FRANCHISE TRENDS

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Franchisor Competency, Video 4

Dent Repair Franchisee Escapes Clutches of Post-Term Covenant-Not-To-Compete After Expiration of Franchise Agreement

Devin Hamden, Plaintiff-Appellee v. Total Car Franchising Corporation, Defendant-Appellant (U.S. Court of Appeals, Fourth Circuit. No. 12-2085. November 22, 2013).

Total Car Franchising (TCF) Corporation is a franchisor that provides auto repair and restoration services with a focus on paint restoration and paintless dent repair. Devin Hamden, who worked for a TCF franchise as an apprentice, was offered the opportunity to himself become a TCF franchisee in 1996. Hamden and TCF executed a franchise agreement for 15 years with an option to renew. Hamden performed paintless dent repair as a TCF franchisee for the full 15 year term. At the expiration of the term, Hamden informed TCF that he would not seek a renewal of the franchise agreement and would operate his own independent business.

The franchise agreement, like all other franchise agreements, also contained a post-term noncompetition clause that prohibited competition for two years after the termination of the agreement. The franchisee and TCF executed a noncompetition and confidentiality agreement which incorporated the franchise agreement. The confidentiality agreement contained three distinct restrictive covenants: non-competition; non-disclosure; and non-solicitation.

Upon appeal, after the franchisor's motion for preliminary injunction was

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Franchise Law: Fraud and Good Faith in Franchise Law

denied in part by the federal trial court, the Fourth Circuit Court of Appeals held that, although the covenants applied to the termination of the agreement, they were not triggered by a mere expiration of the agreement at the end of the fifteen year term. In essence, after noting that the terms had similar dictionary definitions, the court ruled that the terms termination and expiration were not necessarily analogous as used by the franchise agreement. Specifically, according to the court, as set forth below, termination was the complete severance of the business relationship, where expiration was a formal termination on a closing date:

> Turning to the case *sub judice*, Section 8 indicates that termination occurs upon an action: either Hamden's violation of the Franchise Agreement or his notice of his intent to terminate. Applying Clinch Valley's principles, the Franchise Agreement's failure to indicate that termination arises passively through expiration, which it recognizes as a separate event in Section 2, indicates that expiration does not trigger the restrictive covenants. *Cf. Specialty Rental Tools & Supply, LP v. Shoemaker*, 553 F.3d 415, 421 (5th Cir. 2008) (limiting "terminate" to an affirmative act rather than the mere passage of time where the contract referred to the end of the employment "as 'ending' - not as 'terminating' " on a particular date, and the section defining termination only listed a number of affirmative acts, available to both parties, necessary to end the agreement).

Accordingly, the court determined that the noncompetition and non-solicitation clauses of the confidentiality agreement and the post-term restriction in the franchise agreement applied only if the agreement was terminated before the expiration date. Thus, because Hamden's separation from TCF was as a result of expiration, those non-competition provisions were unenforceable against Hamden. However, the non-disclosure clause of the confidentiality agreement contemplated the expiration of the agreement at the end of the fifteen year term and bound Hamden into perpetuity when he signed the franchise agreement.

Franchisor Unable to Side-Step Claims of Franchisor Franchise Fee Overcharges

Arcangelo, Inc. and Buying Power United, LLC, Plaintiffs v. DirectBuy, Inc. and Trivest Partners, LP, Defendants (U.S. District Court, N.D. Indiana. November 20, 2013).

A federal court held that a franchisor of a members-only buying club, DirectBuy, Inc., and its affiliate Trivest Partners, LP, could have breached a franchise agreement with two franchisees by charging the franchisees more for advertising and marketing than permitted under the franchise agreement. Specifically, the franchisees alleged that Paragraph 3.03 of the DirectBuy Franchise Agreement limits DirectBuy's right to charge

Franchise Law – Franchisees' Franchise Termination Damages

Alleged Franchise Supplier Kick-Backs to Franchisor and Franchisor Fraud Not Actionable

BP West Coast Products LLC, Plaintiff v. SKR Inc, et al. Defendants, (U.S. District Court, W.D. Washington. Case No. C11-6074, October 22, 2013).

The franchisee, SKR Inc. and its principals, entered into an am/pm franchise agreement and an ARCO gasoline dealer agreement (GDA) giving BP the exclusive right to supply gasoline to the station. Both agreements were for 20 years. SKR later stopped ordering gasoline from BP and began selling unbranded gasoline. The franchisee claimed that BP had failed to abide by its covenant to sell SKR gas at a competitive price. BP filed suit and SKR counterclaimed.

First, the court rejected the franchisee's counterclaim for violation of the Washington Consumer Protection Act (CPA) based on alleged discrimination between fuel retailers in violation of the Washington Franchise Investment Protection Act (FIPA) and the Washington Gasoline Dealer Bill of Rights Act. The franchisee's claim was fatally defective according to the court because it did not allege that it was treated differently from other am/pm-ARCO dealerships, instead claiming that it was treated differently from 'other' gasoline-only dealers to the extent that gasoline-only dealers were not required to pay a $70,000 am/pm fee, a 14 percent royalty on inside sales, nor were they required to participate in mandatory sales programs. The franchisee could not make

franchisees for national marketing and advertising to a maximum of 3% of annual gross new membership sales (the '3% Cap'). Although the court did not rule in favor of either the franchisor or franchisee on the substantive claim, it did hold, however, it was unable to make a definitive interpretation of the interrelated provisions in the franchise agreement concerning marketing and advertising.

The franchisees relied upon the following language in the franchise agreement:

> ***3.03 Marketing and Legislative Fund Contributions***. You agree to contribute (at such times as we may designate from time to time) to the Marketing and Legislative Fund $1,000 during each of our fiscal years, except that you are not required to make any contributions during the first 12 months in which you operate your Center. We have the right from time to time to increase the amount you are required to contribute to the Marketing and Legislative Fund, provided we may not increase the amount of your contributions to more than 3% of the gross amounts you charge for new memberships (including renewal option fees, but excluding renewal fees).

Based on this language, the franchisees contended that that "Franchisee contributions to fund the creation, development, and placement of marketing, advertising and related programs are expressly capped" by the 3% limitation in §3.03, but that DirectBuy breached that limitation by implementing "a marketing and advertising program that drastically exceeded the mutually-agreed upon 3% Cap." The court, however, pointing out Section 7 of the agreement also deals with the concept of "Marketing and Advertising", stated as follows:

> Here's what it says, in pertinent part: "[DirectBuy] may, in our sole discretion, establish and administer a fund ("the Marketing and Legislative Fund") for the creation and development of marketing, advertising, and related programs and/or legislative, legal and regulatory defense programs relating to buyer clubs and other laws and regulations that affect DirectBuy centers." [DE 1-1 at 19.] Section 7.01 goes on to explain that DirectBuy "will have sole discretion over all aspects of programs financed by the Marketing and Legislative Fund, including creative concepts, media, materials and endorsements of marketing and advertising programs," and that DirectBuy cannot assure franchisees "that any particular DirectBuy center will benefit directly or pro-rata from the placement of advertising." [Id. at 20.] The Fund "may be used to pay for the cost of preparing and producing marketing and advertising materials and programs we select, including television and Internet media (such as Web sites), video, audio and written advertising materials," and DirectBuy "may furnish [franchisees] with marketing, advertising and promotional materials at cost, plus any related administrative, shipping, handling and storage charges." *[Id.]*

Adding more to the morass, there was yet another section of the Franchise Agreement which dealt with "Marketing Materials." Section §4.04 provided that the franchisees "agree to execute such agreements as we may require to protect our interests in connection with any Marketing Materials

an antidiscrimination claim because the gasoline-only dealers were not similarly situated to the franchisee, which was an am/pm-ARCO dealer.

Second, the franchisee was unable to establish its claims that BP violated the Washington Franchise Investment Protection Act (FIPA) and the Washington Gasoline Dealer Bill of Rights Act (GDBRA) by charging unreasonable prices for gas, beer, soda, salty snacks, and tobacco. In this regard, the franchisee alleged that third-party vendors, such as Costco, charged the franchisee higher prices than it would pay if it bought the products directly from the vendors. According to the court, however, the franchisee provided no facts or evidence to support that claim. Further, with regard to the franchisee's claim that the franchisor had overcharged the franchisee for gas, the court held that the franchisee had waived its claims by failing to notify the franchisor of price nonconformities within 30 days of delivery, as required by the gasoline dealer agreement.

Third, the franchisor successfully battled the franchisee's counterclaim that BP violated the vertical price fixing provisions of the GDBRA and the Oregon Motor Fuel Franchise Act by allegedly taking retaliatory actions when SKR refused to comply with BP's pricing scheme. Contrary to the franchisee's allegations that BP allegedly set the profit margin that would be charged by its franchisees based on prices offered by competitors in a particular zone, trial testimony showed that the prices were determined based on the cost and prices of surrounding gas stations.

Fourth, the court rejected the franchisee's claim for fraud and negligent misrepresentation regarding alleged prices and profits. In this regard, the franchisee principals testified at trial that their lender had provided a projected 32 percent profit margin, and that they had made their own profit calculations with a 19 percent profit margin. Further, the court pointed out that the evidence showed that it was common knowledge that profit margins in Washington were around 30

and to pay such reasonable charges for Marketing Materials as we may assess from time to time." That section also defined "Marketing Materials" as "sales and marketing tools and materials as [DirectBuy], from time to time, develop[s] and use[s] for DirectBuy Centers, such as infomercials, Internet marketing tools (e.g., member marketing websites), sales videotapes and sales materials."

Reading these provisions together, the court concluded that the definitional language in §4.04 and §7.01 is overlapping in that both sections refer to marketing and advertising materials, including websites and video. Then the court rejected DirectBuy's argument that "the language of the two provisions clearly indicates that costs associated with the *placement* of advertising, as opposed to the *creation and development* of advertising, fall only within the ambit of §4.04. The problem with this reading is that §7.01 refers to "the placement of advertising" and §4.04 does not, so the division of the costs associated with the different functions is not so clear as DirectBuy insists.

The court then refused to buy into DirectBuy's argument that the franchise agreement was clear on the issue:

> At this stage of the case, I can't make a definitive interpretation of these interrelated contractual provisions and their application to the disputed charges. DirectBuy raises a question about whether the Marketing and Legislative Fund ever actually existed, but the allegations of the complaint plausibly suggest that it did, and any fact dispute cannot be resolved on a motion to dismiss. In any event, the fundamental question to be answered in this case is whether the charges that ArcAngelo complains of were assessed as contributions to the Marketing and Legislative Fund (under §3.03 and §7.01) or were they assessed as charges for Marketing Materials (under §4.04)? Or were they imposed as fees of some other kind altogether? What ArcAngelo characterizes as charges for national marketing and advertising programs subject to the 3% cap, DirectBuy characterizes as charges for "sales leads" that are governed by §4.04 and not subject to any cap (except for reasonableness). [DE 32 at 1.] To get to the bottom of the disagreement about the disputed charges, a number of subsidiary questions need to be resolved. These involve factual determinations that cannot be made at this time. The complaint's allegations are sufficient to permit a reasonable inference that DirectBuy and Trivest are liable for breach of the Franchise Agreement.

Court Refuses to Protect Franchisee from Abusive Ice Cream Franchise Agreement

percent for ARCO stores and around six cents per gallon. Therefore, according to the court, the franchisee could not have detrimentally relied on any profit estimates by BP's sales manager. In addition, the court also rejected the franchisee's fraud claims because the franchise agreement contained a clause stating that BP provided no representation as to profit or income.

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Delaware Passes Law to Protect Motorhome Franchisees/Dealers

Delaware has enacted a law that regulates agreements between recreational vehicle (motorhome) manufacturers and dealers. The relationship/termination law prohibits a manufacturer or distributor from terminating, cancelling, or failing to renew a dealer agreement without good cause.

Under the new law, a franchisor's termination of a franchisee will be examined for lawfulness using the following factors: (1) the extent of the affected new recreational vehicle dealer's penetration in the area of sales responsibility; (2) the nature and extent of the new recreational vehicle dealer's investment in its business; (3) the adequacy of the new recreational vehicle dealer's service facilities, equipment, parts, supplies, and personnel; (4) the effect of the proposed action on the community; (5) the extent and quality of the new recreational vehicle dealer's service under new recreational vehicle or new recreational trailer warranties; (6) the new recreational vehicle dealer's failure to follow agreed-upon procedures or standards related to the overall operation of the dealership; and (7) the new recreational vehicle dealer's performance under the terms of its manufacturer-dealer agreement.

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Gregory Fowler and Doubri Enterprises, LLC, Plaintiffs v. Cold Stone Creamery, Inc., Defendant (U.S. District Court, D. Rhode Island. November 22, 2013).

The franchise agreement between an Arizona ice cream shops franchisor, Cold Stone Creamery, and a Rhode Island franchisee was not unconscionable, as argued by the franchisee. In addition, the court also refused to find that the mandatory choice of Arizona forum selection provision in the parties' agreement was unconscionable.

In support of its argument that the franchise agreement should be stricken as unconscionable, the franchisee contended that it faced an absence of meaningful choice in 'accepting' that agreement in that Cold Stone drafted the franchise agreement in its entirely, employed standard boilerplate terms in doing so, and did not provide the franchisee the opportunity to negotiate. The franchisee explained that its only choice was to accept the franchise agreement as written. The court, however, was not persuaded, stating that "[t]his argument overlooks an obvious second option: to decline the franchise and walk away." The court further drove home its point stating that "courts have no general power to relieve parties of bad bargains".

In addition, with regard to the forum selection clause in particular, the court again rejected the franchisee's argument that the forum selection clause was buried within the franchise agreement and couched in legalese. To the contrary, held the court, the franchisee had been provided with and viewed a separate franchise offering circular that prominently displayed a risk factor informing prospective franchisees of the risks posed by out-of-state litigation, including a forum selection clause.

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California's Franchise Investment Law Passed to Conform to FTC Act's 2007 Amendments

California's Franchise Investment Law was modified by amending the existing statute's requirement that, for the exemption from the law's disclosure requirements to apply, certain written disclosures be made by a franchisor at least 10 business days prior to the sale or material modification of a franchise. The amendments change the 10-day requirement to 14 days prior to the sale or modification. The new law also replaced the term "offering circular, "with the term "franchise disclosure document."

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Thanks for your interest in our Newsletter, and we look forward to answering any questions you might have either on the cases discussed in this issue of Franchise Trends, or on general trends in franchise law.

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