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

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Franchisor Competency, Video 4

Unsettled Business: Appellate Court Finds That Genuine Issues of Material Fact Did Exist Over Whether or Not Parties Entered Into a Valid Settlement Agreement

Med. Shoppe Int'l, Inc. v. Siddiqui (4th Cir. Nov. 5, 2013)

Franchisor, a national corporation that grants franchisees licenses to operate prescription pharmacies, appealed a trial court's grant of summary judgment in favor of franchisees. The trial court had found that there were no genuine issues of material fact about whether or not a valid settlement agreement was executed between the two parties in an earlier suit.

The original franchisee of two franchise pharmacies owed a substantial amount of money to the franchisor. Franchisor terminated the franchise agreement and gave franchisees a deadline by which to close the units. However, before this deadline, the original franchisee transferred his two franchise units to a new franchisee without the franchisor's permission. And, as a result of these events, the franchisor filed a lawsuit against the original franchisee as well as the new franchisee. To attempt to resolve the litigation, the parties drafted a Settlement and Release Agreement, which provided in part that the two franchise units must be converted into pharmacies under a different franchise or name. The old franchisee and the franchisor signed the settlement agreement.

However, before the new franchise documents, personal guaranties, and other related documents could be signed and executed, two events occurred: 1) the franchisees entered into two bills of sale for the franchise units,

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Franchise Discrimination - Video 2 of 2

Franchise Law: Fraud and Good Faith in Franchise Law

and each bill of sale provided that the Buyer must discharge any liabilities associated with the franchise before the execution of the bill of sale; but 2) the new franchisee (or the Buyer) died before discharging any liabilities and before the execution of documents that allowed proper conversion of the old franchises into the new franchises. Therefore, the U.S. Court of Appeals for the Fourth Circuit decided that there were genuine issues of material fact or questions over whether or not the settlement agreement was validly executed, as well as who should have executed the settlement agreement. Thus, the Fourth Circuit appellate court vacated the district court's order of summary judgment and remanded the case for adjudication pursuant to the appellate court's ruling.

Not So Fast [and Furious]: Court Rules That Agreement Between Two Parties Did Not Constitute a Franchise Agreement Under New York's Franchised Motor Vehicle Dealer Act (FMVDA):

JJLG Motors, Inc. v. SMS-Retail Corona (N.Y. Sup. Ct. Aug. 22, 2013)

The plaintiff in this case was a franchised retail motor vehicle dealer, and it entered into a business agreement with defendants. The agreement provided that the defendants would design and assemble high performance modified automobiles, derived from new-stock vehicles. And in return, plaintiffs would purchase "wholesale" these modified vehicles from defendants and also have the right, for one year, to resell five modified vehicles in particular without competition from other dealers in the tri-county area.

The issues were (1) whether or not the agreement constituted a franchise agreement under New York's Franchised Motor Vehicle Dealer Act; and (2) if the agreement was indeed a franchise agreement, whether under the Act, defendants would have been required to repurchase a modified vehicle that had been unsatisfactory to the plaintiff.

The Supreme Court of New York held that the agreement between the plaintiff and defendants was not a franchise agreement as recognized in the Act. The agreement did not reference or use the term "franchise"; it did not refer to the Act; and it did not refer to "license" or a "community of interest", which are terms that were used prominently in the Act. The court also recognized that the parties were experienced or sophisticated car vendors, and that there was no extrinsic or de facto evidence that a "community of interest" was created through plaintiff's significant capital investment or through plaintiff's significant bargaining power. In this manner, the defendants were also not required under the Act to repurchase a vehicle that the plaintiffs had deemed unsatisfactory.

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Franchise Law – Franchisees' Franchise Termination Damages

Covenant Not to Compete: Trial Court Issues Preliminary Injunction Against Salon Owners

Rpc Acquisition Corp. v. J & D World Corp. (D. Minn. July 2, 2013)

Defendant-Franchisees signed five franchise agreements to run five franchise units of PRO-CUTS hair salons. Part of each franchise agreement was the right of franchisees to benefit from the "goodwill" of the PRO-CUTS brand. Goodwill is term that describes intangible but valuable property of a company and that encompasses the general reputation of a brand or a store, its customer networks, and some intellectual property created by the company. Also as part of the franchise agreements, franchisees agreed that if terminated from the franchise, they would agree not to compete with the PRO-CUTS franchise by operating or being associated with a competitor for two years and within a six mile radius of any of PRO-Cuts units.

Some time after franchisees opened these salons, plaintiff-franchisor discovered that franchisees were diverting products out of the franchise locations, failing to pay amounts due under the contracts, and when asked, did not allow franchisors access to their books and records. Franchisor validly terminated their franchise agreements.

This case came before the district court in Minnesota because franchisor sought a preliminary injunction that would stop or enjoin franchisees from continuing to benefit from the goodwill of the brand and from continuing to compete with the

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Claims of Marketing Overcharging Against Franchisor and Franchisor's Successor Not Yet Ripe for Dismissal

ArcAngelo, Inc. v. Directbuy, Inc., 2013 WL 6095678 (N.D.Ind. 2013)

A recent decision from the United States District Court for the Northern District of Indiana resolved a motion to dismiss in a class action case by DirectBuy franchisees ("ArcAngleo", one of the franchisee plaintiffs) against their franchisor. DirectBuy is the franchisor of members-only buying club franchises, from which members can buy home and office furnishings and other products.

The crux of the complaint is that over a period of years DirectBuy allegedly charged franchisees more for advertising and marketing than the Franchise Agreement permitted. In addition to DirectBuy, Trivest Partners, LP, is also named as a defendant. Trivest, LP is alleged to control Trivest Fund IV, LP, the company that acquired a controlling interest in DirectBuy in late 2007.

The complaint alleged myriad causes of action, including breach of contract and of the duty of good faith, tortious interference with the Franchise Agreements, criminal conversion, unjust enrichment, and breach of fiduciary duty. The franchisor and Trivest filed a motion to dismiss the complaint. Although the Court refused to dismiss the franchisees' breach of contract claim, it dismissed almost every other claim alleged by the franchisees.

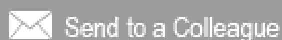
With regard to the contract claim, ArcAngelo alleged that that "Paragraph 3.03 of the DirectBuy Franchise Agreements limited DirectBuy's right to charge Franchisees for national marketing and advertising to a maximum of 3% of annual gross new membership sales (the '3% Cap')." ArcAngelo contended that "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."

Section 7 of the franchise agreement also dealt with the concept of "Marketing and Advertising", stating, 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."

Section 7.01 went 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

franchise, even after termination of their franchise agreements. The franchise agreements provided that upon termination, the franchisees must stop using all confidential information and trademarks of the franchise, including the name Pro-Cuts and any telephone numbers associated with the franchise units.

The judge ruled that (1) plaintiff-franchisors did meet the standard for a preliminary injunction because they had a substantial likelihood of succeeding on the merits of the case - in showing that defendant-franchisees were infringing on the franchise's intellectual property marks; that the parties had entered into an enforceable non-compete agreement; and that the non-compete agreement is reasonable and enforceable. The judge also held that (2) if preliminary injunction is not granted, then franchisors would be irreparably harmed because their goodwill would be damaged; franchisees would have access to confidential information which would be used to unfairly compete with other franchisees; and the lack of an injunction might embolden other franchisees to breach their franchise agreements. Therefore, the judge ordered franchisees to stop using PRO-Cut's intellectual property and marks; to stop operating the five salons and to not compete in any other ways with the franchise within the non-compete territory; to stop using any telephone numbers associate with the five salons; from retaining any confidential information, including PRO-cuts operation manuals; and to all of the above within five business days.



No Mandatory Mediation or Arbitration: Court Finds That Case Fell Under Franchise Agreement's Exception to Mandatory Alternative Dispute Resolution.

Synergistic International, LLC v. Monaghan (C.D.I.L., October 10, 2013)

pro-rata from the placement of advertising." The franchise agreement further stated that 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."

Last, there was another section in the Franchise Agreement that dealt with "Marketing Materials"-that is § 4.04, which stated that the franchisees "agree to execute such agreements as we may require to protect our interests in connection with any Marketing Materials and to pay such reasonable charges for Marketing Materials as we may assess from time to time." Section 4.04 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."

The Court noted 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." The Court further characterized DirectBuy's suggestion as unpersuasive 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. According to the Court, the fault with the franchisor's reading was "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 overlap in the two provisions hardly constitutes the kind of "unambiguous terms of the Franchise Agreement" that DirectBuy blithely insists create a clear distinction that defeats ArcAngelo's reading of the contract."

Although the Court was aware of a related case involving almost identical allegations that seemed to cut in favor of the franchisor, the court temporarily distinguished that case by pointing out the other case had been fully litigated, unlike this case, which was in its very early stages, with no evidence having been admitted. "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." Further, the Court stated that: "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)."

In sum, the Court concluded that it simply did not have sufficient evidence from the parties yet "to get to the bottom of the disagreement about the disputed [franchise agreement] charges, and that these involve factual

Defendant-franchisees filed a Motion to Compel Mediation and/or Arbitration and to dismiss or stay proceedings pending the completion of mediation and/or arbitration. Franchisees entered into a franchise agreement with franchisor to operate a Glass Doctor franchise. Section 14 of the franchise agreement stated that disputes arising out or relating to the contract would e settled using mediation and then arbitration if necessary (both are alternative dispute resolution procedures - alternative to litigation).

However, Section 14.K of the franchise agreement provided that there were exceptions to mandatory alternative dispute resolution, including a provision entitled "emergency relief". This provision would allow the franchisor to file a lawsuit rather than go into alternative dispute resolution. The exception provided specifically that franchisor would be free to seek declaratory relief, restraining orders, and/or preliminary injunctive relief if "a situation [should] arise relating to the [trade][m]arks or relating to a situation in which Franchisor will suffer irreparable loss or damage unless Franchisor takes immediate action, including but not limited to threatened or actual conduct in violation of Section ... 13 of this Agreement."

Section 13 of the franchise agreement provided that the franchisee would not compete with the franchisor upon the termination or non-renewal of the franchise agreement for a period of two years, during which franchisees would not, among other things, use the franchise's trademarks. Upon termination of the franchise agreements, plaintiff-franchisors alleged that defendant-franchisees had failed to abide by the non-compete clause of the agreement by intentionally diverting business away from the former franchise unit and by using identical or indistinguishable trademarks of the franchise to do so.

The District Court of Illinois found that plaintiffs had demonstrated that the case fell under the exception in their franchise agreement precluding mandatory alternative dispute resolution. The court found that the claims filed in the case did

determinations that cannot be made at this time."

NEW FRANCHISING LAWS

Delaware -- Recreational vehicles

A new Delaware law 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.

For purposes of determining whether there is good cause for the proposed action, any of the following factors may be considered: (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.

Illinois -- Motor vehicles

A new Illinois law provides that it is a violation of the motor vehicle dealer law to require a motorcycle dealer to install displays or fixtures not related to products made by the manufacturer, or to relocate to a new or alternate facility. House Bill No. 2508 was approved August 16, 2013, and becomes effective June 1, 2014

Iowa - Motor Vehicles

A recent Iowa enactment states that a franchisor may not unreasonably alter a motor vehicle dealer's area of responsibility and establishes a review process for changes to a dealer's area of responsibility. House Bill No. 395 was approved April 24, 2013, and became effective July 1, 2013

Texas -- Motor vehicles

A new Texas law prohibits a franchisor from coercing a franchisee to relocate an existing dealership of the same line-make to property that is subject to a specific use agreement. It also amends the circumstances under which a franchisee may protest an application to relocate a

relate to the non-compete clause, as well as trademark infringement actions (the latter of which was enumerated expressly in Section 14.K of the franchise agreement above).

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dealership. Senate Bill No. 854 was approved June 14, 2013, and became effective September 1, 2013

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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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