You are receiving this periodical based upon previous specific and general contacts with the Goldstein Law Group regarding franchise law issues. We look forward to keeping you updated on the current trends in franchise court decisions around the country in both state and federal courts.

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FRANCHISE TRENDS

Franchisor Competency, Video 4

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Franchisee Demolishes Franchisor on Wrongful "Constructive Termination" Claim

Tilstra v. BouMatic LLC, United States Court of Appeals, Seventh Circuit, June 30, 2015, 2015 WL 3953403, is a somewhat rare example of a franchisee decimating a franchisor through jury trial on a de facto termination claim. In this pro-franchisee decision by Judge Posner, of the United States Circuit Court for the Seventh Circuit, a dealer in dairy ("milking parlor") equipment (the corporate plaintiff, owned by Sid Tilstra), in southwestern Ontario, sued a manufacturer of this equipment, BouMatic, a Wisconsin company. Tilstra had been a dealer in BouMatic's dairy equipment for about twenty years. He claimed that the franchisor, in bad faith and deviously, forced him to sell his dealership to a neighboring BouMatic dealer at a below-market price. After a trial, the jury agreed with Tilstra and awarded him $471,124 in damages. The appellate court was asked to rule the district court's decision upholding the jury verdict.

The record showed the following facts. Each BouMatic dealer was assigned a territory within which it has the exclusive right to sell and service BouMatic products. Tilstra's territory included "arguably the richest dairy county in Canada," on

Franchise Law – Franchise Discrimination 1:2 - Jeff Goldstein: Franchise Lawyer

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Franchise Law: Fraud and Good Faith in Franchise Law

Franchise Law – Franchisees' Franchise Termination Damages

which 55,000 dairy cows grazed. Tilstra had been making a profit of about $400,000 a year. The dealership contract reserved to BouMatic "the right to change, at its sole discretion, the assigned territory," but further provided that "BouMatic shall not terminate this [dealership] Agreement or effect a substantial change in the competitive circumstances of this Agreement without good cause and only upon at least ninety (90) days' advance written notice sent by certified mail. The term 'good cause' means Dealer's failure to comply substantially with essential and reasonable requirements imposed upon Dealer by BouMatic."

The record showed that another BouMatic territory assigned to a competing dealer, Dortmans, was adjacent to Tilstra's territory, and grazed only about half the number of dairy cows as Tilstra's territory. Although Dortmans tried to buy Tilstra's dealership in order to obtain his territory, no agreement was reached because Tilstra was demanding a much higher price than Dortmans was willing to pay.

The BouMatic franchise district sales manager, Ghey, believed that Tilstra was doing a poor job, and in 2009, BouMatic's regional sales manager, Stephane Desjardins, advised Ghey by email that "We [should] approach Sid [Tilstra] again and ask him to sell. If he refuses or makes it too difficult, we would in the short term, modify the territory lines in favor of Advanced [another adjacent BouMatic dealer] and Dortmans. This would ... put unbearable pressure on Sid [to sell]-without cancelling him outright or immediately."

In turn, Desjardins and Ghey told Tilstra that BouMatic would eliminate his territory altogether unless he agreed to sell his dealership, with all its assets, to the Dortmans within a month. Evidence also existed showing that BouMatic threatened to stop selling dairy equipment to Tilstra. Tilstra, although willing to sell his dealership, would not cut his price to the level demanded by Dortmans. On January 8, seven days after the franchisor-imposed sales deadline, BouMatic's North American Director of Sales sent Tilstra a letter reminding him that BouMatic had decided to "have Dortmans ... take over the territory covered by your company.... [O]ur decision ... is not negotiable and ... we will proceed with or without your cooperation." Within the next month, Tilstra sold the dealership to Dortmans for $500,000 plus a five-year consulting contract under which he would receive a total of $310,000 in consulting fees. The sale closed in March.

According to Judge Posner, Tilstra had valued the goodwill of his dealership at $1.5 million; however, due to the pressure exerted on him by BouMatic, which sided with Dortmans, Tilstra had been forced him to sell it for half that amount to

Dortmans, even after factoring in the amount of the consulting contract. Two and a half years later, Tilstra sued BouMatic in this case. The only claim that made it to trial was that BouMatic had violated the dealer agreement.

Judge Posner agreed with the lower court that "The jury was entitled to find that BouMatic, though it did not purport to terminate its contract with Tilstra, in fact terminated it, and did so without complying with the provision, quoted earlier, forbidding termination 'without good cause and only upon at least ninety (90) days' advance written notice sent by certified mail.'" In so agreeing, the Court of Appeals explicitly noted that it had taken into account that BouMatic didn't formally terminate the agreement; the termination was more indirect, based on a threat to terminate: "But by telling Tilstra that unless he sold out to Dortmans his territory would be shrunk to zero, BouMatic was telling him that he was finished, his dealership doomed; for without a territory his position as a BouMatic dealer would be untenable."

The Court of Appeals next examined the territorial clause of the dealership agreement which stated that the "Dealer shall purchase BouMatic products only ... for resale to purchaser-users in Dealer's assigned territory ... [and] shall solicit sales only in their assigned territory unless allowed by BouMatic in writing prior to any solicitation." Continuing, the Court of Appeals reasoned that "if Tilstra's territory were eliminated, Tilstra wouldn't be able to buy any products from BouMatic for resale to anyone, or solicit any sales from anyone. In other words, no territory, no dealership."

BouMatic defended this result based on the language in the dealership contract that reserved to it "the right to change, at its sole discretion, the assigned territory." The Court of Appeals quickly brushed aside this excuse pointing out that when the argument was taken to its extreme it would absurdly read out of the agreement the explicit termination provision. On this point Judge Posner made clear that "Elimination of a dealership's entire territory is certainly a change, but were it a change permitted by the contract, it would amount to allowing termination 'without good cause,' contrary to an explicit contract term. The Appeals Court refused to adopt such an 'untenable interpretation' of the contract.

Interestingly, and notably, Judge Posner chose to discuss how the covenant of good faith and fair dealing played into the case, describing initially that "Contract law imposes on both parties to a contract a duty of good faith in the performance of their contractual obligations." From there, the Appeals Court then segued to the concept of "bad faith", stating that "One form of bad faith that Wisconsin law recognizes is 'evasion of the

Court Slams Former Franchisees That Steal Franchise Secrets After Franchise Termination; However, Franchisees Escape Post-Term Covenant

In Capital Meats, Inc., v. The Meat Shoppe, LLC, 2015 WL 4249166 (D.C. Md. July 9, 2015), the United States District Court for the District of Maryland granted in part and denied in part a motion by the franchisee defendants to dismiss the case. The Plaintiff in Capital Meats, Capital Meats, Inc. ("CMI"), sued several entities referred to collectively as "The Meat Shoppe" and several former CMI employees who went to work for The Meat Shoppe (collectively, "defendants"). CMI alleged in nine counts that the defendants, when they resigned en masse to establish and operate a competing business, The Meat Shoppe, carried out the following: violated Virginia contract law; transgressed the Maryland Uniform Trade Secrets Act ("MUTSA"); infringed the post-term restrictive covenant not-to-compete; and committed several Maryland business and competition-related torts.

According to the pleadings, on January 5, 2015, the Retail Dealer defendants did not show up for their regularly-scheduled warehouse pickups, and Meghan Tunney informed CMI that she had resigned effective immediately. CMI asked the defendants to return all of CMI's property in their possession, including Megan Tunney's access to the CMI Database which had been installed on her personal computer. Meghan Tunney did not produce the requested property, but instead thereafter provided it to her counsel in February 2015. With regard to specific property, there apparently existed a surveillance video showing the following: Meghan Tunney moving around files inside CMI's Baltimore office and removing some of them from the office; Combass and Fincham (other

defendants) removing documents and property; and shredding of documents by a CMI employee later hired by The Meat Shoppe.

Shortly thereafter, the individual defendants and approximately 100 of CMI's sales force began working (and, CMI alleges, began operating) at competing businesses, all operating under the name, The Meat Shoppe. That entity, a named defendant, was also "a wholesale meat distributor that sells and distributes frozen meat, poultry, and seafood via door-to-door sales in Maryland, the District of Columbia, Delaware, Pennsylvania, Virginia, and West Virginia." CMI alleged that in addition to such selling, the defendants "engaged in malicious and deceitful actions in an effort to solicit and steal CMI's customers," including the making of false statements to customers and CMI employees that CMI is or will be out of business so as to entice them to switch to The Meat Shoppe. Toward its damages claim, CMI alleged that the four CMI regional offices at issue lost significant business to The Meat Shoppe subsequent to the mass resignation on January 5, 2015, which resulted in CMI losing around 70% of its revenue.

With regard to the alleged breach of the restrictive covenant provision, the Court surprisingly held that, although the clause was supported by legal consideration, it failed to include certain crucial material terms thereby making the restrictive covenant unenforceable. Initially, on this point, the Court stated that: "Restrictive covenants, like any contract, "must be sufficiently definite to enable a court to give it an exact meaning, and must obligate the contracting parties to matters definitely ascertained or ascertainable." Applying this principle to the instant case, the Court held that the "Territory" that Retail Dealers are prohibited from competing in after their CMI employment ends is defined by ¶ 2 of the Distributorship Agreement; as

spirit of the bargain.'" In turn, the Court identified BouMatic's conduct as blatant bad faith. Moreover, Judge Posner characterized the termination as a "de facto termination" or "constructive termination" since the franchisor had taken away or "cancelled" the dealer's entire territory. Judge Posner then proceeded to identify another form of bad faith recognized in Wisconsin law as an "abuse of a power to specify terms," which, in this case, arose out of the power to specify the size and shape of the dealer's territory. The Court of Appeals then noted that BouMatic had "backhandedly" admitted that it had acted in bad faith by arguing that it had good cause to terminate Tilstra.

Tellingly, however, BouMatic had "never told Tilstra that [it was terminated], as required by the contract, or proved at trial that Tilstra had failed "to comply substantially with essential and reasonable requirements imposed upon [Tilstra] by BouMatic." Examining BouMatic's apparent motive for its conduct, the Appeals Court recognized that BouMatic thought it would make more money if Dortmans rather than Tilstra managed Tilstra's territory; however, the Court was very clear that the dealership contract was not an "at will" contract: "But the dealership contract did not authorize BouMatic to terminate a dealer merely because it had found a substitute that it thought it could make more money from. That would have made the contract terminable at will by BouMatic. In The dealership agreement specified that Tilstra may terminate it at will but BouMatic may terminate only if it has good cause to do so.

The issue of remedy, or amount of damages, was also heavily disputed in the trial court and on appeal. As Judge Posner expressed, "With regard to remedy, BouMatic fires a blunderbuss of objections" to the calculation of damages by Tilstra's financial expert, Sciannella. BouMatic, for instance, attacked the expert because Sciannella did not have Tilstra's financial statements, which were prepared in the ordinary course of business, verified by outside accountants. The Appeals Court rebuffed that assessment concluding that "an expert witness is not required to verify all the facts on which he relies; he can rely on hearsay (in this case, what the accountants stated in the financial statements) provided that such reliance is an accepted practice in his profession, as it is." BouMatic's next attempt to disparage the expert opinion pivoted off of a provision in the dealership agreement that "regardless of which party terminates this Agreement, Dealer shall not be entitled to any termination compensation or to any compensation for goodwill." The Court effortlessly rejected this line of declaring that "the section of the agreement in which this provision appears conditions BouMatic's right to terminate a dealer on good cause and 90-day written notice, and BouMatic did not comply with those conditions and so cannot rely on the

such, the definition of "Territory" is a material term necessary for evaluating the geographic scope of the non-compete clause and the larger question of its enforceability. Seemingly exasperated with the lack of specificity in the agreements, the Court concluded that: "The problem with each of the Distributorship Agreements cited and attached by plaintiffs, however, is that ¶ 2 is blank-no county and state is listed." Facially, therefore, there was no non-compete clause to enforce because "Territory" as it is used in ¶ 11 is meaningless. In other words, CMI's decision to omit a geographic scope rendered the restrictive clause overbroad and unreasonably "harsh and oppressive" to the Retail Dealers.

Interestingly, in rejecting the defendants' motion to dismiss CMI's claim that the defendants had violated the post-termination restrictive covenant, the Court, in a related hidden footnote, showed again its overarching conservative jurisprudential view towards the issues raised by the case when it rejected CMI's alternative argument that Maryland contract law allowed the Court to "blue pencil" the restrictive covenant. In essence, the Court found that Maryland law makes a clear distinction between "removing the offending language" on the one hand and "supplementing or rearranging the remaining language" on the other. As the Court explained, "Here, CMI is not simply asking me to excise terms but instead to add and rearrange contract language. This kind of "flexible blue penciling" was endorsed by the Maryland Court of Special Appeals in the Holloway case, but as I noted in a previous case, "[n]o Maryland case since Holloway has applied the flexible approach" and it was a departure from "the traditional use of the strict divisibility rule by Maryland courts."

Next, the Court ruled that CMI's count alleging a violation of the Maryland Uniform Trade Secret Act ("MUTSA"), prohibiting the misappropriation of

provision we quoted." Very simply, according to Judge Posner, there was little hope for BouMatic legally after it broke the agreement: "It broke its contract with Tilstra, thereby exposing itself to a liability that would have been excluded only if BouMatic had terminated Tilstra's dealership for good cause."

BouMatic asserted additional more technical arguments attacking the franchisee's expert's testimony. First, BouMatic objected that the expert assumed - as impermissible speculation -- that had Tilstra not been terminated, his dealership would have remained as valuable as it had been in recent years. As before, Judge Posner disregarded this attack: "But the damages calculated by the expert under the rubric of "goodwill" were the sum of the discounted future earnings of the dealership based on that assumption, and that is a standard method of business valuation, known as the 'capitalized earnings' approach." BouMatic's argument on this path continued, when it pointed out that even if it couldn't lawfully shrink Tilstra's territory to zero, it could shrink it some, and that would reduce Tilstra's dealership profits. Again the Court of Appeals rebuffed the contention: "But the jury was entitled to find that any shrinkage attempted by BouMatic would have been a further attempt to transfer the dealership to Dortmans without complying with the contractual provisions governing termination or with the duty of good faith performance imposed by contract law."

Incredibly, BouMatic's arguments did not end there with respect to causation and damages. BouMatic also argued that Tilstra could have mitigated its damages by obtaining a comparable dealership from another supplier of milking-parlor equipment, or remaining independent. And, again, Judge Posner, in one lengthy sentence, refused to recognize the alleged defect: "But there was evidence that it is difficult to secure a new dealership and that a dealership is necessary to remain competitive-indeed, without a dealership and thus an assured source of supply of milking-parlor equipment, Tilstra might be relegated to manufacturing its own such equipment, which would hardly be a realistic option."

Based on the above, the Court of Appeals affirmed the judgment of the district court, which had upheld the jury verdict in favor of the franchisee.

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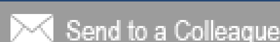

trade secrets, would not be dismissed. The defendants moved to dismiss the MUTSA claim on two grounds, including: (1) the CMI database and the CMI Call Center Website are not "trade secrets" under the MUTSA, and (2) CMI has not alleged that any defendant in fact "misappropriated" that information. The Court explained why it rejected both arguments.

First, according to the Court, the two services were highly valued by CMI, as measured in several ways, including the amount spent by CMI to create the Database and Call Center Website-allegedly over $260,000 and $500,000, respectively, and the fact that CMI invested that money with the intent of deriving a greater economic benefit over time (in the form of more efficient door-to-door sales and correspondingly higher revenues). In further explaining the Court's view that the services had value, it stated that "CMI and the Retail Dealers utilized the information in regard to customers, their payment information, and what products they bought to better target regions and customers to increase sales. Moreover, the value of the Database and Call Center Website continued to increase as more sales were made and additional information was gathered and entered."

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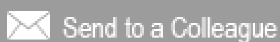

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Dunkin' Franchisee Terminated Despite its being Unable to Complete Remodel Due to Government Interference - Defendant franchisees began, but did not complete, the required renovations. Defendants contracted with an architecture firm approved by Dunkin', A & A Architects, to design the remodel. The architect drew up plans for a remodel and submitted the plans to local government authorities for approval of building permits. The plans called for placing a bathroom over a "well stub," a plugged top of a water well, and county health officials objected to the placement of a well stub in the middle of a bathroom floor. Health officials refused to allow the renovations to continue until the plans changed. Dunkin Donuts Franchising LLC v. Claudia III, LLC, United States District Court, E.D. Pennsylvania, July 14, 2015 Slip Copy, 2015 WL 4243534

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Another Wyndham Hotel Franchisee Fails to Retain Counsel and is Defaulted by Judge in Wyndham's New Jersey Home-Court - After the hotel franchisee defendants failed to retain an attorney or defend Wyndham's claims, the Court considered whether to enter a default judgment against the franchisees as follows: (1) whether the party subject to the default has a meritorious defense; (2) the prejudice suffered by the party seeking default judgment; and (3) the culpability of the party subject to default. In so doing, the Court concluded that in the absence of any responsive pleading and based upon the facts alleged in the Complaint, the Defendants did not have a meritorious defense. Further, the Court found that Howard Johnson would suffer prejudice absent entry of default judgment as HJI will have no other means of obtaining relief. In addition, the Court found that the Defendants acted culpably as "they have been served with the Complaint, are not infants or otherwise incompetent, and are not presently engaged in military service." In turn, the Court awarded both $104,314.02 in "Recurring Fees", and $177,105.77 in liquidated damages. Howard Johnson Intern., Inc. v. SV Hotels, LLC, United States District Court, D. New Jersey, July 10, 2015Slip Copy2015 WL 4199280

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