL.³⁴ A pivotal shift on this issue came about in 1999, when the Seventh Circuit held that the WFDL voided choice-of-law clauses without regard to choice-of-law rules.³⁵ Simply put, as long as an entity meets the definition of a “dealer” under the WFDL, Seventh Circuit precedent holds that it is entitled to protection under the WFDL, regardless of any agreement to the contrary.³⁶

Any analysis of choice of law under the WFDL begins with the decision of the Wisconsin Supreme Court in *Bush v. National School Studios, Inc.*,³⁷ which is the seminal case addressing enforceability of choice-of-law clauses under the WFDL. There, the court addressed whether the parties’ Minnesota choice-of-law clause was enforceable or whether the WFDL governed the parties’ relationship.³⁸ The court acknowledged that Wisconsin law recognizes the general principle “that parties to a contract may expressly agree that the law of a particular jurisdiction shall control their contractual relations,” which is sometimes termed the “party autonomy principle.”³⁹ At the same time, the court explained, the party autonomy principle does not permit parties to select a law “at the expense of important public policies of a state whose law would be applicable if the parties['] choice of law provision were disregarded,” at least so far as Wisconsin law is concerned.⁴⁰ The court then turned its attention specifically to the WFDL and explained that the WFDL’s statement of purpose and policy—to protect dealers against unfair treatment by grantors—“coupled with the explicit directive that the effect of the WFDL ‘may not be varied by contract or agreement,’” demonstrated Wisconsin’s “strong public policy” favoring application of the WFDL.⁴¹ Accordingly, the court refused to “honor the parties’ choice of law clause.”⁴²

In *Diesel Service Co. v. AMBAC International Corp.*, the Seventh Circuit addressed the proper choice-of-law analysis in the face of a conflict between Minnesota and Wisconsin law.⁴³ The plaintiff in *Diesel Service* was a Minnesota corporation that distributed auto parts in several states, including Wisconsin.⁴⁴ The parties’ agreement did not have a choice-of-law clause, and the plaintiff argued that Wisconsin law, and the WFDL by extension, should apply.⁴⁵ The court disagreed and found, after engaging in a choice-

34. See, e.g., *Generac Corp. v. Caterpillar Inc.*, 172 F.3d 971, 975–76 (7th Cir. 1999); *Morley-Murphy Co. v. Zenith Elecs. Corp.*, 142 F.3d 373, 381 (7th Cir. 1998); *Ferguson-Kubly Indus. Servs., Inc. v. Circle Env’t, Inc.*, 409 F. Supp. 2d 1072, 1076 (E.D. Wis. 2006); *Bush v. Nat’l Sch. Studios, Inc.*, 407 N.W.2d 883, 887–88 (Wis. 1987).

35. *Generac Corp.*, 172 F.3d at 974–75.

36. *Id.*

37. *Bush v. Nat’l Sch. Studios, Inc.*, 407 N.W.2d 883, 886–88 (Wis. 1987).

38. *Id.* at 886.

39. *Id.*

40. *Id.*

41. *Id.* at 887–88.

42. *Id.* at 888.

43. *Diesel Serv. Co. v. AMBAC Int’l Corp.*, 961 F.2d 635, 638 (7th Cir. 1992), *overruled by* *Generac Corp. v. Caterpillar Inc.*, 172 F.3d 971 (7th Cir. 1999).

44. *Id.* at 636.

45. *Id.* at 636–37.

of-law analysis under the *Restatement* factors, that Minnesota law applied.⁴⁶ The court specifically rejected plaintiff's argument that the WFDL applied so long as the plaintiff met the definition of a "dealer" under the statute.⁴⁷ Instead, the court imposed a two-step analysis: first, courts must analyze whether the applicable forum's choice-of-law factors point to application of Wisconsin law and second, if that analysis points to Wisconsin law, only then may a court go on to decide if the WFDL's requirements are satisfied.⁴⁸

In *Generac Corp. v. Caterpillar Inc.*, a panel of the Seventh Circuit reversed *Diesel Service* while addressing whether an Illinois choice-of-law clause prevented application of the WFDL.⁴⁹ The court grounded its holding in *Bush*, noting that it provided "[t]he strongest support for [its] result," and held that the Illinois choice-of-law provision was unenforceable.⁵⁰ The *Generac* court, however, went one rather significant step further by overruling *Diesel Service*,⁵¹ holding that the WFDL "announc[ed] a particular choice of law rule for dealership cases," specifying "who can take advantage of its protections through its definitions of the terms 'dealer' and 'dealership,' and has 'thus obviate[d] the need to resort to general choice of law principles.'"⁵² In other words, the *Generac* framework does not engage in any choice-of-law analysis and "simply" asks whether a party seeking application of WFDL "is a Wisconsin dealer entitled to the protections of the WFDL, under the statute as authoritatively interpreted by the Wisconsin courts."⁵³

In light of *Bush* and *Generac*, Wisconsin courts and federal courts within the Seventh Circuit consider the law "settled" that courts "must apply the provisions of the WFDL notwithstanding the choice-of-law provision in the Agreement."⁵⁴ The rationale from these decisions can certainly be appreciated: courts should give anti-waiver provisions, like the one reflected in Wisconsin Statute Section 135.025(3), their literal meaning and prohibit parties from contracting around the substantive statutory protections, which is the precise effect of a choice-of-law clause.⁵⁵ But, as will be explored in the next

46. *Id.* at 637–45.

47. *Id.* at 638–39.

48. *Id.* at 637–45; see also *Generac Corp. v. Caterpillar Inc.*, 172 F.3d 971, 974 (7th Cir. 1999).

49. *Generac Corp.*, 172 F.3d at 973.

50. *Id.* at 975.

51. *Diesel Serv. Co. v. AMBAC Int'l Corp.*, 961 F.2d 635 (7th Cir. 1992).

52. *Generac Corp.*, 172 F.3d at 976.

53. *Id.*

54. *Ferguson-Kubly Indus. Servs., Inc. v. Circle Env't, Inc.*, 409 F. Supp. 2d 1072, 1076 (E.D. Wis. 2006).

55. The court in *Dale Carnegie & Assocs., Inc. v. King*, 31 F. Supp. 2d 359, 363 (S.D.N.Y. 1998), nicely explains the various approaches on this issue:

Courts in other jurisdictions have reached a variety of results on this and closely related questions. Some have held that a contractual choice of law clause displaces an otherwise applicable franchise statute, even of the forum state, as long as there is a reasonable relationship between the law chosen and the parties' relationship. *E.g.*, *United Wholesale Liquor Co. v. Brown-Forman Distillers Corp.*, 108 N.M. 467, 470–71, 775 P.2d 233, 236–37 (1989). Others have held that a governing law clause displaces an otherwise applicable franchise statute unless the statute evidences a clear legislative intention to override such clauses. *E.g.*, *JRT, Inc. v. TCBY Systems, Inc.*,

section in more detail, the rationale also assumes its conclusion, namely that the anti-waiver provision or state public policy of the law in question governs in the first place. That assumption is now being challenged as to the WFDL specifically, and some courts will accord more weight to the party autonomy principle than others.

III. The Ninth Circuit Breaks Step and Enforces a Contractual Choice-of-Law Clause That Displaces the WFDL

Just over a year ago, the Ninth Circuit in *ACD Distribution LLC v. Wizards of the Coast LLC* held that a Wisconsin distributor's agreement stating that its relationship with a Washington manufacturer is governed by Washington law was enforceable and required dismissal of the Wisconsin distributor's WFDL claim.⁵⁶ Before turning to the court's analysis, it is important to set out the case's procedural history.

The litigation initially began in Wisconsin state court and was brought by the Wisconsin distributor.⁵⁷ There, the distributor was able to obtain a temporary restraining order against the Washington manufacturer for allegedly violating the termination provisions of the WFDL.⁵⁸ The Washington manufacturer removed the case to the United States District Court for the Western District of Wisconsin based on diversity jurisdiction and immediately sought transfer pursuant to 28 U.S.C. § 1404(a) in accordance with the parties' agreed-upon forum-selection clause.⁵⁹ The Wisconsin distributor opposed enforcement of the forum-selection clause, arguing that it was entitled to a Wisconsin forum under the WFDL.⁶⁰ The Wisconsin federal court disagreed and held that, pursuant to the Supreme Court's decision in *Atlantic Marine Construction Co., Inc. v. United States District Court for the Western District of Texas*,⁶¹ transfer to the United States District Court for the Western District of Washington was appropriate.⁶² The Wisconsin federal court specifically rejected the distributor's argument that the WFDL prevented

52 F.3d 734, 739 (8th Cir. 1995) (non-forum statute); *Banek Inc. v. Yogurt Ventures U.S.A., Inc.*, 6 F.3d 357, 360 (6th Cir. 1993). Still others have held that otherwise applicable state franchise protection statutes "trump" governing law clauses. *E.g.*, *Bush v. Nat'l School Studios, Inc.*, 139 Wis.2d 635, 641-45, 407 N.W.2d 883, 886-87 (1987) (forum statute); *see Instructional Systems, Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 614 A.2d 124 (1992).

The explanation for these various approaches is beyond the scope of this article. But suffice it to say that the differing results do not appear to be the function of statutory differences as much as differences in the substantive law governing conflicts.

56. *ACD Distrib., LLC v. Wizards of the Coast LLC*, 2021 WL 4027805, at *1-2 (9th Cir. Sept. 3, 2021).

57. *ACD Distrib., LLC v. Wizards of the Coast, LLC*, 2018 WL 4941787, at *1 (W.D. Wis. Oct. 12, 2018).

58. *Id.*

59. *Id.*

60. *Id.*

61. *Atl. Marine Constr. Co., Inc. v. U.S. Dist. Ct. for W. Dist. of Texas*, 571 U.S. 49 (2013).

62. *ACD Distrib.*, 2018 WL 4941787, at *2.

enforcement of the forum-selection clause, explaining that “forum selection clauses are not automatically voided by the WFDL.”⁶³

Once transferred, the Washington manufacturer moved to dismiss the distributor’s WFDL claim based on the parties’ choice-of-law clause.⁶⁴ In addressing this choice-of-law question, the Washington federal court began first by applying an interesting and little-known doctrine regarding choice-of-law principles. The general rule for a federal court sitting in diversity is that it applies the choice-of-law rules of the forum state.⁶⁵ However, in a transfer scenario, that rule usually gives way to the rule that “the law applicable to a diversity case does not change upon a transfer initiated by a defendant.”⁶⁶ In other words, typically, the Washington federal court, as a transferee court, would have applied Wisconsin’s choice-of-law rules. But another exception exists: “[W]hen a party bound by a forum-selection clause flouts its contractual obligation and files suit in a different forum, a 28 U.S.C. § 1404(a) transfer of venue will not carry with it the original venue’s choice-of-law rules.”⁶⁷ Thus, the original rule kicks back in and the choice-of-law rules of the court’s forum state apply.

Applying Washington’s choice-of-law rules, the Washington federal court held that Washington courts “generally enforce choice of law provisions” subject to the *Restatement (Second) of Conflicts of Laws*.⁶⁸ Under Section 187 of the *Restatement*, the court undertook the step-by-step analysis, skipping Section 187(1) and deciding the case under Section 187(2). That section provides as follows:

(2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties’ choice, or

(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.⁶⁹

The court found that neither (a) nor (b) was applicable. As to subsection (a), Washington clearly had a substantial relationship to the parties and

63. *Id.* (citing Rolfe v. Network Funding LP, 2014 WL 2006756, at *1 (W.D. Wis. May 16, 2014); Brava Salon Specialists, LLC v. Label.M USA, Inc., 2016 WL 632649, at *2 (W.D. Wis. Feb. 17, 2016); DeTemple v. Leica Geosystemes, Inc., 2009 WL 3617616, at *5 (E.D. Wis. Oct. 29, 2009)).

64. ACD Distrib., LLC v. Wizards of the Coast, LLC, 2020 WL 3266196, at *1 (W.D. Wash. June 17, 2020), *aff’d*, No. 20-35828, 2021 WL 4027805 (9th Cir. Sept. 3, 2021).

65. See *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941).

66. *ACD Distrib.*, 2020 WL 3266196, at *4.

67. *Id.*

68. *Id.*

69. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971).

transaction because the manufacturer was located in Washington.⁷⁰ That will almost always be enough to demonstrate a substantial relationship with a forum.⁷¹ As to subsection (b), the court held that the distributor failed to show that Wisconsin had a “materially greater interest” than Washington in determination of the issue.⁷² The distributor argued that Wisconsin had a greater interest because “the WFDL dictates as much.”⁷³ The court rejected this argument “because it assumes Wisconsin law applies in the first place.”⁷⁴

One might think that the court should at least take account of the WFDL’s restrictions on choice-of-law clauses to determine whether Wisconsin has a materially greater interest than Washington. And the court anticipated that objection, noting that, even if the WFDL’s policy were relevant, Washington’s interests in “protecting the justifiable expectations of the contracting parties” overrode any interest Wisconsin may have.⁷⁵

On appeal, the Ninth Circuit affirmed in an unpublished decision.⁷⁶ The appellate court explained that “[w]hile Wisconsin has an evident policy favoring distributors like ACD . . . , Washington has not adopted such a policy.”⁷⁷ Instead, Washington has an “interest in protecting the justifiable expectations of contracting parties, which includes letting the parties choose the law to govern the validity of the contract and the rights created thereby.”⁷⁸ The Ninth Circuit further noted that the distributor had “not shown why Wisconsin’s interest in protecting its in-state dealers overrides the justifiable expectations memorialized in a freely negotiated contract between two highly experienced and successful businesses who defined in advance the terms of their business relationship and explicitly chose Washington law to govern any disputes.”⁷⁹

In response to a dissenting colleague,⁸⁰ the majority reiterated the district court’s reasoning and declined to give force to the WFDL’s expressed policy “disfavoring the termination of dealers without good cause.”⁸¹ Like the district court, the majority explained that “the Washington Supreme Court has rejected such reasoning as ‘circular’ because it assumes that Wisconsin law applies in the first place.”⁸²

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. ACD Distrib., LLC v. Wizards of the Coast LLC, 2021 WL 4027805, at *2 (9th Cir. Sept. 3, 2021).

77. *Id.*

78. *Id.* (cleaned up).

79. *Id.* (cleaned up).

80. The dissent would have held that “Wisconsin had a materially greater interest in the determination of th[e] dispute than did Washington,” and it held that the Court need to “look no further than the Wisconsin Fair Dealership Law” to make that determination. *Id.* at *2–3 (Ebel, J., dissenting).

81. *Id.*

82. *Id.* (citing *Erwin v. Cotter Health Ctrs., Inc.*, 167 P.3d 1112, 1123 (Wash. 2007)).

In the wake of *ACD Distribution*, at least one other federal court has applied its rationale and enforced a choice-of-law clause that displaced application of the WFDL. In *Crazy Lenny's E.Bikes, LLC v. Alta Cycling Group, LLC*,⁸³ a federal district court enforced a California choice-of-law clause and rejected the plaintiff's argument that the WFDL precluded its enforcement.⁸⁴ It looked to *ACD Distribution* and held that "Section 1646.5 of the California Civil Code requires enforcement of the choice of law provision in the Dealer Agreement."⁸⁵ Traces of the reasoning from *ACD Distribution* can be found in other prior decisions,⁸⁶ but *ACD Distribution* is the first time that a court has set up a clear framework for enforcement of choice-of-law provisions and avoiding application of the WFDL.

How impactful the *ACD Distribution* case will be remains to be seen. First, the Ninth Circuit's decision is unpublished. Under Ninth Circuit Local Rule 36-3, it may be cited but it is not considered binding precedent. To be sure, a district court may consider the reasoning in *ACD Distribution* persuasive, particularly on analogous facts, as the court did in *Crazy Lenny's*, but unpublished opinions like *ACD Distribution* simply do "not bind district courts in [the Ninth Circuit] in other cases."⁸⁷

Second, the decision relied heavily on the Washington Supreme Court's decision in *Erwin v. Cotter Health Centers*⁸⁸ that refused to accept the "circular" reasoning that another state's law applies because the other state says its law cannot be avoided.⁸⁹ Respect for the party autonomy principle is not unique to Washington,⁹⁰ but whether the results can be replicated consistently under another state's law is unclear. It happened in *Crazy Lenny's*

83. *Crazy Lenny's E.Bikes, LLC v. Alta Cycling Grp., LLC*, 2022 WL 1537029, at *3 (C.D. Cal. May 12, 2022).

84. *Id.*

85. *Id.*; CAL. CIV. CODE § 1646.5 provides that "parties to any contract, agreement, or undertaking, contingent or otherwise, relating to a transaction involving in the aggregate not less than two hundred fifty thousand dollars (\$250,000), including a transaction otherwise covered by subdivision (a) of Section 1301 of the Commercial Code, may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not the contract, agreement, or undertaking or transaction bears a reasonable relation to this state."

86. *Praefke Auto Elec. & Battery Co. v. Tecumseh Prod. Co.*, 110 F. Supp. 2d 899, 906 (E.D. Wis. 2000), *rev'd sub nom. on other grounds*, *Praefke Auto Elec. & Battery Co. v. Tecumseh Prod. Co.*, 255 F.3d 460 (7th Cir. 2001) ("The WFDL reflects a 'compelling interest' of the state of Wisconsin, . . . and therefore overrides parties' choice of law provisions in cases where Wisconsin law would otherwise apply." (emphasis added)); *Popeyes, Inc. v. YCALWB, Inc.*, 1988 WL 125458, at *4 (E.D. La. Nov. 21, 1988) ("Overall, the interest analysis mandates application of Louisiana law. Both states have strong interests in applying their laws. Both states have a citizen or citizens to protect. However, because the conduct occurred in Louisiana and because Louisiana was apparently the center of the relationship between the parties, we conclude that Louisiana has a closer connection with the case.").

87. *United States v. Clay*, 2018 WL 10321882, at *1 (C.D. Cal. July 12, 2018).

88. *Erwin v. Cotter Health Ctrs.*, 167 P.3d 1112 (Wash. 2007).

89. *Id.* at 1123–24.

90. *See, e.g., DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 677 (Tex. 1990) (respecting parties' contractual agreements regarding choice of law because "their choice advances the policy of protecting their expectations").

pursuant to a California statute requiring enforcement of choice-of-law clauses, so this will be a trend to monitor.

Third, Washington law has a franchise relationship statute, the Franchise Investment Protection Act,⁹¹ and, although neither the district court nor the Ninth Circuit placed much weight on its presence, the absence of any state statutory protections for a franchisee may tilt the scales in other cases. In the case of Washington's franchise statute, it protects out-of-state franchisees in some circumstances, like the Wisconsin distributor in *ACD Distribution*, and permits them to assert claims against in-state franchisors.⁹² Other state franchise statutes, however, do not apply to out-of-state franchisees.⁹³ The presence or absence of franchisee protections likely will be a factor under a conflict-law-analysis, especially one under the *Restatements*.

Finally, the decision in *ACD Distribution* was possible because of the forum-selection clause in the agreement. As has been shown, a Wisconsin state or federal court, applying Wisconsin's choice-of-law rules, would likely hold any contrary choice-of-law provision unenforceable. But because forum-selection clauses are enforceable, and because a "dealer" cannot take advantage of the general transfer rule regarding application of the choice-of-law rules that the transferor court would have applied, the combination of a forum-selection clause and choice-of-law clause may result in avoiding application of the WFDL.⁹⁴

CONCLUSION

In the wake of *ACD Distribution*, franchisors and franchisees should pay special attention to the role that choice-of-law and forum-selection clauses play in their relationship. For many years, the WFDL was unavoidable for franchisors dealing with franchisees who operate in Wisconsin, and Wisconsin franchisees took it for granted that they would be protected by the WFDL. But now, there is precedent for uprooting those expectations. Within Wisconsin courts and the Seventh Circuit, a choice-of-law clause that attempts to avoid application of the WFDL is unlikely to be enforced. Outside of Wisconsin courts and the Seventh Circuit, it is a more open question. In other words, the forum for litigating choice-of-law clauses can play a decisive role in whether a choice-of-law clause will displace the WFDL. Thus, franchisors and franchisees should be aware of the impact a forum-selection clause will have on the choice-of-law question.

91. See WASH. REV. CODE § 19.100 *et seq.*

92. *Red Lion Hotels Franchising, Inc. v. MAK, LLC*, 663 F.3d 1080, 1083 (9th Cir. 2011).

93. See, e.g., WIS. STAT. § 135.01 *et seq.*; CONN. GEN. STAT. § 42-133e *et seq.*; N.J. STAT. § 56:10-1 *et seq.*

94. See Bryan P. Couch, *Are Franchisees Subject to Personal Jurisdiction in the Franchisor's Home State?*, 28 FRANCHISE L.J. 150, 154 (2009), for a discussion on how forum-selection clauses can be used to navigate franchise relationship statutes.

Educating Courts: Using Franchise Lawyers and Consultants as Expert Witnesses in Franchise Cases and Avoiding Exclusion of Testimony as “Legal Opinion”

*Glenn Plattner, David Harford & Makaela O’Connell**



Mr. Plattner



Mr. Harford



Ms. O’Connell

I. Introduction

Despite the ubiquity of the franchise business model in the United States, few people understand the particulars of what it means to be involved in franchising or the web of state and federal regulations that apply to it. This lack of understanding is fine for the day-to-day business operations of franchising. A customer buying frozen yogurt does not care whether the franchisor provided adequate site location assistance or whether the franchisee belongs to an association of franchisees. But for franchisors and franchisees involved in a legal dispute, the ignorance of jurors, judges, and arbitrators about the standards, norms, and rules governing the industry may prove disastrous. Hiring an expert that is capable of explaining the franchise industry to a jury, judge, or arbitrator helps the parties and their advocates avoid this problem.

**Glenn Plattner (glenn.plattner@bclplaw.com) is a partner in Bryan Cave Leighton Paisner LLP’s Santa Monica office. He is a California State Bar Certified Specialist in Franchise and Distribution Law. David Harford (david.harford@bclplaw.com) is a partner in Bryan Cave Leighton Paisner LLP’s Irvine office. He is a California State Bar Certified Specialist in Franchise and Distribution Law. Makaela O’Connell (makaela.oconnell@bclplaw.com) is an associate in Bryan Cave Leighton Paisner LLP’s Santa Monica office. They are all members of the firm’s Commercial Disputes practice group focusing on litigation related to franchise law and the franchise industry.*

In this article, the authors discuss the use of franchise industry expert witnesses in legal proceedings. Section II provides an overview of the standards for admissibility of expert testimony in state and federal court, with a special focus on the rules involving whether expert testimony is helpful and “fit” for admissibility or mere legal conclusion, which is likely to be excluded. In Section III, the authors discuss the application of the admissibility standards both to franchise experts, as well as experts in other industries. Section IV outlines considerations for retaining and using franchise experts, the most effective uses of franchise lawyers and consultants as testifying experts, and suggestions for avoiding the exclusion of this testimony on the grounds that it is a legal conclusion.

II. Fundamental Principles on the Admissibility of Expert Testimony

A. *The Federal Standard (Daubert)*

The prevailing standard for the admission of expert testimony is Federal Rule of Evidence 702, as interpreted by the Supreme Court in *Daubert v. Merrell Dow Pharmaceuticals*.¹ The standard set forth in *Daubert* was so influential that the Judicial Conference of the United States, with the approval of the Supreme Court and Congress, amended Federal Rule 702 in 2000 to codify the rules created by it and its progeny.² Under the current standard, an expert witness may testify in the form of an opinion if “(a) the expert’s scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue; (b) the testimony is based on sufficient facts or data; (c) the testimony is the product of reliable principles and methods; and (d) the expert has reliably applied the principles and methods to the facts of the case.”³ Rule 702 now permits the admission of expert opinion testimony only if it meets three requirements: “qualification, reliability and fit.”⁴ The qualification requirement refers to the witness’ possession of specialized knowledge, skills, or training.⁵ Reliability means that expert bases their opinion upon some method, procedure, or observation other than the expert’s subjective beliefs.⁶ The final requirement that the testimony is “fit” restricts expert testimony to opinions that are relevant to the case and helpful to the trier of fact.⁷ Because Rule 702 is procedural,

1. *Daubert v. Merrell Dow Pharm.*, 509 U.S. 579 (1993).

2. FED. R. EVID. 702 (notes to 2000 amendments).

3. *Id.*

4. *Ocean City Express Co., Inc. v. Atlas Van Lines, Inc.*, 194 F. Supp. 3d 314, 326 (D.N.J. 2016).

5. *Schneider ex. rel. Estate of Schneider v. Fried*, 320 F.3d 396, 404 (3d Cir. 2003).

6. *Id.*

7. *Id.*

it applies in all federal cases, whether they involve substantive state law or federal questions.⁸

B. State Standards

The majority of state courts have also adopted *Daubert*.⁹ Some state courts have held that *Daubert* applies only to novel scientific evidence.¹⁰ Before *Daubert*, the standard created in *Frye v. United States* had been the “dominant” test for admissibility of expert opinion testimony for about seventy years.¹¹ Although the *Daubert* Court concluded that the adoption of the Federal Rules of Evidence superseded *Frye*, several states, including California, still use the *Frye* test to determine the admissibility of expert opinion evidence in their state courts.¹²

The *Frye* test requires that expert testimony must adhere to generally accepted standards in the expert’s field to be admissible in court.¹³ In instances of novel theories or techniques, in which there was not yet a “general acceptance” in the relevant community, the test considers whether the techniques, when properly performed, generate results that are reliable within the scientific community generally.

While adhering to the *Frye* standard, the California Supreme Court has noted that if it is considering the expert’s method for the first time, *Daubert* may guide the analysis.¹⁴ By contrast, Florida courts apply the *Frye* standard when the expert bases their opinion on new or novel scientific techniques.¹⁵

8. *Hendrix ex rel. G.P. v. Evenflo Co., Inc.*, 609 F.3d 1183, 1193 (11th Cir. 2010) (applying *Daubert* in federal diversity case in Florida).

9. “Thirty-eight states have either explicitly adopted *Daubert* or held that its factors are persuasive in evaluating expert witness testimony.” *Savage v. State*, 166 A.3d 183, 207 n.3 (Md. 2017) (Adkins, J., concurring); *see, e.g.*, *Farm Bureau Mut. Ins. Co. of Ark., Inc. v. Foote*, 14 S.W.3d 512 (Ark. 2000) (adopting *Daubert* guidelines for expert testimony); *State v. Porter*, 698 A.2d 739 (Conn. 1997) (adopting *Daubert* standard); *Nelson v. State*, 628 A.2d 69 (Del. 1993) (finding *Daubert* consistent with Delaware case law); *Willie v. State*, 204 So. 3d 1268 (Miss. 2016); *State v. Mealor*, 825 S.E.2d 53 (S.C. Ct. App. 2019); *State v. Lemler*, 774 N.W.2d 272 (S.D. 2009).

10. *See, e.g.*, *Gilkey v. Schweitzer*, 983 P.2d 869 (Mont. 1999) (medical opinion regarding appropriate standard of care for informed consent is not novel scientific evidence); *Torres v. State*, 962 P.2d 3 (Okla. Crim. App. 1998), *reh’g denied* (Aug. 11, 1998), *cert. denied*, 525 U.S. 1082 (1999) (*Daubert* not applying to evidence showing gang affiliation).

11. *People v. Leahy*, 882 P.2d 321, 326 (Cal. 1994) (citing *Frye v. United States*, 293 F.1013 (D.C. Cir. 1923)).

12. *See, e.g.*, *Sargon Enters., Inc. v. Univ. of S. Cal.*, 288 P.3d 1237, 1252 n.6 (Cal. 2012) (California following the *Frye* approach); *State v. Marshall*, 975 P.2d 137, 140 (Ariz. Ct. App. 1998) (Arizona has not adopted *Daubert*); *Bahura v. S.E.W. Investors*, 754 A.2d 928 (D.C. 2000) (noting that the *Frye* test remains in effect in the District of Columbia); *State v. Copeland*, 922 P.2d 1304, 1310 (Wash. 1996) (“*Frye* remains the standard. . .”); *cf. Flanagan v. State*, 625 So. 2d 827, 828 (Fla. 1993) (noting that “novel scientific evidence is not admissible in Florida unless it meets the” *Frye* test).

13. *Frye*, 293 F. at 1014.

14. *Leahy*, 882 P.2d at 321.

15. *See, e.g.*, *Overton v. State*, 976 So. 2d 536, 550 (Fla. 2007) (“DNA test results are generally accepted as reliable in the scientific community, provided that the laboratory has followed accepted testing procedures that meet the *Frye* test to protect against false readings and contamination.”); *cf. Ramirez v. State*, 651 So. 2d 1164, 1167 (Fla. 1995) (“[T]he principal inquiry

A small number of states use their own tests for the admissibility of scientific evidence and other expert testimony.¹⁶ In Georgia, the trial court makes the determination of whether the procedure or technique has reached a scientific state of certainty to be competent evidence based on the evidence available to the court, as opposed to the consensus of the greater scientific community at large.¹⁷ The Virginia Supreme Court has articulated a similar standard in which the trial court makes the decision as to the reliability of the expert testimony.¹⁸ Utah courts consider the “inherent reliability” of the method rather than general acceptance—meaning, in the absence of general acceptance, other proof of reliability may also be sufficient.¹⁹ Wisconsin trial courts have an extremely limited “gatekeeper role” function. They admit scientific evidence if it will aid the jury or is reliable enough to be probative.²⁰ Even under this loose standard, the witness still must first be qualified as an expert witness under Wisconsin Rule of Evidence 907.02²¹ because “[a]n opinion for which there is no proper foundation—for which the witness has no . . . ‘scientific, technical, or other specialized knowledge’—is not ‘reliable enough to be probative.’”²²

C. The Prohibition on Expert Testimony Offering Legal Conclusions

Whether *Daubert*, *Frye*, or some other standard applies to the admission of expert testimony, courts generally agree that expert witnesses should not be permitted to testify regarding legal conclusions.²³ For example, a number of federal circuits hold that an expert witness may not give an opinion on

under the *Frye* test is whether the scientific theory or discovery from which an expert derives an opinion is reliable.”).

16. See, e.g., *Reinhard v. State*, 770 S.E.2d 314 (Ga. Ct. App. 2015); *State v. Butterfield*, 27 P.3d 1133 (Utah 2001); *Dowdy v. Commonwealth*, 686 S.E.2d 710 (Va. 2009); *Watson v. State*, 219 N.W.2d 398 (Wis. 1974); *City of W. Bend v. Wilkens*, 693 N.W.2d 324 (Wis. Ct. App. 2005).

17. *Spencer v. State*, 805 S.E.2d 886 (Ga. 2017).

18. *Spencer v. Commonwealth*, 393 S.E.2d 609 (Va. 1990).

19. *Alder v. Bayer Corp.*, 61 P.3d 1068 (Utah 2002).

20. *In re Commitment of Labor*, 661 N.W.2d 898, 902–03 (Wis. Ct. App. 2003) (“In Wisconsin, scientific testimony is admissible if it is an aid to the jury or reliable enough to be probative.”) (internal citations omitted); cf. *Green v. Smith & Nephew AHP, Inc.*, 617 N.W.2d 881, 891 (Wis. App. 2000), *aff’d*, 629 N.W.2d 727 (Wis. 2001) (“The fundamental determination of admissibility comes at the time the witness is ‘qualified’ as an expert. In a state such as Wisconsin, where substantially unlimited cross-examination is permitted, the underlying theory or principle on which admissibility is based can be attacked by cross-examination or by other types of impeachment.”).

21. WIS. STAT. ANN. § 907.02.

22. *Green*, 617 N.W.2d at 891.

23. See, e.g., *Convertino v. U.S. Dept. of Just.*, 772 F. Supp. 2d 10, 13 (D.D.C. 2010) (noting that “the standard is that expert witnesses may not testify and offer legal conclusions *at all*”); *Smith v. Childs*, 437 S.E.2d 500, 505–06 (N.C. Ct. App. 1993) (“An expert is not allowed to testify that a particular legal standard, or legal term of art, has been met.”); *Nichols v. State*, 340 S.E.2d 654, 658 (Ga. App. 1986) (“Hence it is a legal conclusion which the expert witness is not permitted to draw.”); *Summers v. A.L. Gilbert Co.*, 82 Cal. Rptr. 2d 162, 175 (Ct. App. 1999) (“There are limits to expert testimony, not the least of which is the prohibition against admission of an expert’s opinion on a question of law.”).

ultimate issues of law.²⁴ Legal conclusions usurp the role of the court in deciding the law and invade the province of the jury to decide the case.²⁵ Because the judge and jury have an independent duty to make their decisions, an expert's legal conclusions are not "helpful" to making a decision and inadmissible on this ground.²⁶

III. The Admissibility of Expert Testimony in Franchising Disputes

Because the nuances of franchising are outside the common experience of a court or jury, expert testimony about franchising and the franchise industry may be critical in a franchise dispute. In cases where it would assist the judge or jury to understand an important franchise issue, courts applying the elements of *Daubert* often permit expert testimony, unless the expert crosses over into providing improper legal conclusions. Experts may provide testimony about the "ultimate issue,"²⁷ including testifying regarding mixed questions of law and fact, but an expert may not tell the trier of fact how to decide a case or otherwise assert a legal conclusion. While courts formulate this rule in clear and definitive terms, the distinction between permissible opinion and legal conclusion, especially for experts in franchising and lawyer-experts, often proves more elusive in practice.

A. The Admission of Testimony of Experts in Franchising

Franchise experts are usually allowed to provide testimony regarding franchise industry customs and practices, a niche or specialized subsection of the franchise industry, the application of franchise statutes or rules to the situation, and the calculation of financial revenue or financial damages. Most often, courts admit testimony on franchising, whether offered by lawyers or non-lawyers, when the proponent of the evidence identifies ambiguity in the parties' respective obligations, such that evidence of industry practice informs a decision about how to interpret a contract. Courts also admit testimony where the expertise in franchising is a corollary of the underlying testimony—such as an expert in franchising offering an opinion about how a party calculates its gross revenues. Courts do not hesitate to limit, or exclude completely, testimony that appears to repeat the governing law or offer a naked opinion on liability.

24. *Specht v. Jensen*, 853 F.2d 805, 808 (10th Cir. 1988) (citing *Marx & Co. v. Diners' Club, Inc.*, 550 F.2d 505 (2d Cir.), *cert. denied*, 434 U.S. 861 (1977) ("It is not for witnesses to instruct the jury as to the applicable principles of law, but for the judge."); *United States v. Zipkin*, 729 F.2d 384 (6th Cir. 1984) (reversing the trial court's decision to allow a bankruptcy judge to testify regarding his interpretation of the Bankruptcy Act and his own orders, holding that "[i]t is the function of the trial judge to determine the law of the case"); *Owen v. Kerr-McGee Corp.*, 698 F.2d 236, 240 (5th Cir. 1983) (holding that a witness's offering a legal conclusion on the contributory negligence of a party infringing upon the jury's role in deciding the case).

25. *Summers*, 82 Cal. Rptr. 2d at 178.

26. *Id.*

27. See FED. R. EVID. 704.

1. Testimony on Franchise Industry Customs and Standards

Courts most frequently admit expert testimony on franchising that educates the judge or jury regarding industry customs, practices, and standards. With an issue regarding the intent of the parties in an ambiguous contract, courts consider industry custom testimony as part of the extrinsic evidence necessary to resolve the ambiguity. In *TCBY Systems, Inc. v. RSP Co., Inc.*, for example, the Eighth Circuit affirmed a district court's decision to permit a franchise expert to testify about the adequacy of TCBY's site review and evaluation process.²⁸ In the trial court, the franchisee asserted that the franchisor had breached its obligation to provide "reasonable assistance" in selecting a site for a store.²⁹ The trial court found the franchise agreement to be sufficiently ambiguous to permit the testimony of the franchisee's expert, who opined that the franchisor's site selection process did not meet the minimum custom and practice observed by franchisors in the fast-food industry.³⁰ The Eighth Circuit affirmed the admission of the testimony even though it related to an ultimate issue for the jury because the "testimony helped the jury understand what is reasonable in the franchise industry."³¹

Similarly, in *Craig Food Industries v. Weihing*, a state court of appeal in Utah affirmed the trial court's decision to allow the franchisee plaintiff to submit industry custom testimony from a non-lawyer franchise expert.³² Here, the franchise expert held a PhD in Business Administration and regularly consulted for a large number of fast-food franchise operations.³³ The trial court found that a paragraph in the franchise agreement was ambiguous as to the parties' obligations; specifically, it was ambiguous as to the amount of advertising in which franchisees must engage; the nature of uniform promotions, specials, and discounts; and whether the franchisor can compel the franchisee to participate in these marketing ventures.³⁴ Because the court determined that the franchise agreement was ambiguous, it allowed expert testimony regarding industry customs to assist the court, in a bench trial, with determining the parties' intent with respect to the franchise agreement.³⁵

In *Stuller v. Steak N Shake Enterprises*, the United States District Court for the Central District of Illinois considered testimony on "custom and practice" in franchising in a dispute regarding the franchisor's ability to dictate pricing to franchisees.³⁶ Both sides submitted testimony from franchising experts, the experts had extensive knowledge of franchise law with one being an attorney and the other a certified public accountant, and neither

28. *TCBY Sys., Inc. v. RSP Co., Inc.*, 33 F.3d 925, 928 (8th Cir. 1994).

29. *Id.* at 927–28.

30. *Id.* at 929.

31. *Id.*

32. *Craig Food Indus., Inc. v. Weihing*, 746 P.2d 279 (Utah Ct. App. 1987).

33. *Id.* at 282.

34. *Id.*

35. *Id.* at 283.

36. *Stuller, Inc. v. Steak N Shake Enters., Inc.*, 877 F. Supp. 2d 674, 687–88 (C.D. Ill. 2012).

side challenged the admissibility of this testimony.³⁷ Nonetheless, the court discussed the expert testimony on franchising, holding that it was admissible to determine the parties' intent in an ambiguous agreement and considering it as extrinsic evidence of "trade usage in the relevant industry."³⁸

In *Wolsey Limited v. Foodmaker, Inc.*, the United States District Court for the Southern District of California did not find a contract ambiguous, but still permitted a franchisee to call two franchise consultants as expert witnesses to testify about the nature of franchise relationships in general and the alleged breaches of the franchisor's obligations within their relationship.³⁹ The franchisee characterized the expert's anticipated testimony as relating to franchise industry standards, franchise practices, and the franchise relationship.⁴⁰ The franchisor sought to exclude the testimony as irrelevant, arguing that the experts were offering legal conclusions and that the jury needed to base its decision on the language of the franchise agreement.⁴¹ The court denied the motion to exclude the witnesses. It held that the proposed testimony of the experts was outside the common experience of the jury and would be helpful to understanding the issues in the case.⁴² The court also noted that the franchisor had hired its own expert in franchising issues.⁴³ While allowing for the possibility of limiting instructions for the testimony, the court, citing to *TCBY Systems*, permitted both sides to introduce testimony from franchising experts.⁴⁴

The district court's approach in *Wolsey* demonstrates the difficulty inherent in fashioning a clear rule regarding whether expert testimony on franchising standards is helpful or "fit" for admission to a jury. The court recognized that the industry has its own unique practices that are unfamiliar to most people, but acknowledged the possibility that such testimony might veer into improper legal conclusions.⁴⁵

In *RWJ Management Co., Inc. v. BP Products North America, Inc.*, a federal district court in Illinois barred the plaintiff's expert from providing legal conclusions that the defendant breached its "duty of good faith and fair dealing."⁴⁶ The court allowed the expert to testify as to fuel-pricing claims, but only to the extent that franchise disclosure practices were relevant to those claims.⁴⁷ The court also allowed the expert to testify as to "franchise industries practices and procedures to the extent that testimony will inform the

37. *Id.* at 694.

38. *Id.* at 690–91.

39. *Wolsey, Ltd. v. Foodmaker, Inc.*, No. 96-CV-634-E(JFS), 1998 WL 2001059, at *7–8 (S.D. Cal. Dec. 3, 1998).

40. *Id.* at *8.

41. *Id.* at *7.

42. *Id.* at *8.

43. *Id.*

44. *Id.*

45. *Id.*

46. *RWJ Mgmt. Co., Inc. v. BP Products N. Am., Inc.*, No. 09 C 6141, 2011 WL 87444, at *1 (N.D. Ill. Jan. 10, 2011).

47. *Id.* at *2.

trier of fact on issues or evidence relating to Plaintiffs' fraud and negligent representation claims."⁴⁸

Most courts recognize that franchise experts can help a jury to understand how the industry works. Attorneys handling cases that involve franchise issues should carefully review the facts and issues in their particular cases, so that they can determine whether a franchise expert would be helpful. If there is a challenge to the proposed franchise expert, the attorney will need to present a convincing argument to the judge regarding why custom and practice evidence would assist the jury and why such testimony does not cross the line into improper legal opinion.

2. Testimony Explaining the Meaning of Franchise Laws and Rules

Despite the general prohibition on the admission of legal conclusions, there is no outright prohibition against testimony on franchise laws and rules. A court may allow a franchise expert to provide explanations of statutes or rules, so long as the explanation is necessary, that is, meaning the nuances of the statute or rule is not something that the average juror or trial judge would understand without the guidance or expertise of an expert witness.

In *United States v. Parker*, the Eighth Circuit affirmed a district court decision to admit testimony regarding "the Federal Trade Commission's definition of a franchise and the disclosure obligations under federal franchise law that accompany classification as a franchise" for the purposes of proving a defendant's "intent and motive."⁴⁹ In *Parker*, the government had to prove that the defendant had committed fraud in selling automotive tool distributorships to the public.⁵⁰ At trial, the government offered expert testimony from a lawyer from the Federal Trade Commission (FTC) regarding the scope and applicability of the FTC's Franchise Rule.⁵¹ The defendant objected to the testimony as irrelevant and unduly prejudicial because it tended to show that the defendant had violated the FTC Franchise Rule, which was an impermissible legal opinion and not the proper subject for a criminal charge in this case.⁵² The court rejected the defendant's arguments, finding that the expert's testimony helped establish that the defendant falsely claimed to his dealers that he had complied with all laws when he knew he was selling unregistered franchises.⁵³ The court allowed the expert's testimony, because he did not try to testify that the defendant *was subject to the rule*, but rather, his testimony was limited "to the scope and obligations of the rule."⁵⁴

The admission of expert testimony on the FTC Franchise Rule in *Parker* may prove to be an outlier. It was a criminal case in which the government

48. *Id.*

49. *U.S. v. Parker*, 364 F.3d 934, 940 (8th Cir. 2004).

50. *Id.* at 937–38.

51. *Id.* at 941. The FTC Franchise Rule can be found at 16 C.F.R. Parts 436 & 437.

52. *Id.*

53. *Id.* at 942.

54. *Id.* at 942–43.

charged the defendant with mail fraud—as opposed to a prosecution for violating provisions of a franchise law. Thus, the testimony did not instruct the jury on the meaning of the law underlying the charges and only served to prove the defendant's intent. The recognition of franchise regulations as unique, however, reinforces the point that an expert in the industry may offer testimony that helps the finder of fact reach the right result in a case involving franchising.

3. Testimony on Financial Issues

Courts may admit the testimony of a franchise expert—either an attorney or non-attorney—to explain how franchised business make specific financial calculations. To increase the likelihood that financial expert testimony will be permitted, the proponent will need to demonstrate that the case involves a unique issue regarding the financial accounting or profitability of a franchised business. For example, in *City of Allen, Texas v. Time Warner Cable Texas, LLC*, a federal district court in Texas permitted the plaintiffs' non-attorney franchise expert to testify about the defendant's methodology for calculating its gross revenue, including how it resulted in an underpayment of franchise fees under the Texas Public Utility Regulatory Act (PURA).⁵⁵ While the court allowed the testimony regarding the financial methodology, the court indicated that it would not allow the expert to opine on whether the defendant complied with PURA. The court reasoned that, because the expert's report

merely shows how Defendant calculated its gross revenue and how this resulted in an underpayment . . . [the expert] has not—and cannot—offer an opinion on whether Defendant violated or was noncompliant with Chapter 66 of PURA. . . . To the extent that she does, the testimony would be inadmissible.⁵⁶

In *Hetrick v. Ideal Damage Development Corp.*, the United States District Court for the Middle District of Florida permitted a franchisor to introduce the expert testimony of a franchise consultant regarding the causation of the franchisee's financial losses.⁵⁷ The franchisee claimed that it would not have entered into its relationship with the franchisor if the franchisor had not made misrepresentations to the franchisee regarding the success of other outlets or the potential of the Atlanta market.⁵⁸ The franchisor offered the testimony of a franchise consultant to testify regarding his opinion that the franchisor did not cause the franchisee's damages.⁵⁹ The franchisee challenged the expert on multiple grounds, none of which was successful.⁶⁰ The court found the expert's methodology reliable because the expert testified

55. *City of Allen, Tex. v. Time Warner Cable Tex., LLC*, No. 6:19-CV-345-ADA-JCM, 2021 WL 8442040, at *5–6 (W.D. Tex. Oct. 5, 2021).

56. *Id.* at *4.

57. *Hetrick v. Ideal Image Dev. Corp.*, No. 8:07-CV-871-T-33TBM, 2011 WL 672344 (M.D. Fla. Feb. 17, 2011).

58. *Id.* at *1.

59. *Id.* at *2.

60. *Id.* at *2–4.

that the information he relied upon—company financial records and point of sale system data—was the type of data he had typically relied upon in his work as a franchise consultant for the previous twenty years.⁶¹ The court also found that the “franchise industry” was an appropriate subject for expert testimony and that the proffered testimony would assist the trier of fact in assessing the cause of the franchisee’s financial losses.⁶²

Franchise cases often involve financial issues that are industry specific and beyond the ability of an ordinary accountant. Courts have expressed a willingness to allow franchise expert testimony in those cases where knowledge of the industry, combined with financial expertise, would assist the jury in understanding the issues in dispute.

4. Expert Testimony Based upon a Method, Practice, or Analysis Unique to a Franchise Industry

In the case in which a franchising expert utilizes technology or analytical methods that may be characterized as specific to a franchised industry, the expert is likely to be permitted to testify so long as the testimony satisfies the *Daubert* standards related to reliability. For example, in *GPI-AL v. Nissan North America*, a federal district court in Alabama considered the admissibility of an expert opinion on “dealer network analysis” in a case in which a Nissan dealership sued Nissan for its decision to allow a new dealership to open near the plaintiff’s dealership.⁶³ Nissan offered the testimony of its expert to establish that its decision to offer a new dealership was based on considerations related to market penetration in the relevant market and not a consideration prohibited by the franchise relationship. The dealer moved to exclude the testimony as unreliable, but, in a detailed opinion addressing the merits of the plaintiff’s objections, the district court denied the challenge. The court found that the expert, “using his decades of experience and judgment,” properly collected and analyzed data relating to the sales of Nissan cars in the geographic market to conclude that Nissan did not have sufficient market penetration in the market and that a “reasonable solution” was to open a new dealership.⁶⁴ While the plaintiff had criticized the expert’s methods as lacking an objective standard, the court rejected the argument, holding that the federal courts routinely admit testimony that is not “drawn from quantifiable, objective, singular data points, so long as their methods are reliable.”⁶⁵

It is unclear whether an argument that the analysis offered an improper legal conclusion would have had better success, but it is undeniable that, where an expert’s testimony is based upon unique methodologies, a court

61. *Id.*

62. *Id.* at *4.

63. *GPI-AL, Inc. v. Nissan N. Am., Inc.*, 2019 WL 5269100, at *1–2 (S.D. Ala. Oct. 17, 2019).

64. *Id.* at *7.

65. *Id.*

is more likely to find that it is “helpful” for the fact finder to consider it as something outside their every-day understanding and experience.

B. *The Exclusion of Expert Testimony on Franchising*

While it is clear that testimony on franchising may be admissible in a franchise dispute, there is no guarantee of admissibility; many courts have excluded expert testimony that fails to satisfy the three *Daubert* prongs of “reliability, qualifications, and fit.”⁶⁶ When courts strike such testimony, they frequently do so on the ground that the expert is offering an inadmissible legal conclusion. In these cases, the court will characterize the proffered testimony as testimony regarding a legal issue such as whether a party acted in “good faith” or is liable for a breach of a legal duty. Improper opinion testimony is viewed as unfit for the case, i.e., that the expert opinion is irrelevant to the case and unhelpful to the trier of fact and therefore does not satisfy the “fit” factor set forth in *Daubert*.⁶⁷

In *W.O. Burgers 1, LLC v. Watsonburger of Oklahoma*, the franchisee sought to introduce testimony of a franchise lawyer on the definition of a franchise under the FTC Rule.⁶⁸ The trial court excluded the testimony because it did not aid the jury as the court had already given the jury an instruction with the same information.⁶⁹ The Texas Court of Appeals affirmed the exclusion order noting that “[m]erely because a witness has knowledge, skill, expertise, or training does not necessarily mean that the witness can assist the trier of fact.”⁷⁰

Similarly, in *Palazzetti Import/Export, Inc. v. Morson*, the testimony of a franchise lawyer on franchise law issues was excluded despite the witness’s acknowledged expertise.⁷¹ In *Palazzetti*, the plaintiff, who had entered into a licensing arrangement permitting it to use the defendant’s brand name for furniture stores in Boston, sued the licensee.⁷² The licensee asserted as a defense that the agreement was a franchise agreement subject to rescission because the plaintiff had not made the required disclosures under New York’s franchise law.⁷³ To address this defense, the plaintiff offered the testimony of a lawyer that had participated in drafting New York’s franchise law. The expert sought to provide testimony regarding the elements of a franchise agreement and the absence of such elements in this case.⁷⁴ The expert

66. *Ocean City Express Co., Inc. v. Atlas Van Lines, Inc.*, 194 F. Supp. 3d 314, 326 (D.N.J. 2016).

67. *Schneider ex. rel. Estate of Schneider*, 320 F.3d 396, 404 (3d Cir. 2003).

68. *W.O. Burgers 1, LLC v. Watsonburger of Okla., Inc.*, No. 05-09-00397-CV, 2011 WL 989051 (Tex. App. Mar. 22, 2011).

69. *Id.* at *2.

70. *Id.*

71. *Palazzetti Import/Export, Inc. v. Morson*, No. 98 CIV 722(FM), 2001 WL 793322, at *1 (S.D.N.Y. July 13, 2001).

72. *Id.*

73. *Id.*

74. *Id.* at *3.

also proposed to provide testimony on industry custom in franchising.⁷⁵ While the trial court agreed that the witness was “unquestionably an expert in franchise law,” it excluded the testimony.⁷⁶ The trial court found most of the testimony unhelpful to aiding the jury because it held that an average juror could understand the elements of a franchise agreement.⁷⁷ The court also ruled that the proposed testimony on industry custom was irrelevant because industry custom was not an element of New York’s franchise law.⁷⁸

In *Lift Truck Lease and Service v. Nissan Forklift Corp.*,⁷⁹ the court excluded a distributor’s expert testimony on custom and practice in the forklift industry because it was irrelevant in determining whether a manufacturer had “good cause” to terminate a dealer under the Missouri Power Equipment Act.⁸⁰ The court found that manufacturers had no obligation to conform their terminations to “industry custom and practice” under the law, so the testimony would not help the jury decide the case.⁸¹

In *Traummann v. Southland Corp.*, the plaintiffs offered a declaration by their expert witness, a franchise attorney, to oppose the franchisor defendant’s motion for summary judgment.⁸² The district court granted the motion and excluded the expert’s declaration.⁸³ The court explained that the expert’s opinions regarding California franchise laws and their application to this case were not a proper subject for expert testimony because they did not help determine the facts at issue.⁸⁴ The court held that expert testimony must embrace factual issues and may not include legal opinions or conclusions.⁸⁵ The court found that while Federal Rule of Evidence 704 allows opinion testimony as to an ultimate issue, testimony consisting of legal conclusions or opinions is not admissible.⁸⁶

In *Gabana v. Gap*, a clothing store offered testimony on the “types of business procedures and techniques that are customarily observed in franchising and distributorships.”⁸⁷ The plaintiff, who alleged it was a franchisee, objected to the report as an improper legal conclusion and irrelevant.⁸⁸ The court reached its own conclusions on the disputed issues without relying upon the proffered expert testimony.⁸⁹

75. *Id.*

76. *Id.* at *1–2.

77. *Id.* at *3.

78. *Id.* at *2–3.

79. *Lift Truck Lease & Serv., Inc. v. Nissan Forklift Corp.*, No. 4:12-CV-153 CAS, 2013 WL 3154012, at *8 (E.D. Mo. June 21, 2013).

80. Mo. REV. STAT. ANN. § 407.753

81. *Lift Truck Lease*, 2013 WL 3154012, at *7–8.

82. *Traummann v. Southland Corp.* 858 F. Supp. 979, 985 (N.D. Cal. 1994).

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.*

87. *Gabana Gulf Distrib., Ltd. v. GAP Int’l Sales, Inc.*, No. C 06-02584 CRB, 2008 WL 111223, at *12 (N.D. Cal. Jan. 9, 2008), *aff’d*, 343 F. App’x 258 (9th Cir. 2009).

88. *Id.*

89. *Id.*

In *JOC Inc. v. ExxonMobil Oil Corp.*, a federal district court granted summary judgment for the defendant franchisor, Exxon.⁹⁰ The court held that the opinion of the franchisee plaintiff's expert on whether Exxon charged the plaintiff "unfair" or "commercially reasonable" prices was an impermissible legal conclusion, which the court disregarded.⁹¹

It is not evident whether the approaches of the lawyers or experts in these cases differed dramatically from cases in which the court decided to admit testimony on industry practice. The clearest conclusion to draw from these cases is that any party seeking the admission of testimony on franchising must scrupulously avoid appearing to offer mere legal conclusions as opposed to helpful information about the unique customs, practices, and relationships in the franchise industry or that give rise to franchise relationships. Such testimony may be admitted—even if offered by a lawyer or about the meaning of a franchise law—if the Court determines that it is helpful to deciding the case.

C. Legal Opinions Admitted in Cases in Other Industries: Lessons for the Franchise Industry

When attorneys testify as experts, there is a fine line between admissible opinion on a legal issue and giving the fact finder a conclusory (and inadmissible) legal opinion. The basis for this distinction is that "testimony on the ultimate factual questions aids the jury in reaching a verdict; testimony which articulates and applies the relevant law, however, circumvents the jury's decision-making function by telling it how to decide the case."⁹² Cases addressing the admissibility of expert testimony in other specialized industries shed light on a best-practices approach to introducing testimony from experts in franchising—especially franchise lawyers.

Courts often utilize attorney experts to opine on the issue of reasonable attorney's fees and the value of legal services provided.⁹³ Courts also turn to attorney expert witnesses to testify regarding legal ethics.⁹⁴ In most legal malpractice cases, "expert testimony is necessary to establish the standard of care since only an attorney can competently testify to whether the defendant comported to the prevailing legal standard."⁹⁵ In these cases, courts

90. *JOC Inc. v. ExxonMobil Oil Corp.*, No. CV 08-5344 (SRC), 2013 WL 12159044 (D.N.J. Jan. 22, 2013).

91. *Id.* at *9.

92. *Specht v. Jensen*, 853 F.2d 805, 808 (10th Cir. 1988).

93. *See, e.g., United States v. Oaks, Ltd.*, 798 F.2d 1417 (6th Cir. 1986) (attorney expert witness testifying that the average fee for time involved was appropriate although it represented a "premium"); *cf. Travieso v. Travieso*, 474 So. 2d 1184, 1186 (Fla. 1985) ("Generally, lawyers are willing to testify gratuitously for other lawyers on the issue of reasonable attorney's fees. This traditionally has been a matter of professional courtesy.").

94. *See, e.g., Herrick Co. v. Vetta Sports, Inc.*, No. 94 CIV. 0905 (RPP), 19098 WL 637468, at *2 (S.D.N.Y. Sept. 17, 1998) ("Where an attorney is called as an expert to testify regarding legal ethics, . . . it can reasonably be forecast that the expert's opinion will be accorded great weight by the jury, who are unfamiliar with the rules of professional responsibility.").

95. *Geiserman v. MacDonald*, 893 F.2d 787, 793 (5th Cir. 1990) (internal citations omitted); *Marx & Co., Inc. v. Diners' Club Inc.*, 550 F.2d 505, 512 (2d Cir. 1977) ("In the securities law field, as in taxation, there are areas in which the expert can testify.").

will generally admit attorney expert testimony when the expert is explaining a law or statute to the jury, but will exclude the testimony if the attorney expert goes too far and tells the fact finder how to apply the law.⁹⁶

For example, in *MCC Management of Naples, Inc. v. International Bancshares Corp.*, the Tenth Circuit upheld the admission of the testimony of an attorney expert witness in which he discussed “common methodology” that tax lawyers use to interpret the type of agreement that was at issue in the case.⁹⁷ The expert had not played any role in the negotiating or drafting of the subject agreement, and the Tenth Circuit held that his testimony was proper “if the expert does not attempt to define the legal parameters within which the jury must exercise its fact-finding function.”⁹⁸ The expert testified as to three possible interpretations of the subject agreement and the implications of each interpretation.⁹⁹ Nevertheless, the expert told the jury, “you need to bring your own sort of reasons and based upon all of the testimony you have here as to how broad or how narrow you want to interpret [the disputed phrase].”¹⁰⁰ The Circuit Court found that the expert’s testimony was helpful to a lay jury because “intricate arrangement and technical tax jargon were illuminated by his experience with FDIC-bank agreements and knowledge of industry custom, tax law, and authorities in the field.”¹⁰¹ The important distinction in this case is that the expert explained the nuances of tax law generally, but explicitly left the decision of the ultimate issue to the trier of fact.

Like cases involving expert testimony on franchising, a number of cases exclude expert testimony related to specialized or complex industries where the court finds that the expert offers mere legal conclusions. And, like the franchise cases, the results reflect the fact that the line between improper opinion and admissible testimony is unclear. In *Berkeley Investment Group, Ltd. v. Colkitt*, a securities dispute, the Third Circuit held that an expert witness could testify as to the customs and business practices within the

96. See, e.g., *Specht*, 853 F.2d at 808 (“While testimony on ultimate facts is authorized under Rule 704, the committee’s comments emphasize that testimony on ultimate questions of law is not favored.”); *United States v. Curtis* 782 F.2d 593, 599 (6th Cir. 1986) (“Experts are supposed to interpret and analyze factual evidence. They do not testify about the law because the judge’s special legal knowledge is presumed to be sufficient, and it is the judge’s duty to inform the jury about the law that is relevant to their deliberations.”); *Marx & Co., Inc.*, 550 F.2d at 505.

97. *MCC Mgmt. of Naples, Inc. v. Int’l Bancshares Corp.*, 468 F. App’x 816, 821 (10th Cir. 2012).

98. *Id.*

99. *Id.* at 821–22.

100. *Id.* at 822.

101. *Id.*; see also *Smith v. Ingersoll-Rand Co.*, 214 F.3d 1235, 1246 (10th Cir. 2000) (“[The expert] did no more than explain his interpretation of the meaning of hedonic damages and offer four broad areas of human experience which he would consider in determining those damages.” Importantly, the expert “did not apply the facts of the case to the criteria he proffered to the jury”); *Wright v. Liberty Mut. Fire Ins. Co.*, No. 06-CV-351-RJC-KLM, 2009 WL 3077964, at *4 (D. Colo. Sept. 23, 2009) (holding the expert “may not instruct the jury on the proper standards to be followed by medical providers, he may explain his view of Defendant’s conduct based upon his familiarity with industry practices. Therefore, the Court will permit him to express the opinion that Defendant’s conduct was reasonable because it followed the provisions of the CMTG.”).

securities industry.¹⁰² However, the court held that the expert could not opine “as to whether Berkeley complied with legal duties that arose under the federal securities laws” because such testimony would be an impermissible legal conclusion that should be left up to the trier of fact.¹⁰³

Similarly, in *Commodores Entertainment Corp. v. McClary*, the court held that a lawyer expert’s opinion strayed too far into the prohibited realm of legal conclusions.¹⁰⁴ In *Commodores Entertainment*, a trademark dispute over the ownership of the mark “The Commodores” that took place several decades after one of the members left the group, the Eleventh Circuit affirmed the exclusion of a testimony from a trademark attorney whom the defendant wanted to call as an expert.¹⁰⁵ The court reasoned that the expert’s report was “replete with legal opinion” because the expert opined that the defendant had an ownership interest in the disputed trademark, “that a hiatus from a band is not enough to relinquish ownership in the band,” and that a trademark owner can continue to exploit the trademark even after they have severed their relationship with the band.¹⁰⁶ The court held that such opinions were legal conclusions and thus were not an appropriate topic for expert testimony.¹⁰⁷

Similarly, in *Hyland v. HomeServices of America, Inc.*, a real estate antitrust matter, the Sixth Circuit affirmed the district court’s decision to limit the testimony of plaintiff’s expert witnesses.¹⁰⁸ The expert testimony at issue included opinions that a price fixing conspiracy existed, which was the ultimate issue in the case.¹⁰⁹ “Given that the experts were free to testify at length as to all the other aspect of the real estate market, the exclusion of the challenged testimony, which called for a legal conclusion, is within the purview of the district court.”¹¹⁰

IV. How to Use Franchise Industry Experts to Educate the Trier of Fact

Parties in franchise disputes have had varying success in introducing expert witnesses. In determining whether to retain a franchise expert, counsel should carefully review the law in their jurisdiction and consider the facts and issues in dispute. Before retaining an expert, counsel needs to vet the expert’s qualifications, determine whether the expert’s opinion will assist the trier of fact, whether it involves an improper opinion or legal conclusion, and whether the proposed testimony will satisfy the *Daubert* test. It is equally as important to be aware of the types of expert testimony judges have admitted

102. *Berkeley Inv. Group, Ltd. v. Colkitt*, 455 F.3d 195 (3d Cir. 2006).

103. *Id.* at 218.

104. *Commodores Entm’t Corp. v. McClary*, 879 F.3d 1114 (11th Cir. 2018).

105. *Id.*

106. *Id.* at 1129.

107. *Id.*

108. *Hyland v. HomeServices of Am., Inc.*, 771 F.3d 310 (6th Cir. 2014).

109. *Id.* at 322.

110. *Id.*

in franchise disputes and, conversely, some of the common pitfalls experienced by franchise expert witnesses.

A. *Selecting Experts*

When selecting an expert, there are the obvious considerations, such as the expert's qualifications, but it is important to keep in mind the less evident factors that are equally important to take into account.

For example, the expert's prior history as an expert witness is especially important to consider. If the expert has ever been subject to a *Daubert* (or similar) challenge, determine whether the court ultimately excluded the expert's testimony. This would be a red flag if the expert's testimony was excluded in a prior case because the expert lacked qualifications. At a minimum, practitioners should do an Internet search of the expert's name to make sure nothing negative is revealed—opposing counsel will certainly do this, and it will avoid unpleasant surprises at deposition or trial.

Another consideration is the expert's prior performance when challenged in depositions and when cross-examined by opposing counsel at trial. The court's receptiveness of the expert can be important as well, especially if previous trial judges have been critical of the expert. Also, consider whether the expert derives a large portion of their annual compensation by testifying as an expert witness and, if so, if they testify exclusively for one side (franchisor vs. franchisee) as this could make the expert more or less credible to the trier of fact. Finally, the expert's mannerisms, vocabulary, and way of speaking are important as well if selecting a testifying expert.

In some instances, if the methodology and qualifications of an expert are stellar, but the expert is not well equipped to provide testimony, it may still be worth retaining the person as a non-testifying expert or consultant. Non-testifying experts neither need to submit a written report, nor are they subject to cross-examination. Generally, a party does not have to identify non-testifying experts to the other side or turn over any communications or work product.

Non-testifying experts should be selected on the basis of their relevant qualifications and their ability to help with analysis and strategy, the cross-examination of the opposing party's expert, and providing additional assistance to the testifying expert. It should be kept in mind that if one expert bases their testimony on the statistics or methodology of another, and that testimony is found to be unreliable, likely the testimony from both experts will be excluded.¹¹¹

B. *Successful Utilization of Franchise Industry Expert Witness*

Franchise experts have provided admissible expert witness testimony regarding franchise industry-specific standards.¹¹² For example, experts have opined

111. See, e.g., *Mercedes-Benz USA, Inc. v. Coast Auto. Grp., Ltd.*, 362 F. App'x 332 (3d Cir. 2010) (excluding both experts' testimony because the first expert's testimony did not pass the reliability prong of the *Daubert* test, and the second expert's testimony was based on the first expert's report).

112. See *supra* Section III.

on auto industry standards,¹¹³ hotel licensing and management agreements,¹¹⁴ and the Petroleum Marketing Practices Act.¹¹⁵ Franchise law experts have also opined on the impact of the enforcement of a franchise agreement,¹¹⁶ the duties of franchisors and franchisees,¹¹⁷ the impact on a franchisee when a change in the franchise relationship occurs,¹¹⁸ and the value of a franchise brand.¹¹⁹ Franchise attorneys are used as expert witnesses when testifying as to the calculation of damages, for example, lost profits.¹²⁰

C. Avoiding Exclusion of Testimony as a Legal Conclusion

Advocates seeking to submit testimony on franchising can improve the chances that the expert's testimony will be admitted into evidence by keeping in mind several lessons from prior cases in franchising and other industries. Characterizing testimony as relevant to ambiguities in the parties' relationship may avoid the court viewing the testimony as mere legal conclusions, even if the testimony necessarily informs and relies upon the expert's understanding of franchise laws. Similarly, arguments about admissibility should be framed by emphasizing the esoteric issues inherent in the franchise industry or by pointing out the unique methods utilized in the expert's analysis.

Testimony from franchise experts need not avoid any mention of the franchise laws. To the contrary, because the nuances of franchise relationships arise out of the laws, any good franchise expert should have a grasp of the meaning and purpose of the franchise laws relevant to the case (or the issue upon which they will testify), and testimony about the law may be necessary to educate the fact finder in the case. Advocates can make a compelling case to admit such testimony when their experts carefully avoid phrasing their opinions as conclusions about liability or how a legal rule in franchising "should" be viewed by the jury and focus instead on why the testimony helps the fact finder apply the franchise laws to the facts of the case.

In the end, it is better for all involved in franchise disputes to have experts in franchising who can explain to the uninitiated why something like site location assistance may or may not be important to a franchisee. Obtaining the correct result in any case turns on whether the fact finder understands the nuances of the issues. In a unique industry like franchising, expert testimony from a franchising expert may be the only way to accomplish this goal.

113. AMCO Transmissions, Inc. v. Baker, No. CIV. A. 06-CV-05252, 2008 WL 5245768 (E.D. Pa. Dec. 16, 2008).

114. Atmosphere Hosp. Mgmt., LLC v. Shiba Invs., Inc., No. 5:13-CV-05040-KES, 2016 WL 379639 (D.S.D. Jan. 29, 2016).

115. Akshayraj, Inc. v. Getty Petroleum Mktg., Civil Action No. 06-2002 (NLH), 2007 WL 4554212 (D.N.J. Dec. 20, 2007).

116. Big O Tires, LLC v. Felix Bros., Inc., 724 F. Supp. 2d 1107 (D. Colo. 2010).

117. Fransmart, LLC v. Freshii Dev., LLC, 768 F. Supp. 2d 851 (E.D. Va. 2001).

118. Gen. Motors Corp. v. State Motorcycle Rev. Bd., 862 N.E.2d 209 (Ill. 2007).

119. Equitable Life Assur. Soc. of United States/Marriott Hotels, Inc. v. State Tax Comm'n of Missouri, 852 S.W.2d 376 (Mo. Ct. App. 1993).

120. See, e.g., Progressive Child Care Sys., Inc. v. Kids 'R' Kids Int'l, Inc., No. 2-07-127-CV, 2008 WL 4831339 (Tex. App. Nov. 6, 2008).



An Overview of the Franchise Advertising Rules and New Forms of Advertisements

Cindy Kaneko*

I. Introduction

False advertising claims have always been a common claim among businesses, but are poised to become even more prevalent as businesses increasingly use creative advertising in a new media landscape to capture the audience's attention. A fundamental component of marketing strategies is now digital advertising, which must follow traditional advertising regulations. While a viral post on Instagram could lead to millions of viral impressions, that same post could lead to potential liability. Further, a franchisor could even be held vicariously liable for advertisements posted by its franchisees.¹ In one case, a franchisor was ordered to pay civil penalties of \$753,199 for advertisements that it approved and an additional \$50,000 for unapproved advertisements by its franchisees.²



Ms. Kaneko

Franchise advertising generally is heavily regulated under federal and state laws. What is more, certain states prohibit a franchisor from publishing advertisements marketing the sale of franchises unless it is approved by a state agency. This article provides an overview of the advertising laws applicable to the franchise community. Section II discusses laws of general applicability about false advertising and about the sale of franchises. Section III details the state regulations governing the approval of advertisement about the sale of franchises, as compliance with these regulatory steps is crucial to avoiding creating unnecessary regulatory issues. And Section IV examines overlooked advertising regulations for endorsements and sweepstakes. The article also discusses new forms of advertisements, including the metaverse, a certain social media platform, and digital audio advertisement.

1. See *People v. JTH Tax, Inc.*, 151 Cal. Rptr. 3d 728, 734–35 (Ct. App. 2013).

2. *Id.* at 735.

**Cindy Kaneko (cindy.kaneko@bclplaw.com) is an associate in the Santa Monica, California, office of Bryan Cave Leighton Paisner LLP.*

II. False Advertising Laws

A. Federal Law

Regardless of content, all advertising must comply with federal and state laws that prohibit false, deceptive, or unfair advertising. While certain industries are subject to additional regulation,³ two federal laws regulate unfair and deceptive advertising generally. Those laws are Section 5 of the Federal Trade Commission Act⁴ and Section 43(a) of the Lanham Act.⁵

1. The Federal Trade Commission Act and the Franchise Rule

The Federal Trade Commission Act of 1914 (FTC Act) created the Federal Trade Commission (FTC) to protect consumers and oversee enforcement of false, deceptive, or unfair advertising laws.⁶ Section 5(a) of the FTC Act declares that “[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.”⁷ Under the FTC Act, advertising is considered “unfair” if it causes or is likely to cause substantial injury to consumers; consumers cannot reasonably avoid the injury; and the injury is not outweighed by countervailing benefits to consumers or to competition.⁸ Advertising is considered “deceptive” if there is a representation, omission or practice that is likely to mislead the consumer acting reasonably under the circumstances, and the representation, omission, or practice is “material,” meaning that it is likely to affect the consumer’s decision-making with respect to the advertised product or service.⁹ Accordingly, the FTC Act prohibits material misrepresentations about any business opportunity, including franchises.¹⁰

One of the regulations that the FTC has passed under its general rule-making authority under Section 5 of the FTC Act is the Franchise Rule. Franchise lawyers are familiar with the FTC Franchise Rule, which provides prospective purchasers of a franchise the material information needed in order to weigh the costs and benefits of investing in a franchise.¹¹ Under the Franchise Rule, a franchisor must provide to all potential franchisees a disclosure document that contains twenty-three specific items of information about the offered franchise.¹² With respect to its advertising program,

3. See, e.g., 15 U.S.C. § 45a (labels on products).

4. 15 U.S.C. § 45.

5. 15 U.S.C. § 1125.

6. FEDERAL TRADE COMMISSION, About the FTC, <https://www.ftc.gov/about-ftc>.

7. 15 U.S.C. § 45(a)(1).

8. *Id.* § 45(n).

9. FEDERAL TRADE COMMISSION, ENFORCEMENT POLICY STATEMENT ON DECEPTIVELY FORMATTED ADVERTISEMENTS 1 (2015), https://www.ftc.gov/system/files/documents/public_statements/896923/151222deceptiveenforcement.pdf.

10. See Press Release, Federal Trade Commission, FTC Sues Burger Franchise Company That Targets Veterans and Others with False Promises and Misleading Documents (Feb. 8, 2022), <https://www.ftc.gov/news-events/news/press-releases/2022/02/ftc-sues-burger-franchise-company-targets-veterans-others-false-promises-misleading-documents>.

11. See FTC Franchise Rule, 16 C.F.R. § 436.

12. *Id.* § 436.5.

the franchisor must describe the following: the franchisor's obligation to conduct advertising; the circumstances when the franchisor will permit the franchisees to use their own advertising material; whether there is an advertising council composed of franchisees that advises the franchisor on advertising policies; whether the franchisee must participate in a local or regional advertising cooperative; whether the franchisee must participate in any other advertising fund; if not all advertising funds are spent in the fiscal year in which they accrue, how the franchisor uses the remaining amount, including whether the franchisees receive a periodic accounting of how advertising fees are spent; and the percentage of the advertising funds, if any, that the franchisor uses principally to solicit new franchise sales.¹³

The FTC Act and the Franchise Rule do not create a private right of action. Instead, the FTC holds franchisors accountable by taking enforcement actions against those which violate these laws.¹⁴ FTC enforcement of the general advertising rule is common and can impact even well-known and established brands or companies. For example, in 1997, Ashland, a division of Valvoline, settled a lawsuit brought by the FTC for false and unsubstantiated ads about its "TM8 Engine Treatment" product.¹⁵ As part of the settlement, Ashland was prohibited from making any claims about the performance or attributes of any engine treatment "unless it possesses and relies upon competent and reliable evidence to support the claims."¹⁶

FTC enforcement of the Franchise Rule has been more sporadic, but the FTC has become more active in taking enforcement actions based on the Franchise Rule. In February 2022, the FTC sued Burgerim, a fast-food chain, after it attracted more than 1,500 people to purchase franchises by using false promises and withholding information required under the Franchise Rule.¹⁷ In the complaint, the FTC alleged that Burgerim and its owner recruited potential franchisees "by pitching the opportunity as 'a business in a box,' that required little to no business experience, downplaying the complexity of owning and operating a restaurant."¹⁸ The FTC further alleged that Burgerim pocketed millions of dollars, but the majority of the franchisees were unable to open the restaurants.¹⁹ Under the Franchise Rule, each violation carries a potential civil penalty of up to \$46,517.²⁰

13. *Id.* § 436.5(k)(4).

14. *Id.* § 436.5(k)(4).

15. See Press Release, Federal Trade Commission, Valvoline Settles Charges (Oct. 8, 1997), <https://www.ftc.gov/news-events/news/press-releases/1997/10/valvoline-settles-charges>.

16. *Id.*

17. See Press Release, Federal Trade Commission, FTC Sues Burger Franchise Company That Targets Veterans and Others with False Promises and Misleading Documents (Feb. 8, 2022), <https://www.ftc.gov/news-events/news/press-releases/2022/02/ftc-sues-burger-franchise-company-targets-veterans-others-false-promises-misleading-documents>.

18. *Id.*

19. *Id.*

20. *Id.*

2. The Lanham Act

Section 43(a) of the Lanham Act establishes a federal cause of action for false or misleading advertising. Unlike the Franchise Rule and the FTC Act, the Lanham Act creates a private right of action for enforcing the law. The Lanham Act provides in pertinent part:

Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which . . .

(B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities, shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.²¹

Accordingly, the Lanham Act prohibits false advertising with respect to one's own goods, services, or commercial activities, as well as false advertising concerning *another's* goods, services, or commercial activities.

Claims under the Lanham Act are frequently brought by businesses, rather than consumers themselves,²² and lawsuits under the Lanham Act can become contentious. To bring a claim for false advertising under the Lanham Act, the plaintiff must establish the following elements: a false or misleading statement of fact about a product; a statement that either deceived, or had the capacity to deceive a substantial segment of potential consumers; a material deception in that it was likely to influence the consumer's purchasing decision; the product is in interstate commerce; and an injury or likely injury to the plaintiff as a result of the statement at issue.²³ If the statement is misleading, then the plaintiff must also introduce evidence of the statement's impact on consumers, referred to as "materiality."²⁴

Monetary and equitable remedies are available under the Lanham Act.²⁵ The monetary relief available to the plaintiff includes the defendant's profits, any damages sustained by the plaintiff, and the costs of the action.²⁶ Injunctive relief is also available to prevent a violation of any right of the registered mark or to prevent a violation of the Lanham Act.²⁷

21. 15 U.S.C. § 1125(a).

22. See, e.g., *Jack Russell Terrier Network of N. Ca. v. Am. Kennel Club, Inc.*, 407 F.3d 1027, 1037 (9th Cir. 2005) (holding that the appellants lacked standing under the Lanham Act since "[t]he [appellant] is not a competitor of the [appellees] that has suffered a competitive injury"); cf. *Lexmark Int'l, Inc. v. Static Control Components, Inc.*, 572 U.S. 118, 136 (2014) ("By the time the Lanham Act was adopted, the common-law tort of unfair competition was understood not to be limited to actions between competitors. . . . It is thus a mistake to infer that because the Lanham Act treats false advertising as a form of unfair competition, it can protect only the false-advertiser's direct competitors.").

23. *Pizza Hut, Inc. v. Papa John's Int'l, Inc.*, 227 F.3d 489, 495 (5th Cir. 2000).

24. *Id.*

25. 15 U.S.C. § 1117 (monetary relief); 15 U.S.C. § 1116 (injunctive relief).

26. *Id.* § 1117(a).

27. *Id.* § 1116(a).

In the franchising context, claims under the Lanham Act arise when a competitor uses a franchisor's mark. For instance, franchisors often seek injunctive relief under the Lanham Act when a terminated franchisee continues to use the franchisor's trademark.²⁸ Claims under the Lanham Act also arise based on advertisements through Internet search engines. In *Rescuecom Corp. v. Computer Troubleshooters USA, Inc.*, a computer service franchise sued its competitor under the Lanham Act after its competitor purchased keyword-linked advertising so that the defendant's website appeared each time an Internet user performed a Google search of the plaintiff's trademark.²⁹

The Eleventh Circuit has clarified, however, that although the Lanham Act requires a franchisor to control its own trademark, this duty does not subject a franchisor to liability for its franchisee's infringement of another's trademark based upon the franchisor's failure to supervise its franchisee with reasonable diligence.³⁰

B. State Law

Similar to the FTC Act, almost every state has enacted its own "Little FTC Act," which generally prohibits the use of unfair or deceptive conduct in the advertising and sale of goods and services to the public.³¹ These acts, are, in essence, the states' way of making Section 5 of the FTC Act actionable

28. See, e.g., *Dunkin' Donuts Franchised Rests. LLC v. Cardillo Cap., Inc.*, 551 F. Supp. 2d 1333, 1338 (M.D. Fla. 2008) (granting permanent injunction under the Lanham Act after finding that "[the] defendants used the Dunkin' Donuts Marks in commerce after termination of the Franchise Agreements. . . . It is also clear that using the Dunkin' Donuts Marks was likely to have caused confusion among consumers, who wrongly believed defendants to be operating a franchised Dunkin' Donuts shop.").

29. *Rescuecom Corp. v. Computer Troubleshooters USA, Inc.*, 464 F. Supp. 2d 1263, 1264 (N.D. Ga. 2005); see also *Zerorez Franchising Sys., Inc. v. Distinctive Cleaning, Inc.*, 103 F. Supp. 3d 1032, 1039 (D. Minn. 2015) (the franchisee suing its competitor under the Lanham Act based on allegations that "[its competitor] used Google's AdWords advertising service to create and display the allegedly infringing advertisements").

30. *Mini Maid Servs. Co. v. Maid Brigade Sys., Inc.*, 967 F.2d 1516, 1521(11th Cir. 1992). *Mini Maid Services Co. v. Maid Brigade Systems, Inc.* involved a suit between franchisors of competing residential cleaning service businesses stemming from the conduct of the defendant's franchisee. *Id.* at 1517. The franchisee placed advertisements that included the plaintiff's service mark. *Id.* at 1518. Although the district court concluded that the plaintiff could recover the amount of the defendants' profits that resulted from the alleged infringement, the Eleventh Circuit vacated the district court's judgment. *Id.* at 1519. The court reasoned that "although the Lanham Act [] require[s] a franchisor to control its own trademark and to comply with court orders, these duties do not subject a franchisor to liability for a franchisee's infringement of another's trademark based upon the franchisor's failure to supervise its franchisee with 'reasonable diligence.'" *Id.* at 1521. The court noted that a "franchisor might be liable for contributory trademark infringement, even if the franchisor did not itself perform any infringing act." *Id.*

31. See, e.g., MD. CODE ANN., COM. LAW § 13-105 ("It is the intent of the General Assembly that in construing the term 'unfair or deceptive trade practices', due consideration and weight be given to the interpretations of § 5 (a)(1) of the Federal Trade Commission Act by the Federal Trade Commission and the federal courts."); R.I. GEN. LAWS § 6-13.1-3 ("It is the intent of the legislature that . . . great weight shall be given to the interpretations of the Federal Trade Commission and the federal courts relating to § 5(a) of the Federal Trade Commission Act . . ."); WASH. REV. CODE § 19.86.920 ("It is the intent of the legislature that, in construing this act, the courts be guided by final decisions of the federal courts and final orders of the federal trade commission . . .").

in private lawsuits. It is beyond the scope of this paper to detail all of the nuances and variations between each of these statutes as they relate to standards of proof, available remedies, and prerequisites.³² However, any person—franchisor or otherwise—who engages in public facing advertisements should understand the scope of the Little FTC Acts, especially those applicable in its home state and where it has large customer bases.

States such as California, Minnesota, North Dakota, South Dakota, and Washington also have provisions in their franchising laws that broadly prohibit any advertisement “concerning *any franchise*” that contains any statement that is false, misleading, or omits to make any statement necessary in order to make the statements made not misleading.³³ Certain states have more narrow statutes that prohibit franchises from publishing advertisements that contains false or misleading information as it relates to representations specifically about the sale of franchises. For example, Michigan prohibits any advertisement “concerning *the offer or sale of a franchise*” if it contains a statement that is false, misleading, or omits to make any statement necessary in order to make the statements made not misleading.³⁴ Furthermore, in Wisconsin, a franchisor cannot offer or sell a franchise through any communication that “includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made . . . not misleading.”³⁵

C. False Advertising Claims Against Franchisors

Lawsuits between competitor brands are common as companies push the envelope with their advertising. For example, in 2019, MillerCoors filed a false advertising claim against Anheuser-Busch Companies, LLC (AB), the seller of Bud Light beer, for television commercials that aired during the Super Bowl and the Oscars.³⁶ MillerCoors claimed that AB’s commercials

32. See, e.g., Lenore Albert & Michael Thurma, *Unfair and Deceptive Practices: A Comparison of the FTC Act and California’s UCL*, 22 COMPETITION: J. ANTITRUST & UNFAIR COMP. L. 51 (2013); Bethany L. Appleby, Robert S. Burstein & John M. Doroghazi, *Cause of Action Alcemy: Little FTC Act Claims Based on Alleged Disclosure Violations*, 36 FRANCHISE L.J. 429 (2017).

33. CAL. CORP. CODE § 31157 (“No person shall publish any advertisement concerning any franchise in this state after the commissioner finds that the advertisement contains any statement that is false or misleading . . .”); MINN. STAT. § 80C.09 (“No person shall publish or cause to be published in this state any advertisement concerning any franchise after the commissioner has found that the advertisement contains any statement that is false or misleading . . .”); N.D. CENT. CODE § 51-19-10 (“No person may publish any advertisement concerning any franchise in this state after the commissioner finds that the advertisement contains any statement that is false or misleading . . .”); S.D. CODIFIED LAWS §37-5B-23 (“No person may publish or cause to be published in this state any advertisement concerning any franchise after the director has found that the advertisement contains any statement that is false or misleading . . .”); WASH. REV. CODE § 19.100.110 (“No person shall publish in this state any advertisement concerning a franchise . . . after the director finds that the advertisement contains any statements that are false or misleading . . .”).

34. MICH. COMP. LAWS § 445.1525.

35. WIS. STAT. § 553.41.

36. Complaint ¶¶ 1, 66–70, *MillerCoors, LLC v. Anheuser-Busch Cos., LLC*, 2019 WL 3992334 (W.D. Wis. July 10, 2019).

deceived consumers into believing that they will consume corn syrup if they drink Miller Lite and Coors Light beers.³⁷

Franchises are no exception to these lawsuits. In 2007, Carl's Jr. sought a preliminary injunction based on false advertising claims against Jack in the Box.³⁸ Carl's Jr. alleged that television commercials advertised by Jack in the Box misleadingly implied that its competitors who sold "Angus" hamburgers used an unsavory cut of the beef to make its hamburgers.³⁹ The U.S. District Court for the Central District of California denied the plaintiff's preliminary injunction, reasoning that Carl's Jr. failed to prove that the commercials were misleading because it failed to establish "substantial extrinsic evidence that a significant portion of the commercial audience has been deceived or evidence of Defendant's intent to mislead consumer."⁴⁰

In 2020, a false advertising claim was brought against Burger King after the plaintiffs (customers of the chain) alleged that Burger King misled them into believing that its plant-based patty would be flame broiled on a different grill than the one used to cook beef and chicken.⁴¹ The U.S. District Court for the Southern District of Florida dismissed the lawsuit and rejected the plaintiffs' argument that the advertisement promised more than a non-meat patty.⁴² Two years later, another lawsuit was filed against Burger King alleging that its advertisements overstated the size of certain menu items.⁴³

Furthermore, in 2022, the U.S. District Court for the Central District of California allowed the plaintiffs' false advertising claim against the franchisor of Subway restaurants and its franchisee advertising trust fund to move forward.⁴⁴ The lawsuit claimed that advertisements saying that Subway food products are made with "100% tuna" is false and misleading.⁴⁵

Even a simple four-word slogan in an advertising campaign can lead to a false advertisement claim. In *Pizza Hut, Inc. v. Papa John's Int'l, Inc.*, Pizza Hut filed a false advertising claim under the Lanham Act for Papa John's slogan "Better Ingredients. Better Pizza."⁴⁶ Pizza Hut claimed that the slogan was a false statement of fact when viewed in the context of Papa John's overall advertising campaign.⁴⁷ The Fifth Circuit held that the slogan was not actionable under the Lanham Act because, standing alone, it was not an

37. *Id.* ¶ 1.

38. *CKE Rest. v. Jack in the Box, Inc.*, 494 F. Supp. 2d 1139, 1141–42 (C.D. Cal. 2007).

39. *Id.* at 1147.

40. *Id.* at 1144–45 ("Without substantial extrinsic evidence that a significant portion of the commercial audience has been deceived or evidence of Defendant's intent to mislead consumers, Plaintiffs raise at most only serious questions regarding whether they can establish that the statements are false and have a tendency to deceive consumers.").

41. *Williams v. Burger King Corp.*, 2020 WL 5083550, at *1 (S.D. Fla. July 20, 2020), *appeal dismissed*, 2020 WL 8620165 (11th Cir. Sept. 15, 2020).

42. *Williams*, 2020 WL 5083550, at *6.

43. *Coleman v. Burger King Corp.*, Case No. 1:22-cv-20925 (S.D. Fla.) (filed Mar. 28, 2022).

44. Jonathan Stempel, *UPDATE 1-Subway Can Be Sued Over Its Tuna, U.S. Judge Rules*, *REUTERS* (July 11, 2022), <https://www.reuters.com/article/subway-tuna-lawsuit-idAFL1N2YSILZ>.

45. *Id.*

46. *Pizza Hut, Inc. v. Papa John's Int'l, Inc.*, 227 F.3d 489, 491 (5th Cir. 2000).

47. *Id.*

objectifiable statement of fact upon which consumers would be justified in relying.⁴⁸ The court, however, found that the slogan was misleading when it was used with a series comparative advertising, but Pizza Hut failed to adduce any evidence demonstrating that the facts conveyed by the slogan were material to consumers' purchasing decisions.⁴⁹

Courts have also dismissed false advertising claims against franchisors if the damages are highly speculative. For example, from 1995 to 2001, McDonald's advertised promotional games and represented that "all customers had a fair and equal opportunity to win all of the offered prizes, including the cash prizes."⁵⁰ In 2001, the U.S. Department of Justice found that certain of McDonald's promotional games had been compromised by a criminal ring led by an individual employed by the company that McDonald's hired to operate those games.⁵¹ The individual diverted at least twenty million dollars in prizes from the promotional games.⁵² In response, a Burger King franchisee brought a class action suit against McDonald's for false advertising under the Lanham Act.⁵³ The class alleged that McDonald's advertisements that claimed that each player had a fair and equal chance to win the prizes were false because many of the prizes were stolen.⁵⁴ The U.S. District Court for the Northern District of Georgia held that the class lacked prudential standing to assert a false advertising claim, reasoning that any damages would be highly speculative given the number of McDonald's fast food competitors, the difficulty in determining what percentage of the customers would have gone to Burger King but for McDonald's allegedly false advertisements, and the fact that the promotional games took place over a period of several years in many geographic markets throughout the world.⁵⁵

III. State Franchise Advertising Laws

In addition to running afoul of false advertising laws, a franchisor must follow state procedural rules as certain states require that a franchisor's advertisement for the sale of franchises be filed with the state before it is published.

A. California

California requires that a franchisor offering or selling a franchise file its proposed advertising to the office of the commissioner at least three business days before it is first published.⁵⁶ The commissioner will not notify the

48. *Id.*

49. *Id.*

50. *Phoenix of Broward, Inc. v. McDonald's Corp.*, 441 F. Supp. 2d 1241, 1245 (N.D. Ga. 2006), *aff'd*, 489 F.3d 1156 (11th Cir. 2007).

51. *Id.*

52. *Id.*

53. *Id.* at 1246.

54. *Id.*

55. *Id.* at 1251.

56. CAL. CORP. CODE § 31156.

franchisor if the advertisement is approved.⁵⁷ The franchisor will be notified, however, if the commissioner finds that the proposed advertisement is “false or misleading or omits to make any statement necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading and so notifies the person in writing.”⁵⁸ If notified, the franchisor can make a written request that the order be rescinded.⁵⁹ The commissioner will then hold an administrative hearing to grant or deny the request within fifteen business days after receiving the request.⁶⁰

An offer to sell is not made in California merely because (1) the publisher circulates a bona fide newspaper or other publication of general, regular, and paid circulation in California and has had more than two-thirds of its circulation outside of California during the past twelve months; or (2) a radio or television program originating outside of California is received in California.⁶¹

California also requires additional standards for any advertisement of the sale of a franchise. The advertisement cannot contain any statement or inference that the purchase of the franchise is a safe investment or that failure, loss, or default is impossible or unlikely, or that earnings or profits are assured.⁶² Any advertisement referring to the registration of the franchises under California’s Franchise Investment Law must also contain the following statement in capital letters of at least 10-point font:

THESE FRANCHISES HAVE BEEN REGISTERED UNDER THE FRANCHISE INVESTMENT LAW OF THE STATE OF CALIFORNIA. SUCH REGISTRATION DOES NOT CONSTITUTE APPROVAL, RECOMMENDATION OR ENDORSEMENT BY THE COMMISSIONER OF BUSINESS OVERSIGHT NOR A FINDING BY THE COMMISSIONER THAT THE INFORMATION PROVIDED HEREIN IS TRUE, COMPLETE AND NOT MISLEADING.⁶³

The advertisement should also contain both the name and address of the person using the advertisement, and any advertisement that refers to an exemption from or reduction in taxation under any law should be based on an opinion of counsel, and the name of such counsel should be stated in the advertisement.⁶⁴

An offer to sell a franchise is exempt from the filing requirements, however, if the offer or advertisement is made on the Internet. To qualify for the exemption, the Internet offer must comply with the following requirements: (1) an indication, either directly or indirectly, that the franchise is not being offered to the residents of California; (2) the offer cannot be directed to any

57. CAL. CODE REGS. tit. 10, § 310.156.

58. CAL. CORP. CODE § 31157.

59. *Id.* § 31157.

60. *Id.*

61. *Id.* § 31013.

62. CAL. CODE REGS. tit. 10, § 310.156.1(a).

63. *Id.* § 310.156.1(c).

64. *Id.* § 310.156.1(d)–(f).

person in California by or on behalf of the franchisor or anyone acting with the franchisor's knowledge; and (3) no franchises can be sold in California by or on behalf of the franchisor until the offering has been registered under the Franchise Investment Law and declared effective.⁶⁵

For the Internet exemption to apply, the franchisor must (1) file a written verified notice with the commissioner; (2) the notice must include the uniform resource locator (URL) address or similar address or device identifying the location of the Internet advertisement, a statement agreeing to comply with the California Franchise Investment Law when posting on the Internet, and the franchisor's name, address, telephone number, and contact person; (3) the advertisement cannot be directed to any person in California by or on behalf of the franchisor or anyone acting with the franchisor's knowledge; and (4) the notice must contain the following statement, in clear readable type of at least twelve-point size:

OUR WEBSITE HAS NOT BEEN REVIEWED OR APPROVED BY THE CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT. ANY COMPLAINTS CONCERNING THE CONTENT OF THIS WEBSITE MAY BE DIRECTED TO THE CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT at www.dbo.ca.gov.⁶⁶

B. *Illinois*

The Illinois Franchise Disclosure Act prohibits any advertising that contains or refers to an opinion of counsel unless the franchisor obtained the counsel's prior written consent and the name and address of the counsel is included in the advertising.⁶⁷ Illinois also requires that any advertisement that "suggests a range or specific level of sales, income, gross or net profits, or other types of earnings claims must be consistent with the guidelines contained in Item 19 of the [Franchise Disclosure Document]."⁶⁸

Any advertising in connection with the offer or sale of franchises cannot contain a statement that the purchase of a franchise is a safe investment, is free from risk of loss or failure, or an assurance of earnings or profit.⁶⁹ The advertising can use words such as "success," "profits," or "profit potential" if the terms are "reasonably qualified."⁷⁰

C. *Maryland*

In Maryland, a franchisor must submit a copy of any advertisement offering to sell a franchise to the commissioner at least seven business days before it is first published.⁷¹ In addition, a copy of the advertisement offering to sell

65. *Id.* § 310.100.3.

66. *Id.* § 310.156.3.

67. ILL. ADMIN. CODE tit. 14, § 200.302.

68. *Id.* § 200.304.

69. *Id.* § 200.301.

70. *Id.*

71. MD. CODE ANN., BUS. REG. § 14-225.

a franchise must also be submitted to the Maryland Securities Division for review at least five days before it is used.⁷²

An advertisement for a franchise offering must list the name and address of the person sponsoring the advertisement.⁷³ The advertisement, however, cannot refer to the following: (1) that the purchase or sale of the franchise is a safe investment, free from risk of loss or default, or as a guarantee or assurance of earnings or profits; (2) an earnings claim, unless permitted by the commissioner; or (3) an opinion of counsel without stating the name and address of the counsel.⁷⁴ An advertisement in the form of videotapes or audiotapes must be accompanied by a written transcript and a description of the contents.⁷⁵

Maryland offers an exemption to any Internet advertisement of an offer to sell a franchise if (1) the offer indicates, either directly or indirectly, that the franchise is not being offered to a resident of Maryland; (2) the advertisement is not otherwise directed to any person in Maryland; and (3) no franchises are sold in Maryland by or on behalf of the franchisor until the offering has been registered and declared effective.⁷⁶

A franchisor must also maintain a complete set of records of each sale of a franchise, including advertising materials, for a period of five years.⁷⁷ Upon a reasonable request during business hours, the commissioner can examine the advertising materials as it considers necessary or appropriate in the public interest or for the protection of the prospective franchisees.⁷⁸

D. Minnesota

In Minnesota, a franchisor must file a copy of any advertisement that offers to sell a franchise with the commissioner at least five business days before its publication.⁷⁹ The law also prohibits a franchisor from publishing any statement that is false or misleading or that omits to make any statement necessary in order to make the statements made not misleading.⁸⁰

In addition, Minnesota requires that any advertisement that offers a franchise contain the name and address of the person using the advertisement, the name or the primary commercial symbol of the franchisor, and the Minnesota registration number assigned by the commissioner.⁸¹ The advertisement cannot refer to the following: (1) the acquiring of a franchise as an assurance of earnings or profits, as a safe investment, or as free from loss, default, or failure or that such is impossible or unlikely; (2) any projections

72. MD. CODE REGS. 02.02.08.09.

73. *Id.* 02.02.08.09.

74. *Id.* 02.02.08.09.

75. *Id.* 02.02.08.09.

76. *Id.* 02.02.08.18.

77. *Id.* 02.02.08.15.

78. *Id.* 02.02.08.15.

79. MINN. STAT. § 80C.09.

80. *Id.*

81. MINN. R. 2860.4100.

or statements of operations of or income from the operation of any franchise; or (3) any counsel's opinion without stating the name and address of the counsel.⁸²

E. *New York*

In New York, a franchisor must file any advertisement to a prospective franchisee with the Department of Law at least seven days before it is published.⁸³ All advertisements relating to a franchise offering must contain the following statement in easily readable print: "This advertisement is not an offering. An offering can only be made by a prospectus filed first with the Department of Law of the State of New York. Such filing does not constitute approval by the Department of Law."⁸⁴ Moreover, a classified advertisement that is more than five inches long and one column of print wide must contain the following statement: "This offering is made by prospectus only."⁸⁵ The statement must also be made in all broadcast advertisements that last thirty seconds or less.⁸⁶

New York provides an exemption from the filing requirements for a franchise offering on the Internet as long as the franchisor discloses the URL address identifying the location of the Internet advertising to the Department of Law and the advertisement is not directed to any person in the state of New York.⁸⁷

F. *North Dakota*

In North Dakota, a franchisor must file its proposed advertising, which offers a franchise, with the commissioner at least five business days before its first publication.⁸⁸ The law also expressly prohibits any advertising that is false or misleading or omits to make any statement necessary in order to make the statements made not misleading.⁸⁹

North Dakota's Securities Commissioner issued an Order Regarding Franchise Advertisement on the Internet in which franchisors are given an exemption from the filing requirements for any franchise offering on the Internet.⁹⁰ To qualify for the exemption, the franchisor must provide the URL address identifying the location of the Internet advertising on the cover page of a franchise offering circular included with an application for registration, on the cover page of a franchise offering circular included with an application for exemption from registration on file with the Securities

82. *Id.*

83. N.Y. COMP. CODES R. & REGS. tit. 13, § 200.9.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.* § 200.12.

88. N.D. CENT. CODE § 51-19-10.

89. *Id.*

90. Order Regarding Franchise Advertisement on the Internet, ND Sec. Comm'r (Apr. 2, 2002).

Commissioner, or in a notice filed with the Securities Commissioner.⁹¹ The Internet advertisement also cannot be directed to any person in the state of North Dakota.⁹²

G. Rhode Island

Rhode Island requires a franchisor offering or selling a franchise to maintain a complete and accurate set of books and records of the offers and sales of franchises, including advertising correspondence with the franchisees and the prospective franchisees.⁹³ The books and records must be maintained at an office readily accessible to the franchisor for five years.⁹⁴ Moreover, no person can publish any advertisement offering to sell a franchise unless the advertising materials have been maintained for five years.⁹⁵

H. Washington

In Washington, a franchisor must file any advertisement offering a franchise at least seven days before its publication.⁹⁶ Advertisements used to offer a franchise must not contain any statement or inference that a purchase of a franchise is a safe investment or that failure, loss, or default is impossible or unlikely, or that earnings or profits are assured.⁹⁷ The law also states that the advertisement used to offer a franchise “should normally” contain the name and address of the person using the advertisement, and the advertisement “should not normally” contain a projection of future franchisee earnings.⁹⁸

To qualify for the advertising filing exemption in Washington, the franchisor must disclose the URL address where the advertising appears, either on the cover page of the Franchise Disclosure Document, or on a notice filed with the state’s director within five business days after publication.⁹⁹ The Internet advertisement also cannot be directed to any person in the state of Washington.¹⁰⁰

IV. Other Practical Advertising Laws

A. Endorsements

Digital influencer marketing is now a central component of advertising strategies, as businesses rely on influencers for advertising opportunities.¹⁰¹

91. *Id.*

92. *Id.*

93. 19 R.I. GEN. LAWS ANN. § 19-28.1-13.

94. *Id.*

95. *Id.* § 19-28.1-12.

96. *Id.* § 19.100.100.

97. WASH. ADMIN. CODE § 460-80-510.

98. *Id.*

99. *Id.* § 460-80-530.

100. *Id.*

101. Lion Shirdan, *The Rise of Digital Influencer Marketing and the Importance Of Intuition*, FORBES (Dec. 22, 2021), <https://www.forbes.com/sites/forbesagencycouncil/2021/12/22/the-rise-of-digital-influencer-marketing-and-the-importance-of-intuition/?sh=76f327d5fa52>.

Individuals and companies can now post advertisements in a few minutes with a click of a button. Given the ease of posting advertisements through social media platforms, advertising through endorsements is prevalent.

Under the FTC Act, endorsements must be disclosed. An endorsement is defined as “any advertising message . . . that consumers are likely to believe reflects the opinions, beliefs, findings, or experiences of a party other than the sponsoring advertiser, even if the views expressed by that party are identical to those of the sponsoring advertiser.”¹⁰² The endorsement must be disclosed in a conspicuous place if the endorser has any financial relationship with the brand, such as if the endorser is paid to promote the product or service or if the endorser is offered the product or service for free or at a discount.¹⁰³ The FTC advises that the disclosure be placed with the endorsement message itself, and not be mixed in with a series of hashtags or links.¹⁰⁴ If the endorsement is in a picture on Snapchat or on Instagram Stories, then the disclosure should be superimposed over the picture and the viewers should have enough time to notice and read the disclosure.¹⁰⁵ If the endorsement is in a video, then the disclosure should be in the video and not just in the description.¹⁰⁶ The disclosure should be repeated periodically if the endorsement is made through a live stream.¹⁰⁷

The endorsers may be liable for statements made in the course of their endorsements.¹⁰⁸ By the same token, the brands will also be subject to liability for false or unsubstantiated statements made through endorsements or for failing to disclose material connections between themselves and their endorsers.¹⁰⁹

Furthermore, some states require franchisors to disclose any endorsements. For example, California and Washington require full disclosure of any compensation or other benefit given or promised by the franchisor for any advertisement containing any endorsement of the franchises by any public figure.¹¹⁰ These states require that the disclosure be made in the same document that contains the advertisement, or, if the advertisement is via radio or television, then the disclosure must be part of the same program without any intermission or intervening material.¹¹¹

B. *Promotions, Sweepstakes and Contests*

Promotions, sweepstakes, and contests are regulated at both the federal and state level. A sweepstake is a promotion where prizes are given to individuals

102. 16 C.F.R. § 255.0.

103. See FED. TRADE COMM’N, DISCLOSURES 101 FOR SOCIAL MEDIA INFLUENCERS, (Nov. 2019), https://www.ftc.gov/system/files/documents/plain-language/1001a-influencer-guide-508_1.pdf.

104. *Id.* at 4.

105. *Id.*

106. *Id.*

107. *Id.*

108. 16 C.F.R. § 255.1(d).

109. *Id.*

110. CAL. CODE REG. tit. 10 § 310.156.1(e); WASH. ADMIN. CODE § 460-80-510(4).

111. *Id.*

at random, while a contest is promotion that awards prizes based on skill. Sweepstakes and contests are regulated by the Federal Communications Commission (FCC), the FTC, and the U.S. Postal Service.

The FCC's Contest Rules require that radio and television broadcast licensees disclose on air any material terms of any contests that they broadcast.¹¹² In 2015, the FCC expanded this rule by allowing the broadcasters to disclose material contest terms either on air or on the Internet.¹¹³ If the latter, then the written disclosure must be on the station's website, the licensee's website, or any website that is readily accessible to the public if neither the individual station nor the licensee has its own website.¹¹⁴ In addition, the station must also have a conspicuous link or tab to the material contest terms on its website's homepage, periodically announce on air the availability of material contest terms on the website, identify the web address where the terms are posted, and maintain material contest terms on the website for at least thirty days after the contest has concluded.¹¹⁵

The FTC's Telemarketing Sales Rule requires that telemarketing calls used to promote a contest or sweepstakes contain certain disclosures, such as the odds of winning; a statement that no purchase or payment is required to win the prize or to participate in the promotion; a statement that any payment will not increase the person's chances of winning; instructions on how to participate, or an address or local or toll-free telephone number to which the customers may write or call for information on how to participate; and all material costs or conditions to receive or redeem the prize.¹¹⁶

Under the Deceptive Mail Prevention and Enforcement Act (DMPEA), the U.S. Postal Service is given authority to prevent deceptive practices in skill contests and sweepstakes mailings. The DMPEA requires that all promotional mailing materials include the following disclosures: the estimated odds of winning; the quantity, estimated retail value, and nature of the prize; and the name and address of the sender.¹¹⁷

Several states also have additional bonding and filing requirements. The bonding requirement protects consumers in that it guarantees payment of the prizes offered. For example, Florida regulations require a sponsor to post a bond and register any sweepstake for consumer products or services at least seven days before the start of the sweepstake if the total value of the prize is over five thousand dollars.¹¹⁸ Similarly, New York regulations require that a sponsor post a bond and file a statement with the secretary of state at least thirty days before any sweepstakes for consumer products, if the value of the prize is over five thousand dollars.¹¹⁹ Although Rhode Island does not

112. 47 C.F.R. § 73.1216.

113. *Id.*

114. *Id.*

115. *Id.*

116. 16 C.F.R. § 310.3(a)(1).

117. 39 U.S.C. § 3001.

118. FLA. STAT. § 849.094.

119. N.Y. GEN. BUS. LAW § 369-e.

have a bond requirement, it does have a registration requirement for “retail business” promotions if the total value of the prizes offered is more than five hundred dollars.¹²⁰ Moreover, certain states such as Colorado, Florida, Maryland, North Dakota, and Washington expressly prohibit entry fees.¹²¹

V. New Forms of Advertisements

Successful advertising strategies benefit both franchisors and franchisees.¹²² The COVID-19 pandemic pushed digital advertising to the forefront as consumers were forced to stay at home and spend more of their time online.¹²³ Accordingly, new forms of advertisement are centered around digital platforms, replacing traditional forms of advertising such as print advertising, television and radio commercials, and billboards. Emerging advertising trends include the use of the metaverse, the social media application TikTok, and digital audio advertising.

A. *The Metaverse*

The industry’s largest franchise brands have indicated that the metaverse will be the next big advertising trend. Businesses that integrate their brand into the metaverse could build lasting competitive advantages.¹²⁴ Although the word is still being defined, the “metaverse” is used to describe virtual platforms where users can interact with each other in a virtual environment. It can also be characterized as “a gaming platform, a virtual retail destination, a training tool, an advertising channel, a digital classroom, [and] a new gateway to digital experiences.”¹²⁵ McKinsey & Company has forecasted that by 2030, the metaverse is expected to have a higher share of advertising placements and budgets as consumers spend more time each day in the metaverse, creating new metaverse advertisements such as virtual billboards.¹²⁶

In recent years, several businesses have integrated their brands into the metaverse through Roblox, a popular online gaming platform. For example,

120. 11 R.I. GEN. LAWS § 11-50-1.

121. See COLO. REV. STAT. § 6-1-803; FLA. STAT. § 849.094(2)(e); MD. COM. LAW § 13-305(b); N.D. CENT. CODE § 53-11-02(1); WASH. REV. CODE § 9.46.0356.

122. Steven Beagelman, *Three Pillars of Success for Franchisors in Franchise Development*, FORBES (May 20, 2022), <https://www.forbes.com/sites/stevenbeagelman/2022/05/20/three-pillars-of-success-for-franchisors-in-franchise-development/?sh=27340d9e532f>.

123. Megan Graham, *How a Stay-at-Home Year Accelerated Three Trends in the Advertising Industry*, CNBC (Mar. 13, 2021), <https://www.cnbc.com/2021/03/13/how-covid-19-changed-the-advertising-industry-.html>

124. MCKINSEY & COMPANY, *VALUE CREATION IN THE METAVERSE 6* (June 2022), <https://www.mckinsey.com/~media/mckinsey/business%20functions/marketing%20and%20sales/our%20insights/value%20creation%20in%20the%20metaverse/Value-creation-in-the-metaverse.pdf>.

125. *Id.* at 10.

126. *Id.* at 61 (“The metaverse is expected to assume a higher share of advertising placements and budgets as consumers spend more time in metaverse per day (up to 4-6hrs/d converting from online time spent) and popular gaming worlds expand to broader digital entertainment use-cases (e.g., concerts); with new, more immersive metaverse-native ad-types emerging (e.g., visual search, virtual billboards)”).

Gucci launched an art installation on Roblox that attracted twenty million visitors.¹²⁷ Nike has also launched “Nikeland,” an interactive metaverse game on Roblox that attracted over six million people from over two hundred countries in the first five months.¹²⁸ Chipotle also launched two advertising campaigns in the metaverse. In 2021, it opened a virtual Chipotle restaurant on Roblox to celebrate its twenty-first year of its Halloween event, “Boorito.”¹²⁹ The first thirty thousand users to visit the virtual restaurant each day received a free burrito code, where its customers could then use on orders in its app or website.¹³⁰ In 2022, Chipotle launched the “Chipotle Burrito Builder” on Roblox where players could roll burritos in the metaverse to earn “Burrito Bucks.”¹³¹ The two games attracted six million unique users, many of whom also signed up for Chipotle’s rewards programs; the “Boorito” daily sales surpassed those associated with Chipotle’s previous Halloween campaigns.¹³²

Moreover, other franchises have indicated plans to advertise in the metaverse. In February 2022, Panera filed trademark applications for “Paneraverse” to trademark downloadable virtual food and beverage items for “use in virtual worlds.”¹³³ Similarly, McDonald’s filed trademark applications for “operating a virtual restaurant featuring actual and virtual goods” and “operating a virtual restaurant online featuring home delivery.”¹³⁴ In March 2022, Wendy’s announced that it was launching Wendyverse in Meta’s Horizon Worlds to create a virtual restaurant where fans could virtually interact with each other.¹³⁵

127. *Id.* at 43 (“Gucci launched the Gucci Garden—a two-week art installation on Roblox that attracted 20 million visitors.”).

128. Greg Petro, *Gen Z Set to Lead Retailers into the Metaverse*, FORBES (May 14, 2022), <https://www.forbes.com/sites/gregpetro/2022/05/14/gen-z-set-to-lead-retailers-into-the-metaverse/?sh=33c0033518ed>.

129. Press Release, Chipotle, Chipotle to Open Virtual Restaurant on Roblox with \$1 Million in Free Burritos and Serve Up \$5 Digital Entrée Offer for Boorito (Oct. 26, 2021), <https://newsroom.chipotle.com/2021-10-26-Chipotle-To-Open-Virtual-Restaurant-On-Roblox-With-1-Million-In-Free-Burritos-And-Serve-Up-5-Digital-Entree-Offer-For-Boorito>.

130. *Id.*

131. Press Release, Chipotle, Fans Can Roll Burritos at Chipotle in the Metaverse to Earn Burritos in Real Life, (Apr. 5, 2022), <https://newsroom.chipotle.com/2022-04-05-FANS-CAN-ROLL-BURRITOS-AT-CHIPOTLE-IN-THE-METaverse-TO-EARN-BURRITOS-IN-REAL-LIFE>.

132. Ann-Marie Alcántara, *Metaverse Spending to Total \$5 Trillion in 2030*, McKinsey Predicts, WALL STREET J., (June 14, 2022), <https://www.wsj.com/articles/metaverse-spending-to-total-5-trillion-in-2030-mckinsey-predicts-11655254794>.

133. Mason Bissada, *McDonald’s Files Trademark for Metaverse—Based ‘Virtual Restaurant,’* FORBES (Feb. 9, 2022), <https://www.forbes.com/sites/masonbissada/2022/02/09/mcdonalds-files-trademark-for-metaverse-based-virtual-restaurant/?sh=666d179d6678>.

134. *Id.*

135. Press Release, The Wendy’s Co., Welcome to the Wendyverse™: Wendy’s® Opening First Restaurant in Virtual Reality (Mar. 30, 2022), <https://www.prnewswire.com/news-releases/welcome-to-the-wendyverse-wendys-opening-first-restaurant-in-virtual-reality-301513961.html>.

B. Social Media Channels

Franchise brands should leverage their social media platforms in order to create opportunities to engage with their consumers. Social media has given businesses, especially franchises, new ways of advertising their product or services. The advantages of social media include lower costs and the ability to quickly distribute advertisements. Advertising through the social media application, TikTok, is quickly becoming a popular advertising strategy.

TikTok is a mobile application where users can post, share, and watch short-form videos. In terms of downloads, TikTok has been the top app in the United States for each quarter since 2021, and the top app worldwide in the first quarter of 2022.¹³⁶ TikTok's "For You" feed allows users to scroll through short videos uploaded by other creators. The videos that end up on each user's "For You" feed are based on the users' previous activity history. Accordingly, TikTok's algorithm gives every video a chance to go viral regardless of the creator's popularity.¹³⁷

Franchises can advertise by directly uploading their own videos on TikTok that could potentially land on millions of users' feeds. For example, Crumbl is a gourmet cookie franchise that started in October 2017 and grew to over two hundred stores in over thirty states, with franchisees opening eighty-four stores in 2020 alone.¹³⁸ The franchise uses its social media accounts in order to reveal its weekly cookie flavors to its 2.7 million Instagram followers and 5.7 million TikTok followers.¹³⁹ The franchise claims that it does not advertise its franchising program and that everything has simply been word of mouth.¹⁴⁰

C. Digital Audio Advertisements

Digital audio advertising is the presentation of advertisements through online streaming platforms such as podcasts and music streaming applications. Although traditional radio currently still outpaces digital audio with respect to audience numbers, the numbers may be shifting.¹⁴¹ Podcasts tend to draw in niche audiences, providing the potential for more targeted

136. Lauren Forristal, *TikTok Was the Top App by Worldwide Downloads in Q1 2022*, TECHCRUNCH (Apr. 26, 2022), <https://techcrunch.com/2022/04/26/tiktok-was-the-top-app-by-worldwide-downloads-in-q1-2022/>.

137. Zarnaz Arlia, *TikTok's Takeover of Marketing and Commerce in 2022*, FORBES (Feb. 23, 2022), <https://www.forbes.com/sites/forbescommunicationscouncil/2022/02/23/tiktoks-takeover-of-marketing-and-commerce-in-2022/?sh=66d913015b4f>.

138. Laura Michaels, *Inside the Craze at Fast-Growing Franchise Crumbl Cookies*, FRANCHISE-TIMES (Oct. 27, 2021), https://www.franchisetimes.com/franchise_news/inside-the-craze-at-fast-growing-franchise-crumbl-cookies/article_e29c5860-31da-11ec-9667-83789573129c.html.

139. *Id.*

140. Ben Coley, *Crumbl Cookies Rises from Emerging Brand to Category Leader*, QSR (Sept. 21, 2021), <https://www.qsrmagazine.com/exclusives/crumbl-cookies-rises-emerging-brand-category-leader>.

141. Paul Kelly, *The Future of Digital Audio Advertising Belongs to Podcasts—And Radio*, FORBES (Aug. 10, 2022), <https://www.forbes.com/sites/forbesbusinessdevelopmentcouncil/2022/08/10/the-future-of-digital-audio-advertising-belongs-to-podcasts-and-radio/?sh=7f92e57050cf>.

advertisements.¹⁴² Moreover, while social media ads can be easily overlooked as people scroll through their feeds, podcast listeners listen for at least eighty percent of a podcast episode.¹⁴³ Franchises can also opt for “host-read ads” in which a host learns about the product or service and then reads off talking points about the product or service in their own voice to their listeners.¹⁴⁴

VI. Conclusion

Advertising is a critical component of franchise brands, and, as such, claims for false advertising are heavily litigated. As new forms of digital advertising become the norm, advertisements can be posted in a matter of seconds, and regulations regarding the various forms of advertisements can be easily overlooked. But the new does not mean unregulated. Franchisors and franchisees must ensure that all advertising—including the new forms of content discussed above—still complies with the tried and true regulations. To be sure, some issues will certainly need to be sorted out. For example, what state’s law applies to interactions in the metaverse? But the starting point for every entity in the franchise system is an awareness of the continuing obligations to comply with both federal and state law to protect the entity from future liability with regard to both advertisements for the sale of their goods or services, and for the sale of franchises.

142. *Id.*

143. Heather Osgood, *Succeeding With Podcast Advertising in a Recession*, FORBES (Aug. 10, 2022), <https://www.forbes.com/sites/forbesagencycouncil/2022/08/10/succeeding-with-podcast-advertising-in-a-recession>.

144. *Id.*



A Crash Course on Interpretation of the “Marketing Plan or System” Element of State Franchise Statutes

Michael D. Braunstein & Megan B. Center*

I. Introduction

Many commentators have written and spoken about accidental franchises and the definitional element of a “franchise” known as the “marketing plan or system,” how it has been interpreted, and what happens when an unsuspecting “franchisor” gets it wrong.¹ Yet, the ever-changing landscape of evolving business arrangements requires continued attentiveness to, and understanding of, the law as it develops and may apply to novel business practices. Oversight of a franchise system by a franchisor requires compliance with both the pre-sale disclosure requirements under the Federal Trade Commission’s (FTC) Franchise



Mr. Braunstein



Ms. Center

1. See, e.g., Megan B. Center, *Accidental Franchises: It Takes a Community (of Interest)*, 39 FRANCHISE L.J. 546 (2020); Paul R. Fransway, *Traversing the Minefield: Recent Developments Relating to Accidental Franchises*, 37 FRANCHISE L.J. 217 (2013); Charles S. Modell, *The Accidental Franchise, When a Business Relationship Becomes a Trap*, 13 BUS. L. TODAY 45 (Jan./Feb. 2004); Daniel J. Oates, Shannon L. McCarthy & Douglas C. Berry, *Substantial Association with a Trademark: A Trap for the Unwary*, 32 FRANCHISE L.J. 130 (2013); James R. Sims III & Mary Beth Trice, *The Inadvertent Franchise and How to Safeguard Against It*, 18 FRANCHISE L.J. 54 (1998); Rochelle Spandorf, *Structuring Licenses to Avoid the Inadvertent Franchise*, 2:4 LANDSLIDE 35 (Mar./Apr. 2010).

*Megan B. Center (megan.center@quarles.com) is a Partner with the Washington, D.C. office of Quarles & Brady LLP in the Business Law Practice Group. Center focuses her practice on representing franchisors in a variety of industries, counseling them on every stage of the franchise relationship, including regulatory compliance, both at the state and federal level, and preparation of franchise disclosure documents and day-to-day franchise system issues. Center also regularly represents buyers and sellers in mergers and acquisitions and private equity transactions, with a focus on transactions involving entire franchise systems, and also assists clients with complex commercial agreements. Michael D. Braunstein (mbraunstein@zarcolaw.com) is an attorney at Zarco, Einhorn, Salkowski, P.A. in Miami, Florida. Michael focuses his practice on complex commercial litigation with a specialty in franchise disputes. Michael routinely handles franchise disputes nationwide in both state and federal court as well as domestic and international arbitration tribunals as well as complex business transactions.

Rule (the FTC Rule) and a patchwork of state franchise statutes (that regulate both pre-sale conduct and post-signing relationship). However, certain businesses that would not believe they are operating a franchise system may subject themselves to applicable franchise statutes based on their conduct and underlying agreements and business relationships (even if unintended).² The FTC Rule does not provide a private right of action to aggrieved third parties; however, many state franchise statutes provide a right of action for its citizens against what many deem an “accidental” or “inadvertent” franchisor.³ Unfortunately, for the “accidental” or “inadvertent” franchisor, and its executives and salespeople in certain states, those statutory claims may result in an award of damages, rescission, injunctive relief, and attorneys’ fees. Thus, franchise lawyers must understand the ins and outs of the definitional elements of a franchise under both federal and state law. This article analyzes the case law that interprets the bothersome definitional element known as the “marketing plan or system.” Section II covers the FTC’s statutory definition of a franchise under the FTC Rule. Section III discusses how various states define the effect of marketing plan usage by rule, statute, or common law. Finally, Section IV provides final thoughts and guidance regarding the proscription of marketing plans in various businesses.

II. The FTC Rule Definition of a Franchise

The FTC Rule governs, and sets a baseline for the regulation of, the offer and sale of franchises in the United States.⁴ The FTC Rule defines a “franchise” as

any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

- (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark;
- (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee’s method of operation, or provide significant assistance in the franchisee’s method of operation; and
- (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.⁵

2. See, e.g., 16 C.F.R. § 436.1 *et seq.*

3. See Dale E. Cantone, Kim A. Lambert & Karen C. Marchiano, *So It Really Is a Franchise: Bringing Non-Compliant Franchisors into Compliance*, AM. BAR ASS’N 37TH ANN. FORUM ON FRANCHISING, W-18 (2014). In addition, violation of these laws may be grounds to assert a state consumer or deceptive trade practices act claim. *Id.*

4. See 16 C.F.R. § 436.1 *et seq.*

5. 16 C.F.R. § 436.1(h).

A commercial relationship or arrangement is deemed a “franchise” under the FTC Rule when it meets all three of the elements described above.⁶

Twenty-six states also regulate the offer and sale of franchises. Of those states, several utilize the grant of a “marketing plan or system” prescribed in substantial part by the franchisor, instead of the second element of “assistance/control” in the FTC Rule, in their definition of a franchise.⁷

Judicial and regulatory interpretation of these statutes has yielded vastly different results. Thus, a company’s failure to evaluate how a particular state defines a franchise, and how courts interpret that particular definition, can have substantial consequences for its business model because state authorities could impose penalties and fines not only for the franchisor-company but the franchisor-officers as well.

III. State-by-State Survey of the Definitional Element of a “Marketing Plan or System”

A. California

In California, the California Corporations Code, covering both the California Franchise Relations Act (CFRA) and the California Franchise Investment Law (CFIL), defines a “franchise” as a contract or agreement whereby a person operates a business “under a marketing plan or system prescribed in substantial part by a franchisor,” in which the plan is substantially associated with the franchisor’s trademark name or other commercial symbol that designates the franchisor, and the franchisee must pay a franchise fee.⁸

California courts have set forth the broadest interpretation of a “franchise.” In *Boats & Motor Mart v. Sea Ray Boats, Inc.*, Boats & Motor Mart (Boats) sold powerboats manufactured by Sea Ray pursuant to a license agreement.⁹ Throughout their course of dealing, Sea Ray agreed to provide press kits, marketing advice, and training for Boats’ sales representatives and, in turn, Boats agreed to aggressively sell, display, and advertise Sea Ray products.¹⁰ When Sea Ray discontinued sales of its products to Boats, Boats filed suit pursuant to the CFRA, which, if applicable, would prohibit Sea Ray’s termination absent good cause.¹¹ Thus, the CFRA’s applicability to the parties relationship was dispositive. In defining a “franchise,” the CFRA

6. *Id.*

7. See, e.g., HAW. REV. STAT. § 482E-2; MINN. STAT. § 80C.01; MISS. CODE § 75-24-51(6); MO. REV. STAT. § 407.400(1); NEB. REV. STAT. § 87-402(1); N.J. STAT. § 56:10-3(a); S.D. CODIFIED LAWS § 37-5A-3; WIS. STAT. § 135.02.

8. See CAL. CORP. CODE § 31005(a); see also *id.* § 31005(b) (noting the definition of “franchise” also applies to certain contracts in the oil and gas industry); *id.* § 31005(c) (noting the definition of “franchise” does not apply to certain retail co-ops that operate on a non-profit basis).

9. See *Boat & Motor Mart v. Sea Ray Boats, Inc.*, 825 F.2d 1285, 1285–86 (9th Cir. 1987) (applying California law).

10. *Id.* at 1287.

11. *Id.* at 1288. The parties’ agreement contained a provision permitting termination on thirty days’ written notice and waived liability for losses arising out of the agreement. *Id.*

referenced guidelines issued by the California Department of Corporations (now known as the California Department of Financial Protection and Innovation (CDFPI)).¹² The court found that the guidelines indicated that a franchisee is “one of several outlets selling a manufacturer’s product,” and, by causing the “outlets” to operate with uniformity with respect to the quality and price and under the appearance of centralized management, the manufacturer assumed responsibility for them.¹³ Based on the extensive advertising and promotional materials issued by Sea Ray, Sea Ray’s territorial advertising restrictions, and Sea Ray’s detailed instructions on employee and other business practices, the court held that Boats was in fact a franchisee because it followed a system prescribed in a substantial part by Sea Ray.¹⁴

In *People v. Kline*, the California Court of Appeals held that a marketing plan existed, even if not fully detailed, when a hotdog kiosk seller (Kline) promised to provide a prospect (and purported franchisee) with a distinctive retail location and business name.¹⁵ Kline was convicted of one count of unlawful sale of a franchise under the CFIL for offering to sell, and actually selling, the right to operate distinctive hotdog kiosks operating under the name “Aunt Hilda’s Pennsylvania Dutch Steamed Franks.”¹⁶ Kline told the prospect that he was offering a franchise for \$25,000.00 and that the entire operation would be “turn key.”¹⁷ Kline provided documents outlining projected sales and expenses and told the prospect that an expert would handle the menu.¹⁸ Kline led the prospect to believe that the day-to-day operations would be handled by Kline’s company.¹⁹ At trial, Kline argued that the business opportunities he sold did not constitute a “franchise” by arguing that California had a more limited definition of a franchise than other states.²⁰ Specifically, Kline based his argument on the guidelines that CDFPI issued in 1974.²¹ Noting that the 1974 guidelines were not determinative and that the final determination on interpretation of a statute rested with the courts, the court explicitly rejected a narrow interpretation of what would constitute a marketing plan, reasoning that the legislature’s intent was to protect franchisees.²² The court found that, by agreeing to provide sales and marketing assistance, menu planning, and the use of “identifiable and distinctive” kiosks, Kline had “at least implied” a statutory marketing plan.²³

12. *Id.*

13. *Id.* at 1289.

14. *Id.* (citing Cal. Dep’t of Corps., Release 3-F (1974)).

15. *See People v. Kline*, 110 Cal. App. 3d 587, 594 (Ct. App. 1980).

16. *Id.* at 594, 598.

17. *Id.* at 591.

18. *Id.*

19. *Id.*

20. *Id.* at 593.

21. *Id.*

22. *Id.* at 594–95.

23. *Id.* at 594.

After these decisions, the CDFPI issued further guidelines in 1994 to clarify when an agreement or relationship constitutes a franchise.²⁴ The guidelines, based on prior interpretive opinions, thoroughly outlined the requirements for a franchise to be found under California law.²⁵ One such requirement is that the purported franchisee *must* operate under a marketing plan or system prescribed in substantial part by the franchisor.²⁶ *The 1994 Guidelines* explain that if a franchisee is free to sell products according to the franchisee’s own systems, methods, or ideas, then no marketing plan exists.²⁷ On the contrary, if a franchisor claims that it has a successful marketing plan to provide to a prospective franchisee, courts may presume the existence of a marketing plan.²⁸ A franchisor’s control over the payment, credit, and warranty practices of the franchisee may also suggest the existence of a marketing plan.²⁹ Likewise, when a franchisor prohibits certain methods of distribution or when a franchisor provides the franchisee with “sales aids or props,” even if only *recommending* use of the same, a marketing plan may exist by implication.³⁰ However, the mere imposition of a business procedure or technique that is to some extent restrictive will not constitute a marketing plan if the same is “customarily observed in business relationships in the particular trade or industry.”³¹ For example, a contractual obligation for one party to use “best efforts” to make sales does not constitute a marketing plan or system prescribed in substantial part by the franchisor.

Following the issuance of *The 1994 Guidelines*, in *US Mac Corp. v. Amoco Oil Co.*, the California Court of Appeal held that a franchise relationship existed because the relationship between the parties satisfied the marketing plan element.³² Specifically, Amoco granted US Mac the right to distribute its products in China and, in connection with the distributorship, the right to use Amoco trademarks and marketing materials.³³ However, Amoco required, under the distribution agreement, that any materials bearing its trademarks indicate that US Mac was an independent distributor.³⁴ When Amoco required US Mac to purchase \$1.2 million in product, which was not part of the original distribution agreement, US Mac alleged that a franchise agreement existed and that Amoco had materially modified it.³⁵ The court looked to the terms of the distribution agreement and held that a marketing

24. See Cal. Dep’t of Bus. Oversight, Commissioner’s Release 3-F: When Does an Agreement Constitute a “Franchise” (1994), <https://dfpi.ca.gov/commissioners-release-3-f> [hereinafter *The 1994 Guidelines*].

25. *Id.*

26. *Id.*

27. *Id.* (citing Comm’r Opinion No. 71/25F).

28. *Id.* (citing Comm’r Opinion Nos. 75/2F, 79/2F, and 4736F).

29. *Id.*

30. *Id.* (citing Comm’r Opinion No. 73/40F).

31. *Id.* (citing Comm’r Opinion No. 71/42F).

32. See generally *US Mac Corp. v. Amoco Oil Co.*, No. B137658, Bus. Franchise Guide ¶11,963 (Cal. Ct. App. Aug. 16, 2000).

33. *Id.* at 3.

34. *Id.*

35. *Id.* at 4.

plan existed because Amoco (1) restricted US Mac's ability to sell certain products; (2) provided US Mac with specialized training; and (3) provided US Mac with detailed advice on sales.³⁶

Even to the present day, California courts have relied on *The 1994 Guidelines* in determining whether a franchise relationship exists under the CFIL. In *Sunflora, Inc. v. Natural Solutions, LLC*, the U.S. District Court for the Central District of California relied on *The 1994 Guidelines* in holding that several restrictions in an exclusive territory agreement indicated the existence of a marketing plan and therefore a franchise relationship.³⁷ The court noted that “[w]hile any one of the examples of restrictions may not amount to ‘a marketing plan or system prescribed in substantial part by a franchisor,’ several such restrictions taken together may be sufficient to amount to such a plan or system.”³⁸ Sunflora alleged that Natural Stone, the purported franchisor, misrepresented the nature of the documents governing the parties’ relationship—which Sunflora contended actually constituted a franchise agreement.³⁹ Sunflora further alleged that a franchise agreement did exist, because there were indirect franchise fees built into the goods they were required to purchase and, thereby, a marketing system that it had to abide by according to the factors outlined in *The 1994 Guidelines*.⁴⁰ The court denied Natural Stones’ motion to dismiss because Natural Stone: (1) prescribed or limited resale prices; (2) restricted the use of advertising or mail order business; (3) gave detailed directions and advice concerning operating techniques; (4) assigned an exclusive territory; (5) limited the sale of competitive products; (6) provided for uniformity or distinctiveness of appearance; and (7) prohibited engaging in other activities.⁴¹ Each of these indicators, together, constituted a marketing plan under applicable law.⁴²

B. Connecticut

Similar to California, in Connecticut under the Connecticut Franchise Act (CFA), a “franchise” is defined by statute as a contract or agreement whereby a franchisee is granted the right to operate a business “under a marketing plan or system prescribed in substantial part by a franchisor,” which plan is substantially associated with the franchisor’s trademark name or other commercial symbol that designates the franchisor, and includes “any agreement between a manufacturer, refiner, or producer and a distributor.”⁴³

In deciding whether a marketing plan exists, the courts consider the parties’ written agreement; however, because language can be deceptive, courts

36. *Id.* at 8.

37. See *Sunflora, Inc. v. Nat. Sols., LLC*, No. CV2001141CJCMRWX, 2021 WL 8316392 (C.D. Cal. Dec. 16, 2021).

38. *Id.* (quoting *The 1994 Guidelines*, *supra* note 24).

39. *Id.* at *1.

40. *Id.*

41. *Id.* at *3.

42. *Id.* at *5.

43. See CONN. GEN. STAT. 42-133e(b).

will look beyond the written agreement and consider the "reality" of the relationship between the parties by observing their conduct.⁴⁴ If a court finds a contract ambiguous such that it is allowed to also consider the parties' intent, courts examine the control that a potential franchisor has over a purported franchisee.⁴⁵ Although, as noted by the Connecticut Supreme Court, there is no "precise formula as to how many or which factors create the level of control indicative of a franchise,"⁴⁶ and several courts have relied on the list of factors set out in *Consumers Petroleum of Connecticut, Inc. v. Duhan* to determine whether a marketing plan existed in a gasoline distributorship.⁴⁷ There, the court analyzed whether the franchisor had control over (i) hours and days of operation; (ii) advertising; (iii) lighting; (iv) employee uniforms; (v) prices; (vi) trading stamps; (vii) hiring; (viii) sales quotas; and (ix) management training.⁴⁸ Analyzing the above factors, the court in *Duhan* found insufficient evidence of a marketing plan and no franchise relationship where the lessor (i) set the monthly rent based on the number of gallons of gasoline sold with a minimum rent of \$400 per month; (ii) required that the station not to be closed for a period in excess of forty-eight hours; (iii) set the hours of operation; (iv) required that no advertising signs be placed on the premises without the permission of the lessor (purported franchisor); (v) required that the lessee provide the necessary number of employees to run the business; and (vi) would lend certain equipment to the lessee to be used for storing and dispensing products sold by the lessor only.⁴⁹

In *Hartford Electric Supply Co. v. Allen-Bradley Co.*, the Connecticut Supreme Court interpreted whether a distribution agreement constituted a franchise agreement when a manufacturer of high-tech industrial automation products terminated a distributor who, in turn, sought protection under the CFA.⁵⁰ The distributor sought a temporary injunction restraining the manufacturer from terminating the distribution agreement and alleged, *inter alia*, that the manufacturer qualified as a "franchisor" and violated the CFA for terminating the agreement without good cause.⁵¹ In determining whether the CFA applied, the court analyzed "whether a marketing plan or system [was] substantially prescribed."⁵² Finding the CFA applied to the parties' relationship, the court interpreted the definition of a marketing plan broadly in favor of the distributor, based on the legislative intent of the CFA

44. See *Hartford Elec. Supply Co. v. Allen-Bradley Co.*, 250 Conn. 334, 348 (1999) (quoting *Petereit v. S.B. Thomas, Inc.*, 853 F. Supp. 55, 60 (D. Conn. 1993)).

45. See, e.g., *Hartford Elec. Supply Co.*, 250 Conn. at 348 (explaining the need to examine "actions" that constitute an agreement or arrangement between the parties).

46. *Id.*

47. *Consumers Petroleum of Conn., Inc. v. Duhan*, 38 Conn. Supp. 495 (Conn. Super Ct. 1982).

48. *Id.* at 498–99.

49. See *id.* at 498.

50. See *Hartford Elec. Supply Co. v. Allen-Bradley Co.*, 250 Conn. 334, 335 (1999).

51. *Id.* at 343.

52. *Id.* at 348.

to prevent a franchisor from unfairly exercising leverage on a franchisee.⁵³ The court relied on the factors in *Consumers Petroleum* and stated that pricing is “one of the most significant” factors to consider, and a statutory marketing plan is likely found when a franchisor has significant control over a franchisee’s pricing.⁵⁴ Additionally, the court stated that when a franchisor provides marketing and sales support, requires a franchisee to submit regular audited financial statements, requires franchisee to maintain and utilize a training center according to the franchisor’s specifications, or exercises significant control over a franchisee’s inventory or hiring decisions (by threat of termination or otherwise), then it is likely that a statutory marketing plan exists.⁵⁵

As demonstrated below, when determining whether a statutory marketing plan exists, the courts look at the level of control a franchisor exerts over a franchisee’s business. The Connecticut Petroleum Franchise Act (CPFA) substantively mirrors the statutory definition of a franchise and applies to the oil and gas industry.⁵⁶ When interpreting the CFA, some courts have sought guidance from opinions interpreting the CPFA.⁵⁷ In *Ackley v. Gulf Oil*, the court stated that when a gas station operator maintains complete control over advertisement, prices, operational hours, employee selection, and financial records, the gas station operator does not operate the business according to a statutory marketing plan.⁵⁸

In *Chem-Tek, Inc. v. General Motors Corp.*, interpreting the CFA, the U.S. District Court for the District of Connecticut found that when a party to an agreement (i) controls the hiring and firing of franchisee employees; (ii) provides financial assistance for salaries and advertising material; (iii) organizes marketing conferences; (iv) sets the prices for products; and (v) prohibits the other party from offering products other than those specified by the setting party, then the other party is operating a business according to a marketing plan.⁵⁹

Likewise, when a purported franchisor exerts “overwhelming” control of a purported franchisee’s business, that party operates its business according to a statutory marketing plan.⁶⁰ In *Carlos v. Phillips Business Systems, Inc.*, the U.S. District Court for the Eastern District of New York, analyzing Connecticut law, found that, within the meaning of the CFA, “overwhelming control” exists when a party must (1) prominently display the other party’s

53. *Id.* at 349, 357.

54. *See id.* at 351–52.

55. *See id.*

56. CONN. GEN. STAT. § 42-133j-n.

57. *See Chem-Tek, Inc. v. Gen. Motors Corp.*, 816 F. Supp. 123, 129 (D. Conn. 1993) (applying Connecticut law) (citing *Consumers Petroleum of Conn., Inc. v. Duhan*, 452 A.2d 123 (Conn. Super. Ct. 1982)).

58. *See Ackley v. Gulf Oil Corp.*, 726 F. Supp. 353, 355 (D. Conn. 1989) (applying Connecticut law).

59. *See Chem-Tek*, 816 F. Supp. at 129.

60. *See Carlos v. Philips Bus. Sys., Inc.*, 556 F. Supp. 769, 776 (E.D.N.Y. 1983) (applying Connecticut law).

logo on entranceways and letterhead; (2) answer the phone in a manner prescribed by the other party; (3) conform to warranty policies; (4) hire salespeople at the request of the other party; (5) provide periodic sales reports to the other party; (6) maintain specified levels of inventory; (7) conform to advertising and promotional policies set by the other party; (8) purchase inventory at unfavorable prices; and (9) submit to franchisor decisions in negotiations with third-parties.⁶¹

Comparatively, when a distributor's business operations are independent of a supplier's control, courts have held that no marketing plan or system exists under the CFA.⁶² For example, a lessor merely prescribing lessee's business hours and days of operation and requiring its approval for advertising signs are likely insufficient to find that a lessee is operating under a statutory marketing plan.⁶³ Some courts have even found that a marketing plan did not exist where a manufacturer set sales quotas, recommended retail prices with set price caps and sale strategies, and set annual meetings.⁶⁴ Likewise, in *Aurigemma v. Arco Petroleum Products Co.*, the U.S. District Court for the District of Connecticut found no franchise relationship existed under the CFA, where a lessor placed certain restrictions on a lessee.⁶⁵ The court reasoned that the lessor's requirements that the lessee maintain sufficient inventory, fully illuminate the premises, maintain employee uniforms, and be subject to safety inspections and financial audits, alone, did not eliminate the lessee's independence or create a marketing plan.⁶⁶ The court reached its conclusion by analyzing whether the lessor, through its restrictions, "usurp[ed] the operator's ability to exercise independent judgment on marketing decisions," concluding that it did not.⁶⁷ Additionally, some courts have found that when a lessor sells products to a lessee, and allows the lessee to use the lessors trademark, those facts alone do not constitute a statutory marketing plan.⁶⁸

61. *Id.* at 776–77; *see also* Kollar v. Allstate Ins. Co., 2018 WL 4688301, at *8 (D. Conn. Sept. 28, 2018) (finding that an independent insurance agent stated a valid claim for violations of the Connecticut Franchise Act where the insurance company, *inter alia*, required the agent to exclusively offer and sell Allstate products).

62. *Ross v. Shell Oil Co.*, 672 F. Supp. 63, 66 (D. Conn. 1987) (holding that minimum control requirements for a marketing plan were not met where the purported franchise agreement did not set minimum purchase amounts, prices, or sales quotas).

63. *See Consumers Petroleum of Conn., Inc. v. Duhan*, 38 Conn. Supp. 495, 498 (Super. Ct. 1982) ("[T]hese factors alone are insufficient to sustain a finding that there was a marketing plan or system present in the case before us.").

64. *See Dittman & Greer, Inc. v. Chromalox, Inc.*, 2009 WL 3254481 (D. Conn. Oct. 6, 2009) (applying Connecticut law).

65. *See generally* *Aurigemma v. Arco Petroleum Prods. Co.*, 698 F. Supp. 1035 (D. Conn. 1988).

66. *See id.* at 1040.

67. *See id.*

68. *See R. R. Murty Narumanchi v. Shell Oil Co.*, BUS. FRANCHISE GUIDE ¶ 8720 (D. Conn. Dec. 10, 1986).

C. Illinois

The Illinois Franchise Disclosure Act (IFDA) defines a “franchise” by requiring the grant of a marketing plan or system prescribed or suggested in substantial part by a franchisor, association with a franchisor’s trademark, name, or logo, and a franchise fee of five-hundred dollars (\$500) or more.⁶⁹ Additionally, the IFDA itself outlines several characteristics of a marketing plan, including specification of price or discount plans, use of particular sales or display equipment, specific sales techniques, and specific advertising or promotional materials.⁷⁰

Under the IFDA, a marketing plan or system does not need to be detailed or comprehensive; the element is satisfied when the franchisee has the right to sell under a marketing plan, even if the franchisee is not obligated to do so.⁷¹ A party’s provision of, or a mere agreement to provide, another party with training, promotional materials, and direct sales assistance is sufficient to find a marketing plan under the IFDA.⁷² However, a sales agreement where the manufacturer does not assist in the “affirmative act” of offering and selling products does not satisfy the requirements of a marketing plan or system and the definition of a “franchise” under the IFDA.⁷³

D. Indiana

Under the Indiana Franchise Act (IFA), a franchise exists when the operator of a business has the right to sell goods or services under a marketing plan or system prescribed in substantial part by a franchisor; there is substantial association with the franchisor’s trademark, name, or logo; and there is a franchise fee.⁷⁴

69. See 815 ILL. COMP. STAT. 705/3(1).

70. See *id.* at 705/3(18) (“Marketing plan or system” means a plan or system relating to some aspect of the conduct of a party to a contract in conducting business, including but not limited to (a) specification of price, or special pricing systems or discount plans, (b) use of particular sales or display equipment or merchandising devices, (c) use of specific sales techniques, (d) use of advertising or promotional materials or cooperation in advertising efforts; provided that an agreement is not a marketing plan or system solely because a manufacturer or distributor of goods reserves the right to occasionally require sale at a special reduced price which is advertised on the container or packaging material in which the product is regularly sold, if the reduced price is absorbed by the manufacturer or distributor.”).

71. See *To-Am Equip. Co. v. Mitsubishi Caterpillar Forklift Am., Inc.*, 953 F. Supp. 987, 994 (N.D. Ill. 1997) (finding that “advice about how to run the business need not be comprehensive in order to amount to a ‘marketing plan’”).

72. See *Blankenship v. Dialist Int’l Corp.*, 568 N.E.2d 503, 506 (Ill. Ct. App. 1991); see also *Salkeld v. V.R. Bus. Brokers.*, 548 N.E.2d 1151, 1156 (Ill. Ct. App. 1989) (holding that when a producer offers support to a licensee in marketing, training, advertisement, and promotion, then the producer has “amply” satisfied the statutory requirements of a marketing plan).

73. See *Account Servs. Corp. v. DAKCS Software Servs., Inc.*, 208 Ill. App. 3d 392, 398 (Ill. App. Ct. 1990) (finding no franchise where an alleged “plan” that did not “assist the plaintiffs in the affirmative act of selling or their offering of [] services”).

74. See IND. CODE § 23-2-2.5-1; see also IND. CODE § 9-32-2-13 (noting definition of franchise changes and does not include a marketing element when dealing with a vehicle manufacturer and distributor); *Ervin Equip. Inc. v. Wabash Nat’l Corp.*, 187 F. Supp. 3d 968, 977 (N.D. Ind. 2016) (noting dealers can claim violation of Indiana franchise law using both the franchise

Indiana courts have outlined several factors to consider in determining whether a marketing plan or system exists under the IFA.⁷⁵ Indiana courts have recognized the existence of a marketing plan where a producer exercises significant control over a distributor's business operations, particularly, in the areas of (1) geographic control of sales; (2) sales quotas; and (3) control of employee training and sales.⁷⁶ The primary factor is whether a purported franchisor places substantial restrictions on a purported franchisee's business and marketing decisions.⁷⁷ In *McLane v. Pizza King Franchises*, the Indiana Superior Court found that the mere use of "franchise" in a party's corporate name does not necessarily create a franchise relationship and that the existence of only one or two restrictions that a party does not deem "substantial" will not, by itself, create a statutory marketing plan under the IFA.⁷⁸ Specifically, a wholesaler's restriction of the location of a retailer and manner of retail delivery does not constitute a substantial restriction, and, because the minimum control requirements of a marketing plan were not met, no franchise relationship existed, and the IFA did not govern the relationship.⁷⁹ Similarly, a party's provision of free promotional materials and recommended prices to its counterparty will not constitute a marketing plan or system under the IFA.⁸⁰

E. Maryland

The Maryland Franchise Registration and Disclosure Law (MFRDL) is nearly identical to the CFA.⁸¹ In *Koehler Enterprises, Inc. v. Shell Oil Co.*, the U.S. District Court for the District of Maryland even cited to several cases interpreting the CFA to support its conclusion that when a distributor acts independently of a supplier's control, a marketing plan does not exist.⁸² There, a distributor alleged that the supplier induced the operator

definition specific to manufacturer-dealer relationship, and the general definition of franchise that has the marketing plan element).

75. See, e.g., *McLane v. Pizza King Franchises*, No. S 356-86, 1987 WL 92061 (Ind. Super. Ct. Sept. 4, 1987).

76. See *Master Abrasives Corp. v. Williams*, 469 N.E. 2d 1196, 1200 (Ind. Ct. App. 1984); see also *Hoosier Penn Oil Co. v. Ashland Oil Co.*, 934 F.2d 882 (7th Cir. 1991) (holding that when a manufacturer does not exercise significant control over distribution areas, employee hiring and training, sales quotas, and communication with distributor clients, then the manufacturer has not prescribed a marketing plan or system).

77. See *McLane*, 1987 WL 92061, at *9.

78. *Id.* at 10.

79. *Id.*

80. See *Richard I. Spiece Sales Co. v. Levi Strauss N. Am.*, 19 N.E.3d 345, 357-58 (Ind. App. 2014).

81. See MD. CODE, BUS. REG. § 14-201(e) ("Franchise" means an expressed or implied, oral or written agreement in which: (i) a purchaser is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by the franchisor; (ii) the operation of the business under the marketing plan or system is associated substantially with the trademark, service mark, trade name, logo-type, advertising, or other commercial symbol that designates the franchisor or its affiliate; and (iii) the purchaser must pay, directly or indirectly, a franchise fee.").

82. See *Koehler Enters., Inc., et.al. v. Shell Oil Co.*, BUS. FRANCHISE GUIDE ¶10,252 (D. Md. Feb. 12, 1993); see also *id.* at *10 (citing numerous Connecticut decisions on the CFA).

of a gasoline service station to execute a second agreement on the basis of a series of false representations as to the supplier's then-present intention regarding the type of service station that would be constructed.⁸³ At one point, the distributor even declined to execute the "franchise" agreement on the basis of perceived discrepancies between the parties' oral negotiations and the written agreement as proposed.⁸⁴ Ultimately, the distributor claimed that the supplier convinced the distributor to execute the agreement based on the franchisor's oral interpretation of the written agreement at closing.⁸⁵ The court denied summary judgment as to both intentional and negligent misrepresentation claims asserted under the MFRDL, holding that the minimum control requirements of a marketing plan were not present and, thus, no franchise relationship existed.⁸⁶

F. Michigan

Under Michigan's Franchise Investment Law (MFIL), the "franchise" definition utilizes several characteristics that guide Michigan courts in determining whether a marketing plan exists, including requirements that (1) the franchisee purchase most of its goods from the franchisor or approved vendors; (2) the franchisee follow an operating plan, standard procedure, training manual, or substantial equivalent; (3) the franchisor assists with training franchisee employees; (4) the franchisor assist with finding franchisee locations; and (5) the franchisor assists the franchisee with marketing the franchisor's products.⁸⁷ Additionally, the statute also considers limitations placed on the franchisee regarding the type, quality, or quantity of goods and services that the franchisee may provide to its customers, or whom the franchisee can sell to, as factors indicating that a marketing plan is in place.⁸⁸

G. New York

New York's statutory definition of a franchise differs from other states in that a franchise relationship exists where just one of the two prongs is satisfied: substantial association with a franchisor's trademark, name, or logo, and a franchise fee paid, *or* a marketing plan/system prescribed in substantial part by the franchisor and a franchisee fee paid.⁸⁹ New York courts have created a narrower definition of marketing plan, where licensees or distributors must prove that the licensor or manufacturer exercised significant control over daily business operations in order to claim the existence of a marketing plan.⁹⁰ New York's narrower approach may be due to their more lenient

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.*

87. See MICH. COMP. LAWS. § 445.1502(3) (1984); MICH. ADMIN. CODE r. 445.101.

88. See MICH. ADMIN. CODE r. 445.101.

89. See N.Y. GEN. BUS. LAW § 681(3).

90. See, e.g., *Safe Step Walk in Tub Co. v. CKH Indus., Inc.*, 242 F. Supp. 3d 245 (S.D.N.Y. 2017); see also *Aristacar Corp. v. Attorney General*, 541 N.Y.S.2d 165, 167 (Sup. Ct. 1989) (holding

inquiry of whether a franchise exists. The court in *Safe Step Walk in Tub Co. v. CKH Industries, Inc.*, reasoned that a "marketing plan," as defined by New York law, is essentially the same as the control requirement promulgated by the FTC's definition of a franchise.⁹¹ In *Safe Step*, CKH entered into a distribution agreement to sell and install Safe Step tubs in the greater New York City area.⁹² The agreement explicitly stated that CKH was an independent contractor, not a franchisee.⁹³ However, Safe Step required CKH to meet either a minimum sales requirement or advertising budget requirement.⁹⁴ Additionally, Safe Step granted CKH the right to serve as the exclusive licensee in the outlined geographic area.⁹⁵ Furthermore, Safe Step required CKH to "vigorously promote" Safe Step products within its territory, maintain certain record keeping procedures, and keep Safe Step informed of market conditions.⁹⁶ CKH eventually claimed that a franchise relationship existed and that Safe Step had violated New York franchise law.⁹⁷ The court ultimately held that any state definition that uses "marketing plan" or "community of interest" to define a franchise is essentially including a control element, and, therefore, the minimum requirement of a marketing plan was met where these factors are present.⁹⁸

H. North Dakota

North Dakota courts have issued little to no opinions interpreting the "marketing plan or system" element of its franchise statute.⁹⁹ However, in *Meadow Fresh Farms, Inc. v. Sandstrom*, which was an appeal from an order issued by the North Dakota Securities Commissioner that unregistered franchises were offered and sold by Meadow Fresh Farms in violation of the North Dakota Franchise Investment Law, the North Dakota Supreme Court held that a preponderance of evidence existed for the North Dakota Securities Commissioner to find a "marketing plan or system."¹⁰⁰ Namely, Meadow Fresh Farms provided (1) a detailed bonus structure for distributors; (2) centralized bookkeeping; (3) policies for distributor advancement; (4) assistance

that when a licensor regulates virtually every aspect of a licensee's operation, then the licensor has satisfied the control requirements of a marketing plan.); cf. *Nat'l Survival Game of N.Y., Inc. v. NSG of LI Corp.*, Bus. FRANCHISE GUIDE ¶ 9294 (N.Y. Sup. Ct. Nov. 14, 1988) (finding no statutory marketing plan exists when a licensee operates their own business, independent of any licensor control, and is only required to make regular payments for the use of the licensor's name).

91. See *Safe Step*, 242 F. Supp. 3d at 257, 260 (citing 16 C.F.R. § 436.1(h) ("(2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation")).

92. See *id.* at 251.

93. *Id.* at 252–53.

94. *Id.* at 252.

95. *Id.*

96. *Id.* at 261.

97. *Id.* at 251, 259 (CKH also claiming that Safe Step violated Connecticut, New Jersey, and Rhode Island franchise laws).

98. *Id.* at 260.

99. N.D. CENT. CODE § 51-19-02.

100. *Meadow Fresh Farms, Inc. v. Sandstrom*, 333 N.W.2d 780 (N.D. 1983).

with customer meetings; (5) suggested prices; and (6) a comprehensive advertising program.¹⁰¹

I. *Oregon*

The case law interpreting what constitutes a franchise under the Oregon Franchise Transactions Law (OFTL) is limited but telling, as Oregon is one of the only states with a narrow view of this definitional element. In *Leonetti Furniture Manufacturing Co. v. Sealy, Inc.*, Leonetti sued for violation of the OFTL based on a license agreement between it and Sealy to manufacture and sell Sealy-Ohio mattresses.¹⁰² Pursuant to the parties' license agreement, Leonetti was required to meet minimum sales goals, use its best efforts to sell Sealy-Ohio mattresses and maintain adequate production facilities, and Sealy-Ohio was allowed to inspect the production of Sealy-Ohio mattresses.¹⁰³ Further, there were even circumstances where Sealy-Ohio had discussions with Leonetti about the conduct of its salespeople.¹⁰⁴ However, these facts were not enough to sway the U.S. District Court for the District of Oregon in determining that no franchise relationship existed between the parties.¹⁰⁵ Specifically, Leonetti had failed to prove that the minimum control requirements were met.¹⁰⁶ Interestingly, the court noted that the Oregon statute was analogous to the control element under the FTC Rule.¹⁰⁷ Because the court determined that the parties' relationship did not fulfill the "control" FTC Rule element, the court did not need to specifically address the substance, or application, of the "marketing plan or system" element.¹⁰⁸

J. *Tennessee*

Tennessee is the only state to create the definitional element "marketing plan" purely via case law without an underlying definition to interpret. Called upon to determine whether a manufacturer met its repurchasing requirement under the Tennessee Law for the Repurchase of Terminated Franchise Inventory (TRTFI), the Tennessee Supreme Court constructed its own definition of a "franchise" because the Tennessee legislators had not already done so.¹⁰⁹ In *Middle Tennessee Associates, Inc. v. Leeville Motors*, Middle Tennessee Associates (MTA) and Leeville Motors (Leeville) entered into a distribution agreement for gardening equipment.¹¹⁰ When Leeville Motors fell behind on payments, MTA offered to repurchase the inventory subject to a fifteen percent restocking fee, less than what is required under the

101. *Id.* at 784–85.

102. *See* *Leonetti Furniture Mfg. Co. v. Sealy, Inc.*, BUS. FRANCHISE GUIDE ¶9,756, at p. 4 (D. Or. Oct. 16, 1990).

103. *Id.* at *11.

104. *Id.*

105. *Id.* at *30.

106. *Id.*

107. *Id.*

108. *Id.* at *10.

109. *Middle Tenn. Assocs., Inc. v. Leeville Motors*, 803 S.W.2d 206 (Tenn. 1991).

110. *Id.* at 208.

TRTFI, prompting Leeville Motors’ claim under the TRTFI.¹¹¹ Following other states’ guidance set forth in a treatise on franchise contracts, the court held that a “franchise” exists when three elements are present, including “a franchisor who is engaged in the business of selling or distributing goods under a *marketing plan or system* devised and prescribed by the franchisor.”¹¹² In so holding, the court overturned the appellate court decision, which had favored the purported franchisee, noting that “selling brand name merchandise does not make an independent dealer a franchisee,” as the court was unable to identify any “marketing system.”¹¹³

K. Virginia

Virginia, like many other states, has afforded its statute a broader reading of a “marketing plan or system,” providing an expansive covered class of potential franchisees. At the regulatory level, the Virginia State Corporation Commission (VSCC) has held that a marketing plan or system exists where a licensor (ATC) granted a license to two licensees (Y&G and Triplex) to use the ATC name and provided the licensees with billing statements and training/promotional material to recruit new members.¹¹⁴ Here, the VSCC instituted an investigation against ATC for violation of the Virginia Retail Franchising Act (VRFA).¹¹⁵ Ultimately, the three-person panel of the VSCC found that ATC had offered and sold unregistered franchises in violation of the VRFA.¹¹⁶ In response, ATC submitted a letter requesting reconsideration in connection with the determination due to the fact that ATC had received a letter from a staff member of the VSCC noting that its arrangement was not a franchise and that an internal investigation into the issue had ceased.¹¹⁷ The VSCC determined that the record outlining ATC’s conduct before and after receipt of the letter demonstrated a complete lack of reliance on the staff letter and upheld its decision.¹¹⁸ The VSCC noted that it is not bound by the staff letter and that the staff member had delivered the staff letter after execution of one of the license agreements outlined above.¹¹⁹ Ultimately, the VSCC required ATC to rescind the systems broker agreements and pay restitution to each of Y&G and Triplex (instead of payment to the Treasurer of Virginia).¹²⁰ Because the VSCC found a “marketing plan or system” where the franchisor merely provided optional billing statements and optional training/promotional material, this case represents one of the broadest constructions of the definition of a marketing plan or system.

111. *Id.*

112. *Id.* at 211 (emphasis added).

113. *Id.* (citing *Lobdell v. Sugar ‘N Spice, Inc.*, 658 P.2d 1267, 1271 (Wash. Ct. App. 1983)).

114. *Commonwealth of Virginia ex rel. Y & G Co. and Triplex, Inc. v. Am. Trade Exchange, Inc.*, Case No. SEC870114, 1988 WL 1703284 (Va. State Corp. Comm’r Aug. 12, 1988).

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

Continuing this broad reading, the Virginia Supreme Court in *Crone v. Richmond Newspapers, Inc.* held that the VFRA applied to a distribution relationship where distributors were required to purchase a minimum amount of newspapers, deliver them to distribution points designated by the producer, RNI, and provide RNI with regular sales reports.¹²¹ Furthermore, the distribution racks had to meet size, color, and logo requirements set by RNI.¹²² The Virginia Supreme Court highlighted the legislators' express policy in passing the VFRA, namely "[to] correct inequities in the franchise system and to provide franchisees more direct, simple and complete judicial relief against franchisors who fail to deal in a lawful manner with them."¹²³ The court reversed and remanded the lower court decision in favor of RNI, holding that a franchise relationship did exist and that RNI could not terminate the relationship without reasonable cause.¹²⁴

As evidenced by the results in *American Trade Exchange* and *Crone*, accidental and purposeful franchisors can be subject to consequences for violations of these state laws both at the regulatory level and the judicial level.

L. Washington

Washington outlines the factors that it will consider in determining whether a "marketing plan or system" exists under the Washington Franchise Investment Protection Act (FIPA). Specifically, those factors include "(a) price specifications, special pricing systems or discount plans; (b) sales or display equipment or merchandising devices; (c) sales techniques; (d) promotional or advertising materials or cooperative advertising; (e) training regarding the promotion, operation, or management of the business; or (f) operational, managerial, technical, or financial guidelines or assistance."¹²⁵

In *Atchley v. Pepperidge Farm, Inc.*, the U.S. District Court for the Eastern District of Washington, on remand from the Ninth Circuit, held that a manufacturer has not prescribed a statutory marketing plan where it merely sets some distributor prices and guarantees an initial acquisition loan, but otherwise allows a distributor to operate independently.¹²⁶ The court noted that the control element was key to the existence of a "marketing plan."¹²⁷ An additional relevant factor is whether there is a provision of financial support or whether PFI audited the books of Atchley or inspected its premises.¹²⁸ Ultimately, the court did not find any of these control factors, in addition

121. See *Crone v. Richmond Newspapers, Inc.*, 384 S.E.2d 78 (Va. 1989).

122. *Id.* at 79.

123. *Id.* at 78.

124. *Id.* at 81.

125. See WASH. REV. CODE. § 19.100.010(11).

126. *Atchley v. Pepperidge Farm, Inc.*, No. CV-04-452-EFS., 2012 WL 6057130 (E.D. Wash. Dec. 6, 2012).

127. See *id.* at *8.

128. *Id.* at *14 (citing *Hartford Elec. Supply Co. v. Allen-Bradley Co.*, 736 A.2d 824, 834 (Conn. 1999)).

to any of the other elements of a “franchise” under FIPA, and held that no franchise relationship existed.¹²⁹

M. Wisconsin

The Wisconsin Franchise Investment Act (WFIA) outlines the factors that it will consider in determining whether a “marketing plan or system” exists, including an agreement that (i) requires a distributor or licensee to purchase substantial portion of goods from sources approved by licensor; (ii) requires distributor or licensee follow an operating plan, standard procedure, or training manual or its substantial equivalent; (iii) requires distributor or licensee be limited as to the type, quantity and/or quality of any product or service the distributor or licensee may sell; (iv) limits which accounts or persons the licensee or distributor can sell to; (v) has termination or inventory buy-backs exercisable substantially at the will of the licensor; and (vi) requires that the licensor to assist the distributor or licensee in training, obtaining locations or facilities for operation of the franchisee’s business or in marketing the franchisor’s product or service.¹³⁰

Contrary to Wisconsin courts’ generally broad interpretation of the definition of a franchise under the Wisconsin Fair Dealership Law (WFDL),¹³¹ which governs the *relationship* of two parties to a franchise agreement (as defined by the WFDL), the determinations under the WFIA are much narrower. For example, in *Otto v. Synthetic Surfaces*, the fact that a distributor was required to attend sales training provided by a manufacturer (subsection (vi) above), alone, was insufficient to fulfill the minimum requirements to establish the existence of a marketing plan and, in turn, a franchise relationship.¹³² Namely, the court evaluated several of the other factors noted above in refusing to find a franchise relationship when a manufacturer put no limits on the customers a distributor could solicit and engage (subsection (iv) above), is not required to purchase most of its supplies from a specified supplier (subsection (i) above), and is not required to operate according to a plan laid out by a producer (subsection (ii) above).¹³³

Again, starting on the regulatory side this time in *In the Matter of the KIS Corp.*, the Wisconsin Commissioner of Securities (WCS) found that a manufacturer (KIS) offered and sold unregistered franchises in violation of the WFIA.¹³⁴ KIS recommended, but did not require, the use of prices for products, and also offered an operational manual, sales kits, non-mandatory training, maintenance support, supplies, and participation in a cooperative

129. *Id.*, at *10.

130. See WIS. ADMIN. CODE § 31.01(4)(a).

131. See *Ziegler Co., Inc. v. Rexnord, Inc.*, 407 N.W.2d 873 (Wis. 1987) (rejecting a rigid rule and establishing two “guideposts” to use in determining existence of franchise relationships with respect to the definitional element “community of interest”).

132. *Otto v. Synthetic Surfaces, Inc.* 103 Wis. 2d 693 (Ct. App. 1981).

133. *Id.* at *3.

134. See *generally In re KIS Corp.*, No. F-86008(E), 1986 WL 1343366 (Wis. Comm’r of Secs. Dec. 24, 1986).

advertising program, which the WCS reasoned fulfilled the “marketing plan” definitional element.¹³⁵ While a “marketing plan” existed, but because it was not mandatory, the WCS held the parties’ relationship did not fulfill the definition of a “franchise” under the WFIA.¹³⁶

Courts and regulatory bodies may also consider whether the underlying agreement contains terms that require a licensee to purchase a substantial portion of goods solely from the licensor’s designated sources.¹³⁷

IV. (Marketing) Plan of Attack

As is always the case, planning and engagement to enable an attorney’s thorough understanding of its client’s business arrangements will help avoid the costly accidental franchise mistake at the state and federal level. Furthermore, an understanding of the legislative intent behind these state statutes (i.e., protecting franchisees who are presumably unable to effectively bargain with their franchisors) will help further the analysis. Before proceeding with a “franchise-adjacent” relationship, it is important that all licensors/distributors/grantors, and their attorneys, have a keen understanding of the nuances of the definitional elements of a franchise under each applicable statute. A “no franchise” disclaimer in an agreement is insufficient and will likely land your client in hot water. Furthermore, to franchise attorneys’ detriment, as is the case with so many issues in the franchise industry, there is not one dispositive factor in a court’s finding of a franchise relationship; oftentimes, it is the existence of several factors that result in the accidental or inadvertent franchise relationship. A recurring theme among accidental franchisors is a combination of the franchisor’s provision of marketing/sales materials or sales techniques, pricing controls, and training. Based on the cases outlined in this article, a combination of those three factors will likely land unsuspecting businesses in the franchise industry whether they like it or not.

Attorneys counseling their clients on how to avoid the franchise designation in the states listed above must investigate each of the statutes’ underpinnings, the legislative intent, and the factors considered by the applicable courts. Certain states call out those specific factors in the statute itself, while other simply do not. A careful reading, and implementation, of those factors can go a long way. Furthermore, any agreement should be carefully crafted with these factors in mind while always explaining the downside of avoiding the franchise designation; loss of control. Lastly, as is the case in most scenarios, companies must act in accordance with the terms of their agreements and avoid extending supervision and assistance beyond those words. Sometimes actions speak louder than words in finding a franchise relationship.

135. *Id.* (no pin cite available).

136. *Id.* (no pin cite available).

137. See generally *Weiss v. Crazy Jim*, No. 79-632, 1980 WL 99605, at *2 (Wis. Ct. App. Jan. 21, 1980) (citing Wis. ADMIN. CODE DFI § 31.01(6)(b)).

LADR Case Note (May 2022) and FLJ Currents (Fall 2022)

Emily I. Bridges & Jared C. Miller*

LADR May 2022 Case Note

ABP Holdings, Inc. v. Rainbow Int'l LLC, No. 10-21-122-CV, 2021 WL 5920276 (Tex. App.—Waco Dec. 15, 2021).

This case discusses the enforcement of non-compete provisions and the proper pleading of affirmative defenses. Specifically, the court addressed the standard for winning temporary injunctive relief to enforce a non-compete and the requirements of raising an unconscionability defense in response to a breach of contract claim.

In November 2016, Rainbow International, LLC (Rainbow) entered into a franchise agreement with ABP Holdings, Inc., whose principals were Anderson, Breckenridge, and Partee. By August 2019, ABP was in default under the franchise agreement. In April 2020 Rainbow sent notice of intent to terminate and ultimately terminated in July 2020. Rainbow later came to believe ABP was violating its post-termination obligations under the franchise agreement's non-compete provision. Rainbow sued ABP in January 2021, seeking injunctive relief and money damages for violating the non-compete. ABP filed a motion to dismiss or, alternatively, to compel arbitration, and Rainbow sought a temporary injunction. The trial court denied ABP's motion to dismiss or compel arbitration and granted Rainbow's motion for a temporary injunction. ABP appealed.

The Texas Court of Appeals addressed three primary issues in the case. First, ABP asserted that the lower court, in finding a valid arbitration agreement yet denying a motion to compel arbitration, nonetheless abused its discretion and deprived appellants of expected arbitration. To do so, the court allegedly implemented an "unconscionable" exception to the arbitration provision, which rendered it illusory. Notably, ABP had not raised this issue



Ms. Bridges



Mr. Miller

*Emily I. Bridges (emilybridges@parkerpoe.com) is an associate at Parker Poe Adams & Bernstein LLP in its Greenville, South Carolina office. Jared C. Miller is a partner at Parker, Hudson, Rainer & Dobbs LLP in its Atlanta, Georgia office (jmiller@pbrd.com).

previously. Second, ABP alleged that respondent, Rainbow, failed to show the lack of an adequate remedy at law and, therefore, should not have qualified for injunctive relief. Third, ABP argued the temporary injunction ought to be dissolved pursuant to Texas Rule of Civil Procedure 683 and further alleged that Rainbow's claim contained only conclusory statements, failing to explain, with sufficient specificity, the "probable, imminent or irreparable" harm respondent would suffer without such relief.

The court rejected ABP's unconscionability argument given that ABP had not raise it in their pleadings, briefing, or arguments at trial. Earlier, ABP argued only that Rainbow's claims did not qualify for any prescribed exceptions in the arbitration provision. Unconscionability, which is an affirmative defense, was not pled and therefore not preserved for appellate review. The court declined to address the merits. As we see here, inattention to proper appellate procedure can prove fatal. Parties facing a claim for breach of contract should anticipate and plead all possible defenses to the claim, and claimants should be mindful of the defenses ultimately pled by counterparties. If applicable, franchisors ought to challenge whether franchisees have properly preserved claims.

Next, the court affirmed the lower court's grant of injunctive relief since Rainbow had shown irreparable harm would flow from ABP's continued violation of the non-compete. The standard of review for a trial court's grant or denial of temporary injunctive relief is "clear abuse of discretion" *Walling v. Metcalfe*, 863 S.W.2d 56, 58 (Tex. 1993). And an appellate court may only overrule a trial court's grant of an injunction if the lower court acted "unreasonably or in an arbitrary manner, without reference to guiding rules or principles." *Butnaru v. Ford Motor Co.*, 84 S.W.3d 198, 211 (Tex. 2002). Rainbow maintained that former franchisees have an inherent competitive advantage (use of franchisors branding, products, technical knowledge, etc.), and the non-compete protects both Rainbow and other franchisees from undue competition in the period immediately following the end of a franchise agreement. Rainbow was unable to quantify or repair the damage done by ABP's non-compliance and had offered sufficient evidence suggesting that ABP would continue to breach the non-compete. The Court of Appeals affirmed the trial court, holding that Rainbow did not have any other adequate remedy at law, so injunctive relief was appropriate.

Importantly, even if Rainbow did not offer sufficient evidence to show it would lack an adequate remedy at law, it could still obtain the relief that it sought. The court explained that a party attempting to win temporary injunctive relief to enforce a restrictive covenant does not need to make such a showing, citing *Letkeman*, 299 S.W.3d at 486, and *Jim Rutherford Investments, Inc.*, 25 S.W.3d at 849, and *Munson*, 948 S.W.2d at 815. In the franchise context, non-compete clauses are often crucial since they, and other restrictive covenants, are essential risk-shifting mechanisms. The lower evidentiary standard described here ought to be leveraged by those parties seeking to ensure compliance with non-competes, just as Rainbow did here.

Finally, the trial court did not violate Rule 683, which covers the requirements and scope of temporary injunctive relief. As the appellate court explained, if an injunction is issued, yet fails to comply with Rule 683, it will be voided since non-compliance constitutes an abuse of discretion. To avoid a finding of non-compliance, the lower court must provide reasons why there would be irreparable injury absent interlocutory injunctive relief. *State v. Cook United, Inc.*, 464 S.W.2d 105, 106 (Tex. 1971). Since Rainbow showed continuing violations of the non-compete (ABP operated a competing business in the same location, advertised their services, and maintained their Rainbow-branded website), which constituted irreparable harm, and the trial court cited these facts, the temporary injunction was compliant with Rule 683. As a result, the Court of Appeals concluded that the injunction should not be voided.

Compliance with Rule 683 is a necessary condition to be granted injunctive relief and win on appeal. Rainbow, by providing relevant and sufficient factual allegations, enabled the court to cite these facts in its order granting injunctive relief. For practitioners involved in motions for injunctive relief, it is crucial to build a record with sufficient facts to support a court order that satisfies the requirements of Rule 683 and similar rules in other jurisdictions.

CURRENTS

AGENCY

Lacertosa v. Days Inn Worldwide, Inc., Bus. Franchise Guide (CCH) ¶ 17,094, Case No. KNL-CV-21-6050397-S, 2022 WL 1051147 (Conn. Mar. 30, 2022)

This case is discussed under the topic heading “Labor and Employment.”

Ward v. Cottman Transmission Systems, LLC, Bus. Franchise Guide (CCH) ¶ 17,073, Case No. 1:18-cv-02155-NLH-MJS, 2022 WL 909637 (D.N.J. Mar. 29, 2022)

This case is discussed under the topic heading “Labor and Employment.”

ARBITRATION

Ivy Bridge v. Nature’s Sunshine Products, Inc., Bus. Franchise Guide (CCH) ¶ 17,052, Case No. 2:21-cv-495-DAK-DAO, 2022 WL 604857 (D. Utah Mar. 1, 2022)

In this lawsuit brought by several distributors relating to changes made to a distributor model, the U.S. District Court for the District of Utah granted the defendant’s motion to dismiss and to compel arbitration based on mandatory arbitration provisions in contracts relating to the distribution relationship. Even though the plaintiff distributors had not executed the agreements containing the arbitration clause, the court found that the

plaintiff distributors were bound by the arbitration clause because they were aware of the contracts and had accepted benefits under the contracts.

The plaintiffs were twenty longtime distributors of products manufactured by defendant Nature's Sunshine Products, Inc. (NSP). NSP manufactures and distributes herbal supplements through non-exclusive distributors pursuant to a multilevel marketing model. In September 2020, NSP made changes to its multilevel marketing model to move toward a retail "direct sales to consumers" model. The plaintiff distributors allege that these changes to the model, including to the model's compensation plan, breached oral promises that NSP had made to the distributors. The plaintiff distributors asserted claims against NSP for promissory estoppel, unjust enrichment, breach of oral contract, breach of the implied covenant of good faith and fair dealing, and intentional interference with prospective economic advantage. In response to the plaintiffs' claims, NSP filed a motion to dismiss and compel arbitration based on a mandatory arbitration clause that NSP contended was contained in all of the contracts governing its distribution arrangement with the distributors.

The plaintiffs conceded that their claims were covered by the scope of the arbitration clause, but alleged that they were not bound by the arbitration clause since they never signed a contract containing the arbitration clause. NSP argued that the plaintiffs were aware of the contracts and had accepted benefits under the contracts and thus were bound by the arbitration clause. The court agreed with the defendants.

NSP contended that its relationship with its distributors is governed by a "Membership Agreement," consisting of three different contracts, including a set of "Policies and Procedures," which contained an arbitration clause applying to "any legal cause of action arising out of or relating to the Membership Agreement." The distributors countered, however, that their relationships with NSP were not pursuant to any written or signed agreement. The court held, though, that the distributors were bound by the agreements because they were aware of and accepted benefits under the agreements. Among other evidence, the court relied on evidence that, when NSP made changes to its compensation model, it offered distributors certain payments, which, to receive, the distributors had to satisfy certain conditions, including compliance with NSP's Policies and Procedures (which contained the arbitration clause). The court found it significant that each plaintiff received those payments and none of them returned the payments or rejected the terms upon which they received the payments.

The court also rejected the plaintiff distributor's contention that they did not receive notice of the arbitration provision. On this issue, the court relied upon the declaration submitted by NSP testifying that the Policies and Procedures, containing the arbitration clause, were emailed to each of the distributors. Although the distributors pointed to a lack of evidence, they actually received the emails, and the distributors did not submit a declaration

stating they did not receive the emails. The court held that these email notifications provided sufficient notice and that no paper notice was required “in this day and age.” Finally, the court rejected the distributors’ argument that the lack of their signature on any document containing an arbitration clause was fatal, holding instead that an agreement to arbitrate must be in writing, but that agreement need not be executed provided that it is agreed to.

Finally, the court rejected the distributors’ argument that the contract was unconscionable both because they had not met their burden of showing unconscionability and because they were barred from arguing unconscionability after having accepted benefits under the contract.

CHOICE OF LAWS

***Havtech, LLC v. AAON Inc.*, Bus. Franchise Guide (CCH) ¶ 17,084, Case No. SAG-22-00453, 2022 WL 1213476 (D. Md. Apr. 25, 2022)**
This case is discussed under the topic heading “Dealership.”

CONTRACT ISSUES

***Shepard and Associates, Inc. v. Lokring Technology, LLC*, Bus. Franchise Guide (CCH) ¶ 17,040, Case No. 1:20-CV-02488-PAB, 2022 WL 312711 (N.D. Ohio Feb. 17, 2022)**

In this dispute between a manufacturer and a distributor, the U.S. District Court for the Northern District of Ohio granted, in large part, the motion for preliminary injunctive relief filed by the manufacturer, Lokring Technology. The court found that Lokring had satisfied its burden of demonstrating that it was likely to succeed on the merits of its trade secrets claims, breach of contract claims, and other claims and otherwise satisfied the standard for preliminary injunctive relief based on evidence of misappropriation of its customer database and other misuse and improper disclosures of its confidential information.

Lokring designs and manufactures mechanically attached fittings for use in pressure piping systems. In April 2016, Lokring entered into a contract (Distributor Agreement) with Plaintiffs Shepard & Associates, Inc. and Brad Shepard (collectively, Plaintiffs) to act as Lokring’s exclusive distributor for portions of the southwestern United States. The Distributor Agreement required Plaintiffs to take certain steps to protect Lokring’s confidential information and also required Plaintiffs to cause each of their employees to enter into confidentiality and non-competition agreements. In February 2019, Plaintiffs hired Jared Guidry as a technical sales consultant. Although Guidry’s offer letter stated his employment was conditioned on his agreement to confidentiality and non-competition agreements, he never actually was presented with or signed such agreements. In June 2020, another employee of the distributor, acting pursuant to instructions from Brad

Shepard, downloaded a spreadsheet containing Lokring's customer database, called its "Big Contact List," which contained information on over 26,000 customers. The employee forwarded the Big Contacts List to both Shepard and Guidry. Guidry and Shepard later forwarded the Big Contacts List to their personal email accounts. Shortly thereafter, Lokring terminated the distributor agreement. Following the termination, Guidry left Shepard & Associates and accepted employment with a Lokring competitor, Tube-Mac. Guidry thereafter solicited several of Lokring's customers, including one of Lokring's biggest customers, on behalf of Tube-Mac. Lokring presented evidence that Guidry could only have made certain of the solicitations based on information in the Big Contacts List. Guidry also sent disparaging emails about Lokring to Lokring's customers and notified certain customers of what he described as a design flaw in Lokring's product, attaching a document discussing that issue (Corrosion Allowance Document).

As a result of the foregoing conduct, Lokring filed numerous claims against Plaintiffs and Guidry, including claims for misappropriation of trade secrets, breach of contract claims, and unfair competition claims. The court granted a temporary restraining order and required Plaintiffs to return the Big Contacts List and Corrosion Allowance Document to Lokring and refrain from using or disclosing Lokring's confidential information. The court subsequently held a six-day evidentiary hearing pertaining to Lokring's motion for a preliminary injunction.

On consideration of Lokring's motion for a preliminary injunction, the court dismissed Guidry, a Texas resident, due to lack of personal jurisdiction. The court initially found that Guidry, who worked for the distributor in Texas, was subject to jurisdiction under Ohio's long-arm statute because he had committed tortious acts outside Ohio that caused injury within Ohio by using his Lokring email account, which was located on Lokring's Ohio-based server, in order to misappropriate Lokring's confidential information. However, after conducting a due process analysis, the court found that it nonetheless lacked personal jurisdiction over Guidry because he had not purposefully availed himself of the laws of Ohio.

As to Plaintiffs Shepard & Associates and Brad Shepard, the court granted, in large part, Lokring's request for preliminary injunctive relief. First, the court found that Lokring had a strong likelihood of success on the merits of its state law (Ohio Uniform Trade Secrets Act) and federal law (Defend Trade Secrets Act) trade secrets claims against Plaintiffs and enjoined Plaintiffs from further misuse of Lokring's trade secret information and confidential information. The court found a substantial likelihood that Lokring would be able to establish that its Big Contacts List constituted a protectable trade secret. The court noted that the voluminous customer database contained specific customer information on over 26,000 customers that was not publicly available and that Lokring took significant steps to protect the database and its other confidential information, including

by having Plaintiffs execute a non-disclosure agreement and maintaining a secure IT network. The court rejected Plaintiffs' argument that Lokring's licensing of the Big Contacts List to Plaintiffs destroyed its trade secret status, finding that Plaintiffs were contractually required to keep the list confidential and that ownership remained in Lokring. Combined with the strong evidence that Plaintiffs had misappropriated the Big Contacts List by failing to return it after termination of the distributor agreement and by Shepard's forwarding the list to his personal email account, the court held that Lokring was entitled to injunctive relief. However, the court found that Lokring had not established a likelihood of success on the merits of its trade secrets claim as to the Corrosion Allowance Document due to evidence suggesting that document originated from and was owned by a third party.

The court also found that Lokring had demonstrated a substantial likelihood of success on its breach of contract claims against Plaintiffs. Plaintiffs breached the Distributor Agreement by (i) failing to obtain a signed confidentiality and non-competition agreements from Guidry; (ii) disclosing confidential Lokring information to Guidry without obtaining a confidentiality agreement; and (iii) failing to return confidential information to Lokring upon termination of the Distributor Agreement.

The court also found that Lokring had shown a substantial likelihood of success on its claim against Plaintiffs for breaching the non-competition restriction in the Distributor Agreement by virtue of Shepard attending a conference on behalf of Lokring's competitor, Tube-Mac, and as a result of Shepard's ongoing communications with Tube-Mac and customers during the restricted period following termination of the Distributor Agreement.

Finally, the court found that Lokring had shown a substantial likelihood of success on its unfair competition and deceptive trade practices claims against Plaintiffs pursuant to the Lanham Act, and the Ohio Deceptive Trade Practices Act. The court found that, while there was no evidence that Shepard sent emails to Lokring's customers making false statements about Lokring's products, Shepard's breaches of the Distributor Agreement likely made it possible for Plaintiffs' employee, Guidry, to send unfairly competitive and deceptive emails to Lokring customers containing false statements about Lokring and its products.

The court also found that the other components for preliminary injunctive relief were satisfied, including that an injunction was necessary to prevent irreparable harm in the form of the loss of customer goodwill that was likely to be caused by Plaintiffs' unfair competition.

Finally, based on Ohio law and language in the Distributor Agreement, the court tolled and extended the duration of Shepard's non-compete agreement by nearly a year, which was the length of time between the date on which Shepard improperly retained the Big Contacts List to the date when he deleted it from his personal email account, so that Lokring would receive the benefit of the non-compete for which it had bargained.

***Savannah Motorcars, LLC v. Volkswagen Group of America, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,066, Case No. 4:20-cv-37, 2022 WL 866342 (S.D. Ga. Mar. 22, 2022)**

This case is discussed under the topic heading “Dealership.”

***Show Me Hospitality, LLC v. Tim Hortons USA, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,081, Case No. 17-22679-CIV-MARTINEZ/OTAZO-REYES, 2022 WL 1182896 (S.D. Fla. Apr. 21, 2022)**

In this lawsuit, an area developer/franchisee was held liable for contractual fees despite the fact that the franchisor’s restaurant model had changed. The plaintiff, an area developer and franchisee, sued the franchisor for breach of six franchise agreements and the area development agreement under which the franchisee was expected to develop an additional forty restaurants over a five-year period. The franchisor counterclaimed for breach of contract and brought a third-party claim against the guarantor of the franchisee. After reviewing the agreements at issue, the court found that the franchisee’s failure to adhere to the development schedule or pay contractually required fees were not caused by the franchisor’s acts or omissions, and awarded over six hundred thousand dollars in damages to the franchisor.

The development agreement granted the franchisee the right and obligation to develop forty restaurants in the St. Louis, Missouri, area during a five-year period, with the option to develop an additional fifty restaurants. The restaurants were permitted either to be freestanding or carts/kiosks, but the development agreement did require the franchisee to develop a certain number of each type in each of the five years. The failure to adhere to the schedule was considered a breach, unless it was cured or it was due to an act or omission by the franchisor. In addition, the development agreement stated that the franchisee could not transfer any ownership interest in the franchisee entity that would reduce its ownership interest to less than a controlling interest without first obtaining permission from the franchisor. In the six franchise agreements, terms set out the details on specific locations, payment obligations, royalties, advertising, and other fees.

The franchisor approved a total of fourteen locations proposed for development, but only about half were open, and the franchisee did not comply with the development schedule. In 2014, the franchisor was acquired, and significant changes to the business model occurred, including that franchisees were responsible for construction costs. The franchisor’s new management also presented a new, more aggressive development schedule, and the franchisee also presented a new equity partner (which the franchisor rejected). The franchisee closed all locations by 2017.

The franchisee filed a lawsuit in the U.S. District Court for the Southern District of Florida for anticipatory breach of the development agreement, breach of the development agreement and the covenant of good faith and fair dealing, and breach of the franchise agreements. The franchisor

counterclaimed that the franchisee had violated the development agreement and the franchise agreements by failing to pay the required royalties and failure to adhere to the development schedule.

The court first held no anticipatory breach by franchisor had occurred because there was no unequivocal manifestation of an intent to repudiate the prior agreements. The parties had continued to operate under the original development agreement after discussing the new one; therefore, no anticipatory breach had taken place.

Second, the franchisee argued the franchisor had acted in bad faith by rejecting the proposed equity partner. The court held that this rejection was not unreasonable given that it would mean the franchisee was no longer the majority owner of a controlling interest. Finally, the court held the new management of the franchisor did not violate any of the existing contractual obligations to the franchisee.

The franchisor counterclaimed for damages. Because the franchisee had failed to make required payments, and this nonpayment had not been caused by any actions of the franchisor, the franchisor was entitled to judgment and significant damages.

DEALERSHIP

Savannah Motorcars, LLC v. Volkswagen Group of America, Inc., Bus. Franchise Guide (CCH) ¶ 17,066, Case No. 4:20-cv-37, 2022 WL 866342 (S.D. Ga. Mar. 22, 2022)

A federal district court in Savannah denied all summary judgment motions in a case where an asset sale fell through after Volkswagen Group, the franchisor, declined to approve the asset purchase agreement.

Savannah Motorcars, LLC (Savannah) and Peacock RE, LLC (Peacock) agreed to an asset purchase agreement to sell a Volkswagen dealership to Step One Automotive Group, LLC (Step One). In a contemporaneous agreement, Savannah and Peacock agreed to sell two additional auto dealerships for non-Volkswagen cars to Step One. This second purchase agreement included a provision that the approval of the Volkswagen Group was required. Volkswagen did not consent to the sale of its dealership, so Peacock terminated the second purchase agreement.

Savannah and Peacock brought claims against Volkswagen Group under the Georgia Motor Vehicle Franchise Practices Act and for breach of contract. The Georgia law includes a provision requiring a franchisor to approve a proposed transfer unless the franchisor can show that the rejection is not arbitrary and that the prospective purchaser is unfit or unqualified. Savannah and Peacock and Volkswagen Group filed cross-motions for summary judgment.

The district court first addressed whether Peacock had standing to bring a lawsuit against Volkswagen Group as the owner of the real property on which the dealership was located. The court held that Peacock did

have standing because it asserted an injury in fact, a causal connection, and redressability from a court decision.

The court then held there remained questions of fact as to whether Volkswagen Group reasonably denied the proposed purchase agreement. First, there was a dispute as to whether Volkswagen Group had sufficient time to review the documents relevant to the proposed purchase agreement and whether the documents submitted to it met the good-faith standard of the dealership agreement. Additionally, the dealership agreement included a right of first refusal for Volkswagen Group. The court found that this right of first refusal was independent of the Georgia statute such that even if Volkswagen Group showed that Peacock and Savannah interfered with this right, it would still be required to show that Step One was an unfit purchaser. Factual questions arose regarding whether Step One met Volkswagen Group's standards for operational knowledge and financial ability. The court next examined whether Volkswagen Group applied its policies on potential purchasers in a consistent manner, finding conflicting evidence on this question.

Finally, the court held there remained question of fact as to whether Volkswagen Group caused the termination of the second purchase agreement. There were questions as to whether other conditions precedent, including approvals by the other automobile manufacturers would have been satisfied prior to the closing date, so it was unclear whether Volkswagen Group's failure to approve the initial purchase agreement was the cause of the second agreement's failure. As such, the court denied both motions for summary judgment.

***Havtech, LLC v. AAON Inc.*, Bus. Franchise Guide (CCH) ¶ 17,084, Case No. SAG-22-00453, 2022 WL 1213476 (D. Md. Apr. 25, 2022)**

A federal district court in Maryland dismissed a complaint for wrongful termination by an HVAC equipment dealer against a manufacturer, specifically citing to the choice-of-law provision.

The dealer, Havtech, was located in Delaware and Maryland, and it distributed parts and equipment for the construction industry. The supplier, AAON, out of Oklahoma and Texas, manufactured such equipment and sold it through dealers like Havtech. The parties had a policy agreement that stated either party could terminate the agreement at any time with good cause or without cause upon thirty-days advance written notice.

In January 2022, AAON notified Havtech in writing that it was terminating the agreement in thirty days, and Havtech sued. Specifically, Havtech brought a single cause of action under the Maryland Equipment Dealer Contract Act (MEDCA). MEDCA requires, in part, good cause for a supplier or dealer to terminate a contract

The agreement at issue included a termination clause that specifically gave either party the ability to terminate the contract without cause upon advanced written notice. Moreover, the agreement contained a choice-of-law

provision, which stated that the agreement “shall be governed and construed in all respects in accordance with the laws of the state of Oklahoma. Any litigation institute by Rep against AAON pertaining to any breach or termination of this appointment, or pertaining in any other manner to this.”

The court first examined whether Maryland’s fundamental policy exception applied and held that it did not. The court stated that Havtech failed to establish the state of Maryland had a materially greater interest than Oklahoma in this case as one of the supplier corporations was located in Oklahoma. Since both states had comparable interests in the litigation, the court held that the choice-of-law clause should control and should not be overridden.

Next, the court held that Maryland case law did not support a finding of statutory case law such that Maryland law would control. Finally, the court held that the stand-alone tort claim did not fall outside of the purview of the choice-of-law clause. The MEDCA claim was not independent of the parties’ agreement and depended on an invalidation of the agreement, so it fell within the scope of the choice-of-law provision. Because MEDCA was the only basis for recovery, the court dismissed the entire action.

DEVELOPMENT AGREEMENT

***Show Me Hospitality, LLC v. Tim Hortons USA, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,081, Case No. 17-22679-CIV-MARTINEZ/OTAZO-REYES, 2022 WL 1182896 (S.D. Fla. Apr. 21, 2022)**

This case is discussed under the topic heading “Contract Issues.”

GOOD FAITH/FAIR DEALING

***Savannah Motorcars, LLC v. Volkswagen Group of America, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,066, Case No. 4:20-cv-37, 2022 WL 866342 (S.D. Ga. Mar. 22, 2022)**

This case is discussed under the topic heading “Dealership.”

***Show Me Hospitality, LLC v. Tim Hortons USA, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,081, Case No. 17-22679-CIV-MARTINEZ/OTAZO-REYES, 2022 WL 1182896 (S.D. Fla. Apr. 21, 2022)**

This case is discussed under the topic heading “Contract Issues.”

INDEMNIFICATION

***Lacertosa v. Days Inn Worldwide, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,094, Case No. KNL-CV-21-6050397-S, 2022 WL 1051147 (Conn. Mar. 30, 2022)**

This case is discussed under the topic heading “Labor and Employment.”

INJUNCTIVE RELIEF

***Shepard and Associates, Inc. v. Lokring Technology, LLC*, Bus. Franchise Guide (CCH) ¶ 17,040, Case No. 1:20-CV-02488-PAB, 2022 WL 312711 (N.D. Ohio Feb. 17, 2022)**

This case is discussed under the topic heading “Contract Issues.”

LABOR AND EMPLOYMENT

***McArdle-Bracelin v. Congress Hotel, LLC*, Bus. Franchise Guide (CCH) ¶ 17,049, Case No. 1:20-CV-861 (TJM/TWD), 2022 WL 486805 (N.D.N.Y. Feb. 17, 2022)**

In this putative labor law class action, the U.S. District Court for the Northern District of New York denied the motion for judgment on the pleadings filed by the franchisor defendants, Embassy Suites Franchise LLC and Hilton Franchise Holding LLC. The franchisor defendants moved to dismiss all claims filed against them by a former server at one of their franchisee hotels for allegedly unpaid wages. Among other defenses, the franchisor defendants argued that they were not liable because they did not employ the plaintiff. The court, however, denied the franchisor defendants’ motion, holding that the plaintiff had pled sufficient facts to assert a plausible joint employer claim, thus allowing the plaintiff’s claims to proceed to discovery.

In this case, the named plaintiff was a server at a restaurant in one of the franchisee hotels. The plaintiff asserted several claims against both the franchisee and franchisor on behalf of a putative class of similarly situated non-exempt employees who had been employed by defendants over a six-year period. The plaintiff alleged that the defendants did not properly compensate non-exempt employees by charging mandatory service fees to hotel customers, but then failing to distribute all of the collected service fees to the service employees. In particular, the plaintiff alleged that hotel guests were charged twenty-percent mandatory service fees, which the customers assumed would be paid in their entirety to service staff as gratuities, but defendants only remitted a portion of these service fees to the employees. The plaintiff alleged that the defendants provided her and the proposed class with itemized wage statements that did not include information required by New York law, including by failing to provide the name of the employer, merely listing the name “Embassy Suites.” The plaintiff alleged that all of the defendants jointly exercised control over her employment and the employment of the proposed class, thus making them joint employers. Based on these allegations, the plaintiff asserted claims against both the franchisor and franchisee defendants pursuant to New York state law and a claim for unjust enrichment.

The franchisor defendants filed a motion for judgment on the pleadings, arguing that they were not plaintiff’s employer and that the plaintiff had not pleaded sufficient facts to establish joint employer liability. The court, however, rejected this argument, holding that the plaintiff had pleaded sufficient

facts to assert a plausible claim that the franchisor defendants acted as a joint employer. The court analyzed plaintiff's joint-employer claim under the New York statute by looking to the joint-employer test under the Fair Labor Standards Act (FLSA), which contains an identical definition for what constitutes an employer. The court observed that the FLSA uses a very broad definition of employer. The court examined the plaintiff's claims under two types of tests: (i) the "formal control" test, which evaluates, among other things, whether the alleged employer actually supervised the employee and had actual control over the employee's conditions of employment; and (ii) the "functional control" test, which evaluates several other factors.

The court held that the plaintiff's allegations did not satisfy the formal control test because the plaintiff had not alleged that the franchisor defendants had hiring or firing authority over the employees, determined their rate and method of payment, set their work schedules, or maintained any employment records. As to the functional control test, the court observed that several of the factors are difficult to apply to the franchise context and thus did not observe much weight in the court's analysis. Nonetheless, the court found that the plaintiff's allegations were sufficient to assert a plausible claim that the franchisor defendants were joint employers because they extended some degree of control over her employment, including because the franchisee operated under terms created and regulated by the franchisor defendants, several aspects relating to operation of the hotel were directed by the franchisors, and the franchisor defendants established terms relating to worker appearance and the service the hotel provided. Accordingly, the court denied the franchisor defendants' motion for judgment on the pleadings as to the plaintiff's state law claims based on a joint employer theory. The court cautioned, though, that its holding was based on the lenient standard at the pre-discovery motion to dismiss stage and observed that the plaintiff's allegations were "barely" sufficient to allege joint employer status.

The court also denied the franchisor defendants' motion for judgment on the pleadings as to the plaintiff's unjust enrichment claim. The franchisor defendants argued that they played no role in the wage notices and pay statements that allegedly deprived the plaintiff of pay. The court, however, found that the plaintiff's allegations, including that the franchisor defendants played a role, as joint employer, in creating the policies about which the plaintiff complained, were sufficient at the motion-to-dismiss stage to state a claim.

***Lacertosa v. Days Inn Worldwide, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,094, Case No. KNL-CV-21-6050397-S, 2022 WL 1051147 (Conn. Mar. 30, 2022)**

In this case, the court held that the franchisor was entitled to summary judgment on a lawsuit filed by a guest injured by a fall at a Days Inn hotel.

The plaintiff was a guest at a branded Days Inn hotel in Connecticut and, while walking near the swimming pool, a piece of tile caused him to trip and fall. The guest filed suit against the franchisor, alleging building code

violations, failure to maintain the pool structure, failure to inspect, failure to warn, and negligence. The franchise agreement stated that the franchisee was an independent contractor and not the franchisor's agent. Additionally, the franchisor argued that it did not have a duty to the franchisee because the franchisee had the legal responsibility for maintain the premises in a reasonably safe condition.

The court first examined whether plaintiff had presented any issue of material fact as to whether any form of agency relationship existed. First, the court examined whether there was an actual agency relationship, but determined there was not. The court held that the franchisor did not have any right to possess and control the property, citing to the franchise agreement that explicitly stated that the franchisee would "exercise full and complete control over and have full responsibility for your contracts, daily operations, labor relations, employment practices and policies. . . ." Because the plaintiff did not present any additional evidence contrary to the franchise agreement, the court held that the plaintiff was unable to sufficiently allege facts of an actual agency relationship.

The court next examined whether there had been apparent agency, with the plaintiff alleging the franchisor held itself out as providing certain services. The court held that the plaintiff did not adequately allege apparent agency or vicarious liability. While the franchisee was permitted to use the Days Inn trademarks during the operations of its business, the franchisor did not manage or control the day-to-day operations. The franchisor further did not hire or fire employees or otherwise maintain the property. As such, the plaintiff had failed to establish apparent agency.

Finally, the plaintiff alleged that the franchisor was directly liable to the plaintiff because Days Inn itself was negligent and careless. The court held that no evidence indicated the franchisor had provided the materials for the pool or the flooring, or that Days Inn was responsible for the pool's maintenance, warnings, or inspecting the pool for hazards. The franchisee had this responsibility as it was responsible for the premises at issue. Therefore, the court granted summary judgment to Days Inn.

Furthermore, the court determined that, based on the language of the franchise agreement, the franchisee was required to provide insurance and defend and indemnify the franchisor.

***Patel v. 7-Eleven, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,065, 183 N.E.3d 398 (Mass. 2022)**

This case arose as a question certified from the First Circuit to the Massachusetts Supreme Court. The issue was whether the state's independent contractor statute applied to the franchisor-franchisee relationship and was not in conflict with the rules set forth in the FTC Franchise Rule.

A group of 7-Eleven franchisees brought a class action alleging the franchisor had (1) misclassified franchisees as independent contractors, instead

of employees in violation of the Massachusetts statute; (2) violated the Massachusetts Wage Act; and (3) violated the Massachusetts Minimum Wage Law. Under the terms of the franchise agreements, the franchisees had various obligations to keep the stores open and use the franchisor's preferred vendors, payroll system, and other guidelines. However, the franchisees did not receive any salary, but were permitted to draw pay from the franchised stores' gross profits.

The parties filed cross-motions for summary judgment, and the district court granted summary in favor of the franchisor, holding that the Massachusetts independent contractor statute could not apply to the franchisor-franchisee relationship because of an inherent conflict between it and the FTC rules. However, the First Circuit certified to the Massachusetts Supreme Court the question of whether the three-prong test for independent contractors under the Massachusetts independent contractor statute applied to the franchisor-franchisee relationship.

Under the state statute, an individual is presumed to be an employee, and therefore subject to the state employment laws, unless the party can demonstrate certain elements, including freedom from control and direction, the service is performed outside the usual course of business of the employer, and the individual is customarily involved independently in the established area of the same nature as the service performed.

The Massachusetts court held that because the independent contractor statute neither expressly included nor expressly excluded the franchise relationship, then the legislature must have intended for it to be applied in this context. Next, the Massachusetts court noted that the FTC Rule was a pre-sale disclosure rule that did not regulate the exact nature and terms of the franchise relationship. Therefore, the court was not faced with a direct conflict between the state statute and the FTC Rule. The Massachusetts court held that the alleged conflict identified by the district court rested on a misunderstanding of the nature of the FTC disclosure rules, which is timely pre-sale disclosure to a prospective franchisee. As such, the district court erred in its decision.

The Massachusetts Supreme Court further held that a franchisor can be in compliance with the FTC rule and make the required disclosures and, if a franchise is determined to be an employee under the independent contractor rule, still comply with the wage statutes. Moreover, the "control" over a franchisee's method of operation, as stated in the definition of a franchise under the federal act, does not mean every franchisee is an employee under the ABC test. The court found that control and direction in connection with the franchisee's method of operation and control of an individual's performance of certain services are not automatically coextensive.

Therefore, the Massachusetts held there was no conflict between the ABC test and the FTC rule, so the independent contractor statute does apply to the franchise relationship.

***Ward v. Cottman Transmission Systems, LLC*, Bus. Franchise Guide (CCH) ¶ 17,073, Case No. 1:18-cv-02155-NLH-MJS, 2022 WL 909637 (D.N.J. Mar. 29, 2022)**

In this employment lawsuit brought by a former employee of a New Jersey franchise location against the franchisor, the U.S. District Court for the District of New Jersey denied the franchisor's motion for summary judgment. Even though it was undisputed that the alleged unlawful acts were committed by the franchisee, not the franchisor, the court found disputed issues of fact as to whether the franchisor exercised sufficient control over the franchisee's employees so as to subject the franchisor to liability as an employer.

The Plaintiff, Zevin Curtis Ward, worked as a mechanic at a New Jersey auto repair franchise location of Cottman Transmission. The plaintiff employee filed a lawsuit against both the franchisee, who was his direct employer, and the franchisor. The plaintiff alleged that he was subject to harassment and discrimination by the franchisee on the basis of race and national origin. The plaintiff also alleged violations of the Fair Labor Standards Act pertaining to alleged overtime work for which he was not paid the overtime rate required by federal law. After the plaintiff filed a charge with the Equal Employment Opportunity Commission (EEOC), the franchisee allegedly told the plaintiff that if the EEOC charge did not "go away," the plaintiff would lose his job. The plaintiff subsequently filed suit against both the franchisee and the franchisor pursuant to Title VII of the Civil Rights Act, the New Jersey Law Against Discrimination, and the Fair Labor Standards Act (FLSA), alleging discrimination, retaliation, and violations of the FLSA.

The franchisor moved for summary judgment on all claims against it, arguing that it was not the plaintiff's employer and was not responsible for the franchisee's alleged actions. The district court denied the franchisor's motion for summary judgment, finding genuine issues of disputed fact as to whether it was plaintiff's employer. The court analyzed both the federal Title VII claim and New Jersey state statutory claim under the same standard. The critical issue on the franchisor's motion for summary judgment as to both claims was whether the franchisor could be liable for the franchisee's conduct under the principle of respondeat superior. The franchisor argued it did not have sufficient control over the employee and over employment decisions in general to make it the employer and subject to liability for the franchisee's conduct. The court found conflicting evidence as to whether an employer-employee relationship existed and the amount of control that the franchisor had over the franchisee's employees. While the court recognized that the franchisor had no involvement in hiring the employee, did not provide any tools or equipment to the employee, and did not pay the employee or provide him with any benefits, the court found that evidence regarding the franchisor's ability to control hiring decisions and day-to-day management of the franchise location was sufficient to preclude summary judgment. In particular, the court focused on provisions in the franchising agreement

that authorized the franchisor to assist in hiring and training employees and established certain hiring requirements, although the franchisor testified those rights were not really enforced. The trial court also cited disputed evidence as to whether the franchisor exercised control over the day-to-day management of the franchise location, including the hours that the location must be open and thus the hours of the employees. Finally, the court observed disputed evidence as to whether the franchisor had authority, when visiting the location, to instruct employees to modify their performance to comply with brand standards. For similar reasons, the court also denied the franchisor summary judgment on the plaintiff's FLSA claim.

NON-COMPETE AGREEMENTS

***Shepard and Associates, Inc. v. Lokring Technology, LLC*, Bus. Franchise Guide (CCH) ¶ 17,040, Case No. 1:20-CV-02488-PAB, 2022 WL 312711 (N.D. Ohio Feb. 17, 2022)**

This case is discussed under the topic heading "Contract Issues."

TRADE SECRETS

***Shepard and Associates, Inc. v. Lokring Technology, LLC*, Bus. Franchise Guide (CCH) ¶ 17,040, Case No. 1:20-CV-02488-PAB, 2022 WL 312711 (N.D. Ohio Feb. 17, 2022)**

This case is discussed under the topic heading "Contract Issues."

UNFAIR COMPETITION/UNFAIR AND DECEPTIVE PRACTICES

***Shepard and Associates, Inc. v. Lokring Technology, LLC*, Bus. Franchise Guide (CCH) ¶ 17,040, Case No. 1:20-CV-02488-PAB, 2022 WL 312711 (N.D. Ohio Feb. 17, 2022)**

This case is discussed under the topic heading "Contract Issues."

