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FUNDAMENTALS 201: THE 7 MOST SIGNIFICANT FRANCHISE CASES OF ALL TIME

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I. INTRODUCTION[1]

There are certain cases that have dramatically altered the way franchisor and franchisee attorneys approach and practice franchise law. This article attempts to summarize and analyze, in no particular order, the most important and influential court opinions in franchise law, setting forth the historical context, issues, facts, results, and their effect on franchising. Given that franchise law is a niche practice that is still developing, case law can significantly affect the franchisor-franchisee relationship and can dramatically change the way franchisors and franchisees deal with one another. Moreover, practitioners can often find guidance in legal precedent when drafting franchise agreements and informing clients of their expectations, rights and obligations under a specific franchise agreement. The authors have attempted to select seven key cases in the most litigated and hotly-debated areas of franchise law, which franchisor and franchisee attorneys alike will inevitably face at one time or another in their legal careers, including covenants not to compete, price restrictions, class arbitrations, territorial restrictions, damages, and tying arrangements. While this article will give a glimpse of the evolution of franchise law in these areas, the evolution of franchise law and the continued debate among the franchise bar is certainly far from being over.[2]

II. *ATLANTA BREAD CO. INT'L, INC. v. LUPTON-SMITH*[3] - THE ENFORCEABILITY OF IN-TERM COVENANTS AGAINST COMPETITION

In *Atlanta Bread Co. Int'l, Inc. v. Lupton-Smith*[4], the courts in Georgia examined whether an in-term non-compete in a franchise agreement between the Atlanta Bread Company, a franchisor of bakery/deli restaurants ("ABC"), and Sean Lupton-Smith, a former multi-unit franchisee of ABC ("Lupton-Smith"), was enforceable under Georgia law. During its analysis, the Georgia courts also examined whether the same standards for determining the enforceability of an in-term non-compete apply to a post-term non-compete.

The issues presented in *Atlanta Bread* are of great importance to both franchisors and franchisees. We chose it as one of the most significant franchise cases because it represents one of the first instances in which a court has applied the criteria, traditionally limited to post-termination non-compete covenants, to in-term non-compete covenants. It is not yet clear if other states will follow this approach, whether by judicial decision or by legislation. As a result of the *Atlanta Bread* decision, significant ramifications for franchisors operating in Georgia were brought to light, culminating in changes by the Georgia legislature to address the impact of this decision.

The respective views with respect to in-term non-competes can be summarized as follows: Franchisors seek to impose in-term non-compete covenants to prevent the franchisee from competing against the business the franchisor has authorized the

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[1] This paper represents the collective work of the authors. However, given the nature of the topic and its treatment, as well as the desire to analyze the topic in a unified paper, any particular views expressed herein do not necessarily represent the individual views of each of the authors.

[2] The authors wish to thank Morgan Geller, associate at Zarco Einhorn Salkowski & Brito, PA,, and Abhishek Dube, associate at DLA Piper (US) LLP, for their valuable assistance in preparing this paper.

[3] 679 S.E.2d 722 (Ga. 2009).

[4] *Id.*

franchisee to operate (and from possibly using system information in the other business). While some franchisees may wish to operate other businesses, and thus dislike in-term non-competes, other franchisees may prefer that those in the system remain loyal to the brand.

A. The Facts

Lupton-Smith owned five ABC franchises. In mid-February of 2006, ABC notified Lupton-Smith that it intended to terminate all five of Lupton-Smith's franchises due to a violation of the non-competition clauses contained in his franchise agreements. Specifically, ABC stated that the termination was due to Lupton-Smith operating a competing business called PJ's Coffee & Lounge in Atlanta (which featured a full-service bar, and a menu offering bagels, breakfast pastries and toasted sandwiches – which was similar to an ABC outlet), while using ABC's methods and proprietary information. Lupton-Smith brought a suit for injunctive relief against ABC when the franchises were terminated and challenged the enforceability of both the in-term and post-term non-compete covenants contained in the franchise agreements.[5] Specifically, at issue were three restrictions:

1. The *in-term restrictive covenant* – restricting Lupton-Smith from engaging in certain activities. Each of the franchise agreements contained the following clause:

> *During the term of this Agreement, neither Franchisee nor any Principal Shareholder, for so long as such Principal Shareholder owns an Interest in Franchisee, may, without prior written consent of Franchisor, directly or indirectly engage in, or acquire any financial or beneficial interest in (including any interest in corporations, partnerships, trusts, unincorporated associations or joint ventures), advise, help, guarantee loans or make loans to, any bakery/deli business whose method of operation is similar to that employed by store units within the System. (Emphasis added)*

2. The *post-term restrictive covenant* – prohibiting Lupton-Smith, for one year following the termination of the agreement, from "directly or indirectly engag[ing] in, or acquir[ing] any financial or beneficial interest in . . . any bakery/deli business whose method of operation is similar to that employed by [store units] within the [ABC] System which is located within a twenty (20) mile radius of any store unit."[6]

[5] 663 S.E.2d at 744-45.

[6] *Id.* at 745.

3. A provision prohibiting Lupton-Smith "at any time" from disclosing the trade secrets and confidential information of the ABC System.[7]

B. Procedural History

In examining the issues in *Atlanta Bread*, all three levels of the Georgia courts reached the same conclusions:

1. The Trial Court

Lupton-Smith filed a request for a temporary restraining order (TRO) and the trial court entered a consent order that sustained the TRO until the parties' franchise agreements expired. After the TRO expired, ABC paid Lupton-Smith approximately $840,000 for the tangible assets of the five stores operated by Lupton-Smith. The case continued with Lupton-Smith seeking damages for wrongful termination of the franchise agreements.

The trial court held that the in-term restriction was invalid as a matter of law and then applied Georgia's nonseverability rule to invalidate the post-term covenant as well.

2. The Court of Appeals (*Atlanta Bread Co. Intl., Inc. v. Lupton-Smith*)[8]

On appeal, ABC argued that the trial court erred in applying post-termination non-compete legal standards to evaluate an in-term non-compete provision in a franchise agreement. The appellate court rejected this argument, holding that although the threat of a restrictive covenant applying during the term of the franchise agreement is not as great as during a post-term covenant, it is still a restraint of trade and must be evaluated under traditional standards of reasonableness under Georgia law.

In a decision with significant ramifications for franchisors operating in Georgia, the Court of Appeals of Georgia invalidated the in-term non-compete covenant for failing to meet the same strict test for reasonableness as required for a traditional post-term non-compete covenant. From the franchisees' perspective, holding that ABC did not have the right to terminate the franchise agreements based on the alleged violation of these non-competition covenants (applying the strict test for reasonableness) would benefit those franchisees who might decide to leave the system, but would not likely be welcomed by franchisees in the system, who generally favor non-competition and loyalty to the system.

a. Invalidation of In-Term Non-compete

The Georgia Court of Appeals upheld the trial court's decision that the in-term non-compete covenants contained in ABC's franchise agreement were unenforceable as a matter of law because (1) it had no territory limitation; (2) it prevented the franchisee from working "in any capacity" in a similar bakery/deli business; and (3) it failed to specify the restricted activities with sufficient particularity, including the meaning of a "bakery/deli business."

[7] *Id.* at 745-46.

[8] 292 Ga.App. 14, 663 S.E.2d 743 (2008).

Under a reasonableness evaluation, the court found that the in-term covenant in ABC's franchise agreement was not reasonable because it lacked any geographic limitation.

The court also pointed out that in addition to the lack of a geographic scope limitation, the activities restricted in the covenant were not stated with sufficient particularity to pass muster under the reasonableness standards established under Georgia law. The court noted that if Lupton-Smith opened up a coffee shop that sold baked goods from other suppliers and was located far outside of ABC's territory or worked as a janitor in a deli, he would be in violation of the in-term non-compete. Because of the lack of particularity as to the nature and kind of businesses and activity that were prohibited, the restriction imposed a greater limitation than necessary to protect the franchisor, and was, the court concluded, an unenforceable restraint of trade.

b. Invalidation of Post-Term Non-compete

The Georgia Court of Appeals also invalidated ABC's post-termination non-compete based on the finding that such post-term covenants were not severable from the in-term covenants. Further, the court noted, Georgia courts do not "blue-pencil" non-compete covenants in franchise agreements, so if one portion of the covenant is invalid then the entire non-compete covenant (which may include both in-term and post-termination covenants) will be held invalid.

Accordingly, the court found that the post-termination covenant was also unreasonable because it contained "shifting and expanding" territorial restrictions. It supported this finding by pointing out that the franchise agreement prohibited franchisees from engaging in competitive activities within 20 miles of any "store unit within the system", which meant that additional restricted territories could be added during the term of a franchisee's agreement as new ABC stores were added to the system.[9]

3. The Supreme Court of Georgia (Atlanta Bread Co. Int'l, Inc. v. Lupton-Smith)[10]

The Georgia Supreme Court agreed that the in-term restrictive covenants are subject to the same strict scrutiny standard applied to post-term covenants and the same reasonableness standards of time, territory, and scope.

a. Affirmed Lower Court Rulings

In its decision, the Supreme Court noted that, "[i]n Georgia, contracts that generally restrain trade are void against public policy."[11] And, that "restrictive (or non-competition) covenants are considered to be partial restraints of trade and must be

[9] *See generally Kroger Properties v. Adams-Cates Co.*, 422 S.E.2d 529 (Ga. 1992) (holding that shifting territorial limitations are not enforceable under Georgia law -- "[a] territorial restriction which cannot be determined until the date of the franchisee's termination is too indefinite to be enforced.") *But see Boulanger v. Dunkin' Donuts Incorporated*, 442 Mass. 635, 815 N.E.2d. 572 (Mass. 2004) (enforcing non-compete that prohibited activity within five miles of any Dunkin Donuts establishment).

[10] 285 Ga. 587, 679 S.E.2d 722 (2009).

[11] 679 S.E.2d 722, 724 (citing *W.R. Grace & Co. v. Mouyal*, 262 Ga. 464(1), 422 S.E.2d 529 (1992).

reasonable as to time, territory and scope to be enforceable."[12] Further, with respect to the non-compete provision at issue, the court noted that:

> *"[a] plain reading of the clause shows that it prohibits the franchisee from engaging in a certain type of business during the term of the parties' agreement and, thus, it is a partial restraint of trade designed to lessen competition. Such restraints, no matter the nomenclature assigned to them, are disfavored in this state as a matter of public policy."*

The Court rejected ABC's argument that the in-term covenant should not be considered a restraint but a "loyalty" provision intended to foster the relationship between franchisor and franchisee, and subject to a different and less strict standard to be enforceable. Further, the Court rejected the "blue-pencil" rule (like the lower courts) and would not allow courts to redraw or reconstruct the covenant to pass judicial standards for reasonableness for time, scope or territorial limitation. Thus, failure to meet the Court's notion of reasonableness on any component would render the entire covenant unenforceable.

b. Application to Employment Law

In its ruling, the Georgia Supreme Court held that franchise agreements are held to the same strict standards as employment agreements. More importantly, the Supreme Court has given franchisees the right to compete with their franchisors during the term of the franchise relationship unless their in-term non-competes are properly limited by geography and scope of activity. This analysis removes any doubt that the Court's analysis in *Atlanta Bread* also will apply to in-term restrictive covenants in an employment agreement.

C. Public Opinion and Legislative Responses

1. Reaction to *Atlanta Bread*

Over the years, franchisors have come to generally expect that (1) non-compete clauses in franchise agreements will be subject to lower scrutiny than those in employment contracts; and (2) in-term covenants will be less problematic to enforce than post-term restraints. In turn, this has increased the likelihood that a franchisee's covenant to not compete in-term would be found enforceable.

As a result of *Atlanta Bread*, however, these expectations will not apply when Georgia law is applicable. Based on the *Atlanta Bread* ruling, effectively, the Supreme Court of Georgia removed the previously drawn distinction in the test to be applied to covenants in franchise arrangements and employment contracts.

2. Legislative Response – Georgia Restrictive Covenants Act

Before the Supreme Court of Georgia announced its decision in *Atlanta Bread*, the Georgia Assembly enacted the Restrictive Covenants Act ("RCA") – which

[12] 679 S.E.2d at 724.

addresses restrictive covenants found in various types of agreements, including (but not limited to) franchise agreements. The RCA enhances the enforceability of non-compete agreements and expressly gives Georgia courts authority to modify otherwise unenforceable non-compete agreements. On May 11, 2011, Georgia's governor signed into law the RCA that reversed the bias against enforcement of restrictive covenants and made it easier to enforce such covenants under Georgia law.[13] The RCA was authorized by a state constitutional amendment passed by Georgia voters in November 2010. It applies to all restrictive covenants entered into after May 11, 2011.

Under the RCA, post-term covenants not to compete still must be reasonable in "time, geographic area, and scope of prohibited activities."[14] No geographic limitation need be spelled out if the restrictive covenant prohibits, for a stated period of time following termination, solicitation of business from the employer's customers with whom the employee had "material contact" while employed. Notably, the RCA authorizes courts to modify restrictive covenants so long as the resulting covenant is not more restrictive with regard to the employee.

The RCA provides for certain presumptions as to the reasonableness of such restrictions. For example:

- In-term restrictive covenants are presumptively reasonable if: (i) their duration is the same as the duration of the parties' relationship; (ii) the geographic scope includes areas in which the employer does business at any time during the parties' relationship, provided the total area is reasonable and/or the covenant contains a list of particular competitors with which employment is prohibited; and (iii) the scope of competitive conduct is measured by the business of the employer.

- Post-termination covenants are rebuttably presumed reasonable if their durations are: (i) 2 years or less for former employees; (ii) 3 years or less for former distributors or franchisees; and (iii) 5 years or less for sellers of a business.

3. Effect on Franchise Agreements

Georgia's RCA should make it easier for franchisors and distributors (as well as employers) to enforce covenants not to compete and other restrictive covenants under Georgia law. As noted, contracts entered into after May 11, 2011 are governed by the RCA.

The *Atlanta Bread* decision is one of the most significant cases affecting franchising because of its unprecedented severe treatment of in-term covenants at the same level as post-term covenants. While the legislative efforts to minimize the impact of that decision on franchisors has evolved, Georgia remains a state where enforcement

[13] The new law modified GA. Code Ann. § 13-8-2(a) to permit contracts "which restrict certain competitive activities," and enacted a new restrictive covenant statute at GA. Code Ann. § 13-8-50, et seq.

[14] *Id.* § 13-8-53(a).

of non-competition covenants is still problematic.[15] Given the relative newness of the RCA, it remains to be seen to what lengths courts will go (especially in light of the strict scrutiny standard that was previously applied for many years) in order to enforce non-compete restrictions. The RCA leaves certain questions unanswered. For example, how will the judicial modification requirement be applied as Georgia courts decide cases under the RCA?[16] We predict that the historical tendency of the Georgia courts to void non-competes may well influence future decisions under the RCA.

Few cases have been decided since reenactment of the RCA[17], and most have confirmed that traditional principles will be applied to contracts entered into prior to November 3, 2010. (When the RCA was initially approved, there was confusion as to its effective date because the legislation in which it was contained (House Bill No. 173) was intended to go into effective on November 3, 2010 (but under the Georgia Constitution, could not take effect until January 1, 2011). To address the gap between the intended effective date (November 3, 2010) and the actual effective date (January 1, 2011), the General Assembly passed House Bill 30 on May 11, 2011 to clarify that the effective date of the RCA would be May 11, 2011. It is now clear that pre-existing Georgia law applies to all Georgia restrictive covenant agreements entered into prior to November 3, 2010. And the RCA applies to all Georgia restrictive covenant agreements entered into after May 11, 2011 – the date the RCA was made effective by Georgia House Bill No. 30. This was later confirmed by the Eleventh Circuit in *Becham v. Synthes USA*, 482 F. App'x 387 (11th Cir. 2012), which also applied the pre-existing Georgia law to Georgia restrictive covenant agreements entered into between November 3, 2010 and May 10, 2011.) Given the newness of the legislative changes, if granting franchises to be operated in Georgia, franchisors should tighten their in-term and post-term covenants by, among other things: (i) defining the nature of business narrowly; (ii) defining the activity prohibited with particularity (*i.e.*, avoid “in any capacity” language); (iii) considering territorial limits on in-term covenants; and (iv) limiting post-term covenants to areas near that franchisee’s operations and where other units operate at the time of entering into agreement. In addition, in granting franchises to be operated in Georgia, franchisors have had to consider including a time limitation on the non-disclosure of confidential information.

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[15] Other states have similar impediments on the enforcement of non-competition covenants. For example, under California law, an in-term covenant not to compete in a franchise-like agreement will be void if it forecloses competition in a substantial share of a business, trade, or market. *Dayton Time Lock Service, Inc. v. Silent Watchman Corp.*, 124 Cal. Rptr. 678 (1975); *Kelton v. Stravinski*, 41 Cal. Rptr.3d 877 (2006); *Comedy Club, Inc. v. Improv West Associates*, 553 F.3d 1277 (9th Cir. 2009), *cert. denied*, 130 S. Ct. 145 (2009).

[16] The RCA provides, in relevant part that “if a court finds that a contractually specified restraint does not comply with the provisions of [the RCA], then the court may modify the restraint provision and grant only the relief reasonably necessary to protect such interest or interests and to achieve the original intent of the contracting parties to the extent possible.” O.C.G.A. § 13-8-55(b).

[17] *Matthew Focht Enterprises, Inc. v. Lepore*, 1:12-CV-04479-WSD, 2013 WL 4806938 (N.D. Ga. Sept. 9, 2013); *Clark v. Johnson Truck Bodies, LLC*, CV411-132, 2012 WL 1014827 (S.D. Ga. Mar. 23, 2012) *Fantastic Sams Salons Corp. v. Maxie Enterprises, Inc.*, 3:11-CV-22 CDL, 2012 WL 210889 (M.D. Ga. Jan. 24, 2012); *Paragon Technologies, Inc. v. InfoSmart Technologies, Inc.*, 312 Ga. App. 465, 718 S.E.2d 357 (2011); *B & F Sys., Inc. v. LeBlanc*, 7:07-CV-192 HL, 2011 WL 4103576 (M.D. Ga. Sept. 14, 2011), on *reconsideration in part*, 7:07-CV-192 HL, 2011 WL 5117712 (M.D. Ga. Oct. 25, 2011), *aff'd in part*, 519 F. App'x 537 (11th Cir. 2013); *Onbrand Media v. Codex Consulting, Inc.*, 301 Ga. App. 141, 687 S.E.2d 168 (2009).

For an excellent collection of the various state laws on covenants against competition, we highly recommend the ABA publication *Covenants Against Competition in Franchise Agreements.*[18]

III. *BROUSSARD v. MEINEKE DISCOUNT MUFFLER SHOPS*[19] - FIDUCIARY DUTY IN THE CONTEXT OF ADVERTISING FUNDS

We selected *Broussard v. Meineke Discount Muffler Shops, Inc.*[20] as one of the top franchise cases for several reasons. First, the almost $600 million jury award (which, when all fees, statutory interest and other payments are included, was believed to be much higher – and the largest damage award ever in franchising), would probably have destroyed the franchisor's business and its ability to function (and as a result, the franchisor's ability to provide services to the franchisees and the diminution in the value of the brand). Second, the Court of Appeals decision on the fiduciary duty issue was significant because it was in the context of advertising funds, which involves the entrusting of funds by franchisees with franchisors. And third, it represents a classic decision addressing the issue of class certification in franchising.

In *Broussard*, auto repair franchisees brought a class action against the franchisor, Meineke, and others, alleging, among other things, the misappropriation of monies in the Meineke advertising fund (the "Fund"). Under the terms of their franchise agreements, Meineke franchisees were required to contribute 10 percent of weekly revenues to the Fund as an advertising contribution. Although Meineke controlled the administration of the Fund, the franchise agreements provided that Meineke was to spend Fund monies exclusively for the benefit of the franchise system. Meineke also told the franchisees that all advertising monies were used for the benefit of the franchisees and that Meineke acted only as a conduit of the franchisee's contributions to advertising media.

At trial, the jury found that Meineke, its in-house advertising agency, its parent companies, and certain of the Meineke officers, committed fraud and breached their fiduciary duties by using the advertising fund monies in violation of the franchise agreement and by making misrepresentations to conceal such violations. The *Meineke* jury returned a verdict in favor of the franchisees that was trebled under RICO to $590,869,788.00, plus interest.[21] The court upheld the jury's findings and found that a fiduciary duty existed on behalf of Meineke to administer the weekly advertising fund because: (1) Meineke agreed to administer the fund for its franchisees' benefit; (2) the franchisees placed their confidence in Meineke's ability to administer the fund on their

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[18] *Covenants Against Competition in Franchise Agreements,* Third Edition, edited by Michael R. Gray and Natalma M. McKnew, (available at http://shop.americanbar.org/eBus/Default.aspx?TabID=251&productId=215737).

[19] 155 F.3d 331 (4th Cir. 1998).

[20] 958 F. Supp. 1087 (W.D.N.C. 1997).

[21] The court dealt with certain complicated release issues with respect to the purported class. Meineke had offered franchisees a new franchise package, the Enhanced Dealer Program ("EDP"). In exchange for releasing Meineke from all claims arising out of past dealings, specifically including the claims at issue in the lawsuit, franchisees who accepted the EDP received a reduced royalty rate and other benefits. This led to numerous legal issues – *e.g.*, former vs. current franchisees who accepted the EDP, former v. current franchisees who did not accept the EDP, conflicts of interest, the EDP releases, adversity among subgroups, etc. – which impacted the potential composition of the class.

behalf; (3) Meineke was the self-appointed agent for the franchisees in procuring advertising; and (4) Meineke represented to the franchisees that the fund was a "trust" for their benefit.

At the time of that decision, many expressed concern that franchisors might increasingly be held to a fiduciary standard in connection with advertising funds.

A. The Court of Appeals Decision

Those concerns, however, were short-lived because the Fourth Circuit Court of Appeals held[22], in part, that the district court committed error in allowing the *Meineke* plaintiffs to advance their fiduciary duty claims. The case was significant for two reasons: (1) the court held that class action lawsuits are generally inappropriate in the franchise context because of the unique contracts and facts presented by individual franchisees' relationships with their franchisor; and (2) the court determined that no fiduciary duty exists between franchisors and franchisees in the advertising fund situation, in particular, or the franchise context in general.

1. The Class Certification

With respect to (1) above, the Fourth Circuit concluded that five significant aspects of the franchisees' factual and legal arguments rendered the case inappropriate for class treatment – *i.e.*, they failed to present common questions of law or fact and the plaintiff's claims were not "typical" of the claims of the class.[23] These five significant aspects were:

a. plaintiffs could not advance a single collective breach of contract action on the basis of multiple different contracts (*e.g.*, materially different contract terms);[24]

b. the plaintiffs' tort statutory claims were based on "individualized representations to franchisees" – *i.e.*, what Meineke said to franchisees and how it described its responsibilities with respect to the advertising account;[25]

c. the reliance element in connection with plaintiffs' fraud and negligent misrepresentation claims were not susceptible to class-wide proof;[26]

d. tolling the statute of limitations on each of the plaintiffs' claims would turn on individualized proof that would be non-typical and unique to each franchisee;[27] and

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[22] 155 F.3d 331 (4th Cir. 1998).

[23] 155 F.3d at 340.

[24] *Id.*

[25] *Id.* at 340-41.

[26] *Id.*

[27] *Id.* at 342.

e. each class member's claim for lost profits was inherently individualized and not appropriate for class treatment.[28]

In short, the Court found that the class that the district court had certified was a "hodgepodge of factually as well as legally different plaintiffs" which should not have been "cobbled together for trial."[29] However, while reaching this conclusion, the Court also pointed out that "a class action may be the most economical and efficient means of litigation in many circumstances, and [it did] not intend to discourage its use when the claims of the named plaintiffs can truly be called representative of class members whose resources would not permit individualized lawsuits."[30]

2. The Fiduciary Duty Claim

With respect to (2) above, despite the reluctance of courts to treat the franchise relationship as a fiduciary one, it is still advisable to include an integration disclaimer in franchise agreements. The integration disclaimer considered by the Fourth Circuit Court of Appeals in *Meineke,* when determining that Meineke did not owe any fiduciary duty to its franchisees, was: "[T]his Agreement constitutes and contains the entire agreement and understanding of the parties with respect to the subject matter hereof. There are no representations, undertakings, agreements, terms, or conditions not contained or referred to herein." The court found that this integration disclaimer emphasized that the franchise relationship was governed solely by the contract and discouraged "the imposition of extra-contractual obligations based upon the welter of conflicting oral statements and representations that plaintiffs introduced at trial."[31]

B. Developments Since *Meineke*

Consistent with the Fourth Circuit Court of Appeals in *Meineke*, courts have all but rejected the notion that a franchisor owes a fiduciary duty to its franchisees (*i.e.*, a relationship based on trust and confidence).[32] Thus, fiduciary relationships have generally not been found in franchise relationships.[33] Moreover, courts have generally not found there to be a fiduciary duty even with respect to advertising funds.[34]

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[28] *Id.* at 342-43.

[29] *Id*. at 343.

[30] *Id*. at 343-44.

[31] *Id*.

[32] *Id.*; *see also Amoco Oil Co. v. Gomez*, 125 F. Supp. 2d 492, 509 (S.D. Fla. 2000) ("The contracts in this case establish a franchiser/franchisee or independent contractor relationship. Such agreements do not automatically give rise to fiduciary obligations.").

[33] S*ee*, *e.g., Pinnacle Pizza Co., Inc. v. Little Caesar Enterprises, Inc*., 560 F. Supp. 2d 786, 801–802 (D.S.D. 2008), *aff'd,* 598 F.3d 970 (8th Cir. 2010) (granting defendant's motion for summary judgment on plaintiff's claim for breach of fiduciary duty based upon the finding that there is no inherent fiduciary duty in a franchise relationship and thus the express disclaimer of the existence of a franchise relationship was valid under South Dakota law); *Thrifty Rent-A-Car System, Inc. v. Best Leasing, Inc*., 229 F.3d 1165 (10th Cir. 2000) ("The record contains nothing indicating a special trust or confidence giving rise to a fiduciary relationship between the [franchisor and franchisee], and the district court was correct in finding that the contract provisions do not provide evidence of such a relationship")*; America's Favorite Chicken Co. v. Cajun Enterprises, Inc.,* 130 F.3d 180 (5th Cir. 1997) (franchisor did not have duty to inform prospective franchisee about certain equipment problems with one restaurant location and competitor's plan to relocate next to another location); *O'Neal v. Burger Chef Sys., Inc.*, 860 F.2d 1341 (6th Cir. 1988) (the franchise

However, there have been a few cases that have held that when the franchisee can demonstrate that it greatly relied on the franchisor and thereby reposed an exceptional degree of trust and confidence in the franchisor, and the relationship is so mutually interdependent, the relationship may rise to the level of a fiduciary one.[35] What

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relationship is usually the result of arm's-length negotiations, where the franchisee is an independent contractor – in this case, the court held that a conventional franchisor-franchisee relationship did not impose a fiduciary or other special duty upon the franchisor in its dealing with a franchisee); *Long John Silver's Inc. v. Nickleson*, 2013 WL 557258 (W.D. Ky. 2013) (granting summary judgment for franchisor on franchisee's fraud by omission claim because franchisor did not have a fiduciary relationship with franchisee)*; Passport Health, Inc. v. Travel Med, Inc.*, 2009 WL 3824743 (E.D. Cal. 2009) (stating that a fiduciary relationship is not created by a franchisor-franchisee relationship under California law); *Robert Basil Motors, Inc. v. General Motors Corp*., 2004 WL 1125164 (W.D. N.Y. 2004) (granting motion to dismiss plaintiff's claim for breach of fiduciary duty based upon finding that courts in Michigan have been reluctant to extend cause of action beyond the traditional fiduciary relationships).

[34] *See, e.g., Murphy v. White Hen Pantry Co.*, 691 F.2d 350 (7th Cir. 1982)(statement in franchise promotional brochure about franchisor "acting as your agent" did not make relationship fiduciary); *Prince Heaton Enters., Inc. v. Buffalo's Franchise Concepts, Inc.*, 117 F. Supp. 2d 1357 (N.D. Ga. 2000) (franchisor's alleged conversion of funds from a national advertising fund did not constitute a breach of fiduciary duty towards a franchisee where the parties' area development agreements specifically disclaimed any fiduciary relationship and a franchisor did not generally owe a fiduciary duty to a franchisee under Georgia law); *D&K Foods, Inc. v. Bruegger's Corp.*, Bus. Franchise Guide (CCH) ¶ 11,506 (D. Md. 1998)(holding franchisor/franchisee relationship is not a fiduciary relationship that would give rise to a duty to disclosure and franchisor's alleged misrepresentations were not actionable under state consumer protection act because the plaintiff failed to specify how the public had been or was likely to have been affected by the alleged conduct, and because the transactions did not involve the public in any way, and, in fact, "were complex, arm's length commercial transactions between highly experienced and sophisticated parties"); *Thompson v. Atlantic Richfield Co.*, 673 F. Supp. 1026 (W.D. Wash. 1987)(no fiduciary relationship between franchisor and franchisee; provisions in franchise agreements that give the franchisor the sole right to determine how advertising funds will be spent are valid). S*ee also Oil Express Nat'l, Inc. v. Burgstone*, 958 F. Supp. 366 (N.D. Ill. 1997) (dismissing a claim by a franchisee that the franchisor breached a fiduciary duty by failing to maintain and administer an advertising fund for the sole purpose of providing regional and national advertising).

[35] *See generally*, Frank J. Cavico, *The Covenant of Good Faith and Fair Dealing in the Franchise Business Relationship*, 6 Barry L. Rev. 61, 104 (2006). Examples of cases that have addressed whether a franchisor-franchisee relationship has arisen to the level of a fiduciary include, among others: *Desert Buy Palm Springs, Inc. v. DirectBuy, Inc.*, 2012 WL 2130558 (N.D. Ind. 2012) (allowing a breach of trust claim to survive a motion to dismiss where franchisor's status as trustee of certain trust accounts in which it deposited money "plausibly suggest[ed] a fiduciary relationship"); *Fitzpatrick v. Teleflex, Inc.*, 630 F. Supp. 2d 91 (D. Me. 2009) (distributor's allegations of the existence of a franchisee-franchisor relationship with manufacturer, and that manufacturer terminated such relationship, was sufficient to state a claim of breach of fiduciary duty under Maine law); *Cottman Transmission Systems, LLC v. Kershner*, 536 F. Supp. 2d 543 (E.D. Pa. 2008) (franchisees stated a claim against franchisor under Pennsylvania law for breach of fiduciary duty based on a listing agreement, in which franchisor agreed to act on the franchisees' behalf; franchisees alleged that an agent-principal relationship was formed by the listing agreement, and that fiduciary duty was breached when franchisor disregarded its duty of loyalty and sought its own profit rather than the franchisees'); *Towne v. Robbins*, 339 F. Supp. 2d 1105, 1112 (D. Or. 2004) and 2005 WL 139077 (D. Or. 2005) (while acknowledging the general rule that "the franchisor-franchisee relationship is not fiduciary in nature," court held that such rule was not absolute and that plaintiffs created a fact issue regarding the existence of a fiduciary relationship by alleging that they were encouraged to, and did, place a significant degree of trust in the franchisor, including the adoption in their personal and professional lives of the franchisor's motivational "belief system"); *Saey v. Xerox Corp.*, 31 F. Supp. 2d 692, 699 (E.D. Mo. 1998) (the court denied motion for summary judgment on breach of fiduciary duty claim because while such a duty is certainly not inherent in franchise or dealer relationship and is very difficult for the franchisee or dealer to prove, its existence can only be determined after a thorough examination of the facts); *Lake Erie Distribs. v Martlet Importing Co.* 221 App. Div. 2d 954 (N.Y. 1995) (plaintiff had entered into a franchise agreement with distributors of beer products; when the defendants terminated the franchise, the plaintiffs commenced an action alleging breach of a fiduciary duty; the court found that in "some rare instances," a distributorship agreement may create a confidential relationship).

distinguishes these cases from the overwhelming number of cases that hold that no fiduciary duty exists in the franchise relationship is the unusual degree of trust and the unique circumstances (and perhaps the particular court) involved. Some potential fiduciary factors to be considered include, for example, the superior and economically powerful position of the franchisor (compared to the franchisee); the unusual extent of control the franchisor maintains over the franchisee; the great disparity in bargaining power of the parties; the typical nationwide size, purchasing power, and technical expertise of the franchisor; the length of the parties' relationship; and the mutuality of interests and intent shared by the franchisor and franchisee.[36]

Today, many franchisors try to avoid many of the risks of advertising funds by ensuring that franchisees participate in administering the fund, usually through an advertising council; by expending funds in an even-handed manner, so that no group of franchisees is favored over another; by avoiding self-dealing entirely; and by providing the franchisees with a regular accounting of the fund. While these actions may be taken by the franchisor for the purpose of decreasing exposure, they also represent best practices – allowing franchisees to have input into advertising decisions, yet reserving to the franchisor the decision of what is best for the entire system.

IV. *STATE OIL CO. v. KHAN, ET AL.*[37] AND *LEEGIN CREATIVE LEATHER PRODUCTS, INC. v. PSKS, INC.*[38] – MAXIMUM AND MINIMUM VERTICAL PRICE-FIXING

For many decades, the antitrust laws made <u>per se</u> unlawful vertical agreements fixing prices, whether or not the price set was a maximum or minimum price. As a result, franchisors – being in a vertical relationship with their franchisees – refrained from controlling the prices at which their franchisees offered the products and services. Consistent with that, many franchisors included in their franchise agreements a provision providing that the franchisee was free to set its own prices. The world of vertical price restraints has changed considerably in recent years as a result of two key Supreme Court decisions, neither of which involved traditional franchises but both of which have increased the ability of franchisors to achieve uniformity in their franchise systems.

A. ***<u>State Oil</u>***

In *State Oil Co. v. Khan, et al.*[39], the U.S. Supreme Court was faced with the issue of whether vertical <u>maximum</u> price fixing should be classified as <u>per se</u> unlawful under the antitrust laws (and therefore violative without any consideration of the competitive effects) or to be judged under the "rule of reason" approach (where the pro- and anti-competitive effects are assessed). Barkat U. Khan and his corporation ("plaintiffs") had entered into an agreement with State Oil Company to lease and operate

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[36] *See Cavico*, 6 Barry L. Rev. 61, 104 (2006) (*citing* 62B Am. Jur. 2d Private Franchise Contracts § 20); Michael J. Lockerby, et al., *Franchising (& Distribution) Currents*, 24 Franchise L.J. 261, 271 (2005); *Saey v. Xerox Corp.*, 31 F. Supp. 2d 692, 699 (E.D. Mo. 1998)(stating that a fiduciary relationship can only be determined after a thorough examination of the facts, after rejecting the notion that no fiduciary relationship may never exist between a franchisor and franchisee.)

[37] 522 U.S. 3 (1997).

[38] 551 U.S. 877 (2007).

[39] 522 U.S. 3 (1997). Mr. Heller was involved in the preparation of an *amicus* brief in the case, supporting the position of State Oil Co.

a gas station and convenience store owned by State Oil. The agreement provided that plaintiffs would obtain the station's gasoline supply from State Oil at a price equal to a suggested retail price set by State Oil, less a margin of 3.25 cents per gallon. Under the agreement, plaintiffs could charge any amount for gasoline sold to the station's customers, but if the price charged was higher than State Oil's suggested retail price, the excess was to be rebated to State Oil. Plaintiffs could sell gasoline for less than State Oil's suggested retail price, but any such decrease would reduce their 3.25 cents-per-gallon margin. Plaintiffs fell behind in lease payments and State Oil commenced eviction proceedings. Plaintiffs then filed suit in court, alleging that, as a result of the arrangement, State Oil had engaged in price fixing in violation of §1 of the Sherman Act.

Almost 30 years earlier, the Supreme Court, in the case of *Albrecht v. Herald Co.*[40], had classified vertical maximum price restraints as per se illegal. In reaching its decision to override *Albrecht,* the Supreme Court considered the history of how vertical restraints, both as to price, territory and others, had been dealt with since *Albrecht*. It also noted that after finding the per se rule applicable to vertical non-price restrictions in *United States v. Arnold, Schwinn & Co.*[41], the court had, in *Continental T.v., Inc. v. GTE Sylvania, Inc.*[42], overruled *Schwinn*, and placed vertical non-price restrictions in the rule of reason category. The Court proceeded to consider the "considerable body of scholarship discussing the effects of vertical restraints," noting that its decision was "also guided by our general view that the preliminary purpose of the antitrust laws is to protect interbrand competition."[43] Given that the setting of maximum prices may well result in "low prices" which benefit consumers, the Court found "it difficult to maintain that vertically imposed maximum prices would harm consumers or competition to the extent necessary to justify their per se invalidation."[44]

In overruling *Albrecht*, the Court made sure to point out that it was not "hold[ing] that all vertical maximum price fixing is per se lawful," but, rather, that vertical maximum price fixing "should be evaluated under the rule of reason."[45] The Court expressed confidence that the "rule of reason analysis will effectively identify those situations in which vertical maximum price fixing amounts to anticompetitive conduct."[46]

B. ***Leegin***

Having decided to move vertical maximum price fixing into the rule of reason category in *State Oil*, ten years later the Supreme Court was faced with the same issue with respect to vertical minimum price-fixing. Almost 100 years earlier (in 1911), the Court, in *Dr. Miles Medical Co. v. John D. Park & Sons, Co.*[47], had held that vertical minimum price fixes should be treated as per se unlawful. But when the issue came

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[40] 390 U.S. 145 (1968).

[41] 388 U.S. 365 (1967).

[42] 433 U.S. 36 (1977).

[43] 522 U.S. at 15.

[44] *Id.*

[45] *Id.* at 22.

[46] *Id.*

[47] 220 U.S. 373 (1911).

before the Supreme Court in 2007 in the case of *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[48]*,* the Court reached a different result.

Once again, as in *State Oil*, the Supreme Court was influenced by "respected economic analysts" who "conclude[d] that vertical price restraints can have pro-competitive effects."[49] The Court explained that "[r]esort to per se rules is confined to restraints… that would always or almost always tend to restrict competition and decrease output."[50] The Court then analyzed potential effects of vertical minimum price fixes, noting that the *Dr. Miles* decision was based on "formalistic" legal doctrine rather than "demonstrable economic effect."[51]

Specifically, the Court pointed out that minimum vertical price restraints can stimulate interbrand competition by reducing intrabrand competition – and that promotion of interbrand competition is "the primary purpose of the antitrust laws."[52] It also noted that vertical price restraints have the potential of providing consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and those that fall in between.[53] Furthermore, the Court pointed out that minimal vertical price restraints can help prevent "free riders" – discount dealers taking advantage of the retailers which furnish more services and invest more in showrooms, product demonstrations and the like.[54]

As a result of the potential pro-competitive effects of such restraints, the Court concluded that they do not "always or almost always" restrict competition and decrease output.[55] Accordingly, the Court, reversing the *Dr. Miles* precedent, held that vertical minimum price fixing should not be per se illegal but should be judged under the rule of reason.

C. Developments Since *State Oil* and *Leegin*

To the extent that *State Oil* and *Leegin* allow franchisors to control the prices being charged by their franchisees, that is a significant benefit for franchisors. Because of the obvious importance of achieving uniformity in a franchise system, there is a real advantage if the prices for items being sold in the system can be the same no matter which particular outlet a customer visits. For example, controlling prices enables franchisors to more easily conduct promotions, as they can advertise a particular price for a product without that price being available "only at participating outlets." However, by in effect allowing franchisors to determine the retail price at which franchisees are required to offer products and services, *State Oil* and *Leegin* deprive franchisees of the freedom to set their own prices and to control their own profit margins. From a system perspective, having uniform prices benefits both the franchisor and the franchisees, as it

[48] 551 U.S. 877 (2007).

[49] *Id.* at 881.

[50] *Id.* at 886 (quoting *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988)).

[51] 551 U.S. at 887 (quoting *Continental T.v., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977)).

[52] *Id.* at 890.

[53] *Id.*

[54] *Id.* at 890-91.

[55] *Id.*

prevents one franchisee from having to compete against another franchisee in the system and may increase the overall business of the franchisees because customers, having been to one system unit, may frequent another system unit knowing what prices to expect.

It should be noted that *State Oil* and *Leegin* address only the federal antitrust laws, not the state antitrust laws or any contractual issues. In addition, while those decisions removed vertical price-fixing from the per se category, they still must pass muster under the rule of reason.

Certain states attorneys general, many of whom filed amicus briefs in the Supreme Court cases, have opposed treating vertical price fixing under the rule of reason. They have continued to attempt to apply their state antitrust laws to vertical price-fixing as a per se violation. This has created uncertainty for franchisors and franchisees as to whether vertical price fixing violates state antitrust laws. For a discussion of the state activity in this area, you may want to review "Antitrust Law, Franchising, and Vertical Restraints," by Robert T. Joseph.[56] An excellent analysis of how the *Leegin* decision has been, or is likely to be, treated on a state-by-state basis can be found in "Waiting for the Other Shoe to Drop: Will State Courts Follow *Leegin*?" by Richard A. Duncan and Alison K. Guerney.[57]

Even if there were no antitrust concerns at all – whether on the federal or state levels – as to vertical price-fixing, there remains the contractual issue of whether the franchisor has the contractual right to set prices for its franchisees. As noted above, many franchise agreements prepared before the changes in the antitrust laws provided that the franchisee could set its own prices.

There have been at least two significant decisions since *Leegin* addressing the contractual aspect of vertical price-fixing -- neither of which involved any antitrust claims, presumably because of the *State Oil* and *Leegin* decisions which essentially doomed any antitrust challenge to a vertical price fix arrangement. In *National Franchisee Association*[58], a franchisee association sued Burger King over its decision to set a $1.00 maximum price for the double-cheeseburger as part of its $1.00 Value Meal menu. The franchisees claimed that Burger King did not have the right under its franchise agreement to unilaterally impose maximum prices to be charged by franchisees and that, in any event, that decision violated Burger King's duty to exercise its pricing judgment "in good faith." The Southern District of Florida held that the provision in the franchise agreement that authorized Burger King to make changes to the standards and, specifically, in the good faith exercise of its judgment, granted Burger King the discretion to set maximum prices, and that Burger King's decision did not rise to the level of bad faith. In reaching its conclusion, the court noted that the price being set was only as to one product and the franchisees had made no showing of the kind of serious injury to their entire business that would support an inference of bad faith.

[56] Franchise Law Journal, Vol. 31, No. 1, Summer 2011.

[57] Franchise Law Journal, Vol. 27, No. 3, Winter 2008.

[58] 2010 WL 4811912 (S.D. Fla. 2010).

A few years later, the federal court in Illinois addressed a somewhat similar issue in *Stuller, Inc. v. Steak N Shake Enterprises, Inc.*[59] There, the franchisor attempted to set the prices the franchisees would charge for virtually all the items on their menu. The court had previously found that the franchise agreements were ambiguous as to whether price was part of the "System" that, according to the agreements, could be changed by the franchisor. The court reaffirmed that conclusion and, because the agreements were ambiguous, the court considered extrinsic evidence. In doing so, the court concluded that the "System" did not include pricing or promotions, and granted summary judgment to the franchisees on that issue.

While the *Burger King* case involved a single menu item and the *Steak N Shake* case involved the whole menu, how a court would rule in a situation involving the price setting of only a few items would depend on the particular facts: What was the language of the franchise agreements? How was "system" defined? What did the disclosure document say on the issue? Were there any previous policy announcements on the issue? Did any franchisee rely on them? What impact would the prices set have on the franchisees?

Accordingly, while *State Oil* and *Leegin* offer benefits for franchisors, as they provide comfort that vertical price fixing will generally not violate the federal antitrust laws, franchisors nevertheless need to be mindful of potential state antitrust and contractual issues that could pose concerns. Similarly, franchisees seeking to challenge the imposition of vertical price restraints may be able to look to their contractual rights and state antitrust laws for protection.

V. *STOLT-NIELSEN S.A., ET AL., v. ANIMALFEEDS INTERNATIONAL CORP.*[60] – CLASS ARBITRATION AND THE FEDERAL ARBITRATION ACT

Because of the large number of franchisees in many systems and the fact that many franchisors have included arbitration clauses in their agreements, the concern about facing a class action in the arbitration context – where there is little ability to challenge an erroneous final decision, which may have systemic implications – is a significant one for many franchisors. On the other hand, franchisees often feel the need, for practical, economic and other reasons, to unite as a group to challenge franchisor actions in the same proceeding and argue that they should not be denied procedures, such as class actions and consolidation. Because of the significance of the issue of class or consolidated arbitration, one of the cases we have selected for inclusion is the U.S. Supreme Court's decision in *Stolt-Nielsen S.A., et al. v. AnimalFeeds International Corp.*[61]

A. The Arbitration and Lower Court Decisions

In *Stolt-Nielsen*, the parties selected a panel of arbitrators and stipulated that their arbitration agreement was "silent" on the issue of class arbitration. The arbitration panel found that class arbitration was permissible under the parties' contract because it was not specifically precluded.

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[59] 877 F. Supp. 2d 674 (C.D. Ill. 2012).

[60] 559 U.S. 662 (2010).

[61] *Id.*

The U.S. District Court for the Southern District of New York vacated the arbitration panel's award, finding that the arbitrator's decision was made in "manifest disregard" of the law in light of the arbitration panel's failure to engage in a choice-of-law analysis. On appeal, the U.S. Court of Appeals for the Second Circuit reversed the District Court and reinstated the arbitrator panel's decision, finding that many of the bodies of law potentially applicable to the parties' dispute (*i.e.*, maritime law or New York law) did not permit class arbitration. The case was appealed and the U.S. Supreme Court granted *certiorari.*

B. The Supreme Court's Decision

The Supreme Court found that instead of applying principles of law based on the Federal Arbitration Act ("FAA"), or either maritime or New York law, the arbitration panel had "imposed its own policy choice and thus exceeded its powers."[62] The Court then addressed the question that was originally referred to the panel because, as the Court noted, "there can be only one possible outcome on the facts before us."[63]

After pointing out that its prior decision in *Green Tree Financial Corp. v. Bazzle,*[64] has "baffled the parties in the case," the Court observed that that case was mistakenly considered by the parties. According to the Court, the parties incorrectly believed that *Bazzle* addressed the issue of the "standard to be applied by a decisionmaker in determining whether a contract may permissibly be interpreted to allow class arbitration."[65] However, the Court observed that *Bazzle* had not addressed that issue, which remained unresolved.[66]

The Court emphasized that the FAA imposes certain rules of fundamental importance, including that arbitration "is a matter of consent, not coercion."[67] In addition, the Court noted that the central purpose of the FAA was to ensure that "private agreements to arbitrate are enforced according to their terms."[68] The Court further noted that it is clear from its own precedents and the contractual nature of arbitration that "parties may specify <u>with whom</u> they choose to arbitrate their disputes."[69] The key, the Court observed, was that courts and arbitrators must give effect to the intent of the parties.[70]

The Court then explained that class arbitration changes the nature of arbitration to such a degree that neither a court not an arbitrator should presume that the parties consented to it merely because they agreed to submit their disputes to arbitration.[71] For

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[62] 559 U.S. at 677.

[63] *Id.*

[64] 539 U.S. 444 (2003)

[65] *Id.* at 680.

[66] *Id.* at 681.

[67] *Id.*

[68] *Id.* at 682 (citing prior Supreme Court cases).

[69] *Id.* at 683 (emphasis in original).

[70] *Id.* at 684.

[71] *Id.* at 685.

example, the Court pointed out that class arbitration poses commercial ramifications comparable to those of class action litigation (resolving disputes between hundreds or even thousands of parties), "even though the scope of judicial review is much more limited."[72] As a result, the Court concluded that the test is "whether the parties agreed to authorize class arbitration" and where the parties stipulated that there was "no agreement on this question, the parties cannot be compelled to resolve their dispute as a class arbitration."[73]

C. **Significance for Franchising**

As noted above, many franchisors include arbitration in their franchise agreements as the method to address disputes – without considering the potential likelihood of facing a class arbitration. Some franchisors, who considered this possibility, included class arbitration waiver clauses in their agreements.[74] For those who did not, *Stolt-Nielsen* provides some comfort that unless their agreement is construed to authorize class arbitration, one will not be imposed.

One negative consequence for franchisors of avoiding class or consolidated arbitration is that, to the extent there may be collateral estoppel in arbitration (and there may not be[75]), by requiring each franchisee to proceed separately, franchisors may end up embroiled in numerous different actions with the possibility of one adverse ruling affecting future actions. In short, franchisees as a group may get several "bites at the apple," with the franchisor needing to prevail in each to avoid other future negative rulings.

The inability to pursue class arbitrations may result in increased costs for franchisees. Any franchisee wishing to pursue a claim who is bound by an arbitration provision must bring an individual arbitration action, and cannot as easily share attorneys' fees and costs (*e.g.*, arbitrator fees) with other franchisees who might have the same claim. This potentially could result in an increase in the number of legal or arbitration proceedings because consolidation is unavailable.

D. **Cases That Have Interpreted *Stolt-Nielsen***

After *Stolt-Nielsen* was decided, franchisors began to feel comfortable that as long as their franchise agreements did not expressly allow class arbitration, none would be imposed. That was a fair interpretation of the *Stolt-Nielsen* decision because it seemed to hold that when an agreement is "silent" on the issue, it would violate the FAA to require the parties to engage in class arbitration. But subsequent decisions have not read *Stolt-Nielsen* so narrowly.

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[72] *Id.* at 686-687.

[73] *Id.* at 687.

[74] In *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), the U.S. Supreme Court provided assistance to those seeking to enforce such class arbitration waiver clauses. There, the Supreme Court held that the FAA preempts states (as California had done) from imposing stringent conditions which lead to rendering class arbitration waivers unconscionable.

[75] *See Vandenberg v. Superior Court*, 21 Cal. 4th 815 (1999) (the California Supreme Court held that a judicially confirmed arbitration award governed by Code Civ. Proc. §§ 1280, et seq. cannot have nonmutual collateral estoppel effect in favor of an arbitration nonparty unless the arbitration agreement being enforced authorizes nonmutual collateral estoppel).

In *Fantastic Sams Franchise Association v. FSRO Association Ltd.*[76], ten of the franchise agreements involved in the case contained no express prohibition on class or collective arbitration. These agreements provided that "[a]ny controversy or claim arising out of or relating in any way to this Agreement or with regard to its formation, interpretation or breach shall be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association."[77] The franchisor argued that arbitration of the ten franchise agreements together was prohibited by the Supreme Court's decision in *Stolt-Nielsen*. Specifically, the franchisor argued that *Stolt-Nielsen* held "as a matter of law that no class or collective arbitration may proceed unless the arbitration agreement expressly authorizes those forms of proceedings."[78] The franchisee association argued, in response, that *Stolt-Nielsen* does not require "express consent" and that, in any event, any prohibitions on class arbitration do not apply to bar an associational arbitration which, it argued, is different from class arbitration.[79]

The U.S. Court of Appeals for the First Circuit rejected the franchisor's argument. The First Circuit, quoting portions from the *Stolt-Nielsen* decision, explained that the case held that class arbitration may not be imposed on a party to an arbitration agreement "unless there is a <u>contractual basis</u> for concluding that the party <u>agreed</u> to" submit to class arbitration.[80] In *Stolt-Nielsen*, the parties agreed that the agreement was "silent" on the issue, which the First Circuit interpreted to mean no contractual agreement for arbitration. According to the First Circuit, the Supreme Court in *Stolt-Nielsen* did not consider what may constitute a "contractual basis" for class arbitration.

Thus, the First Circuit rejected the position that there must be express contractual language evidencing the parties' intent to permit class or collective arbitration.[81] The Court suggested that a change that had occurred in some of the language of the agreement (*i.e.*, an express prohibition on class or collective arbitration was added in the post-1988 agreements), could represent an intent not to exclude class arbitration and that industry practice might also suggest this.[82] Moreover, the Court noted that it could not say as a matter of law that an associational action is equivalent to a class action, so the Court found that *Stolt-Nielsen*, for that reason, might not be applicable. Finally, the Court concluded that because the agreements contained broad language and incorporated the AAA Rules (which allow the arbitrator to decide his or her own jurisdiction), the issue of whether the franchise agreements allowed a class arbitration was for the arbitrator to decide.[83]

As a result of the *Fantastic Sams'* decision, franchisors can no longer assume that merely because their franchise agreements do not expressly authorize class arbitration, no class arbitration will be permitted. As noted above, the best way for

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[76] 683 F.3d 18 (1st Cir. 2012).

[77] 683 F.3d at 20.

[78] *Id.*

[79] *Id.*

[80] *Id.* at 21-22.

[81] *Id.*

[82] *Id.* at 23.

[83] *Id.* at 26.

franchisors to preclude class arbitration is to include a properly drafted no-class arbitration clause in their agreements.

Indeed, *Stolt-Nielson* really stands for the proposition that careful contract drafting of no-class action waiver clauses is essential. The importance of such clauses was underscored last year in the U.S. Supreme Court's decision in *American Express Co., et al., v. Italian Colors Restaurant, et al.*[84] There, the Supreme Court held that a contractual waiver of class arbitration is enforceable under the FAA even when the plaintiff's cost of individually arbitrating a federal statutory claim exceeds the potential recovery. The Supreme Court rejected what had been called the "effective vindication exception" which held that agreements that prevent the effective vindication of federal statutory rights are invalid.[85] While *American Express* did not involve a franchise system, and it related to a federal statutory claim, the rationale that prohibitive expense of individual arbitration cannot overcome an express class waiver seems equally applicable to situations involving franchisees asserting common law and state statutory claims.

It can be debated whether the U.S. Supreme Court's recent rulings in class arbitration cases – *Stolt-Nielson*, *Italian Colors Restaurant*, as well as its decision in *AT&T Mobility LLC v. Concepcion*[86] – are the result of the preference for arbitration mandated by the Federal Arbitration Act or merely an effort to reflect the parties' intent. Regardless, the fact of the matter is that the parties can address the issue by a clear expression in the franchise agreement as to what types of actions in arbitration will be authorized, be it class, consolidated, representative or other group actions.

VI. *SCHECK v. BURGER KING CORP.* AND THE APPLICABILITY OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING TO ENCROACHMENT DISPUTES

An encroachment dispute typically arises when a franchisor authorizes a new franchisee or a company-owned unit within the market area of an existing franchisee. As franchise systems grow and become more sophisticated, the potential market areas for franchisees become more finite. Franchisors generally include express language in their franchise agreements defining whether a franchisee has exclusive or non-exclusive territorial rights and governing the parties' rights and obligations with regard to encroachment. However, in situations where the contract language is unclear or ambiguous concerning the level of territorial protection granted to the franchisee, franchisees have attempted to bring encroachment claims under a theory of a breach of the implied covenant of good faith and fair dealing. In light of the importance of franchise encroachment disputes, this paper would not be complete without a discussion of *Scheck v. Burger King Corp.* and its impact on the development of franchise law and franchise agreements.

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[84] 133 S. Ct. 2304 (2013)

[85] 133 S. Ct. at 2310.

[86] __ U.S. __, 131 S. Ct. 1740 (2011) (voiding class arbitration waivers by judicial rule is pre-empted by the Federal Arbitration Act).

A. ***Scheck v. Burger King Corp***[87]

In *Scheck,* Burger King allowed a Howard Johnson's restaurant located two miles from the location of an existing franchisee's restaurant to be converted into a Burger King restaurant. The franchisee asserted that the conversion would adversely impact the sales of his existing Burger King restaurant, and that, therefore, the conversion constituted a breach of the implied covenant of good faith and fair dealing.[88] Burger King moved for summary judgment on the implied covenant claim, arguing that its actions were explicitly authorized by the franchise agreement and, thus, could not constitute bad faith.[89] The franchise agreement contained the following contractual provision:

> This license is for the described location only and does not in any way grant or imply any area market or territorial rights proprietary to FRANCHISEE.[90]

The court disagreed with Burger King, holding that even though the franchise agreement expressly denied territorial exclusivity to the franchisee, it did not necessarily imply a wholly different right to Burger King to open additional units at will, regardless of their effect on Scheck's operations.[91] The court further stated that "while Scheck is not entitled to an exclusive territory, he is entitled to expect that Burger King will not act to destroy the right of the franchisee to enjoy the fruits of the contract."[92]

B. ***Scheck* is Met with Disagreement and Criticism in the Courts**

Since *Scheck,* the applicability of the implied covenant of good faith in the context of franchise encroachment disputes has generated considerable disagreement, criticism and debate amongst legislatures, professionals and courts alike. A brief review of case law regarding the applicability of the implied covenant of good faith and fair dealing to exclusive territory disputes demonstrates the inconsistency and difficulty in fashioning a definite rule.

In *Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp.*,[93] the Eleventh Circuit, while recognizing that *Scheck* had been criticized, attempted to provide guidance

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[87] 756 F. Supp. 543 (S.D. Fla. 1991), *reconsid. denied,* 798 F. Supp. 692 (S.D. Fla. 1992). Robert Zarco, Zarco Einhorn Salkowski & Brito, P.A., co-author of this paper, represented the franchisee, Scheck, against Burger King.

[88] *Id.* at 545, 549.

[89] *Id.* at 549.

[90] *Id.* (emphasis in original).

[91] *Id.*

[92] *Id.*

[93] 139 F. 3d 1396 (11th Cir. 1998) (applying Massachusetts law). The *Camp Creek* court recognized that the *Scheck* cases have been "criticized, ignored, and distinguished in a number of subsequent opinions." *Id.* at 1403 n.6. *See, e.g., Barnes v. Burger King Corp.*, 932 F. Supp. 1420, 1437-38 (S.D. Fla. 1996) (rejecting *Scheck,* ruling that when "the express terms of the contract provide that Burger King was entitled to open additional Burger King franchises in the vicinity," the franchisee could not sustain a claim for breach of the implied covenant); *Burger King v. Holder*, 844 F. Supp. 1528, 1530 (S.D. Fla. 1993) (the implied covenant of good faith and fair dealing does not constitute a separately actionable contract term); *Burger King Corp. v. Agad*, 941 F. Supp. 1217, 1221 (N.D. Ga. 1996) (where franchise agreement had given franchisee no

to cases involving encroachment. The Court delineated two "fairly simple" propositions taken from the applicable weight of authority: "(1) when the parties include express contract language in the franchise agreement addressing the parties' respective territorial rights , the implied covenant cannot be used to alter the express contractual terms; and (2) when no such express contractual language exist in the franchise agreement, the franchisor is required to act in good faith."[94] In *Camp Creek,* the contract was silent with respect to whether the franchisor could establish a competing hotel franchise within the same market area as the franchisee.[95] Rather, the agreement only limited the franchisor's right to grant additional licenses at the specific location of the franchisees' hotel.[96] The Court found that the franchise agreement was silent with respect to whether the franchisor had the right to establish company-owned properties that directly compete against the franchisee. Thus, the Court found that the opening of a competing company-owned hotel could constitute a violation of the duty of good faith and fair dealing.[97]

However, less than a year after *Camp Creek*, in *Burger King Corp. v. Weaver*,[98] the Eleventh Circuit reconsidered the reasoning in *Scheck*. In *Weaver,* the court was faced with two franchise agreements, one which explicitly stated that the franchisee does not have a right of exclusivity, and one which did not contain such language.[99] Neither of the franchise agreements contained any language governing Burger King's limitations on the location of competing Burger King franchises.[100] The court concluded that Weaver's claim of encroachment based on the implied covenant of good faith and fair dealing failed as a matter of law, holding that "a cause of action for breach of the implied covenant cannot be maintained (a) in derogation of the express terms of the underlying contract or (b) in the absence of breach of an express term of the underlying contract."[101] In rejecting *Scheck*, the Eleventh Circuit explained that *Scheck* incorrectly held that Florida law recognized the implied covenant of good faith as an independent cause of action absent an express breach of contract,[102] and found the reasoning of *Scheck* "unconvincing logically":

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territorial exclusivity, franchisee could not use an implied term to contravene the express provisions of the agreement); *but see In re Vylene Enters.*, 90 F.3d 1472, 1477 (9th Cir. 1996) (applying *Scheck*'s reasoning to a franchise agreement silent on the issue of exclusive territory, holding that the franchisee, although not entitled to an exclusive territory, was still entitled to expect that the franchisor would "not act to destroy the right of the franchisee to enjoy the fruits of the contract").

[94] *Camp Creek Hospitality,* 139 F.3d at 1403.

[95] *Id.* at 1404.

[96] *Id.*

[97] *Id.* at 1405.

[98] 169 F.3d 1310 (11th Cir. 1999).

[99] *Id.* at 1313.

[100] *Id.*

[101] *Id.* at 1318 ("Weaver's failure to identify an express contractual provision that has been breached dooms his claim for breach of the implied covenant of good faith and fair dealing.").

[102] *Weaver* relied on the holding of *Hospital Corp. of America v. Fla. Medical Center, Inc.*, 710 So. 2d 574 (Fla. 4th DCA 1998), in holding that the claim for breach of the implied covenant of good faith and fair dealing failed as a matter of law. In *Hospital Corp.*, the Fourth District Court of Appeal held that "a duty of good faith must relate to the performance of an express term of the contract," meaning that before the duty of good faith attached, "FMC was required to establish that there was a term of the contract which HNC was

> The *Scheck* court held that the franchisee had a cause of action, even though the franchise agreement provided no right to exclusive territory, because BKC had not expressly reserved the right to license additional Burger King® restaurants nearby. The flaw in this reasoning is that right and duty are different sides of the same coin; if one party to a contract has no *right* to exclusive territory, the other party has no *duty* to limit licensing of new restaurants. . . . Thus, in this case, if Weaver's franchise agreement did not grant him a right to an exclusive territory, BKC incurred no duty to refrain from licensing new franchises in the area.[103]

Weaver makes clear that the result of a case involving the implied covenant of good faith and encroachment will depend on the language contained in the franchise agreements, as well as the governing state law applied by the judge or panel of judges deciding the issue.[104] Indeed, a survey of case law since *Scheck* reveals that courts across the country have cited the case with approval, disapproval, and with criticism, generally rejecting a franchisee's efforts to override express contractual terms under the theory of a breach of the implied covenant of good faith and fair dealing, while also recognizing that a franchisor does not have free reign to act arbitrarily or in bad faith.[105]

For example, in the 1996 decision of *Vylene v. Naugles*,[106] the Ninth Circuit, applying California law, relied on *Scheck* in holding that the franchisor's construction of a competing restaurant within a mile of the franchisee's restaurant was a breach of the implied covenant of good faith and fair dealing, notwithstanding the fact that the

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obligated to perform." 710 So. 2d at 575. In so holding, *Hospital Corp.* included citations to *Weaver* and *Scheck,* followed by an explanation that *Scheck* involved a "duty of good faith and fair dealing found in [a] franchise agreement where contractual relationship was ongoing." *Id.*

[103] *Weaver,* 169 F.3d at 1317 (emphasis in original).

[104] Indeed, whether state law recognizes a breach of the implied covenant of good faith and fair dealing as an independent cause of action absent a breach of an express contractual term will greatly affect a court's decision. While *Scheck* continues to be cited by cases for the general propositions surrounding the implied covenant of good faith and fair dealing, subsequent cases applying Florida law will continue to rely on *Scheck* only where there is an alleged breach of an express contractual obligation breached. *See, e.g., Urquhart v. Manatee Mem'l Hosp.*, No. 06-cv-1418-T-17-EAJ, 2007 WL 781738, at *5 (M.D. Fla. Mar. 13, 2007) (citing *Scheck* in support of proposition that Florida law recognizes the implied covenant of good faith and fair dealing, but cautioning that a claim for a breach of the implied covenant will not lie absent an allegation that an express term has been breached); *Anthony Distribs. v. Miller Brewing Co.*, 882 F. Supp. 1024, 1031 (M.D. Fla. 1995) (same); *Burger King Corp. v. Austin*, 805 F. Supp. 1007, 1013 (S.D. Fla. 1992) (citing *Scheck* in support of holding that where contract vests franchisor with complete discretion with respect to material decisions, implied covenant of good faith and fair dealing applies).

[105] *See Transport Truck & Trailer, Inc. v. Freightliner LLC,* No. CV-06-282-S-BLWat *4 (D. Id. Jan. 29, 2007) (while "nonexclusive" language in franchise agreement meant that franchisor could potentially authorize competitors to operate in franchisee's nonexclusive area, franchisor's right to do so "was not a license to act in bad faith"); *Servpro Industries, Inc. v. Pizzillo,* 2001 WL 120731 (Tenn. Ct. App. 2001) (franchisor did not breach the implied covenant of good faith and fair dealing by allowing another franchisee to encroach upon existing franchisee's territory, where franchisor had policy giving it discretion to take steps against franchisees who encroach upon the territory of other franchisees but franchisee did not allege any bad faith, such as malice or desire to damage franchisee's business). Robert Zarco, co-author of this paper, and Robert Einhorn of Zarco Einhorn Salkowski & Brito, represented the franchisee in *Servpro Industries, Inc.*

[106] 90 F.3d 1472 (9th Cir. 1996).

franchisee was not entitled to an exclusive territory.[107] However, only five months later, the Ninth Circuit in *Chang v. McDonald's Corp.*[108] rejected *Scheck* as conflicting with Illinois law, and held that where the franchise agreement provided that the franchisee does not have a right to an exclusive market area, the contract negates any inference that the franchisor's actions in opening two nearby competing restaurants constituted a breach of the implied covenant.[109]

Moreover, district courts in Michigan and Illinois have also rejected *Scheck* on state law grounds, and have distinguished *Scheck* from cases where the franchise agreement expressly provides that the franchisor maintains the sole and unlimited right to establish other competing restaurants at any location desired.[110] However, even in situations where express contractual language defining territorial rights exists, the outcome of a given dispute remains unclear, as judicial interpretation of the implied covenant of good faith and fair dealing in the years since *Scheck* has muddied the waters with respect to the application of the covenant of good faith and fair dealing in encroachment disputes between franchisors and franchisees .[111]

C. <u>Legislative Efforts to Prevent Encroachment</u>

There have been several attempts at the federal and state level to regulate the franchisor-franchisee relationships with respect to encroachment and the duty of good faith. While the FTC Franchise Rule requires a franchisor to include specific language in

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[107] *Vylene* confirms that some courts continue to recognize a franchisee's legitimate business interests where a franchisor places a new franchise or company-owned unit in close proximity to the existing franchise. *See, e.g., Legend Autorama, Ltd. v. Audi of Am., Inc.,* 954 N.Y. S.2d 141,143-44 (N.Y. 2d App. 2012) (covenant of good faith and fair dealing is not inconsistent with nonexclusivity provision of dealer agreement, and a party may not exercise an explicit discretionary right to frustrate the other party's right to receive benefits under the agreement); *Photovest Corp. v. Fotomat Corp.* 606 F.2d 704 (7th Cir. 1979); *In the Matter of the Arbitration Between Gateway Equip. Corp. v. Caterpillar Paving Prods., Inc.*, Bus. Fran. Guide 11,846 (W.D.N.Y. 2000) (although franchise agreement did not grant an exclusive territory, it expressly reserved the right to the franchisor to sell products within franchisee's "area of primary responsibility" "directly or through other outlets," arbitration panel's finding that agreement was ambiguous was upheld. Extrinsic evidence showed a 30-year history of no overlapping territories to support franchisee's claim that franchisor was precluded from granting another franchise within franchisee's "area of primary responsibility"); *Lakeworth Lodging Partners, Ltd. v. Best W. Int'l, Inc.*, Bus. Fran. Guide 12,580 (D. Ariz. 2003) (noting that Best Western may have acted in a manner that was inconsistent with its franchisee's reasonable expectations, the court refused to dismiss an existing franchisee's claim for breach of the covenant of good faith and fair dealing where Best Western approved a plan to locate a franchised hotel within five miles of the projected location of franchisee's second hotel).

[108] 105 F.3d 664 (9th Cir. 1996) (unpublished opinion).

[109] *Id.* at *5.

[110] *See, e.g., Cook v. Little Caesar Enters.*, 972 F. Supp. 400, 409 (E.D. Mich. 1997) (applying Michigan law); *Cohn v. Taco Bell Corp.*, No. 92-cv-5852, 1994 WL 13769, at *6 (N.D. Ill. Jan. 14, 1994) (finding *Scheck* inapplicable to cases where a franchise agreement contains a provision which expressly permits the franchisor to open competing franchises or company stores wherever it wants). Even where contractual language gives franchisor unfettered rights to engage in certain conduct, courts have held that franchisor must still exercise such right reasonably and with proper motive. *See, e.g., Austin,* 805 F. Supp. at 1014 n.20; *Carvel Corp. v. Diversified Mgmt. Grp.*, 930 F.2d 228, 230-31 (2d Cir. 1991); *Beraha v. Baxter Health Care Corp.*, 956 F.2d 1436, 1443-45 (7th Cir. 1992).

[111] As many as *eight* distinct, current approaches have been identified for delineating the law on the implied covenant of good faith and fair dealing. Thomas A. Diamond & Howard Foss, *Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated: A Framework for Resolving the Mystery*, 47 HASTINGS L.J. 585, 585-633 (1996).

the Franchise Disclosure Document if the prospective franchisee will not have an exclusive territory,[112] all anti-encroachment legislative efforts at the federal level have been unsuccessful.[113] Moreover, while about one-third of states have enacted statutes to govern the relationship between franchisees and franchisors, some states have gone even further and enacted laws that directly address the duty of good faith and franchisees' rights against encroachment. For example, Indiana law prohibits "establishing a franchisor-owned outlet engaged in a substantially identical business to that of the franchisee within the exclusive territory granted the franchisee by the franchise agreement; or, if no exclusive territory is designated, competing unfairly with the franchisee within a reasonable area."[114] Moreover, the Iowa Franchise Act[115] prohibits a franchisor, *regardless of the express contract provisions*, from establishing a competing franchise or company-owned unit that "adversely affects" the business of an existing franchisee, unless the franchisee is given either a right of first refusal or compensation for the value of the lost business.[116] Hawaii, Minnesota and Washington likewise make it unlawful for a franchisor to encroach upon a franchisee's "exclusive territory," thereby requiring a right to exclusivity in order for a franchisee to be able to seek relief for encroachment under state "little" FTC acts.[117] However, most of these

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[112] 16 C.F.R. 436.5(l)(5). The FTC staff "construe the term 'exclusive territory' to mean a geographic area granted to a franchisee within which the franchisor promises not to establish either a company-owned or franchised outlet selling the same or similar goods or services under the same or similar trademarks or service marks." *See* FTC Amended Franchise Rule FAQ's, FAQ 25, *available at* http://www.ftc.gov/bcp/franchise/amended-rule-faqs.shtml. The FTC has noted, "[I]t is consistent with the disclosure scheme . . . for a franchisor to grant an exclusive territory yet reserve the right to make sales in the territory through other channels of distribution or competitive brands." FTC Amended Franchise Rule FAQ's at FAQ 37. However, the "other channels of distribution such as Internet, catalog sales, telemarketing or other direct marketing" do not include "non-traditional venues" such as airports, arenas, hospitals, hotels, and malls that "entail an outlet physically located in a franchisee's territory." *Id.* at FAQ 37. Thus, if a franchisor wants to reserve the right to open outlets in "non-traditional venues" it must disclose the lack of an exclusive territory to prospective franchisees. *Id.*

[113] *See, e.g.* Small Business Franchise Act of 1999, H.R. 3308, 106th Cong. § 11 (1999); Small Business Franchise Act of 1998, H.R. 4841, 105th Cong. § 11 (1998); Federal Fair Franchise Practices Act, H.R. 1717, 104th Cong. § 8 (1995); Federal Fair Franchise Practices Act, H.R. 1316, 103d Cong. § 4 (1993); Federal Fair Franchising Practices Act of 1992, H.R. 5961, 102d Cong. § 10 (1992).

[114] Ind. Code 23-2-2.7-2(4).

[115] Iowa Code 523H.6 (creating private right of action).

[116] *Id.*

[117] Haw. Rev. Stat. 482E-6(2)(E) declares an unfair or deceptive act or practice or an unfair method competition for a franchisor to establish "a similar business or to grant a franchise for the establishment of a similar business at a location within a geographical area specifically designated as the exclusive territory in a franchise previously granted to another franchisee in a currently effective agreement, except under the circumstances or conditions prescribed in such agreement." Likewise, Minnesota's statute provides that it shall be "unfair and inequitable" to "compete with the franchisee in an exclusive territory or grant competitive franchises in the exclusive territory previously granted to another franchisee if the terms of the franchise agreement provide that an exclusive territory has been specifically granted to a franchisee." Minn. R. 2860.4400C. While Minnesota requires a franchise agreement to provide for exclusivity, the statutory scheme also provides protection against bad-faith and unreasonable conduct by prohibiting a franchisor from imposing "on a franchisee by contract or rule, whether written or oral, any standard of conduct that is unreasonable." *See* Minn. R. 2860.4400D. Washington's statute governing the relationship between franchisor and franchisee likewise requires the parties to "deal with each other in good faith," and makes it unlawful for a franchisor to compete with an existing franchisee in an exclusive territory or to grant competitive franchises in the exclusive territory granted to another franchisee, and to impose any unreasonable or unnecessary standard of conduct, by contract, regulation, whether written or oral. Wash. Rev. Code § 19.100.180(1), 2(f), 2(h). States have also enacted "anti-encroachment" statutes with respect

statutes provide little guidance with respect to situations faced by courts, as in *Scheck,* where the franchise agreement does not grant a franchisee exclusivity. In such cases, franchisees are left to resort to the implied covenant of good faith and fair dealing, or to fashion other requests for relief based on other applicable statutory provisions or legal theories. .[118]

D. *Scheck's* Impact on Franchising

The *Scheck* decision gave franchisors express guidance on the type of language to include in post-*Scheck* franchise agreements in order to negate any claim to implied territorial or market area protections. While franchisee advocates may see this as a blow to the victory previously won in *Scheck*, franchise agreements now offer more informed choices as to the franchise being offered. As to the issue of territorial protection, there is now more certainty in contracts, thereby resulting in better drafted franchise agreements. A franchisor that does not want to grant its franchisee exclusive territorial rights, should not only state that it is not granting the franchisee territorial rights, but should also expressly delineate its rights with regard to specific territories. A franchisee who is faced with vague or uncertain territorial provisions in its franchise agreement should likewise insist that the parties' rights and obligations with regard to encroachment are clearly described. Accordingly, a well-drafted franchise agreement can arguably prevent unnecessary litigation of encroachment claims based on the implied covenant of good faith and fair dealing.

However, in the wake of *Scheck* and subsequent case law, there is little uniformity among state and federal courts and the implied covenant of good faith and fair dealing will continue to work its way into franchise disputes. One thing that is for certain is that the implied covenant of good faith and fair dealing will remain a hotly contested issue between franchisors and franchisees in the courtroom.

VII. PROHIBITION ON FRANCHISOR'S ABILITY TO OBTAIN FUTURE LOST ROYALTIES IN TYPICAL DEFAULT SITUATION

Courts generally agree that when a franchisee terminates a franchise relationship without cause prior to the expiration of its term a franchisor may recover lost future royalties as part of its damages. However, where a franchisor is the terminating party, even if the termination is with good cause, the law remains unsettled with respect to whether a franchisor's damages include lost future profits.

A. *Postal Instant Press, Inc. v. Sealy*[119]

In 1996, a decision was rendered that launched the debate among the franchise bar surrounding the recovery of lost future royalties.[120] In *Postal Instant Press, Inc. v.*

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to manufacturers and distributors, and dealers. *See, e.g.,* Ala. Code § 8-20-4(3)(1); Cal. Veh. Code § 3062; Conn. Gen. Stat. §§ 42-133dd; Mass. Gen. Laws ch. 93B, § 4(3); N.J. Rev. Stat. § 56:10-7.4.

[118] For example, the Florida Franchise Act provides that is unlawful when selling or establishing a franchise or distributorship for any person intentionally to misrepresent or fail to disclose efforts to sell or establish more franchises or distributorships than it is reasonable to expect the market area for an existing franchise or distributorship to sustain. *See* Fla. Stat. § 817.416 (creating a duty to disclose regarding the franchisor's intentions).

[119] 43 Cal. App. 4th 1704 (Cal. 1996).

Sealy, a California appellate court held that California law prohibits a franchisor from recovering damages for lost future royalties when the franchisor terminates a franchise agreement based on the franchisee's default on its obligation to make royalty payments.

In *Sealy,* after a franchisee failed to make several royalty payments as required by the franchise agreement, the franchisor declared the franchisee to be in default under the franchise agreement, terminated the agreement based on the default, and filed suit seeking damages including past royalties owed and future royalties for the remaining unfulfilled term of the contract.[121] Finding the case to be one of first impression in the entire country, the court ultimately held that the franchisor could not recover lost future profits, reasoning that (1) the franchisee's mere failure to pay was not a "proximate" or "natural and direct" cause of the franchisor's loss of future royalties—rather, it was the franchisor's own decision to terminate the franchise agreement that prevented the franchisor from receiving future royalties;[122] and (2) an award of future royalties would amount to "unreasonable, unconscionable and grossly oppressive damages," in violation of California's statutory and common law prohibition on such damages.[123] The *Sealy* court noted that a franchisor's entitlement to lost profits will ultimately depend on the nature of the breach and to what extent the breach prevents the franchisor from earning those lost future royalties, but failed to delineate any examples of such breaches that would give rise to entitlement to lost future royalties.[124]

B. <u>Judicial Treatment of *Sealy*</u>

Since *Sealy*,*,* a franchisor's ability to recover lost future royalties has remained unsettled.[125] Several courts have adopted *Sealy*'s rationale and have refused to award lost future royalties to franchisors who have terminated a franchise agreement based on

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[120] Prior to 1996, courts had not thoroughly analyzed the franchisor's right to recover future royalties, and there were few decisions on the subject. *See, e.g., McAlpine v. AAMCO Automatic Transmissions, Inc.*, 461 F. Supp. 1232, 1274-75 (E.D. Mich. 1978) (awarding franchisor lost future royalties where franchisees improperly terminated franchise agreements with motive to increase profitability and to achieve higher level of success within their own communities; however, award was based on calculation of average royalty paid by average franchisee in the last year of operation by the franchisee, and such award was cut off on the date new franchisees generated income equal to that of the plaintiff franchisees); *In re Mid-Am. Corp.*, 159 B.R. 48, 53-55 (Bankr. M.D. Fla. 1993) (where franchisee filed for bankruptcy protection and closed down its restaurants, bankruptcy court held that franchise agreement imposed an affirmative obligation on the franchisee to continue to operate the restaurants, and as a result Burger King was entitled to lost future royalties; however, because Burger King was unable to provide evidence of cost savings, the award was too speculative and the claim for lost future royalties failed).

[121] *Id.* at 1707-09.

[122] The proper course of action, according to the *Sealy* court, was to bring a lawsuit against franchisee each time it failed to pay royalties. *Id.* at 1711.

[123] *Id.* at 1710-15 (finding that an award of lost future royalties would "dramatically expand the already enormous bargaining gap between this franchisor and this franchisee" and would "place a bludgeon in the hands of franchisors in contract disputes with their franchisees").

[124] *Id.* at 1713.

[125] Commentators and courts alike have criticized *Sealy*'s suggestion that a franchisor can collect past-due royalties simply by suing the franchisee again and again without terminating the franchise agreement. *See, e.g., Radisson Hotels Int'l, Inc. v. Majestic Towers, Inc.*, 488 F. Supp. 2d 953, 963 n.10 (C.D. Cal. 2007) (where franchise agreement contained liquidated damages clause essentially requiring the breaching franchisee to indemnify the franchisor's lost future royalties, award of lost future royalties to terminating franchisor was permitted).

a failure to timely pay royalties.[126] For example, in 1997, in *I Can't Believe It's Yogurt v. Gunn,*[127] the U.S. District Court for the District of Colorado was faced with similar facts to those in *Sealy,* and likewise found that any loss of future royalties was proximately caused by the franchisor's election to terminate the franchise agreements.[128] The court in *I Can't Believe It's Yogurt* also found that an award of damages based on lost future royalties would be speculative and incapable of being determined with any degree of certainty.[129]

1. <u>Cases Distinguishing *Sealy*</u>

However, other courts have distinguished *Sealy* based on the specific facts surrounding the termination and default of the franchise agreements. For example, in *Oil Express National, Inc. v. D'Alessandro*,[130] an Illinois federal magistrate judge recommended denial of a franchisee's motion for summary judgment on the issue of lost future royalties.[131] In moving for summary judgment, the franchisee argued that future royalties were not available because the franchisor terminated the agreements, which extinguished any further obligation to pay future royalties.[132] The magistrate judge noted that *Sealy* did not apply because the franchisees were alleged to have engaged in anticipatory repudiation by providing written notice to the franchisor that they intended to stop paying royalties, which was specifically not an issue in *Sealy*.[133] Accordingly, *Oil Express National* can be said to stand for the proposition that where a franchisee anticipatorily repudiates the franchise agreement, *Sealy* does not prevent an award of future royalties.

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[126] *See, e.g., Kissinger, Inc. v. Singh*, 304 F. Supp. 2d 944, 950-51 (W.D. Mich. 2003) (agreeing with *Sealy*'s analysis, finding it both "persuasive and consistent with Michigan law"); *Burger King Corp. v. Hinton, Inc.*, 203 F. Supp. 2d 1357, 1366 (S.D. Fla. 2002) (while stating that reliance on *Sealy* was misplaced because Florida law applied, court nevertheless found that franchisee's failure to pay royalties did not "proximately cause BKC's loss. BKC decided to terminate the Franchise Agreements due to [the franchisees'] breach, and it was this action that has caused the loss of future profits."); *but see Burger King Corp. v. Barnes*, 1 F. Supp. 2d 1367, 1371 (S.D. Fla. 1998) (awarding Burger King lost future royalties where franchisee abandoned the franchise and Burger King was able to meet evidentiary burden of proof).

[127] No. 94-cv-2109-OK-TL, 1997 WL 599391, at *24 (D. Colo. Apr. 15, 1997).

[128] *Id.* at *24 (D. Colo. Apr. 15, 1997).

[129] *Id.* The U.S. District Court was again faced with the issue surrounding a franchisor's claim of lost future royalties in the 2009 case of *Rocky Mountain Chocolate Factory, Inc. v. SDMS, Inc.*, where a franchisor sought past-due royalties in the amount of $33,109 as well as lost future royalties totaling $201,708. No. 06-cv-01212-PAB-BNB, 2009 WL 579516, at *5-6 (D. Colo. Mar. 4, 2009). Noting that Colorado law requires a plaintiff to submit substantial evidence providing a reasonable basis for the computation of damages, and relying on *Sealy,* the court found that only net profits, as opposed to gross profits can be awarded. *Id.* at *8-9. Because the franchisor failed to present evidence demonstrating a connection between costs associated with its franchise system and the parties' franchise relationship, the amount of lost net profits was speculative and could not be awarded. *Id.*

[130] No. 96-cv-1528, 1997 WL 723027 (N.D. Ill. Sept. 4, 1997), *adopted*, No. 96-cv-1528, 1998 WL 341809 (N.D. Ill. June 15, 1998). Robert Zarco, co-author of this paper, of Zarco Einhorn Salkowski & Brito, represented the franchisee in this case.

[131] *Id.* at *6 (N.D. Ill. Sept. 4, 1997).

[132] *Id.*

[133] *Id.* at *5.

Likewise, a federal court in Pennsylvania, applying California law, in *RemedyTemp, Inc. v. Taylor*[134], denied a franchisee's motion for summary judgment where each party claimed that the other breached and terminated the agreement.[135] Ultimately, if a jury found that it was the franchisee, and not the franchisor, who terminated the franchise agreement, *Sealy* would not bar the franchisor's recovery of lost future royalties.[136] While *Sealy* may be viewed to stand for the simple proposition that where a franchisor terminates the franchise agreement, an award of lost future royalties is improper, the subsequent case law reveals that the facts of a particular case can often complicate or alter the analysis.

Specifically, in *It's Just Lunch Franchise, LLC v. BLFA Enterprises, LLC*,[137] a California federal court re-visited the *Sealy* framework and suggested that a franchisor may be entitled to recover future lost royalties "even if the franchisor terminates the agreement, if the franchisee's conduct proximately caused the damages, and the award is neither excessive, oppressive nor disproportionate."[138] The franchisee failed to make the required royalty payments, and the franchisor brought suit, alleging that the franchisee, by letter, terminated the franchise agreement, closed the franchise and ceased doing business.[139] Thereafter, the franchisor informed the franchisee that because the franchisee abandoned the business, the franchise agreement had been terminated.[140] Accordingly, both parties disputed who actually terminated the franchise agreement.[141] In support of its motion to dismiss, the franchisee argued that the court must follow *Sealy* and deny the recovery of future lost profits, but the court disagreed, noting that *Sealy* did not preclude an award of future royalties under the facts pled by the franchisor.[142] *It's Just Lunch* therefore supports the position taken by some courts in recent cases that a franchisor who terminates a franchise agreement based on a franchisee's abandonment of the franchise could be entitled to an award of lost future royalties.[143]

[134] No. 96-cv-6778, 1998 WL 111806 (E.D. Pa. Feb. 5, 1998)

[135] *Id.* at *2.

[136] *Id.*

[137] No. 03-cv-0561-BTM-LSP, 2003 WL 21735005 (S.D. Cal. July 21, 2003).

[138] *Id.* at *3 (citing *Sealy*, 43 Cal. App. 4th at 1718).

[139] *Id.* at *1.

[140] *Id.*

[141] *Id.*

[142] *Id.* at 2-3.

[143] *See, e.g., Moran Indus. v. Mr. Transmission of Chattanooga, Inc.*, 725 F. Supp. 2d 712, 723-24 (E.D. Tenn. 2010) (where franchisee went forward with retirement plans and transferred the assets of the franchised business to his son, and franchisor thereafter terminated the franchise agreement, court denied franchisee's motion to dismiss claim seeking lost future royalties, concluding that there was not enough evidence to determine whether the franchise had been abandoned by the franchisee); *Meineke Car Care Ctrs. v. RLB Holdings*, 423 F. App'x 274, 281-83 (4th Cir. 2011) (where franchisee closed franchised shops without authorization, court found that lost future royalties could be awarded to franchisor who terminated franchise agreement based on franchisee's abandonment, noting it was the franchisee's decision to close its shops that was the proximate cause of the lost future royalties, rather than the franchisor's termination); *Hardee's Food Sys., Inc. v. Hallbeck*, No. 09-cv-00664-AGF, 2011 WL 4407435, at *3 (E.D. Mo. Sept. 21, 2011) (where franchisee of thirty years closed its last operating restaurant with one and half years remaining on franchise agreement and where franchisor terminated the franchise agreement based on abandonment,

2. **Cases Rejecting *Sealy***

While *Sealy* is often relied upon and cited by courts, some courts have flat out ignored *Sealy* and have taken completely opposite views regarding a franchisor's right to recover future lost royalties, instead adopting traditional contract principles. For example, the Sixth Circuit, in *American Speedy Printing Centers, Inc. v. AM Marketing, Inc.*,[144] applying Michigan law, affirmed the district court's ruling awarding past-due and future lost royalties to the franchisor, who terminated the franchise agreement based on the franchisee's failure to pay royalties.[145] The court reasoned that the franchisor was entitled to be placed in the same position as it would have been if the franchise agreement had been performed for the full term.[146]

C. **Evidentiary Obstacles in Proving Lost Future Royalties**

Even if a court finds that a franchisor is entitled to lost future royalties, many franchisors have been unable to recover such damages due to their failure to submit sufficient evidence to establish the amount of future royalties to a reasonable degree of certainty.[147]

One possible means franchisors have attempted to utilize in order to overcome such evidentiary obstacles, and to avoid the uncertainty surrounding the *Sealy* decision and subsequent case law, is a carefully crafted liquidated damages provision, which is most commonly seen in the hotel industry. For example, in *Radisson v. Hotels Int'l v. Majestic Towers, Inc.*,[148] a California federal court held that, pursuant to a liquidated damages provision contained in a franchise agreement, the franchisor was entitled to recover twice the amount of royalties paid during the prior year if the franchisee was in material default of the franchise agreement.[149] The *Radisson* court held that *Sealy* did not apply because the *Sealy* franchise agreement did not contain a liquidated damages provision.[150] However, if a liquidated damages provision is deemed unenforceable as unreasonably excessive or not reasonably related to the loss at issue, or violative of a

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court denied franchisee's motion for summary judgment on the issue of whether the franchisor was entitled to lost future royalties, distinguishing *Sealy* because the franchisee there did not abandon its franchise).

[144] 69 F. App'x 692 (6th Cir. 2003).

[145] *Id.* at 701.

[146] *Id.* at 698. The fact that shortly after the *American Speedy* ruling was rendered, the U.S. District Court for the Western District of Michigan reached an opposite conclusion on similar facts demonstrates the extent of the uncertainly surrounding this area of the franchisee-franchisor relationship. *See Kissinger*, *supra* note 39.

[147] *See, e.g., Novus Franchising, Inc. v. AZ Glassworks, LLC*, No. 12-cv-1771, 2013 WL 1110838, at *5-6 (D. Minn. Mar. 18, 2013) (where franchisee defaulted and did not oppose franchisor's request for future royalties, court nevertheless refused to grant judgment in favor of franchisor for future royalties, reasoning that franchisor failed to present evidence of saved costs, and failed to present evidence as to how long it would take to locate a new franchisee; and as a result, future royalties were speculative and could not be awarded).

[148] 488 F. Supp. 2d 953 (C.D. Cal. 2007).

[149] *Id.* at 959.

[150] *Id.* at 963.

state's statute barring liquidated damages,[151] then the franchisor's claim is limited to a traditional lost future royalties claim, analyzed within the parameters discussed herein..

D. <u>Legislative Efforts in Response to *Sealy*</u>

On June 24, 2014, California Senate Bill 610[152] was approved by the California Assembly Committee on Business, Professions and Consumer Protection and is advancing before the full California Assembly for a vote.[153] The bill was introduced by Democratic Senator Hannah-Beth Jackson and seeks to safeguard the duty of good faith and fair dealing in franchise relationships, to protect franchisee rights with regard to sales, transfers and terminations, and to reinforce a franchisee's right to join in franchisee associations.[154] Citing *Sealy*, the Senate Judiciary Committee noted in its April 16, 2013 analysis of SB610 that courts have "stressed the bargaining disparity between franchisors and franchisees is so great that the franchise agreements exhibit many of the attributes of adhesion contract and some of the terms of those contracts may be unconscionable."[155] Indeed, with regard to a franchisor's right to terminate a franchise agreement, SB610 would amend Section 20020 of the California Business and Professions Code[156] to provide that

> a franchisor shall not terminate a franchise prior to the expiration of its term, except upon a substantial and material breach on the part of the franchisee of a lawful requirement of the franchise agreement. If there is a substantial and material breach of a lawful requirement of the franchise agreement, the franchisor shall allow the franchisee 30 days to cure the failure before termination.[157]

If passed into law, it will be interesting to see how courts applying California law will treat a franchisor's termination based on a franchisee's failure to pay royalties and whether the amended statute will affect a franchisor's right to seek lost future royalties.

The bill has been met with opposition from the International Franchise Association, California Chamber of Commerce, Civil Justice Association of California, California Grocers Association, and California Retailers Association, which raise concerns with the good faith requirement, arguing that it is an "amorphous term . . . to be applied to the franchisor in its relationship with the franchisee," and provides no benefit

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[151] The Minnesota Franchise Act prohibits a franchisor from obtaining liquidated damages for premature termination, but allows a franchisor to recover lost profits. *See* Minn. Stat. 80C.01-22. Accordingly, in Minnesota, franchisors must overcome evidentiary challenges in order to prove lost profits with reasonable certainty.

[152] S. 610, 2013-2014 Reg. Sess. (Cal. 2013).

[153] S. 610, Assem. Com. Vote (Cal. 2014); Don Sniegowski, *California Franchisee Protection Bill Passes Final Committee,* Blue MauMau (Jun. 24, 2014), *available at* http://www.bluemaumau.org/blue_maumau_business_committee_hearing_californias_sb610. As of the date of publication of this paper, SB 610 has not been passed into law.

[154] S. 610, Sen. Com. Bill Analysis (Cal. 2013).

[155] *Id*.

[156] Cal. Bus. & Prof. Code § 20020.

[157] S. 610, 2013-2014 Reg. Sess.

in the context of detailed franchise contracts which govern complex and ongoing business relationships."[158]

E. What *Sealy* Means for Franchising

Sealy and its progeny have imparted on franchisees and franchisors significant implications in their business relationships going forward. Because the law among courts is uncertain, franchisees should be cognizant of the possible consequences when they abandon or improperly terminate a franchise agreement. Should a franchise agreement contain a provision that provides that a franchisee's abandonment will cause an immediate termination of the franchise agreement, there is a risk to the franchisee that a court will find that the abandonment was a proximate cause of the franchisor's damages.

For franchisors, post-termination remedies of lost future royalties serve to protect their franchise systems, provide compensation for a loss of revenue stream and discourage franchisees from abandoning the franchise. As such, a franchisor's disclosures and language used in its franchise agreement will be significant for a franchisor seeking lost future royalties from a franchisee, since the ability to recover lost future royalties will depend on whether the loss of such profits was a reasonably foreseeable result of the franchisee's breach and whether the damage can be calculated with certainty.[159] Franchisors should therefore ensure that their franchise agreements expressly and specifically state the parties' rights and obligations regarding default, termination and remedies.

Because lost future royalties are often uncertain as a representation of lost profits, franchisors can benefit from a well-drafted liquidated damages provision that sets forth a precise calculation of damages and should be tailored as narrowly as possible to avoid a court from declaring the provision unenforceable as an unreasonable penalty.[160] Liquidated damages provisions also allow franchisees to make better-informed decisions when evaluating whether to purchase a franchise, and ultimately evaluating whether to breach and/or terminate a franchise agreement. While the issue of liquidated damages most often arises in hotel franchises, there are a few other industries that have utilized such clauses,[161] and it will be interesting to see if these clauses will become more prevalent in non-hotel industries, given the reasoning from *Radisson* that suggests that *Sealy* is inapplicable where a liquidated damages clause is at issue.

As the law continues to develop, franchisors will undoubtedly continue to rely on contractual language and traditional contract principles to assert entitlement to lost future royalties, while franchisees will attempt to find support in policy and equitable arguments surrounding the inherent conflict between a franchisee who can no longer afford to pay

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[158] *Id*.

[159] Robert L. Ebe, David L. Steinberg, and Brett R. Waxdeck, *Radisson and the Potential Demise of the Sealy-Barnes-Hinton Rule,* 27 FRANCHISE L. J. 3 (2007).

[160] *See e.g. Century 21 Real Estate, LLC v. All Professional Realty, Inc.,* 889 F. Supp. 2d 1198 (E.D. Cal. 2012) (franchise agreement's liquidated damages provision was enforceable where actual damages were difficult to project and were not readily susceptible of proof, and where agreed upon sum was a reasonable forecast of compensation and did not serve as a penalty).

[161] *See, e.g. Id.* at 1229 (involved real estate brokerage franchise); *Kinnard v. Shoney's, Inc.,* 100 F. Supp. 2d 781, 792 (M. D. Tenn. 2000) (involved restaurant franchise); *Honey Dew Assoc. v. M & K Food Corp.,* 81 F. Supp. 2d 352, 356 (D.R.I. 2000) (involved doughnut franchise).

royalties due to the failure of its franchise and a franchisor who has terminated the franchise agreement based on such failure to pay. *Sealy* and more recent case law stresses the importance of a well-drafted franchise agreement, as the language of the agreement will often dictate the result of a claim for future lost royalties.

VIII. FRANCHISE TIE-IN ARRANGEMENTS

Franchisors and franchisees, alike, as business owners and managers strive to maintain uniformity and quality control with regard to products offered at the franchised business. Franchisors, as trademark owners, are responsible for ensuring the integrity, image, and use of its marks and the respective franchise system. Franchisees, who are responsible for maintaining the franchisor's uniform methods and operations, likewise must sell products that are associated with the franchisor's marks to the public. However, tension often arises as a result of a franchisor's requirements imposed on a franchisee to maintain uniformity of products and services with a franchisee's desire to operate an independent business.

To achieve such uniformity, franchisors sometimes will agree to sell a product (i.e. the tying product) only on the condition that the franchisee also purchase a different product (i.e. the tied product), whether or not that "tied" good or service compliments the original purchase.[162] Where the cost of purchasing the tied product from the franchisor or a designated supplier exceeds the cost that would otherwise be available from an independent vendor, the franchisee may challenge the agreement as an illegal tying arrangement. The franchisor uses its power over the "tying" goods to protect itself from competition from vendors of the tied product, over which it does not have significant control.[163] The franchisee may be compelled to accept the franchisor's conditions[164] or have no reasonable alternative.[165] Courts historically have viewed such arrangements with skepticism because of adverse effects on competition,[166] namely because the power exerted by the tying product essentially shuts competitors out of the tied product

[162] *See Williams v. Hughes Tool Co.*, 186 F.2d 278 (10th Cir. 1950); *Aluminum Co. of Am. v. Sperry Prods.*, 285 F.2d 911 (6th Cir. 1960); *Dehydrating Process Co. v. A. O. Smith Corp.*, 292 F.2d 653 (1st Cir. 1961) (tie-in sales justified); *Emsig Mfg. v. Rochester Button Co.*, 163 F. Supp. 414 (S.D.N.Y. 1958) (express, implied or inherent tying agreements in license contracts, referring to Report of the Attorney General's Comm. at 237 n.56); *Baldwin-Lima-Hamilton Corp. v. Tatnall Measuring Sys.*, 169 F. Supp. 1, 120 U.S.P.Q. (BNA) 34 (E.D. Pa. 1958), *aff'd*, 268 F.2d 395 (3d Cir. 1959) (tying agreements in license contracts justified in part because no injury to competition, partly unlawful); *N.W. Controls, Inc. v. Outboard Marine Corp.*, 333 F. Supp. 493 (D. Del. 1971); *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43 (9th Cir. 1971).

[163] *Atl. Refining Co. v. F.T.C.*, 381 U.S. 357 (1965) (seller capitalizes upon his "economic power in one market to curtail competition in another"); *Harold Butler Enters.ss No. 97, Inc. v. Vanlandingham*, 264 Or. 414 (Or. 1973); *Coniglio v. Highwood Servs.*, 495 F.2d 1286 (2d Cir. 1974); *Sulmeyer v. Coca Cola Co.*, 515 F.2d 835 (5th Cir. 1975); Note, 19 Vand. L. Rev. 926 (1966).

[164] *Greenbelt Homes, Inc. v. Nyman Realty, Inc.*, 426 A.2d 394 (Md. 1981) (cooperative housing development's combination of administrative and real estate brokerage services under mandatory single fee, forcing residents who sold their apartments to pay brokerage services even if they used services of other broker to sell their apartments, was a tie-in which was unreasonable per se and unreasonable restraint of trade in violation of the Maryland Antitrust Act).

[165] *Virtual Maint., Inc. v. Prime Computer, Inc.*, 11 F.3d 660 (6th Cir. 1993), *cert. denied*, 512 U.S. 1216 (1994) (illegal tying arrangement found, despite separate availability, where cost of separate component exceeds cost of package).

[166] *McDavid*, *supra* note 62.

market.[167] Throughout the years, and with the development of case law, courts' disapproval of tying arrangements has diminished.[168]

A. When is Tying Illegal?

Tying arrangements have been challenged as unlawful under section 1 of the Sherman Act, which prohibits contracts "in restraint of trade";[169] section 2 of the Sherman Act, which makes it illegal to "monopolize";[170] section 3 of the Clayton Act, which prohibits exclusivity arrangements that may "substantially lessen competition";[171] and section 5 of the FTC Act, which prohibits "[u]nfair methods of competition."[172] Because courts have relied on tying precedent from claims brought pursuant to an amalgam of statutory provisions, tying case law under the various statutes substantially overlaps.[173]

Courts have generally applied two standards to determine whether a tying arrangement is illegal. Under the *per se* standard, the elements a plaintiff must provide are the following:

> (1) that the defendant tied together the sale of two distinct products or services;
> (2) that the defendant possesses enough economic power in the tying product to market to coerce its customers into purchasing the tied product; and
> (3) that the tying arrangement affects a 'not insubstantial volume of commerce' in the tied product market.[174]

When employing the *per se* standard, courts may allow defendants to argue that the tying arrangement was justified to protect the goodwill associated with the franchisor's trademark, thereby leading to inconsistent and uncertain case law.

Alternatively, other courts have employed a rule of reason analysis, which focuses on the overall effects on the market and is more comprehensive that a *per se*

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[167] *Seigel v. Chicken Delight, Inc.,* 448 F.2d 43, 47 (9th Cir. 1971).

[168] *See, e.g. Illinois Tool Works Inc. v. independent Ink, Inc.,* 547 U.S. 28, 35 (2006).

[169] 15 U.S.C. § 1.

[170] *Id.* § 2.

[171] *Id.* § 14.

[172] *Id.* § 45(a)(1).

[173] *See Standard Oil Co of Cal. v. United States*, 337 U.S. 293, 305-06 (1949).

[174] *See, e.g. Cablevision Sys. Corp. v. Viacom Int'l Inc.*, 13 Civ. 1278 LTS JLC, 2014 WL 2805256 (S.D.N.Y. June 20, 2014)*; Rick-Mik Enterprises, Inc. v. Equilon Enterprises LLC*, 532 F.3d 963, 971 (9th Cir. 2008) (citing *Cascade Health Solutions v. PeaceHealth,* 515 F. 3d 883, 912 (9th Cir. 2008)). However, the U.S. Supreme Court held in *Jefferson Parish Hospital v. Hyde,* that a *per se* standard is only appropriate "if the existence of forcing is probable." 466 U.S. 2, 15 (1984) (*abrogated on other grounds by Ill. Tool Works Inc. v. Indep. Ink, Inc.,* 547 U.S. 28 (2006)).

standard.[175] While courts adopt inconsistent analyses to tie in cases, opinions generally focus on issues of product distinction and "market power."

B. <u>The Seminal Case of *Siegel v. Chicken Delight, Inc*.[176]</u>

The requirement that there be two distinct products has particular importance in franchise disputes because the tying product usually is a trademark or business method, as opposed to a physically distinct product.[177] This significance was addressed in *Siegel v. Chicken Delight, Inc.,* one of the first cases to address the issue of franchise tie-ins.

1. <u>Facts</u>

In *Siegel*, franchisees brought an antitrust class action against their franchisor, Chicken Delight, for injuries resulting from illegal contractual requirements imposed by the franchisor, mandating that franchisees purchase certain essential cooking equipment, dry-mix food items, and trademark bearing packaging exclusively from the franchisor as a condition of obtaining the franchisor's trademark license.[178] Such requirements were in lieu of collecting franchise fees or royalties, and were alleged to constitute an unlawful *per se* tying arrangement pursuant to §1 of the Sherman Act.[179]

2. <u>The District Court Opinion</u>

The District Court for the Northern District of California held that the contractual requirements constituted a tying arrangement in violation of the Sherman Act, ruling that the license to use the Chicken Delight name, trade-mark, and method of operations was a distinct tying item as a matter of law and that "Chicken Delight's unique registered trade-mark, in combination with its demonstrated power to impose a tie-in, established as matter of law the existence of sufficient market power to bring the case within the Sherman Act."[180]

3. <u>The Ninth Circuit Opinion</u>

On interlocutory appeal, Chicken Delight argued that the lower court's ruling conflicted with the rules surrounding tying arrangements, and that the licenses and trademarks are not items separate and distinct.[181] In determining whether the franchisor's license should be regarded as separate distinct items, the Ninth Circuit

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[175] Under the rule of reason, "the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition." *Cont'l T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977).

[176] 448 F.2d 43 (9th Cir. 1971).

[177] Jill M. Aubin, *Franchise Tie-Ins: The State of The Law*, 26 New. Eng. L. Rev. 1 at 7 (1991).

[178] *Siegel,* 448 F.2d at 46.

[179] *Id.* Section 1 of the Sherman Act provides: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." 15 U.S.C. §1.

[180] *Siegel,* 448 F.2d at 47, 50.

[181] *Id.* at 47-48.

looked to the "function of the aggregation," giving consideration to the function of the trade-marks.[182]

In holding that the tied products constituted separate and distinct products from the license, the *Siegel* court distinguished between two types of franchise systems: (1) those set up to distribute trade-marked goods of the franchisor; and (2) those set up "to conduct a certain business under a common trade-mark or trade name," such as was the case in *Siegel.*[183] Under the latter, "the trade-mark simply reflects the goodwill and quality standards of the enterprise which it identifies. As long as the system of operation of the franchisees lives up to those quality standards . . . neither the protection afforded the trade-mark by law nor the value of the trade-mark to the licensee depends upon the source of the components."[184] Accordingly, the *Siegel* Court affirmed the District Court's ruling, stating that the sale of a franchise license to operate a business in a required manner and to benefit from the goodwill of the trademark did not require the sale by the franchisor of the component items.[185] As a result, the test enumerated by *Siegel* "raises not the issue of whether there is a tie-in but rather the issue of whether the tie-in is justifiable."[186][187]

With regard to the element of "sufficient economic power," the Ninth Circuit affirmed the District Court's ruling, noting that because the trademark in question possessed "goodwill and public acceptance unique to it and not enjoyed by other fast food chains," it was "clear that sufficient economic power is to be presumed where the tying product is patented or copyrighted."[188]

C. <u>Legal Significance of *Siegel* and Subsequent Court Opinions</u>

The *Siegel* decision was a victory for franchisees, who could now establish a presumption of market power in tying claims.[189] However, the strength of *Siegel* was fleeting, as other circuits refused to follow *Siegel*,[190] and/or altered the analysis set forth in *Siegel.*[191] Since *Siegel* was decided, courts are increasingly straying away from the

[182] *Id.* at 48.

[183] *Id.* at 48-49.

[184] *Id.* at 49.

[185] *Siegel,* 448 F.2d at 49*.*

[186] *Id.*

[187] As to the "no-justification" requirement, the *Siegel* court applied the test as set forth in *Standard Oil Co. v. United States,* 337 U.S. 293, 305 (1949), which states that the "only situation, indeed, in which protection of goodwill may necessitate the use of tying clauses is where specifications for a substitute would be so detailed that they could not practicably be supplied." *Siegel,* 448 F. 2d at 51 (citing *Standard Oil Co.,* 337 U.S. at 306). In affirming that no justification existed, the *Siegel* court stated that a franchisor "cannot immunize a tie-in from antitrust laws by simply stamping a trade-mark symbol on the tied product – at least where the tied product is not itself the product represented by the mark." *Id.*

[188] *Id.* at 50.

[189] *See, e.g. Warriner Hermetics, Inc. v. Copeland Refrigeration Corp.*, 463 F.2d 1002 (5th Cir. 1972) (applying *Siegel* per se doctrine to distributorship franchise).

[190] *See, e.g., Principe v. McDonald's Corp.*, 631 F.2d 303, 308 (4th Cir. 1980) ("[T]he lease, note and license are not separate products but component parts of the overall franchise package.").

[191] Subsequent to *Siegel,* several courts have combined the separate products and justification elements, and have set forth specific factors that assist in the determination of whether a product should be considered

rationale set forth by the case, and are hesitant of finding tying arrangements as being *per se* illegal.

1. ***Principe v. McDonald's Corp*.[192]: The Fourth Circuit Rejects *Siegel***

In *Principe v. McDonald's Corp,* the Fourth Circuit attempted to develop a new framework of the tying analysis and rejected *Siegel's* "restrictive" emphasis upon a trademark as the emphasis of a franchise.[193]

In *Principe,* the Principes were franchisees of McDonald's who executed a twenty year franchise license agreement and a twenty year store lease.[194] In consideration for the rights under the agreement, the Principes paid a $10,000 license fee and a $15,000 security deposit, and also agreed to pay 2.2 percent of their gross sales as royalties and 8 percent as rent under the lease.[195] The Principes alleged that McDonald's violated federal antitrust laws by tying the store leases and security deposit to the franchise rights.[196]

The district court granted summary judgment for McDonald's on the security deposit note tie in claim, finding that the notes were not products separate from the store leases, but represented deposits against losses.[197] With regard to the store leases tie in claim, the district court directed a verdict for McDonalds, holding that McDonald's only sells one product, and that the license contract and the store leases are part of the overall package offered to franchisees.[198]

In affirming the district court's ruling, the Fourth Circuit held that there was no illegal tying arrangement because the lease was not separable from the franchise to which it pertained.[199] Without "disagreeing" with the result in *Siegel,* the court held that "the proper inquiry is not whether the allegedly tied products are associated in the public mind with the franchisor's trademark, but whether they are integral components of the business method being franchised."[200] Accordingly, "[w]here the challenged aggregation

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separate for purposes of tying arrangements. *See, e.g.* (*Anderson Foreign Motors, Inc. v. New England Toyota Distributor, Inc.,* 475 F. Supp. 973 (D. Mass. 1979) (utilizing a "four-pronged analysis: (1) examination of the product structure itself, (2) investigation of the defendant's product marketing practices, (3) consideration of the behavior of other industrial sellers and (4) analysis of the efficiencies gained by and the business justifications for the product combination).

[192] 631 F.2d 303 (4th Cir. 1980).

[193] *Principe,* 631 F. 2d at 309. While *Principe* criticized *Siegel,* it did not necessarily disagree with the result in *Siegel. Id.*

[194] *Id.* at 304.

[195] *Id.*

[196] *Id.*

[197] *Id.*

[198] *Id.*

[199] *Id.* at 309.

[200] *Id.*

is an essential ingredient of the franchised system's formula for success, *there is but a single product and no tie in exists as a matter of law*."[201]

Contrary to the principle set forth in *Siegel,* which was premised on the belief that the trademark could be sold separately from other items necessary to operate a franchise, the *Principe* court noted that "[i]t is often unrealistic to view a franchise agreement as little more than a trademark license."[202] Rather, a modern franchisee pays for the right to become part of an entire franchise system, which goes beyond the mere right to use a trademark.[203] Indeed, the *Principe* court offered four reasons why the lease was not separable from the franchise: (1) McDonald's is able to obtain better sites than franchisees could select, thereby benefitting franchisees; (2) McDonald's practice of owning all of its own restaurants assures that the restaurants all remain part of the franchise system; (3) Because McDonald's builds and selects the sites itself, it can select franchisees based on management and business potential rather than real estate expertise; (4) McDonald's and its franchisees both have a substantial stake in the restaurant's success, creating a sort of unique partnership relationship.[204] The court concluded that such factors contributed to the overall success of the franchise system, and therefore, an illegal tying arrangement did not exist.[205]

2. ***Krehl v. Baskin-Robbins Ice Cream Co.***[206]**: The Ninth Circuit Revisits *Siegel***

In the wake of *Siegel*, the Ninth Circuit once again revisited the issue of whether a trademark is a separate product, this time reaching an opposite conclusion than it did in *Siegel.* In *Krehl,* the franchisees argued that Baskin-Robbins' policy of conditioning the grant of a franchise upon the purchase of its ice cream exclusively from the franchisor constituted an unlawful tying arrangement.[207]

In holding that the Baskin-Robbins trademark could not be treated as an item separate from the ice cream it represents, the Ninth Circuit distinguished the franchise system that was present in *Siegel.* Specifically, *Siegel* presented a "business format" system, where the tied products were "commonplace articles" and the franchisor could easily maintain quality standards through other, less intrusive means that would not impede competition.[208] On the other hand, Baskin-Robbins employed a "distribution type system," which involves significantly different considerations.[209] Specifically, the franchisor acts as a conduit through which the franchisees sell trademarked goods, to the public, such that the "desirability of the trademark and the quality of the product it represents are so inextricably interrelated in the mind of the consumer as to preclude

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[201] *Id.* (emphasis added).

[202] *Id.*

[203] *Id.*

[204] *Id.* at 310.

[205] *Id.* at 311.

[206] 664 F.2d 1348 (9th Cir. 1982).

[207] *Id.*

[208] *Id.* at 1353.

[209] *Id.*

any finding that the trademark is a separate item for tie-in purposes."[210] Accordingly, the Ninth Circuit affirmed the District Court's entry of an involuntary dismissal entered against the franchisees, who stipulated that Baskin-Robbins would be entitled to judgment absent proof of a *per se* violation of the antitrust laws.[211]

D. ***Eastman Kodak Co. v. Image Technical Services, Inc.***[212] **and the "Market Power" Determination**

A plaintiff asserting an illegal tie-in claim must prove that the defendant has "sufficient power in the tying product market to restrain competition in the market for the tied product."[213] In other words, market power gives a franchisor leverage in forcing a franchisee to buy a certain unwanted product from the franchisor in order to obtain a desired product.[214] The U.S. Supreme Court case of *Eastman Kodak Co. v. Image Technical Services, Inc. (Kodak)* provided some guidance with respect to the determination of "market power."

In *Kodak*, independent service organizations (ISOs) brought an antitrust action against Eastman Kodak to recover for its policies limiting availability to ISOs of replacement parts for its equipment, and making it more difficult for ISOs to compete with it in servicing the equipment.[215] Eastman Kodak had entered into an agreement with independent original equipment manufacturers (OEMs) who agreed not to sell Eastman Kodak equipment to third parties.[216] This drove many ISOs out of business.[217] Eighteen of them sued Eastman Kodak for establishing an unlawful tying arrangement under Section 1 of the Sherman Act.[218]

After determining that replacement parts and service were separate and distinct products, the court addressed whether Eastman Kodak had a "predominant share of the market," or an "appreciable economic power in the tying market" that would suffice to prove an antitrust violation.[219] Eastman Kodak argued that consumers would buy photocopiers elsewhere if it charged monopoly prices for its parts and services.[220] The court found that consumers did not engage in "lifecycle pricing."[221] Individuals do not ordinarily have the information necessary to evaluate the total cost of equipment,

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[210] *Id.* at 1353-54. *Compare Cohen v. All American Hero, Inc.,* 693 F. Supp. 201 (D.N.J. 1988) (because of the "remote connection between the trademark and the products . . . consumers have no reason to associate with the trademark, those component goods used within the operation of the franchised store or in the manufacture of the end product").

[211] *Krehl,* 664 F.2d at 1350.

[212] 504 U.S. 451 (1992).

[213] *Illinois Tool Works v. Independent Ink,* 547 U.S. 28 (2006).

[214] *Jeggerson Parish Hosp. Dist. No. 2. v. Hyde,* 466 U.S. 2, 18 (1984).

[215] *Kodak,* 504 U.S at 451.

[216] *Id.* at 458.

[217] *Id.*

[218] *Id.* at 459 (citing 15 U.S.C. § 1 (1994)).

[219] *Id.* at 464 (citing *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 21-22 (1984)).

[220] *Id.* at 466.

[221] *Id.* at 473.

including parts and servicing, before making their initial equipment purchase.[222] Together with high switching costs, the court rejected Eastman Kodak's bright-line rule that would bar liability in all aftermarket cases where the defendant lacked market power in the primary equipment market, holding that "[l]egal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law. This Court has preferred to resolve antitrust claims on a case-by-case basis, focusing on the 'particular facts disclosed by the record.'"[223]

1. <u>Judicial Treatment of Kodak and Aftermarket Claims</u>

Following *Kodak*, ISOs and other entities filed a number of lawsuits challenging equipment manufacturer's aftermarket policies. However, courts have held there could be no aftermarket claim without a manufacture's change in policy after locking in customers. In *Digital Equipment Corp. v. Uniq Digital Technologies*,[224] Digital did not have market power in the primary equipment market, but Uniq contended that Digital's policy of including an operating system with the computers it sold constituted monopolization of a market for "operating systems for Digital's computers." The Seventh Circuit held that:

> The Court did not doubt in *Kodak* that if spare parts had been bundled with Kodak copiers from the outset, or Kodak had informed customers about its policies before they bought its machines, purchasers could have shopped around for competitive life-cycle prices. The material dispute that called for a trial was whether the change in policy enabled Kodak to extract supracompetitive prices from customers who had already purchased its machines. . . . Concrete evidence that it had so entitled plaintiffs to a trial, the Court held.[225]

In *PSI Repair Services v. Honeywell*,[226] Honeywell manufactured industrial equipment designed around electronic circuit boards. PSI sold circuit board repair services to individuals who had purchased Honeywell's products. PSI alleged that it could not compete because Honeywell had closed access to its components, creating an illegal tie-in between board components and service. Honeywell argued that its policies had always been consistent and thus lawful.[227] The Sixth Circuit agreed that the absence of a policy change was fatal to PSI's claims because the policy change in *Kodak* "was the crucial factor in the Court's decision."[228]

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[222] *Id.*

[223] *Id.* at 466-67.

[224] 73 F.3d 756 (7th Cir. 1996).

[225] *Id.* at 763; *see also id.* at 762 (noting that the *Kodak* assumed change in policy; although it "conceded that customers who had anticipated the change of policy could not be exploited," not all customers "anticipate all changes of policy").

[226] 104 F.3d 811 (6th Cir. 1997).

[227] *Id.* at 819.

[228] *Id.* at 820.

2. Disclosures in Franchise Agreements Are Significant

Courts have likewise distinguished *Kodak* in the franchise context, rejecting claims brought by franchisees and dealers challenging the policies of their suppliers. These cases reject claims of market power in an aftermarket where there is no change in policy and where the franchisee *knew* what it was signing up for.

In *Queen City Pizza v. Domino's Pizza*,[229] the court considered a § 2 monopoly claim brought by a franchisee against a franchisor related to a requirement in the franchise agreement that the franchisee only purchase from the franchisor or approved suppliers. The plaintiffs in *Queen City Pizza v. Domino's Pizza* contended that Domino's unlawfully monopolized an aftermarket for sales of supplies to its franchisees by requiring that they purchase ingredients from Domino's. The Third Circuit determined that "[u]nlike the plaintiffs in *Kodak*, the Domino's franchisees could assess the potential costs and economic risks at the time they signed the franchise agreement.[230] The court noted that the challenged provision in the franchise agreement was part of the deal when the franchisee entered the agreement.[231] Several district courts have reached similar results.[232]

However, in *Burda v. Wendy's International, Inc.,*[233] the Southern District of Ohio refused to dismiss a tying claim brought against Wendy's, who was alleged to have insisted that franchisees purchase items from it or its affiliates after franchisees entered into the franchise agreement. In *Burda,* the franchisees argued that the obligations were not contractual, since the franchise agreement did not provide a basis for a reasonable franchisee to have foreseen that Wendy's would impose exclusive suppliers of its products on franchisees.[234] In distinguishing *Queen City Pizza,* the court agreed, and therefore rejected Wendy's argument in favor of dismissal that the right to insist that franchisees purchase certain products arose from contract, and not from the assertion of market power.[235] Post-*Kodak* decisions since *Queen City Pizza* demonstrate that it has become increasingly difficult for a franchisee to plead facts sufficient to overcome a motion to dismiss a tying claim under federal law. Indeed, "a tying claim generally

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[229] 124 F.3d 430 (3d Cir. 1997).

[230] *Id.* at 439.

[231] *Id.*

[232] *See, e.g.*, *Subsolutions, Inc. v. Doctor's Assocs.*, 62 F. Supp. 2d 616, 626 (D. Conn. 1999) (finding adequately alleged aftermarket in denying motion to dismiss under Rule 12 because the "policy was not in place at the time many franchisees entered into their agreements"); *Little Caesar Enters., Inc. v. Smith*, 34 F. Supp. 2d 513, 515 (E.D. Mich. 1998) (granting summary judgment because a "plaintiff must show that, after a substantial number of customers have sunk significant costs that are not recoverable and face other switching costs, the seller takes some action changing its policy (or acting on a prior undisclosed policy) that takes advantage of its locked in customers lack of information in order to reap supracompetitive profits by imposing a burdensome tie-in") (internal quotation omitted); *Wilson v. Mobil Oil Corp.*, 940 F. Supp. 944, 953 (E.D. La. 1996) (citing *Digital v. Uniq* with approval, but refusing to dismiss complaint under Rule 12 because "it is not at all clear on this record what was disclosed to these plaintiffs about the Mobil supply arrangements or when it was disclosed").

[233] 659 F. Supp. 2d 928 (S.D. Ohio 2009).

[234] *Id.* at 935.

[235] *Id.* at 937. While the allegation in *Burda* were sufficient to overcome a motion to dismiss, the court in *Burda* ultimately granted summary judgment in the franchisor's favor. *Burda v. Wendy's Intern., Inc.,* 2012 WL 4792374 (S.D. Ohio Oct. 9, 2012).

requires that the defendant's economic power be derived from the market, not from a contractual relationship that the plaintiff has entered into voluntarily."[236]

These post-*Kodak* decisions provide guidance to franchisors with restrictive aftermarket policies to avoid the fate of Eastman Kodak. Because post-*Kodak* courts generally analyze market power as it exists prior to the entry of the franchise agreement, disclosure is key in the franchisee-franchisor relationship. If franchisors are forthright about their aftermarket policies, and if their franchisees know that they will be confined to purchasing goods and services from the franchisor and not from anyone else—which disclosures are required under the FTC Rule,[237] the franchisor will likely avoid liability for tying and aftermarket monopolization. Before committing themselves to a contract, franchisees must also be aware of any purchasing requirements of a franchise and must consider the costs of required products and/or services in the operation of the franchised business when deciding whether to purchase a certain franchise.

IX. CONCLUSION

At the heart of our judicial system is the concept of precedent. It is therefore crucial that we, as franchise attorneys, know and understand the impact of prior court decisions as we guide our companies and clients through the world of franchising. Hopefully, the seven cases that we have presented in this paper will assist you in understanding where we have been, so that these precedents can either be followed or changed as circumstances warrant.

236 *Queen City Pizza, Inc.*, 124 F. 3d at 433.

[237] *See* 16 C.F.R. § 436.5(h) (requiring disclosure of franchisee's obligations to purchase or lease goods, supplies, equipment, etc… either from the franchisor, its designee or other suppliers).

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For over 30 years, Mr. Heller's practice has consisted almost exclusively of representing franchisors in franchise and distribution disputes throughout the country, both in litigation, arbitration and mediation. Much of his practice has focused on franchise termination matters, as well as on the more complex franchise cases involving issues affecting the entire franchise system. He has handled cases involving, among other issues, termination, transfers, rights of first refusal, implied covenant of good faith and fair dealing, alternative distribution channels, covenants against competition, trademark infringement, product sourcing and approval, advertising funds, acquisitions of other systems, antitrust and unfair competition. Mr. Heller has been involved in both domestic and international franchise matters. He has represented franchisors in actions involving individual franchisees, franchise associations, class actions, group actions, the Federal Trade Commission and suppliers.

In every year since 2002, Mr. Heller has been listed in *Who's Who Legal: The International Who's Who of Business Lawyers.* Since 2007, he has been listed in every edition of *The Best Lawyers in America*. Since 2006, he has been named a Virginia Super Lawyer in every year. Since 2007, he has been named a Washington, DC Super Lawyer in every year. Mr. Heller was selected as one of the top 100 Franchise Legal Eagles by *Franchise Times* in 2004 as well as in every year from 2006 to 2014.

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Robert Zarco is the Founding Partner of Zarco Einhorn Salkowski & Brito, P.A. Mr. Zarco has earned international recognition in the area of franchise law through his representation of franchisees throughout the world and involving almost every major franchise system in the hospitality, restaurant, petroleum and service industries. He frequently provides expert testimony before various state legislatures and serves as an expert witness regarding franchise issues in trial courts and arbitration proceedings. He is a frequent author on various issues in franchise and hospitality law as well as a speaker and lecturer at various national franchise conferences.

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