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## Franchise Law Update

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# FRANCHISE LAW UPDATE

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## I. INTRODUCTION\*\*\*\*\*

**T**HIS article provides an update of judicial and legislative developments of franchise law in Texas and the Fifth Circuit during the Survey period. Relevant case law from around the country that impacts franchise businesses is also included.

## II. MISREPRESENTATION, DISCLOSURE AND REGISTRATION

### A. WHAT IS A FRANCHISE?

The Texas Business Opportunity Act<sup>1</sup> ("Texas BOA") contains disclosure and registration rules for business opportunities sold or leased in Texas.<sup>2</sup> The Texas BOA defines three types of business opportunities: Any sale or lease of goods or services, for initial consideration to franchisor (or its affiliate) of more than \$500, used by the purchaser to begin a business, in which the seller represents that purchaser will make a profit, where seller represents that it will either: (a) provide locations or assist purchaser in finding locations; (b) provide a production, sales or

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1. TEX. BUS. & COM. CODE ANN. §§ 41.001-303 (Vernon Supp. 2000).  
2. TEX. BUS. & COM. CODE ANN. § 41.153 (Vernon Supp. 2001).

marketing program; or (c) buy back or will be likely to buy back goods purchased or products made from goods made by purchaser from the goods initially purchased or leased by purchaser from seller.<sup>3</sup>

One of the exceptions to the Texas BOA registration and disclosure requirements is a franchise, as defined by 16 C.F.R. Section 436.2(a), so long as the franchisor materially complies with all requirements of the statute and each order and action of the Federal Trade Commission and, before offering or selling any franchise in Texas, files a proper notice with the secretary of state.<sup>4</sup>

16 C.F.R. § 436.2 contains the trade regulation rule of the Federal Trade Commission setting forth “Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures” (“the FTC Rule”). The FTC Rule defines two types of franchises. First, a person (franchisee) sells goods or services that are significantly associated with the franchisor’s mark and franchisor exerts significant control over or provides significant assistance to franchisee’s method of operation, *and* franchisee is required as a condition of commencing the business, to make a payment (or commitment to make a payment) of \$500 or more to franchisor (or its affiliate), before or within six months of commencing operations.<sup>5</sup> Second, a person (franchisee) sells goods or services supplied by franchisor or its affiliates, and the franchisor secures locations, retail outlets, accounts, or rack displays or provides the services of a person able to do either, *and* franchisee is required as a condition of commencing the business, to make a payment (or commitment to make a payment) of \$500 or more to franchisor (or its affiliate), before or within six months of commencing operations.<sup>6</sup>

A January 2000 Informal Staff Advisory Opinion indicates that the FTC may construe nearly any payment of (or a commitment to pay) \$500 or more by a franchisee (buyer) to a franchisor (seller), before or within the first six months of operations, to constitute the required payment element of a franchise.<sup>7</sup> The situation before the FTC involved a company in the business of developing a chain of quick service restaurants that it represented to prospective purchasers as “turnkey” restaurant operations. The company acknowledged that its Operation Agreement satisfied the first prong of the “franchise” definition—significant trademark association and control or assistance. Because the company required no up-front franchise or license fee, it sought an opinion that its Operation Agreement was not a franchise, and should not be governed by the FTC Rule. The Advisory Opinion determined, however, that at least three types of payments being made by the operator (putative franchisee) to

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3. TEX. BUS. & COM. CODE ANN. § 41.004(a) (Vernon Supp. 2001).

4. TEX. BUS. & COM. CODE ANN. § 41.004(b)(8) (Vernon Supp. 2001); 16 C.F.R. § 436.2(a) (2000).

5. 16 C.F.R. § 436.2(a)(1)(i) (2000).

6. 16 C.F.R. § 436.2(a)(1)(ii) (2000).

7. Informal Staff Advisory Opinion 00-2 (Jan. 24, 2000) 2 Bus. Franchise Guide (CCH) ¶ 6506 (Jan. 24, 2000).

the company (putative franchisor) would or could constitute the required franchise payment, so the business relationship should be treated as a franchise.

The Operation Agreement required the operator to pay a “working capital deposit” of \$5,000 to the company before opening a restaurant. This deposit (minus any expenses incurred by the company for the operation of the restaurant that the operator failed to pay) would be returned to the operator at the termination or expiration of the Operation Agreement. The Advisory Opinion determined that this deposit alone would constitute a franchise fee, stating, “That some or all of this deposit may be returned to the investor is irrelevant.”<sup>8</sup> The Advisory Opinion determined that a second type of fee that the operator was required to pay to the company, monthly lease fees of \$1,200 for the restaurant premises and \$750 for equipment, would constitute the required franchise payment, as well. Citing the Interpretive Guides to the Rule, the Advisory Opinion noted that the Commission made clear that the term “required payment” was intended to “capture all sources of revenue which the franchisee must pay to the franchisor . . . for the right to associate with the franchisor and market its goods or services.”<sup>9</sup>

Additionally, the Advisory Opinion stated that certain service charges that the company might receive for its performance of certain accounting functions for the operator (conditioned upon the operator experiencing profits) could also constitute the required payment needed for a franchise. The Advisory Opinion stated, “There is no question that a commitment to pay continuing fees to the franchisor for the right to conduct business (such as royalties), as well as future shares of profits, may constitute a required payment for Rule purposes.”<sup>10</sup> The Advisory Opinion goes on to clarify that the FTC rule does not require the amount of the recurring fees to be fixed at the time the franchise agreement is executed. It held that depending upon the nature of the franchisor’s business, a prospective franchisor might reasonably anticipate paying this company at least \$500 in “operating service charges” during the first six months of operations; so, such payment could also constitute a minimum required payment.<sup>11</sup>

The FTC seems to interpret the “payment” requirement more broadly than courts have in cases brought by franchisees. Although Texas does not have any recent cases interpreting the term “payment,” prior to the issuance of the January 2000 Advisory Opinion, an Indiana court confirmed the traditional analysis that, to constitute a franchise fee under the Indiana Franchise Act, the fee must be a required, non-recoverable, firm-specific investment in another party, and required for the right to conduct

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8. *Id.* at 9727.

9. *Id.* at 9728.

10. *Id.*

11. *Id.*

the business.<sup>12</sup> The Indiana court specifically held that a franchise fee could not be an ordinary business expense because “[t]he statute defines a franchise fee as a fee paid for the right to do business, not as fees paid during the course of business.”<sup>13</sup> Best (the putative franchisee) argued that its payments to Seyfert for purchasing, maintaining, and replacing display racks for snack foods were actually indirect franchise fees. The Indiana court held that these payments were ordinary business expenses that did not constitute a franchise fee.<sup>14</sup> The court rejected Best’s argument that the cost of the racks was not a recoverable business expense because Seyfert set the retail prices for all retail goods. The Court held that even though Best could not raise its prices to recover the expense of the racks, because the racks promoted the sale of the goods, they most likely increased overall sales. The court also held that purchasing the racks was not “required” by Seyfert, since Seyfert had never indicated that it would terminate Best if it did not provide and maintain the racks.<sup>15</sup> The court also denied Best’s claim that the amount it paid (to a third party) for warehouse space was an indirect franchise fee, stating that this was an ordinary business expense and not paid to the seller.<sup>16</sup>

In *Bestest Int’l, Inc. v. Futrex, Inc.*,<sup>17</sup> the plaintiff alleged that it paid \$30,000 to Futrex, Inc. (the putative franchisor) for the right to do business, and this amount constituted a “franchise fee.” The court found that the evidence showed that a previous distributor of medical equipment for Futrex (Norick) had financial problems, owed Futrex money for goods previously purchased and desired to sell its distribution rights to the predecessor of plaintiff. Futrex agreed that Norick could sell its Distribution Agreement to plaintiff’s predecessor as long as Norick paid its past due balance to Futrex. Plaintiff’s predecessor paid a substantial portion of the past due amount directly to Futrex (Norick paid the balance to Futrex). In rejecting plaintiff’s interpretation of the payment, the court noted that the California Commissioner had previously held that “[a] payment to or for the account of third parties not affiliated with the franchisor is not a ‘franchise fee’.”<sup>18</sup>

## B. REGISTRATION

The Sixth Circuit held that a franchisor’s significant involvement in the transfer process could make it become the party to actually “offer or sell” the franchise under South Dakota’s franchise registration statute requir-

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12. *Best Distrib. Co. v. Seyfert Foods, Inc.*, 714 N.E.2d 1196 (Ind. Ct. App. 1999) .

13. *Id.* at 1201 (quoting *Wright-Moore Corp. v. Ricoh Corp.*, 908 F.2d 128, 136 (7th Cir. 1990)).

14. *Id.* at 1203.

15. *Id.*

16. *Id.* at 1203-04.

17. 2 Bus. Franchise Guide (CCH) ¶ 11,915 (C.D. Cal. August 14, 2000).

18. *Id.* (citing *Premier Wine & Spirits of S.D., Inc., v. E. & J. Gallo Winery*, 644 F. Supp. 1431, 1438-39 (E.D. Cal. 1986)).

ing the franchisor to be properly registered in the state.<sup>19</sup> Here, Little Caesar's (franchisor's) financial analyst encouraged the prospective franchisee to purchase the franchises, arranged financing with a lender for the franchise purchases, and strategized with the prospective franchisee on how to structure the purchases. A different franchisor employee acted as the "go between" to negotiate the purchase terms between the prospective franchisee and the then current franchisee. Because, at the time of the sale of the franchises, Little Caesar's registration was expired in South Dakota, the Court upheld the district court's rescission of the franchise agreements.<sup>20</sup>

### C. DISCLOSURE AND MISREPRESENTATION

#### 1. *Disclosure Obligations of Business Brokers*

The FTC staff clarified its position as to when business consultants, who were not employees of a franchisor but offered their clients a variety of business options including franchises, became "brokers" under the Franchise Rule and when their initial meetings with their clients became "first personal meetings."<sup>21</sup> The two specific situations addressed involved a franchise consulting firm ("Frannet") and a business broker firm ("Tom Miller"). Both companies had their clients complete forms that contained information that was very similar to a typical franchise application.<sup>22</sup> Frannet obtained information from consumers in order to educate them about potential business opportunities and evaluate their goals and potential risks. Frannet had contracts with approximately 75 franchisors who would pay it a fee if a referred franchise prospect purchased a franchise. Frannet's literature discussed franchising at length and its primary source of income came from generating franchise sales. Tom Miller's primary concern was to sell on-going businesses, and not franchises, to its clients.<sup>23</sup> It acknowledged, however, that if a business client failed to qualify for the existing businesses that were for sale, but did qualify for franchise opportunities, its brokers may provide the prospect with written historical and overview information (with no earnings claims made) regarding one or more franchise systems. If a prospect was interested in any of the franchises, the Tom Miller broker would provide the name of the prospect to the franchisor and would have no further discussions regarding the franchise opportunity.<sup>24</sup>

Advisory Opinion 99-7 stated that a face-to-face meeting between a franchise prospect and a non-employee of a franchisor constituted a "first

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19. *Little Caesar Enters., Inc. v. OPPCO, LLC*, 2 Bus. Franchise Guide (CCH) ¶ 11,897 (6th Cir. July 14, 2000).

20. *Id.*

21. Informal Staff Advisory Opinion 99-7, [1998-2000 Transfer Binder] 2 Bus. Franchise Guide (CCH) ¶ 6504 (November 12, 1999).

22. *Id.* at 9721, 9722.

23. *Id.* at 9724.

24. *Id.*

personal meeting” when a franchisor’s representative or independent agent:

- (a) received a commission or other compensation if a franchise sale was ultimately consummated;
- (b) met personally with consumers in a setting where there was a likelihood or expectation of discussing the possible purchase of a franchise, and during the meeting the representative;
- (c) sought to match the consumer with one or more specific franchise systems based upon criteria furnished by the consumer;
- (d) discussed the merits of one or more specific franchise systems; and
- (e) contacted the franchisor on behalf of the consumer or otherwise advised the consumer on how to contact one or more franchise systems.<sup>25</sup>

Advisory Opinion 99-7 held that both Frannet and Tom Miller qualified as “brokers” under the FTC rule. It further held that Frannet’s initial meetings with clients appeared to be first personal meetings because Frannet met with prospects specifically to discuss franchise opportunities, not simply to discuss the idea of franchising as a business method. It held that initial meetings by Tom Miller brokers did not appear to be first personal meetings because the discussions of franchising were only incidental, at best, and that any franchising discussions would only occur if the purchase of a listed business was not an option for the prospect.<sup>26</sup> The Advisory Opinion specifically stated that its opinion would be different if Tom Miller advertised new franchise units, instead of only resales by existing franchisees, because this would change the expectations of its clients at the first meeting.<sup>27</sup>

#### D. PRE-CONTRACT MISREPRESENTATIONS AND EARNINGS CLAIMS

##### 1. *FTC Actions*

The court refused to modify two Commission orders to specifically limit the franchisor’s liability for deceptive advertising or marketing activities by franchisees, if the franchisor distributed copies of the orders to all franchisees, contractually bound franchisees to follow the orders, and used best efforts to obtain compliance by franchisees and licensees.<sup>28</sup> In denying the request, the FTC noted that the orders did not make the franchisor strictly liable to franchisees, so vicarious liability would be determined on a case by case basis.

On September 10, 1999, the FTC announced the filing of a consent decree with a photo sticker vending machine franchisor that was charged with failing to provide prospective franchisees with basic disclosure documents and making earnings claims (verbally and in writing) without pro-

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25. *Id.* at 9723.

26. *Id.* at 9724.

27. *Id.*

28. In the matter of Gen. Nutrition Corp., [1998-2000 Transfer Binder] Bus. Franchise Guide (CCH) ¶ 11,787 (January 31, 2000).

viding required earnings claim disclosures.<sup>29</sup> The defendant and its affiliates were (a) ordered to pay a civil penalty of \$11,000; (b) enjoined from promoting, offering to sell, or selling any business opportunity or venture similar to the "Sticker Club" venture, unless they came into compliance with the FTC Rule; (c) enjoined from making any false, misleading statements or implications to any purchasers of any business, opportunity, or venture; and (d) ordered to retain certain records regarding on-going business activities.<sup>30</sup>

On September 20, 1999, the FTC announced the filing of a consent decree with the primary owner of an automotive lubricant product display rack marketer, who was charged with making material misrepresentations to prospective purchasers in violation of the FTC Act, and with failing to provide such purchasers with proper disclosure documents or documentation for the earnings claims made, as required by the FTC rule.<sup>31</sup> The marketer and its primary owner allegedly represented that the purchasers should expect to receive (a) specific earning levels; (b) substantial profits; (c) reliable, company selected references; (d) specific territorial protection; and (e) certain advertising assistance.<sup>32</sup> The FTC alleged that all of these representations were false and that the earnings and profits representations were not substantiated or properly documented. The franchise owner was enjoined against selling or promoting any business opportunity, franchise, or business venture, and against making misrepresentations in connection with the marketing or sale of any goods or services. He was also ordered to comply with a series of reporting and record keeping requirements.<sup>33</sup> In addition, a \$4,000,000 consumer redress judgment was issued against the owner, but this judgment was suspended, subject to a financial investigation, unless the owner was found to have misrepresented the nature and amount of his assets.

On August 8, 2000, the FTC announced its filing of a July 31, 2000 complaint and the subsequent issuance of a temporary restraining order against two corporate sellers of car wash franchises and their principals.<sup>34</sup> The FTC claimed that defendants promised but failed to provide purchasers with a "turnkey" restaurant operation, substantial start-up and ongoing assistance, marketing support, and equipment, in violation of the FTC Act prohibition against false and deceptive representations. The FTC further claimed that the defendants promised (either directly or impliedly) that potential purchasers could expect to achieve specific revenues and substantial profits and that most purchasers did not ever earn such earnings or profits. Some purchasers were given no earnings claim

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29. U.S. v. PVI, Inc., [1998-2000 Transfer Binder] Bus. Franchise Guide (CCH) ¶ 11,702 (S.D. Fla. September 10, 1999).

30. *Id.*

31. U.S. v. QX Int'l, Inc., [1998-2000 Transfer Binder] Bus. Franchise Guide (CCH) ¶ 11,703 (N.D. Tex. September 20, 1999).

32. *Id.* at 32, 230.

33. *Id.* at 32, 231-34.

34. FTC v. The Car Wash Guys Int'l, Inc., 2 Bus. Franchise Guide CCH) ¶ 11,921 (C.D. Cal. July 31, 2000).



document, and some purchasers were given a disclosure document that stated that defendant did not make any earnings representations. The FTC asserted that defendants' promises of specific earnings and/or profits constituted false and deceptive representations, in violation of section 5 of the FTC Act<sup>35</sup> and that defendants' failure to provide an earnings claim document to prospective purchasers constituted a violation of the FTC's Franchise Rule.<sup>36</sup> Most surprising, however, the FTC also asserted that the instances where defendants provided prospective purchasers with a disclosure document stating that defendants made no earnings claim constituted violations of section 436.1(f) of the FTC rule, which prohibits the making of any statement that contradicts the disclosure document. The FTC obtained a restraining order restraining defendants from violating the FTC Rule or FTC Act and sought a permanent injunction, damages, and costs.<sup>37</sup>

## 2. State Actions

### a. Actionable Misrepresentations

The elements of a Texas fraud action are that (1) a material representation was made; (2) it was false; (3) the speaker knew that it was false when made; (4) it was made with the intent of inducing reliance; (5) the other party relied upon it; (6) damages were incurred, and, in the case of a promise to act in the future; (7) the promisor had no intention of performing when he made the promise.<sup>38</sup> Although there were no Texas franchise cases on point during the Survey period, the Sixth Circuit and U.S. District Courts in Massachusetts and California re-affirmed this standard over the past year.

In determining that certain statements by Learning Express (franchisor) constituted actionable misrepresentations, the Massachusetts U.S. District Court looked at the specific statements made by Learning Express.<sup>39</sup> The franchisee claimed that Moore, the Learning Express representative, told him that "he *would be able to* provide the necessary support to allow the [franchisee] to establish a Learning Express franchise retail store in New Jersey and to make it a success"<sup>40</sup> and that another representative of Learning Express stated that "Moore was experienced and was able to assist [the franchisee] in finding an appropriate location, as well as provide them with the training and knowledge necessary to open and successfully operate a Learning Express franchise."<sup>41</sup> The court ruled that the very specific wording of promises made by franchisor (that

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35. 15 U.S.C. § 45(a) (2000).

36. See 16 C.F.R. § 436.1(b)-(e) (2001).

37. See *The Car Wash Guys*, 2 Bus. Franchise Gude (CCH) at 33, 459.

38. See *Ensley v. Cody Res., Inc.*, 171 F.3d 315 (5th Cir. 1999), *reh'g denied en banc*, 181 F.3d 98 (5th Cir. 1999).

39. *Learning Express, Inc. v. Ray-Matt Enters., Inc.*, 74 F. Supp. 2d 79 (D. Mass. 1999).

40. *Id.* at 85 (emphasis supplied).

41. *Id.*

Learning Express would be able to provide sufficient support to allow success) constituted promises or factual assertions sufficient to support franchisee's allegations of misrepresentation and fraud. The court further held that, because the alleged statements were consistent with the franchise agreement provisions promising training and support, the franchisee's reliance upon such statements was reasonable.<sup>42</sup> The court therefore overruled the dismissal of the misrepresentation claim against Learning Express and held that franchisee would have 30 days to re-plead his fraud allegations.

The Texas result, with facts identical to the *Learning Express* case, would probably also allow franchisee to proceed with the fraud claim. Texas law holds that the promise of future performance may be considered the basis of a misrepresentation claim if the speaker did not intend to perform or knew his statement was untrue at the time of the statement, or *if the speaker had specialized knowledge of facts that would or could occur in the future.*<sup>43</sup>

A California U.S. District Court held that, although any misrepresentations regarding sales or profits that could be expected by the franchise prospect were non-actionable opinions, any statements regarding the profitability of existing stores would be actionable representations of fact. The court further held statements by franchisor employees, that they were experienced and would provide assistance to franchisee in training and identifying a location, might be held by the fact finder to constitute actionable statements of fact, so he denied summary judgement on this point.<sup>44</sup>

A franchisor's alleged representations to prospective pizza restaurant franchisees, that the existing pizza outlets in K-Mart stores would not complete with the franchisee and would actually enhance the franchisees' performance, were held to be actionable misrepresentations by the Sixth Circuit.<sup>45</sup> The court held that the representations were as to past, future, and current events, and only the future representations constituted non-actionable representations. The court held that franchisor had instituted a policy of restricting such outlets within one-mile of a franchised restaurant raised the inference that franchisor knew that the representations were false. In rejecting defendant's allegation that the representations by franchisor's sales employee were not actionable statements but were mere expressions of opinion by the employee, the court found that (1) the statements were specific and capable of verification; (2) franchisor's employee had specialized knowledge and authority; and (3) franchisee did

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42. *Id.*

43. *Clardy Mfg. Co. v. Marine Midland Bus. Loans, Inc.*, 88 F.3d 347 (5th Cir. 1996), *reh'g and sugg. for reh'g denied en banc*, 96 F.3d 1447 (5th Cir. 1996), *cert. denied*, 519 U.S. 1078 (1997) (emphasis supplied).

44. *California Bagel Co. v. Am. Bagel Co.*, [Transfer Binder 1998-2000] *Bus. Franchise Guide* (CCH) ¶ 11,880 (C.D. Cal. June 9, 2000).

45. *Little Caesar Enters., Inc. v. OPPCO, L.L.C.*, [1998-2000 Transfer Binder] 2 *Bus. Franchise Guide* ¶ 11,897 (6th Cir. July 14, 2000).

not have any prior experience in dealing with the subject of the K-Mart outlets, so had less specialized knowledge than the speaker.<sup>46</sup>

b. Estoppel and Reasonable Reliance Defenses to Misrepresentation Claims

Despite FTC's broad allegations in *The Car Wash Guys*, courts have seemed willing to grant motions for summary judgment against franchisee claims of pre-sale misrepresentation and fraud when the franchise agreement executed contains (1) a broad integration clause and (2) an acknowledgment by franchisee that franchisor has made no pre-sale representations that are not specifically set forth in the franchise agreement.<sup>47</sup> In *Cook v. Little Caesar Enters., Inc.*,<sup>48</sup> franchisee claimed that it was promised that it would have an exclusive territory encompassing most of Fresno, California. Each Little Caesar franchise agreement that franchisee executed contained an integration clause, an acknowledgment that franchisee had no knowledge of representations contrary to the terms of the franchise agreements, and stated that franchisee had an exclusive territory of one mile from each franchise.<sup>49</sup> The Sixth Circuit affirmed dismissal of the misrepresentation and fraud allegations for two reasons. First, it held that, even if the statements were misrepresentations, reliance would not be reasonable, since the representations were contrary to the acknowledgments by franchisee in his franchise agreement.<sup>50</sup> Second, the court, noting that there was no evidence that the statements were made in bad faith or were untrue when made, held that the statements were not misrepresentations because the alleged statement that franchisee would be given a large exclusive territory was a future promise, and a fraudulent misrepresentation claim must be based upon past or present facts.<sup>51</sup> The court held that although the future promises could be contractual, a breach of contract claim would fail since the parol evidence rule would prohibit evidence of the alleged verbal promises that conflicted with the express terms of the franchise agreement.

Despite the FTC's contention in *The Car Wash Guys*, the courts have also, thus far, continued to hold that a disclosure document statement that franchisor makes no earnings claims may protect a franchisor from franchisee allegations of unauthorized pre-sales earnings claims.<sup>52</sup> In granting defendant's motion for summary judgment against plaintiff's fraud and negligent misrepresentation claims, the court held that a franchisee could not have reasonably relied upon alleged oral representations

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46. *Id.*

47. See *Cook v. Little Caesar Enters., Inc.*, 210 F.3d 653 (6th Cir. 2000); *California Bagel Co.*, 2 Bus. Franchise Guide (CCH) ¶ 11,880.

48. 210 F.3d 653 (6th Cir. 2000).

49. *Cook*, 210 F.3d at 654.

50. *Id.* at 658.

51. *Id.*

52. See *California Bagel Co.*, 2 Bus. Franchise Guide (CCH) ¶ 11,880.

of franchisor's employees regarding the profits of its existing franchisees. The Offering Circular provided to the prospective franchisee specifically stated that "American Bagel does not furnish or authorize its sales persons to furnish any oral or written information concerning the actual or potential sales, costs, income, or profit of a Chesapeake Bagel Bakery. Actual results vary from unit to unit and American Bagel can not estimate the results of any particular franchise."<sup>53</sup>

### III. CONTRACTUAL CHOICE OF FORUM

The use and enforcement of forum selection clauses in commercial contracts have increased dramatically since the United States Supreme Court's decision in *M/S Bremen v. Zapata Off-Shore Co.*,<sup>54</sup> which held that forum selection clauses are valid and enforceable as long as enforcement would not be unreasonable. Despite this decision and the fact that most state courts have held that such clauses are valid and enforceable,<sup>55</sup>

53. *Id.*

54. 407 U.S. 1, 10-11 (1972).

55. *E.g.*, Prof'l Ins. Corp. v. Sutherland, 700 So. 2d 347 (Ala. 1997); Volkswagenwerk, A.G. v. Klipann, 611 P.2d 498 (Alaska 1980); Societe Jean Nicolas et Fils, J.B. v. Mousseux, 597 P.2d 541 (Ariz. 1979); ABC Mobile Sys., Inc. v. Harvey, 701 P.2d 137 (Colo. Ct. App. 1985); Phoenix Leasing, Inc. v. Kosinski, 707 A.2d 314 (Conn. App. Ct. 1998); Elia Corp. v. Paul N. Howard Co., 391 A.2d 214 (Del. Super. Ct. 1978); Manrique v. Fabbri, 493 So. 2d 437 (Fla. 1986); Antec Corp. v. Popcorn Channel, L.P., 482 S.E.2d 509 (Ga. Ct. App. 1997); Cerami-Kote, Inc. v. Energywave Corp., 773 P.2d 1143 (Idaho 1989); Horner v. Tilton, 650 N.E.2d 759 (Ind. Ct. App. 1995); Vanier v. Ponsoldt, 833 P.2d 949 (Kan. 1992); Prezocki v. Bullock Garages, Inc., 938 S.W.2d 888 (Ky. 1997); Lejano v. Bandak, 705 So. 2d 158 (La. 1997); Soc'y of Lloyd's v. Baker, 673 A.2d 1336 (Me. 1996); Gilman v. Wheat, First Sec., Inc., 692 A.2d 454 (Md. 1997); Jacobson v. Mailboxes Etc. U.S.A., Inc., 646 N.E.2d 741 (Mass. 1995); Hauenstein & Bermeister, Inc. v. Met-Fab Indus., Inc., 320 N.W.2d 886 (Minn. 1982); High Life Sales Co. v. Brown-Forman Corp., 823 S.W.2d 493 (Mo. 1992); Woodmen of the World Life Ins. Soc'y v. Yelich, 549 N.W.2d 172 (Neb. 1996); Tandy Computer Leasing v. Terina's Pizza, Inc., 784 P.2d 7 (Nev. 1989); Dancart Corp. v. St. Albans Rubber Co., 474 A.2d 1020 (N.H. 1984); Brooke Group Ltd. v. JCH Syndicate 488, 663 N.E.2d 635 (N.Y. 1996); Perkins v. CCH Computax, Inc., 423 S.E.2d 780 (N.C. 1992); Kennecorp Mortgage Brokers, Inc. v. Country Club Convalescent Hosp., Inc., 610 N.E.2d 987 (Ohio 1993); Central Contracting Co. v. C.E. Youngdahl & Co., 209 A.2d 810 (Pa. 1965); Bakhsh v. Jacrc Enters., Inc., 895 P.2d 746 (Okla. Ct. App. 1995); Prows v. Pinpoint Retail Sys., Inc., 868 P.2d 809 (Utah 1993); Chase Commercial Corp. v. Barton, 571 A.2d 682 (Vt. 1990); Paul Bus. Sys., Inc. v. Cannon U.S.A., Inc., 397 S.E.2d 804 (Va. 1990); Gen. Elec. Co. v. Keyser, 275 S.E.2d 289 (W. Va. 1981); Durdahl v. Nat'l Safety Assocs., Inc., 988 P.2d 525 (Wyo. 1999).

Federal courts have also held such clauses to be valid and enforceable. *E.g.*, *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 10-11 (1972); Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991); Crescent Int'l, Inc. v. Avatar Communities, Inc. 857 F.2d 943 (3rd Cir. 1988); Int'l Software Sys., Inc. v. Amplicon, Inc., 77 F.3d 112 (5th Cir. 1996); M.B. Rests., Inc. v. CKE Rests., Inc., 183 F.3d 750 (8th Cir. 1999); Manetti-Farrow, Inc. v. Gucci Am., Inc., 858 F.2d 509 (9th Cir. 1988); Smith v. Prof'l Claims, Inc., 19 F. Supp. 2d 1276 (M.D. Ala. 1998); Reo Sales, Inc. v. Prudential Ins. Co. of Am., 925 F. Supp. 1491 (D. Colo. 1996); Res. Ventures, Inc. v. Res. Mgmt. Int'l, Inc., 42 F. Supp. 2d 423 (D. Del. 1999); Amermed Corp. v. Disetronic Holding AG, 6 F. Supp. 2d 1371 (N.D. Ga. 1998); Talatala v. Nippon Yusen Kaisha Corp., 974 F. Supp. 1321 (D. Haw. 1997); Deans v. Tutor Time Child Care Sys., Inc., 982 F. Supp. 1330 (S.D. Ind. 1997); Fed. Gasohol Corp. v. Total Phone Mgmt., Inc., 24 F. Supp. 2d 1149 (D. Kan. 1998); Creditors Collection Bureau, Inc. v. Access Data, Inc., 820 F. Supp. 311 (W.D. Ky. 1993); Rooney v. Biomet, Inc., 63 F. Supp. 2d 126 (D. Mass. 1999); Knutson v. Rexair, Inc., 749 F. Supp. 214 (D. Minn. 1990); Galli v.

there continues to be litigation concerning the enforcement of such clauses at both the state and federal level. In addition, because many franchisors require that their franchise agreements contain forum selection clauses, much of the recent litigation has been in the franchisor-franchisee context. This Survey period was no exception as courts at both the state and federal level reviewed the enforcement of forum selection clauses in the context of the franchisor-franchisee relationship.

#### A. ENFORCEMENT OF FORUM SELECTION CLAUSES

##### 1. State Cases

The Wyoming Supreme court held that forum selection clauses are prima facie valid in *Durdahl v. Nat'l Safety Assocs., Inc.*<sup>56</sup> In *Durdahl*, a distributor filed suit against a manufacturer in Wyoming ignoring the forum selection clause in the parties' agreement naming Shelby County, Tennessee as the exclusive jurisdiction for adjudicating disputes involving the agreement between the parties.<sup>57</sup> The court rejected the distributor's arguments against enforcing the clause. The court held, in part, that mutuality of obligation cannot be a defense when a contract is supported by adequate consideration.<sup>58</sup> The fact that causes of action arose prior to the execution of a forum selection clause did not affect the validity of the forum selection clause as the parties can limit the forum in which a cause of action will be brought after the cause of action has materialized.<sup>59</sup> The court also held that the forum selection clause did apply to fraud claims, as they arose out of the contractual relationship.<sup>60</sup> Finally, the court refused to speculate whether the parties were able to negotiate and held that in the absence of contrary evidence, the contract was not a contract of adhesion.<sup>61</sup>

In Texas, an appellate court enforced a forum selection clause at the request of the franchisee, despite claims that the rights to enforce the clause were waived. In *Wallpapers To Go, Inc. v. Brennan*,<sup>62</sup> the franchisor brought suit in Texas state court for breach of the franchise agreement. The franchise agreement contained a forum selection clause that provided litigation between the parties could only be brought in the

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Travelhost, Inc., 603 F. Supp. 1260 (D. Nev. 1985); Republic Mortgage Ins. Co. v. Brightware, Inc., 35 F. Supp. 2d 482 (M.D.N.C. 1999); Shell v. R.W. Sturge Ltd., 850 F. Supp. 620 (S.D. Ohio 1993); Bryfogle v. Carvel Corp., 666 F. Supp. 730 (E.D. Pa. 1987); Scott v. Guardsmark Sec., 874 F. Supp. 117 (D.S.C. 1995); Tex. Source Group, Inc. v. CCH, Inc., 967 F. Supp. 234 (S.D. Tex. 1997); Berrett v. Life Ins. Co. of the Southwest, 623 F. Supp. 946 (D. Utah 1985); JPS Elastomerics Corp. v. Indus. Tools, Inc., 65 F. Supp. 2d 376 (W.D. Va. 1998); Gen. Ins. Co. of Am. v. Fort Lauderdale P'ship, 740 F. Supp. 1483 (W.D. Wash. 1990); P.M. Enters. v. Color Works, Inc., 946 F. Supp. 435 (S.D. W. Va. 1996).

56. 988 P.2d 525 (Wyo. 1999).

57. *Id.* at 526.

58. *Id.* at 528-29.

59. *See id.*

60. *Id.* at 529.

61. *Id.*

62. No. 14-98-00482-CV, 1999 Tex. App. LEXIS 7237 (Tex. App.—Houston [14th Dist.] Sept. 30, 1999) (not designated for publication).

federal district court nearest to the then-current home office of franchisor.<sup>63</sup> The court rejected the franchisor's argument that the franchisee had waived the right to enforce the forum selection clause, holding that the franchisor was attempting to turn a contractual issue into a jurisdictional issue.<sup>64</sup> The court found that the franchisee did not waive its right to enforce the forum selection clause by filing a special appearance and not filing a motion to remove. The court also held that franchisee followed the proper procedure in first withdrawing his special appearance and then filing a motion to dismiss. The court held that franchisee's motion to dismiss was the proper vehicle for invocation of the forum selection clause.<sup>65</sup> The court affirmed the trial court's dismissal and enforced the forum selection clause.

In *B & R Mgmt. & Leasing Corp. v. Triarc Rest. Group*,<sup>66</sup> the New York Supreme Court enforced a similar forum selection clause; however, the choice of forum was applied only to those causes that were related to the franchise agreements. In *B & R Mgmt.*, the franchisor terminated four franchises for failure to make contractually-fixed contributions to an advertising cooperative. The franchise agreement contained a forum selection provision that provided any suit must be filed where franchisor's principal office was then located.<sup>67</sup> The court held it was the policy of New York to enforce contractual forum selection provisions in the absence of a showing of fraud, overreaching, unreasonableness or unfairness, or that enforcement would contravene a strong public policy.<sup>68</sup> The court enforced the forum selection clause but dismissed only those causes of action that related to the franchise agreements as plaintiff failed to present sufficient evidence to invalidate the clauses.<sup>69</sup>

Finally, in *Pepe v. GNC Franchising, Inc.*,<sup>70</sup> the court upheld a forum selection clause as to those causes of action not protected by Connecticut statute. The franchisee filed suit in Connecticut alleging breach of contract, unfair trade practice, violations of Connecticut statutes, and violation of Connecticut's Unfair Trade Practices Act. The franchisor moved to dismiss based upon the forum selection clause requiring that the case be brought in Pennsylvania.<sup>71</sup> The court noted that the general rule in Connecticut is that a forum selection clause is valid and enforceable "absent a strong showing that it should be set aside."<sup>72</sup> However, a Connecticut statute protects a franchisee's right to bring action under certain

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63. *Id.* at \*2.

64. *Id.* at \*6.

65. The court noted that the franchisee did not submit to the jurisdiction of the state court prior to filing its motion to dismiss. Franchisee entered only a special appearance and did not conduct discovery until after withdrawing the special appearance and filing a motion to dismiss. *Id.* at \*8.

66. 269 A.D.2d 804 (N.Y. App. Div. 2000).

67. *Id.* at 805.

68. *Id.*

69. *Id.*

70. 750 A.2d 1167 (Conn. Super. Ct. 2000).

71. *Id.* at 1168.

72. *Id.* at 1167-68.

Connecticut statutes in Connecticut state court. As franchisees asserted a claim for violation of statutes protected by the Connecticut law, the court refused to dismiss that claim. The court did, however, dismiss all other claims pursuant to the forum selection clause as the franchisee failed to present any evidence of fraud or overreaching. The court noted that, had the Connecticut legislature wished to invalidate all forum selection clauses, it could have easily done so.<sup>73</sup> Thus, the enforcement of the forum selection clause as to all other claims was not contrary to public policy.

## 2. Federal Cases

Two cases in the Survey period limited the reach of *Kubis & Perszyk Assocs., Inc. v. Sun Microsystems, Inc.*<sup>74</sup> In *Kubis*, the New Jersey Supreme Court held that forum selection clauses selecting another state are presumptively invalid in franchise cases. The New Jersey District Court first limited the reach of *Kubis* in *Cadapult Graphic Sys., Inc. v. Tektronix, Inc.*<sup>75</sup>

In *Cadapult*, the agreement between the parties contained a forum selection clause mandating that any litigation be brought in Oregon. The plaintiff filed suit in New Jersey claiming violation of the New Jersey Franchise Practices Act on a different agreement, breach of contract, and various federal and state statutory violations.<sup>76</sup> The defendant moved to dismiss or transfer the case based on the forum selection clause. The court held that a forum section clause in diversity cases is interpreted by federal law. While state policy is a factor in evaluating the forum selection clause's validity, it is not dispositive.<sup>77</sup> The plaintiff argued that under the holding in *Kubis*, the forum selection clause would violate strong public policy in New Jersey. The court disagreed, holding that *Kubis* was limited to cases in which a "plaintiff asserts a valid claim under the Franchise Practices Act."<sup>78</sup> The court held that plaintiff failed to bring valid claims under the Franchise Practices Act. The court additionally examined whether the forum selection clause was invalid due to uneven bargaining positions. The court held that the "fear" of plaintiff to negotiate the agreement's provisions with Tektronix did not substantiate an uneven bargaining position.<sup>79</sup> Thus, the court enforced the forum selection clause and transferred the case to Oregon.

The second case that limited the reach of *Kubis* was *Park Inn Int'l, L.L.C. v. Mody Enters., Inc.*<sup>80</sup> In *Park Inn*, a hotel franchisor filed suit against a franchisee in federal court in New Jersey for breach of the

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73. *Id.* at 1169.

74. 680 A.2d 618 (N.J. 1996).

75. 98 F. Supp. 2d 560 (D.N.J. 2000).

76. *Id.* at 562.

77. *Id.* at 565.

78. *Id.* at 566.

79. *Id.* at 568.

80. 105 F. Supp. 2d 370 (D.N.J. 2000).

franchise agreement. The franchise agreement included a forum selection clause designating New Jersey as the proper forum for disputes. The franchisee moved to dismiss for lack of personal jurisdiction and for improper venue. The court held that where the validity of a clause is challenged, it is analyzed under state law.<sup>81</sup> The court noted that forum selection clauses are commonly found to be prima facie valid and enforceable when the New Jersey Franchise Practices Act is not implicated. The court held the instant case was not subject to the New Jersey Franchise Practices Act as the Act "applies only[ ] to a franchise[ ] the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the State of New Jersey."<sup>82</sup> Furthermore, the court held that the presumption in *Kubis* is inapplicable to out-of-state franchise agreements. New Jersey public policy will not support an extension to out-of-state agreements, nor would such an extension further the purposes of the statute.<sup>83</sup>

The franchisee's other claims were rejected. The court held that the failure to read a contract will not excuse enforcement of its provisions. In addition, the court held that the absence of negotiations over the clause will not affect the provision's validity. Finally, the court rejected a claim that the clause was unfair due to the franchisee's lack of sophistication, noting that the franchisee successfully owned and operated several hotels. Consequently, the court found the forum selection clause valid and enforceable and that defendants thereby contractually consented to the jurisdiction of New Jersey courts.

The last federal case in the Survey period to enforce a forum selection clause employs the analysis in *M/S Bremen*.<sup>84</sup> The court in *Eisaman v. Cinema Grill Sys., Inc.*,<sup>85</sup> followed the analysis in *M/S Bremen* after determining that Georgia law, the law selected in the choice of law provision, applied to the forum selection clause. The court first examined whether the forum selection clause was mandatory or permissive.<sup>86</sup> While the clause at issue could be considered permissive as to the franchisor, who was given authority to choose the jurisdiction of any suit, the court concluded that the provision was mandatory because it required franchisee to submit to the jurisdiction chosen by the franchisor.<sup>87</sup> Second, the court determined that enforcement would be reasonable in the instant case. The court dismissed the claims without prejudice to refile in the contractual forum.

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81. *Id.* at 373 (citing *Gen. Eng'g Corp. v. Martin Marietta Alumina, Inc.*, 783 F.2d 352, 356-57 (3d Cir. 1986)).

82. *Id.* at 374 (brackets in the original).

83. *Id.*

84. 407 U.S. 1 (1972).

85. 87 F. Supp. 2d 446 (D. Md. 1999).

86. *Id.* at 449.

87. *Id.* at 450.



## B. REFUSAL TO ENFORCE FORUM SELECTION CLAUSES

1. *State Cases*

During the Survey period, the Texas Supreme Court had an opportunity to address the enforcement of forum selection clauses in a mandamus proceeding styled *In re GNC Franchising, Inc.*<sup>88</sup> Unfortunately, the majority of the court chose not to provide any such clarification and denied the mandamus without stating its reasons. However, a dissenting opinion authored by Justice Hecht and joined by Justice Owen did provide guidance on how the court might address the issue in the future.

*In re GNC Franchising* involved a dispute between four Texas franchisees and their franchisor, GNC Franchising, Inc., a Pennsylvania corporation.<sup>89</sup> The franchise agreements between the parties provided that any action brought by the franchisee against the franchisor shall be brought only within the Commonwealth of Pennsylvania in the judicial district in which the franchisor has its principal place of business.<sup>90</sup> Despite the forum selection clauses, the franchisees and their respective business entities filed suit in a district court in Houston, Texas, against GNC Franchising, Inc., a related GNC entity and two individual GNC employees (collectively GNC). The petition alleged causes of action for fraudulent inducement, fraud, intentional infliction of emotional distress, negligent misrepresentation, and violations of the Texas Deceptive Trade Practices-Consumer Protection Act and the Texas Free Enterprise and Antitrust Act.<sup>91</sup> In response, GNC filed a motion to dismiss the franchisees' claims pursuant to the forum selection clause designating Pennsylvania as the forum for any actions brought by a franchisee.<sup>92</sup> The district court denied the motion, and GNC filed Petition of Writ of Mandamus in the First District Court of Appeals.<sup>93</sup> The Court of Appeals denied the petition in a one page opinion but did not state the reasons for the denial.<sup>94</sup> GNC subsequently filed its Petition for Writ of Mandamus with the Texas Supreme Court. A majority of the Texas Supreme Court denied the Petition but did not state the reason for the denial; thus, the

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88. 22 S.W.3d 929 (Tex. 2000). The majority of Texas appellate courts have found forum selection clauses to be generally enforceable. *E.g.*, *Abacan Technical Servs. Ltd. v. Global Marine Int'l Servs. Corp.*, 994 S.W.2d 839, 843 (Tex. App.—Houston [1st Dist.] 1999, no pet.); *Southwest Intelcom, Inc. v. Hotel Networks Corp.*, 997 S.W.2d 322, 324 (Tex. App.—Austin 1999, pet. denied); *Accelerated Christian Educ., Inc. v. Oracle Corp.*, 925 S.W.2d 66, 70 (Tex. App.—Dallas 1996, no writ); *Busse v. Pacific Cattle Feeding Fund #1, Ltd.*, 896 S.W.2d 807, 812-13 (Tex. App.—Texarkana 1995, writ denied); *Greenwood v. Tillamook Country Smoker, Inc.*, 857 S.W.2d 654, 657 (Tex. App.—Houston [1st Dist.] 1993, no writ); *Barnette v. United Research Co.*, 823 S.W.2d 368, 369 (Tex. App.—Dallas 1991, writ denied).

89. *In re GNC Franchising*, 22 S.W.3d at 929.

90. *Id.*

91. *Id.* at 930.

92. *Id.*

93. *In re GNC Franchising, Inc.*, No. 01-99-01013-CV, 1999 Tex. App. LEXIS 7022 (Houston [1st Dist.] Sept. 16, 1999, pet. denied).

94. *Id.*

reason for the denial is open to speculation.<sup>95</sup> The dissenting opinion, authored by Justice Hecht and joined by Justice Owen, stated that the forum selection clauses at issue were valid and enforceable and that the trial judge's decision was subject to mandamus. The dissent further addressed the arguments raised by the franchisees against enforcement of the forum selection clauses.

The franchisees argued that the forum selection clauses were invalid because the franchisees had alleged that the franchise agreements were fraudulently induced. The dissent, citing the United States Supreme Court's decision in *Scherk v. Alberto-Culver Co.*,<sup>96</sup> noted that in order for a forum selection clause to be rendered invalid by fraud, the clause itself must be fraudulently induced.<sup>97</sup> The dissent further stated that "any other rule would permit the party to a contract to escape a forum selection provision merely by asserting a misrepresentation relating to some aspect of the agreement."<sup>98</sup> In a related argument, the franchisees also argued that the forum selection clauses should not apply to the tort and statutory claims they had asserted. In response the dissent stated:

Some Texas courts have stated that forum-selection clauses should not apply to tort and statutory claims,<sup>99</sup> but others have indicated that such claims are subject to a forum—selection clause if they arise out of the parties' contractual relationship.<sup>100</sup> The latter courts are correct; otherwise a party could escape a forum-selection clause merely by adding some noncontractual claim to his pleadings.<sup>101</sup>

The franchisees claimed that the expense and inconvenience to them of litigation in Pennsylvania makes the enforcement of the forum selection clauses unreasonable. The dissent responded by stating that:

But there is no indication that it would not be at least as expensive and inconvenient for GNC to litigate in Texas. If they read their agreements when they signed them, as must be assumed, the franchisees knew that they were obligating themselves to litigate disputes with GNC in Pennsylvania. The fact that they no longer like the deal is no more reason to excuse them from the forum-selection clause than from any other provision of their agreements.<sup>102</sup>

Finally, the dissent contended that the trial court's decision was subject to mandamus arguing that even if GNC prevailed after a trial on appeal,

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95. *In re GNC Franchising*, 22 S.W.3d at 929.

96. 417 U.S. 506, 519 n.14 (1974).

97. *In re GNC Franchising*, 22 S.W.3d at 930.

98. *Id.*

99. *Citing* Southwest Intelecom, Inc. v. Hotel Networks Corp., 997 S.W.2d 322 (Tex. App.—Austin 1999, pet. denied); *Busse v. Pacific Cattle Feeding Fund #1, Ltd.*, 896 S.W.2d 807 (Tex. App.—Texarkana 1995, writ denied); *Pozero v. Alfa Travel, Inc.*, 856 S.W.2d 243 (Tex. App.—San Antonio 1993, no writ).

100. *Citing* Accelerated Christian Educ., Inc. v. Oracle Corp., 925 S.W.2d 66 (Tex. App.—Dallas 1996, no writ); *Greenwood v. Tillamook Country Smoker, Inc.*, 857 S.W.2d 654, 657 (Tex. App.—Houston [1st Dist.] 1993, no writ); *Barnette v. United Research Co.*, 823 S.W.2d 368 (Tex. App.—Dallas 1991, writ denied).

101. *In re GNC Franchising, Inc.*, 22 S.W.3d at 930.

102. *Id.* at 931.

it would have lost forever the right for which it contracted.<sup>103</sup> The dissent reasoned that an agreement to have disputes resolved in the courts of a certain state is no different from an agreement to have disputes resolved by arbitration, and the refusal to enforce an agreement to arbitrate is subject to mandamus.<sup>104</sup>

## 2. Federal Cases

Texas federal courts have enforced forum selection clauses in the franchisor-franchisee context,<sup>105</sup> but the analysis has been fact specific. As seen in this Survey period, varied facts can result in the court refusing to enforce the clause even though the court has found the clause to be valid. The United States District Court for the Eastern District of Texas recently refused to enforce just such a forum selection clause in *Brock v. Baskin-Robbins USA Co.*<sup>106</sup>

In *Brock*, a diversity action, approximately forty-seven Baskin-Robbins franchisees (including the shareholders of certain corporate franchisees), located in New Mexico, Texas, Louisiana, Mississippi, and Alabama sued Baskin-Robbins Co. and Baskin-Robbins, Inc. in Texas. Their suit alleged thirteen causes of action including fraud, fraud in the inducement, claims under various state consumer protection laws, intentional interference with contractual relations, breach of implied covenants of good faith and fair dealing, breach of fiduciary duty, and conversion.<sup>107</sup> In response, Baskin-Robbins filed a motion to dismiss with respect to certain plaintiffs based on forum selection clauses contained in the parties' franchise agreements and a motion to transfer venue with respect to the remaining plaintiffs whose franchise agreements did not contain a forum selection clause.<sup>108</sup>

In reviewing the motion, the court first set out the standard for seeking the enforcement of a forum selection clause where jurisdiction is based on diversity. The court stated:

Therefore, in the context of a federal court sitting in diversity, when a forum selection clause allows the parties to bring the action in another federal court and venue is proper under section 1391 in the district court where the action is presently pending, the district court should apply the standards of section 1404(a) rather than the standard in *Bremen*.<sup>109</sup>

However, before the court applied the relevant factors to the 1404(a) analysis, the court first made a determination as to whether or not the forum selection clauses were valid. Relying on *Scherk v. Alberto-Culver*

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103. *Id.*

104. *Id.* (citing *Jack B. Anglin Co. v. Tipps*, 842 S.W.2d 266, 272-73 (Tex. 1992)).

105. *See Brock v. Entre Computer Ctrs., Inc.*, 740 F. Supp. 428, 431 (E.D. Tex. 1990).

106. 113 F. Supp. 2d 1078 (E.D. Tex. 2000).

107. *Id.* at 1080.

108. *Id.*

109. *Id.* at 1084 (citing *Stewart Org., Inc. v. Ricoh Corp.*, 487 U.S. 22, 28-29 (1988)).

*Co.*,<sup>110</sup> the court noted that fraud will not invalidate a forum selection clause unless the inclusion of the forum selection itself was the product of fraud or coercion.<sup>111</sup> Under this analysis, the court held that the clauses were valid even in light of the plaintiffs' claims that they signed the franchise agreements in duress.<sup>112</sup> The court next applied the 1404(a) factors to the facts of the case.

In reviewing the 1404(a) factors, the court first focused on the relative bargaining power of the parties. Based on various affidavits from certain plaintiffs, the court concluded that the plaintiffs were in no position to bargain.<sup>113</sup> Although the court stated that this fact alone was not dispositive, it did reduce the weight the court gave the forum selection clauses.<sup>114</sup> In addition, the court recognized a problem with the forum designated by the forum selection clauses at issue. The clause appeared to designate the principal place of business of Baskin-Robbins as the appropriate forum, but later references listed the Middle District of California as the principal place of business. However, at the time of the litigation, Baskin-Robbins' principal place of business had changed to Massachusetts.<sup>115</sup> In addition, the court noted that Baskin-Robbins had not provided evidence concerning the inconvenience to the witnesses if the case were to remain in Texas. These facts again weighed against enforcement of the clause because Baskin-Robbins was arguing for a transfer to California. The court next rejected Baskin-Robbins' arguments concerning the accessibility of the proof. Baskin-Robbins had argued that most of the documents would be located in California and Massachusetts and that many depositions would be out of state. The court stated that it failed to see how these facts would support a transfer to California. The court further took into account the fact that some of the plaintiffs' franchise agreements did not contain forum selections clauses and this fact weighed heavily in favor of retaining the case in Texas.<sup>116</sup> The court finally reviewed the public interest factors finding that they favored keeping the case in Texas.<sup>117</sup> Based on this analysis, the court held that Baskin-Robbins failed to carry its burden and show the court that the case should be transferred to California. The court summarized its analysis by stating:

While a majority of the Plaintiffs have a valid forum-selection clause in their contracts, these contracts were not the result of equal bargaining power. Furthermore, other than the forum-selection clause, Defendants have presented no evidence to the Court indicating that the Middle District of California is more convenient or less burden-

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110. 417 U.S. 506, 519 n.14 (1974).

111. Brock v. Baskin-Robbins USA Co., 113 F. Supp. 2d 1078, 1087 (E.D. Tex. 2000).

112. *Id.*

113. *Id.* at 1087-88.

114. *Id.* at 1088.

115. *Id.*

116. Brock v. Baskin-Robbins USA Co., 113 F. Supp. 2d 1078, 1089-90 (E.D. Tex. 2000).

117. *Id.* at 1090-91.

some. Evidence presented by the Plaintiffs, on the other hand, tends to demonstrate that it is a less convenient forum. Plaintiffs identified several key witnesses who reside in Texas. Several of these witnesses and many Plaintiffs live within driving distance of the Court. These facts, along with the inequality of bargaining power between the Plaintiffs and Defendants, tend to neutralize the presumption set up by the forum-selection clauses.

Other factors favor keeping the case in the Eastern District of Texas. The Plaintiffs whose contracts do not contain forum-selection clauses are entitled to have their choice of forum honored, and judicial economy is best served by keeping these cases together. In addition, the citizens of the Eastern District have a substantial interest in the outcome of this case as it affects the lives of their fellow citizens.<sup>118</sup>

The court therefore denied the motion to dismiss and transfer and it did not enforce the forum selection clauses.

In California, a federal district court refused to enforce a forum selection clause contained in a GNC franchise agreement because the clause contravened California's strong public policy against such provisions.<sup>119</sup> In response, GNC Franchising, Inc. petitioned for permission to appeal the district court's decision to the Ninth Circuit pursuant to 28 U.S.C. §1292(b) and Federal Rule of Appellate Procedure 5. Permission was granted.<sup>120</sup> In *Jones v. GNC Franchising, Inc.*, the Ninth Circuit began its analysis by stating that federal law governs the analysis of the effect and scope of forum selection clauses in diversity cases.<sup>121</sup> The court stated that it had previously held that the rules set forth by the United States Supreme Court in *M/S Bremen v. Zapata Off-Shore Co.* would control the consideration of a motion to dismiss for improper venue based on a forum selection clause. In further discussing the *Bremen* decision, the court noted that the Supreme Court previously held that "a contractual forum selection clause is unenforceable if enforcement would contravene a strong public policy of a forum in which suit is brought, whether declared by statute or by judicial decision."<sup>122</sup> The strong California public policy at issue in the case was a statute in the California Business and Professional Code which provides: "A provision in a franchise agreement restricting venue to a forum outside this state is void with respect to any claim arising under or relating to a franchising agreement involving a franchise business operating within this state."<sup>123</sup> In reviewing this statute, the Ninth Circuit found that the statute stated a strong California state interest against forcing California franchises to litigate in non-California forums due to forum selection clauses.<sup>124</sup> The court therefore held

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118. *Id.* at 1091.

119. *Jones v. GNC Franchising, Inc.*, 211 F.3d 495, 497 (9th Cir. 2000).

120. *Id.*

121. *Id.*

122. *Id.* (citing *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972)).

123. *Id.* (citing CAL. BUS. & PROF. CODE § 20040.5 (West 1997)).

124. *Jones v. GNC Franchising, Inc.*, 211 F.3d at 498.

that the district court did not err in its refusal to enforce the forum selection clause. In this regard the court stated:

We conclude and hold that § 20040.5 expresses a strong public policy of the state of California to protect California franchisees from the expense, inconvenience, and possible prejudice of litigating in a non-California venue. A provision, therefore, that requires a California franchisee to resolve claims related to the franchise agreement in a non-California court directly contravenes this strong public policy and is unenforceable under the directives of *Breman*.<sup>125</sup>

Accordingly, the court upheld the district court's order denying GNC's motion to dismiss or transfer the action.

#### IV. CHOICE OF LAW

Courts continue to apply the approach in Restatement (Second) of Conflict of Laws § 187(2), or a variation thereof adopted by the state, in determining the validity of a choice of law provision in franchise agreements. The Restatement allows for enforcement of a choice of law provision, provided: (1) there is a substantial relationship between the chosen forum and the parties or transaction; or (2) enforcement would not violate a fundamental public policy of the state with the greatest material interest in the particular issue.

In Michigan in *Grand Kensington, LLC v. Burger King Corp.*,<sup>126</sup> the court denied a franchisor's motion to dismiss based on the choice of law provision. The court examined the validity of the provision under the Restatement (Second) of Conflict of Laws § 187(2) adopted by Michigan.<sup>127</sup> The court noted that it must be cautious when invalidating a choice of law provision and that a difference in result depending upon which law is applied does not show a violation of a state's fundamental public policy.

Under the Restatement's analysis, the court first determined that a substantial relationship existed with the chosen forum, Florida, because the defendant maintained its corporate headquarters there.<sup>128</sup> The court then compared the franchise statutes of Michigan<sup>129</sup> and Florida,<sup>130</sup> focusing on whether application of the Florida law would "substantially erode 'the quality of protection that the MFIL would otherwise apply.'"<sup>131</sup> The court concluded that under Florida law, the plaintiffs would be unable to maintain a cause of action. Furthermore, the plaintiff would

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125. *Id.*

126. 81 F. Supp. 2d 834 (E.D. Mich. 2000).

127. The Michigan Franchise Investment Law does not invalidate choice of law provisions. MICH. COMP. LAWS ANN. § 445.1527 (West 1989); *Banek Inc. v. Yogurt Ventures, U.S.A., Inc.*, 6 F.3d 357, 360 (6th Cir. 1993).

128. *Grand Kensington*, 81 F. Supp. 2d at 838.

129. Michigan Franchise Investment Law, MICH. COMP. LAWS ANN. § 445.1505 (West 1989).

130. FLA. STAT. ANN. § 817.416(2) (West 2000).

131. *Grand Kensington*, 81 F. Supp. 2d at 838 (quoting *Banek Inc.*, 6 F.3d at 362).

not fall within the literal interpretation of the Florida statute.<sup>132</sup> The court concluded that the protections afforded to the franchisee would be substantially eroded by the application of Florida law and would, therefore, contravene a fundamental public policy of Michigan. The court invalidated the choice of law provision and applied Michigan law.<sup>133</sup>

The district court in New York also refused to enforce a choice of law provision in *LaGuardia Ass'n v. Holiday Hospitality Franchising, Inc.*<sup>134</sup> *LaGuardia* involved a hotel franchise agreement designating Tennessee law as the applicable law. The court began its analysis by observing that in determining the validity of a choice of law provision in a diversity case, the state law of the jurisdiction should be used. Under New York law, a contract dispute must be governed by the law of the state with the most significant contacts to the contract.<sup>135</sup> However, the New York rule gives way to a contractual choice of law provision provided that the selected state has a substantial relationship to the parties or transaction and enforcing the chosen state law will not violate fundamental New York public policy.

The court concluded that Tennessee did not have a substantial relationship to the parties or the transaction. The court noted that Holiday drafted the agreement, naming Tennessee law in the choice of law provision. Tennessee, at the time the contract was formed, was the home-state of Holiday. However, Holiday later moved its corporate headquarters to Atlanta, Georgia, eliminating the necessary contact for enforcement of the choice of law provision.<sup>136</sup> The court held that the "reasonable relationship" of the chosen state to the agreement must exist at the time of the contract dispute, and not merely at some period in the past.<sup>137</sup> The court concluded that no hardship would be suffered by refusal to enforce the provision as Holiday itself authored the provision and eliminated its validity through its own actions.

Finally, in an unpublished opinion, the Ninth Circuit enforced a choice of law provision in *Mail Boxes Etc., USA, Inc. v. Considine*.<sup>138</sup> The choice of law provision stated: "This agreement is to be construed under and

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132. *Id.* at 839. While the literal interpretation limits those protected by the statute to Florida franchisees, the court held that whether the courts would allow plaintiff to avail himself of the statute was questionable. However, three out of four district courts in Florida permitted a non-Florida franchisee to avail themselves of the Florida statute. *Dickinson v. Executive Bus. Group, Inc.*, 983 F. Supp. 1395, 1397 (M.D. Fla. 1997) (Texas franchisee may have valid claim under FFA); *Burger King Corp. v. Holder*, 844 F. Supp. 1528, 1531 (S.D. Fla. 1993) (FFA applies since Franchisor does business in Florida); *Burger King Corp. v. Austin*, 805 F. Supp. 1007, 1022-23 (S.D. Fla. 1992) (Because choice of law provided for application of Florida law, FFA applies). *But see Barnes v. Burger King Corp.*, 932 F. Supp. 1441, 1443 (S.D. Fla. 1996) (FFA applies only to persons who conduct business in Florida).

133. *Grand Kensington*, 81 F. Supp. 2d at 839-40. The court determined Michigan law was proper using the analysis of the Restatement (Second) of Conflict of Laws § 188(2).

134. 92 F. Supp. 2d 119 (E.D.N.Y. 2000).

135. *Id.* at 127 (citing *Schwimmer v. Allstate Ins. Co.*, 176 F.3d 648, 650 (2d Cir. 1999)).

136. *Id.* at 127-28.

137. *Id.* at 127 (emphasis omitted).

138. No. 99-35901, 2000 U.S. App. LEXIS 16185 (9th Cir. July 11, 2000).

governed by the laws of the State of California except where inconsistent or in conflict with the laws of the State of Washington.”<sup>139</sup> The court noted that in diversity cases, the federal courts use the state conflicts law of the jurisdiction. Applying Washington conflicts law, the court noted Washington law enforced express choice of law provisions, unless to do so would violate a fundamental public policy of the state.<sup>140</sup> The court examined Washington law and determined it did not have a fundamental public policy regarding covenants not to compete, which formed the basis of the dispute.<sup>141</sup>

The courts, however, are not always in agreement. In *Fendi S.r.l. v. Condotti Shops, Inc.*,<sup>142</sup> the court addressed the relationship between a choice of law provision and a forum selection provision in a franchise agreement. In *Fendi*, the franchise agreement between an Italian leather goods manufacturer and a boutique contained both a forum selection clause and a choice of law clause. The agreement called for all disputes or controversies arising from “the interpretation and the execution of [the] contract” to be interpreted under Italian law and brought in the courts in Rome.<sup>143</sup> The Florida Court of Appeals held that the validity of the forum selection clause must be determined using the law of the forum, not the law of the forum chosen in the agreement. The court relied on a majority of jurisdictions that have held the question of a forum selection clause’s validity is a procedural question, determined through application of the law of the forum.<sup>144</sup> The court also noted that the Florida Supreme Court, in *Manrique v. Fabbri*,<sup>145</sup> applied the law of the forum in determining the validity of a forum selection clause where both forum selection and choice of law provisions were included in a licensing agreement.<sup>146</sup> Thus, the court concluded that, when confronted with combined forum selection and choice of law provisions, Florida courts must “construe the forum selection clause without reference to the choice of law provision.”<sup>147</sup>

In direct contrast, the court in *Eisaman v. Cinema Grill Sys., Inc.*<sup>148</sup> held that the validity of a forum selection clause should be determined under the law of the forum chosen in a connected choice of law provision. The court concluded that when the parties choose the law of a particular

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139. *Id.* at \*4.

140. *Id.* at \*5.

141. The court also examined California law, the law of the chosen forum, and determined that California did have a public policy that invalidated covenants not to compete. See *Scott v. Snelling & Snelling*, 732 F. Supp. 1034, 1039-40 (N.D. Cal. 1990).

142. 754 So. 2d 755 (Fla. Dist. Ct. App. 2000).

143. *Id.* at 756.

144. *Id.* at 757-58 (citing *Stewart Org., Inc. v. Ricoh Corp.*, 487 U.S. 22 (1988); *Yamada Corp. v. Yasuda Fire & Marine Ins. Co.*, 712 N.E.2d 926 (Ill. App. Ct. 1999); *Bense v. Interstate Battery Sys. of Am., Inc.*, 683 F.2d 718 (2d Cir. 1982); *Scheck v. Burger King Corp.*, 756 F. Supp. 543 (S.D. Fla. 1991)).

145. 493 So. 2d 437 (Fla. 1986).

146. *Fendi*, 754 So. 2d at 758.

147. *Id.*

148. 87 F. Supp. 2d 446 (D. Md. 1999).



forum in the contract they intend that the contract provision will be interpreted under that chosen forum's law.

## V. NONCOMPETITION AGREEMENTS & OTHER RESTRICTIVE COVENANTS

Covenants not to compete will be enforced in Texas only if they are (1) ancillary to an otherwise enforceable agreement at the time the agreement is made and (2) reasonably limited as to time, geographical area, and scope of activity to be restrained so as to not impose a greater restraint than is necessary to protect the goodwill or business interest of promisee.<sup>149</sup>

In *Snelling & Snelling, Inc. v. Ryvis, Inc.*,<sup>150</sup> a franchisor was denied a preliminary injunction to stop a former franchisee from competing in the personnel placement services business in violation of the express terms of the post-termination obligations of the franchise agreement.<sup>151</sup> Franchisor sought a preliminary injunction to enforce the following obligations: (1) for a two year period, franchisees not solicit clients or employees whom they served or employed; (2) franchisees relocate any continuing personnel business to a location at least 10 miles from their former franchised location; (3) franchisees return all franchise materials; (4) franchisees discontinue the use of "snellingusa" in the search components of their web site; and (5) franchisees assign to franchisor their telephone and fax numbers and related listings. Without expressing an opinion on the terms of the franchisor's covenant not to compete, the court held that because the franchisor was not active in the franchisees' market area, the franchisor faced no irreparable injury from the defendants' continued operation of the personnel placement services. Citing *DFW Metro Line Servs. v. Southwestern Bell Tel. Co.*,<sup>152</sup> the Court held that, "[w]here monetary damages would adequately compensate a plaintiff, a showing of irreparable injury is precluded."<sup>153</sup> The court did go on to state that if franchisor decided actually to enter the two markets in which defendants' new business was located during the next two years, it could then seek injunctive relief, but that the "mere possibility that Snelling may enter a market is inadequate, however, to demonstrate a substantial threat of irreparable injury."<sup>154</sup> The court concluded that the defendants' failure to turn over the franchise materials, telephone and fax numbers, and related listings would constitute irreparable harm, if they failed to return such information to franchisor within fourteen days of its order.

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149. TEX. BUS. & COM. CODE ANN. § 15.50 (Vernon Supp. 1999).

150. No. 3:99-CV-2028-D, 1999 U.S. Dist. LEXIS 17928 (N.D. Tex. Nov. 10, 1999).

151. *Id.*

152. 901 F.2d 1267, 1269 (5th Cir. 1990).

153. *Snelling & Snelling*, 1999 U.S. Dist. LEXIS 17928, at \*5-6.

154. *Id.* at \*11 n.7.

## VI. ENDING THE FRANCHISE RELATIONSHIP

In addition to contractual or common law requirements limiting rights to terminate, franchisors must also comply with statutes governing franchises in particular industries. For example, in Texas, distribution, sale, and leasing of motor vehicles are governed by the Texas Motor Vehicle Commission Code.<sup>155</sup> The Act provides that “[u]nless otherwise specifically provided by Texas law not in conflict with the terms of this Act, all aspects of the distribution and sale of motor vehicles shall be governed exclusively by the provisions of this Act.”<sup>156</sup>

Vehicle manufacturers are prohibited from terminating or refusing to continue any franchise with a dealer unless certain conditions are met.<sup>157</sup> A manufacturer seeking to terminate or refuse to continue a franchise must provide its franchisee with written notice not less than 60 days before the effective date of termination or noncontinuance setting forth the specific grounds for termination or noncontinuance. Further, the manufacturers must inform the dealer that he may be entitled to file a protest with the Board.<sup>158</sup> If the affected dealer files a timely protest, the Board must hold a hearing to determine whether the franchisor has established by a preponderance of the evidence that there is good cause for the proposed termination or noncontinuance.<sup>159</sup> In determining whether good cause has been established for “modifying, replacing, terminating, or refusing to continue a franchise, or for forcing or attempting to force a dealer to relocate or discontinue a line-make or parts or products related to that line-make,” the Board must consider “all the existing circumstances,” including:

- (A) the dealer’s sales in relation to sales in the market;
- (B) the dealer’s investment and obligations;
- (C) injury or benefit to the public;
- (D) the adequacy of the dealer’s service facilities, equipment, parts and personnel;
- (E) whether warranties are being honored by the dealer;
- (F) the parties’ compliance with the franchise agreement; and
- (G) the enforceability of the franchise agreement from a public policy standpoint.<sup>160</sup>

If the franchise is terminated or not continued, another franchise in the same line-make must be established within a reasonable time unless the Board determines, by a preponderance of the evidence, that the community cannot reasonably support such a dealership.<sup>161</sup>

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155. TEX. REV. CIV. STAT. ANN. art. 4413(36) (Vernon 1976 & Supp. 2000).

156. *Id.* 93.01(b) (Vernon Supp. 2000).

157. *Id.* § 5.02(b)(3)(A).

158. *Id.* § 5.02(b)(3)(A)(i)-(iii).

159. *Id.* § 5.02(b)(3)(A)(iv).

160. *Id.* § 5.02(b)(5).

161. *Id.* § 5.02(b)(3)(C).

*Ford Motor Co. v. Motor Vehicle Bd. of the Texas DOT*<sup>162</sup> involved the extent to which the Texas Motor Vehicle Board had authority to order a remedy short of unconditional termination. Plaintiff Metro Ford Trucks, Inc. (“Metro”) was a licensed Ford dealer. Ford had a competitive price assistance (“CPA”) program to reduce wholesale delivery prices below street prices. Prompted by a complaint from another dealer, Ford audited Metro’s CPA program and discovered that Metro had been applying for CPA in the name of one customer while actually selling the truck to another customer, thereby securing higher amounts of CPA than those to which it otherwise would have been entitled. The auditor recommended that Metro reimburse Ford the difference between the CPA allowances received by Metro and those to which it was entitled. The estimated chargeback was \$3.1 million. Ford’s regional sales manager recommended the Metro franchise be terminated for fraud. Metro sued Ford for breach of contract and antitrust violations. Ford counterclaimed for fraud. The district court granted Metro a temporary restraining order preventing Ford from terminating Metro’s franchise and from collecting any chargebacks. Ultimately, the district court dissolved the restraining order and dismissed Metro’s request for injunctive relief to prohibit Ford from issuing a notice of termination. Metro then filed a request for an interlocutory cease and desist order with the Board of Motor Vehicles, arguing that Ford’s proposed chargeback and termination violated the Motor Vehicle Commission Code which prohibits vehicle manufacturers from terminating a dealer without good cause.<sup>163</sup> The Board issued a statutory stay prohibiting Ford from terminating Metro’s franchise. The Board later entered an agreed order removing any reference to termination in the interlocutory cease and desist order and Ford initiated termination proceedings.

During the hearing before the Board, Ford announced that it was selling certain assets of its truck division to Freightliner. The administrative law judge (“ALJ”) found that Freightliner was a necessary party to the administrative proceeding and ordered Freightliner to offer Metro a franchise. Freightliner tendered a franchise agreement to Metro under protest. The ALJ ultimately ruled that Ford had established good cause to terminate Metro’s franchise and that the termination of Metro’s franchise should be conditioned on the sale of the dealership to a buyer selected by Ford and Freightliner at a price established by an independent appraiser. All parties sought review of the Board’s order. The district court affirmed the Board’s order in part, but held that the forced sale remedy was unlawful. All parties appealed the district court’s order. Metro challenged the ALJ’s finding of good cause to terminate. Ford challenged the judgment remanding the case to the Board to fashion a new remedy and the Board’s finding that Ford was not entitled to recover chargebacks. Freightliner challenged the order to sell trucks to Metro or

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162. 21 S.W.3d 744 (Tex. App.—Austin 2000, no pet.).

163. TEX. REV. CIV. STAT. ANN. art. 4413(36), § 5.02(b)(3) (Vernon Supp. 2000).

to help Metro to find a buyer for its franchise. The Board argued the remedy it imposed on the parties was lawful.

Metro challenged the Board's determination that Ford had good cause to terminate under Sections 5.02(b)(5)(C) and (F) of the Motor Vehicle Code because Metro's abuse of its CPA program had injured the public and violated the Ford-Metro franchise agreement. Metro contended that there was no evidence to support the finding that the CPA program abuse resulted in injury to the public. The court found that because Metro had submitted false customer names to Ford in applying for its CPA allowances, Ford was unable to send safety recall information to actual owners of the trucks sold by Metro and that, therefore, there was substantial evidence to support the finding that Metro's CPA program abuse resulted in injury to the public.

Next, Metro argued that Ford should be estopped from seeking to terminate Metro's franchise because Ford personnel induced Metro salesmen to violate the franchise agreement by submitting misleading information to Ford. The court found good cause for termination had been established because Metro knew that its CPA program abuse was contrary to Ford policy but approved use and concealment of these abuses from Ford. The court concluded that by applying for CPA in names other than actual customers, not providing all dealership files to the Ford auditor, and providing Ford with false mailing addresses for its customers, Metro failed to comply with its franchise agreement with Ford.

Finally, Metro contended that the Board abused its discretion by ordering termination for good cause in the absence of evidence that Metro might not perform well as a dealer in the future. The court rejected this argument because the statute mandated evaluation of existing circumstances, not what kind of relationship the manufacturer and dealer might have in the future. Moreover, the court found that Metro's pattern of CPA program abuse and admitted efforts to deceive Ford violated the basic and fundamental precepts of the relationship between a manufacturer and dealer and supported the conclusion that Metro probably would not perform according to the terms of the agreement if allowed to remain a dealer.

Although the Board found good cause for termination, it ordered sale of the franchise by Metro to a buyer suitable to Ford and Freightliner. Freightliner and Ford argued that the Board had no authority to place conditions on the termination of Metro's franchise once Ford had established good cause for termination. Freightliner argued the Board had no power to compel it to treat Metro as a franchise dealer or to condition termination on the finding of a buyer. The court held that the Motor Vehicle Code did not authorize the Board to condition termination on a manufacturer's finding a third party to purchase the terminated franchise at an appraised value. To the contrary, said the court, the Code envisions a termination followed by establishment of a new franchise within a reasonable time. Having concluded there was substantial evidence to sup-

port the Board's finding of good cause to terminate Metro and that the Board's imposition of conditions was unlawful, the appellate court affirmed the district court's judgment that the remedy imposed by the Board was unlawful.

In *David McDavid Nissan v. Subaru of Am.*,<sup>164</sup> an automobile dealership sued an automobile manufacturer alleging that the manufacturer reneged on an oral agreement consenting to relocation. McDavid owned and operated a Subaru dealership and an Oldsmobile dealership in Houston. Subaru's regional vice president orally consented to relocation of the Oldsmobile dealership. The dealer renovated the location and moved his Oldsmobile dealership there in preparation for moving the Subaru dealership to the Oldsmobile location. The manufacturer then informed the dealer that Subaru would not consent to such a move. The dealer terminated the dealership and two other Subaru dealerships it owned and sued Subaru for refusing to permit relocation, alleging violations of the Texas Motor Vehicle Commission Code, breach of contract, breach of duty of good faith and fair dealing, and violations of the Texas Deceptive Trade Practices-Consumer Protection Act ("DTPA").

Subaru moved for summary judgment asserting that the dealer was barred, as a matter of law, from bringing its claims because it failed to raise them before the Texas Motor Vehicle Commission ("TMVC"). The trial court granted Subaru summary judgment.

The court of appeals held that the primary jurisdiction of the TMVC to determine the propriety of denials of *written* requests to relocate dealerships under the TMVC Code did not encompass *oral* relocation requests. Because the dealer asserted that Subaru orally agreed to an oral request to relocate the dealership and then wrongfully rescinded its agreement, Section 5.02(15), which limits the rights of manufacturers to deny or withhold approval of written requests to relocate, did not apply. Because an oral relocation request did not contradict any requirement of the Code, or implicate any rights or obligations under Section 5.02(15), Subaru's disposition of such request could not, as a matter of law, constitute a violation of the Code. The court also found that the exclusivity provision of the Code contravened the open courts provision of the Constitution to the extent that it abrogated dealership claims for breach of oral contract and promissory estoppel without substituting other remedies.

With reference to the dealer's DTPA cause of action, the court held that Section 6.06(a) of the Code required that the TMVC find a violation before the dealer could sue in district court. Section 6.06(a) provides:

Notwithstanding any other provision of law, . . . in addition to the other remedies provided by this subchapter, a person who has sustained actual damages as a result of a violation of [Section 5.01 or Section 5.02 of this Act] may maintain an action pursuant to the terms of Subchapter E, Chapter 17, Business & Commerce Code or any successor statute thereto and shall be entitled to all procedures

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164. 10 S.W.3d 56 (Tex. App.—Dallas 1999, pet. granted).

and remedies provided for therein. In any action brought under this section, and in the interest of judicial economy and efficiency, a judgment rendered pursuant to this section shall pay due deference to the findings of fact and conclusions of law of the Commission contained in a final order which forms the basis of the action.<sup>165</sup>

The court held that because the TMVC had primary jurisdiction to determine whether a Code violation occurred, before maintaining its DTPA cause of action in district court, the dealer was required to present its claim to the TMVC and obtain findings that Subaru violated the Code.

With reference to the dealer's claim of breach of duty of good faith and fair dealing, the court held that because the legislature did not specify that a claimant must obtain a TMVC finding that the Code was violated before it could pursue a cause of action for breach of duty of good faith and fair dealing, and because the Code expressly stated this claim was actionable in tort, the dealer was not required to present this claim to TMVC before pursuing it in court.

Subaru asserted that the dealer had elected its remedy by pursuing a voluntary termination of the dealership and accepting benefits under the termination proceeding in the form of a monetary payment from Subaru. Subaru argued that, because the dealer accepted the final check for repurchase of dealership assets, it was estopped from complaining that Subaru's refusal to allow relocation was unlawful. Under the Code, upon termination of a dealership, a manufacturer must repurchase from a dealership its inventory, parts, signs, tools, and equipment within a specified period of time.<sup>166</sup> This obligation is statutory and not contingent on any finding of breach or fault by either party. Accordingly, the court concluded that the election of remedies doctrine did not apply, and a terminated dealer could accept payments under the statute for repurchase of dealership assets without relinquishing its right to pursue common law and statutory causes of action against the manufacturer. The court also concluded that the dealer was not estopped to sue the manufacturer by accepting payments under the termination provisions.

With regard to the dealer's claim for breach of the written dealership agreement, the court found that summary judgment for Subaru was proper. Section 14 of the dealership agreement unambiguously required Subaru's consent to, among other things, any "relocation of facilities or establishment of facilities."<sup>167</sup> Section 14 further provided that consent or denial was within Subaru's sole discretion. The dealer admitted that he was not claiming Subaru breached the dealer agreement; instead, he was claiming Subaru breached an oral agreement to allow him to relocate the dealership. Accordingly, the court of appeals concluded that summary judgment for Subaru was correct.

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165. TEX. REV. CIV. STAT. ANN. art. 4413(36), § 6.06(a) (Vernon Supp. 2000).

166. *Id.* § 5.02(b)(16)(B-E).

167. *David McDavid*, 10 S.W.3d at 72.

With regard to the dealer's claim for breach of an oral contract, Subaru claimed that no consideration existed for the alleged oral contract. However, because Subaru failed to prove this as a matter of law, summary judgment was improper on that basis. Likewise, because Subaru did not show that it would be unjust, as a matter of law, to refuse to enforce its oral promise, summary judgment was not appropriate on the dealer's promissory estoppel claim. Accordingly, the court of appeals affirmed the trial court's summary judgment in favor of Subaru on the dealer's breach of written contract and DTPA causes of action and reversed summary judgment on the dealer's other causes of action.

In *Ford Motor Co. v. Butnaru*,<sup>168</sup> a prospective dealer sued Ford alleging Ford interfered with agreements it had entered into to buy a car dealership. Graff Ford had a dealership in Del Rio, Texas. The dealership agreement provided that if Graff Ford proposed to transfer the dealership, Ford had a right of first refusal.<sup>169</sup> The prospective dealer entered into a purchase and sale agreement with Graff Ford to buy the dealership conditioned upon approval by Ford. Ford gave notice of intent to exercise its right of first refusal and assigned its right of first refusal to an existing Ford dealer.<sup>170</sup>

The prospective dealer then sued Ford for tortiously interfering with the sale agreement and sought a declaration that the right of first refusal was unenforceable.<sup>171</sup> The district court granted a temporary injunction.<sup>172</sup> The prospective dealer asserted three causes of action. First, he alleged Ford tortiously interfered with the sale agreement by attempting to exercise its right of first refusal. Second, he alleged the existing dealer breached the sale agreement by refusing to convey the dealership. Third, he sought a declaration that the right of first refusal was unenforceable.<sup>173</sup>

The prospective dealer argued that the right of first refusal conflicted with Section 5.01(b), which forbade Ford from rejecting a proposed buyer unless the buyer was not qualified, and Section 5.02(b)(A), which makes it unlawful for a manufacturer to fail to give effect or attempt to prevent a sale of a dealership except as provided in Section 5.01(b) notwithstanding the terms of any agreement.<sup>174</sup> Ford argued that the Board had exclusive original jurisdiction because the crux of the prospective dealer's complaint was that the right of first refusal was invalid because it conflicted with the Texas Motor Vehicle Commission Code.<sup>175</sup>

The court concluded that the trial court did not have jurisdiction over the prospective dealer's claims to the extent they were based upon viola-

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168. 18 S.W.3d 762 (Tex. App.—San Antonio 2000, pet. granted).

169. *Id.* at 764.

170. *Id.*

171. *Id.*

172. *Id.* at 764-65.

173. *Id.* at 765-66.

174. *Ford*, 18 S.W.3d at 766.

175. *Id.*

tions of the Act.<sup>176</sup> The Board did not have the power to grant the prospective dealer any relief because it applied only to existing (not prospective) dealers. Nevertheless, the Board did have authority to investigate and adjudicate violations of the Act and make incidental findings essential to the granting of relief.<sup>177</sup> However, the court held the Act does not abrogate all causes of action that might arise in the context of motor vehicle distribution. To the extent the prospective dealer's claims were not based on violations of the Act, the trial court had jurisdiction over the prospective dealer's common law claims. The court allowed the prospective dealer to sue Ford for breach of contract, tortious interference, and for a declaratory judgment.

## VII. VICARIOUS LIABILITY

Generally, a franchisor is not vicariously liable for the negligence of a franchisee unless the franchisor has the right to control the work from which the claim arises. The essential issue is whether the franchisor has the right to control both the means and details of the process by which the alleged agent is to accomplish his task. In *Risner v. McDonald's Corp.*,<sup>178</sup> Risner, a customer who was attending a birthday party at McDonald's, was sprayed with pepper spray.<sup>179</sup> She sued McDonald's Corporation, McDonald's Restaurants of Texas, Inc., Danrose Management Company, Danrose Corporation, and the manager.<sup>180</sup> The McDonald's and Danrose entities filed motions for summary judgment on the basis that none of them was the owner or occupier of the premises. McDonald's, the franchisor, supported its motion with affidavits that it did not own the restaurant, operate the restaurant, participate in its management, have the right to hire, discharge, or discipline employees, pay utilities at the restaurant, sell any product at the restaurant, sell any product to the restaurant, or hold the right to control the day-to-day activities necessary to carry on the business of the restaurant. Risner pointed to evidence that the franchisor (1) was an additional insured on the franchisee's insurance policy; (2) reserved the right to terminate the franchisee's right to use the McDonald's system and the name; (3) had the right to approve any assignee or sub-assignee; and (4) retained ownership of certain property in connection with the restaurant including the real estate, leasehold improvements, utility deposits, accounts, notes, receivables, vehicles, office supplies, certificates of deposit and investment securities, prepaid expense, the in-store processor, Texas Instrument terminals, and time recorders.<sup>181</sup> The court of appeals held that, because the franchisor did not retain control over the activities concerning which Risner had asserted negligence, the trial court did not err in granting the franchisor

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176. *Id.* at 767.

177. *Id.* at 768.

178. 18 S.W.3d 903 (Tex. App.—Beaumont 2000, pet. denied).

179. *Id.* at 905-06.

180. *Id.* at 905.

181. *Id.* at 906-07.



summary judgment.<sup>182</sup>

Summary judgment for a franchisor was again entered in *Johnson v. Burger King Corp.*,<sup>183</sup> a suit alleging personal injuries from the collapse of a chair in a Burger King restaurant. Johnson argued that summary judgment for Burger King was improper because the franchise agreement between Burger King and the franchisee established that Burger King controlled the franchisee or attempted to do so insufficiently and negligently.<sup>184</sup> Johnson alleged that Burger King was negligent in (1) operating a public establishment in an unsafe manner; (2) failing to maintain furniture in a safe manner; (3) failing to keep a proper lookout and discover defects in equipment or furniture; (4) failing to adequately warn and protect customers from hidden dangers; (5) failing to act prudently under the circumstances; and (6) such other acts of negligence as might be shown at trial.<sup>185</sup> Johnson did not allege any theory of vicarious liability against Burger King for the acts of the franchisee as its agent. The franchise agreement between Burger King and the franchisee stated that the franchisee was an independent contractor and not an agent of Burger King and that Burger King had no control over the terms and conditions of employment of the franchisee's employees.<sup>186</sup> It also required the franchisee to exhibit on the premises notification that the restaurant was operated by an independent operator and not by Burger King. Johnson argued that Burger King was liable for his injuries because the franchise agreement provided that the restaurant would be constructed and improved in a manner authorized and approved by Burger King, the appearance of the franchise restaurant would not be altered except as approved by Burger King, and the franchisee was required to maintain the restaurant in good condition and make all improvements, alterations, and remodeling reasonably necessary to reflect the current Burger King restaurant image.<sup>187</sup> Under the agreement, Burger King had the right to order repairs, but the obligation to maintain the property remained in the franchisee as independent contractor. Johnson produced no summary judgment evidence that Burger King actually ordered any repairs to be made to the furniture in the restaurant where Johnson was injured. Burger King provided its franchisees with a manual of operating data which described in detail how the franchisee should operate the Burger King restaurant, gave Burger King the right to inspect and supplied extensive image standards that included removing damaged furniture. Because Johnson produced no evidence of a right of control nor actual exercise of control over the broken chair, the court found that summary judgment

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182. *Id.* at 907.

183. No. 09-99-548-CV, 2000 Tex. App. LEXIS 5513 (Beaumont Aug. 17, 2000, pet. denied) (not designated for publication).

184. *Id.* at \*5-\*6.

185. *Id.* at \*8.

186. *Id.* at \*8-\*9.

187. *Id.* at \*9-\*10.

for Burger King was proper.<sup>188</sup>

Summary judgment for a franchisor was reversed in *Walters v. Ramada Franchise Sys., Inc.*<sup>189</sup> In that case, Walters was raped while trying to enter her hotel room. She sued the owner of the premises, the franchisor, the franchisor's parent company, and two holding companies. Under the terms of the franchise agreement, Ramada had the "unlimited right to conduct unannounced inspections" and reinspections.<sup>190</sup> The stated purpose of the inspections was for "ascertaining compliance with system standards."<sup>191</sup> Ramada required all guest room to have certain types of locks, required the locks to operate correctly, and required a certain level of exterior lighting. The franchisee could be removed from the reservations system or terminated if standards were not met. The Ramada Inn where the rape occurred failed quality assurance inspections both before and after the rape, eventually resulting in termination of the franchise. Because the record allegedly contained evidence that Ramada retained control over lighting and security at the Ramada Inn, the court held that summary judgment for Ramada was improper.<sup>192</sup> The court also reversed summary judgment against plaintiff on her DTPA, fraud, and agency claims because she presented summary judgment evidence supporting the elements of reliance and producing cause, the only elements Ramada attacked in its no-evidence motion for summary judgment.<sup>193</sup>

#### VIII. CONTRACT CLAIMS

Franchisees continue to assert breach of contract claims against franchisors and vice versa. In *D.G. Bros., Inc. v. Pizza Inn, Inc.*,<sup>194</sup> Pizza Inn, Inc., and Pizza Inn Advertising Plan ("PIAP") sued Brothers for breach of its franchise agreement, seeking amounts due for royalties and advertising. The trial court awarded partial summary judgment in favor of Pizza Inn, Inc., and PIAP. Brothers brought a counterclaim against Pizza Inn, Inc., alleging tortious interference and breach of contract regarding a proposed sale of the franchise. The jury found Pizza Inn, Inc., had breached the franchise agreement and awarded damages to Brothers.<sup>195</sup> The trial court granted Pizza Inn, Inc.'s motion for judgment notwithstanding the verdict and rendered judgment for Pizza Inn, Inc., and PIAP in accordance with the partial summary judgment.<sup>196</sup> Although Brothers did not challenge its liability to Pizza Inn, Inc., or PIAP or the amounts claimed to be owing, it raised affirmative defenses of modifica-

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188. *Id.* at \*12.

189. No. 05-97-02162-CV, 2000 Tex. App. LEXIS 5673 (Dallas Aug. 24, 2000, no pet.) (not designated for publication).

190. *Id.* at \*8.

191. *Id.*

192. *Id.* at \*1, \*8.

193. *Id.* at \*2, \*12.

194. No. 06-98-00151-CV, 2000 WL 16470 (Tex. App.—Texarkana Jan. 12, 2000, pet. denied) (not designated for publication).

195. *Id.* at \*1.

196. *Id.*

tion, excuse, payment, offset, and release. Brothers contended that Pizza Inn, Inc., and others wrongfully interfered with the consummation of a proposed sale of the franchise. Brothers also sought reversal of the trial court's granting of Pizza Inn's motion for judgment notwithstanding the verdict after the jury awarded \$46,000 to Brothers against Pizza Inn.<sup>197</sup> The appellate court affirmed the judgment notwithstanding the verdict because Brothers produced no evidence to support its claim for lost profits.<sup>198</sup>

In *Glazner v. Haase*,<sup>199</sup> a contract to sell a franchise was held to be unenforceable under the statute of frauds. Haase owned a Whataburger franchise in the Longview area. Glazner came to work for Haase. Haase promised to sell his franchise to Glazner. The negotiations were set forth in three letters to Whataburger. Whataburger never granted Glazner a franchise. Glazner left Haase's employ and sued him for breach of contract, unjust enrichment, fraud, and fraudulent inducement. Haase moved for summary judgment on the grounds that (1) the alleged contract was unenforceable under the statute of frauds; (2) the fraud claims were barred by the statute of frauds; (3) Glazner was unable to prove that there was a valid contract; and (4) there was no cause of action for unjust enrichment.<sup>200</sup> The court held that the contract did not satisfy the statute of frauds because it was not supported by consideration and that it was only a "tentative agreement" or "an agreement in principal" showing ongoing negotiations, not a binding agreement.<sup>201</sup> The court affirmed the trial court's summary judgment against Glazner's breach of contract claim but reversed summary judgment on the fraud and fraudulent inducement causes of action.<sup>202</sup>

In *Ford Motor Co. v. Metro Ford Truck Sales, Inc.*,<sup>203</sup> the court of appeals reversed a summary judgment for the franchisor because the franchisor failed to move for summary judgment on the basis that the franchisee had breached the franchise agreement. Metro was a licensed motor vehicle dealership authorized to sell Ford trucks. Ford had a CPA pricing system that reduced the dealer's cost of trucks based on the information that the dealer provided to Ford. To get increased CPA on particular transactions, Metro provided Ford with incorrect names of customers who were purchasing certain trucks. When Ford discovered Metro's misrepresentations, it threatened to terminate the franchise. Metro responded by suing Ford and filing a protest with the Texas Motor Vehicle

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197. *Id.* at \*6.

198. *Id.* at \*6-\*7.

199. No. 06-99-00069-CV, 2000 WL 1062579 (Tex. App.—Texarkana Aug. 4, 2000, pet. filed) (not designated for publication).

200. *Id.* Haase also moved for summary judgment on the ground that the other defendant to the suit, PRU Investments, was not a proper party because Glazner could not prove any basis for piercing the corporate veil.

201. *Id.* at \*3.

202. *Id.* at \*3-4.

203. No. 05-99-00031-CV, 1999 WL 1126280 (Tex. App.—Dallas Dec. 9, 1999, no pet.) (not designated for publication).

Board (TMVB) contesting Ford's proposed franchise termination and chargeback.<sup>204</sup>

Ford moved for summary judgment on Metro's breach of contract claim, asserting that Metro's claims were barred as a matter of law by Metro's misrepresentations in connection with Ford's CPA program that conclusively established Ford's right to terminate and chargeback the excess amounts. Because Ford never moved for summary judgment on that basis, the appellate court could not affirm summary judgment for Ford.<sup>205</sup>

Metro sought summary judgment on the ground that Section 5.02(b)(14) of the Texas Motor Vehicle Commission Code barred all Ford's damage claims as a matter of law.<sup>206</sup> Section 5.02(b)(14) precludes a manufacturer from requiring a dealer to pay or assume any part of any refund, rebate, discount, or other financial adjustment made by the manufacturer to, or in favor of, any customer of a dealer, unless the dealer voluntarily agrees.<sup>207</sup> Ford contended that this section did not apply to its right to recover damages for discounts obtained by fraud. The court held that, because the summary judgment evidence did not conclusively establish Ford's CPA program provided a benefit to or in favor of Metro's customers, Metro was not entitled to summary judgment. The appellate court affirmed the trial court's judgment that Metro recover nothing on its breach of contract claim and reversed the trial court's judgment in favor of Metro on Ford's breach of contract, fraud, and RICO claims.<sup>208</sup>

## IX. DISCRIMINATION CLAIMS

In *Arguello v. Concoc, Inc.*,<sup>209</sup> the 5th Circuit held that although Conoco, Inc. might be liable for the alleged acts of racial discrimination by employees at stores that it owned, it was not liable for such acts by employees of independent Conoco-branded stores because there was no agency relationship with those stores. This suit was brought by plaintiffs of African American and Hispanic decent who alleged that, when they were customers at Conoco stores, on several different occasions, they endured racially derogatory remarks and substandard and disparate treatment by store employees. One of the stores at which the alleged treatment occurred was owned by Conoco, but the other stores were independently owned by third parties who had entered into Petroleum Marketing Agreements ("PMA's") with Conoco, allowing them to market and sell Conoco-brand gasoline and supplies. Plaintiffs sought to hold Conoco liable for their alleged discrimination.

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204. *Id.* at \*1.

205. *Id.* at \*4.

206. *Id.* at \*7.

207. TEX. REV. CIV. STAT. ANN. art. 4413(36), § 5.02(b)(14) (Vernon 1976 & Supp. 2001).

208. *Ford Motor Co.*, 1999 WL 1126280, at \*9.

209. 207 F.3d 803 (5th Cir. 2000), *cert. denied sub. nom.*, *Escobedo v. Conoco, Inc.*, 121 S. Ct. 177, 69 U.S.L.W. 3729 (2000).

The Supreme Court has determined that, to hold a defendant liable under section 1981 for the discriminatory actions of a third party, there must be an agency relationship between the defendant and the third party.<sup>210</sup> The Fifth Circuit stated that "to establish an agency relationship between Conoco, Inc. and the branded stores the plaintiffs must show that Conoco, Inc. has given consent for the branded stores to act on its behalf and that the branded stores are subject to the control of Conoco, Inc."<sup>211</sup> The PMA's entered into between the independently owned stores and Conoco provided that each branded store ("Marketer") "is an independent business and is not, nor are its employees, employees of Conoco. Conoco and Marketer are completely separate entities. They are not partners, general partners . . . nor agents of each other in any sense whatsoever and neither has the power to obligate or bind each other."<sup>212</sup> The court rejected plaintiffs' argument that because the PMA's allowed Conoco to (a) require branded-stores to treat customers fairly, honestly, and courteously, and (b) conduct random bi-annual inspections of the business, Conoco controlled details of the daily operations of the Conoco-branded stores. The Fifth Circuit held, as a matter of law, that there was no agency relationship between Conoco and the Conoco-brand stores.

The court refused, however, to grant a motion to dismiss the plaintiffs' claims for alleged discriminatory conduct by employees of stores owned and operated by Conoco. The court noted that when considering whether an employee's acts are within the scope of employment, some of the factors to be considered are: (1) time, place, and purpose of the act; (2) its similarity to acts which the employee is authorized to perform; (3) whether the act is commonly performed by employees; (4) the extent of departure from normal methods; and (5) whether the employer would reasonably expect such act would be performed.<sup>213</sup> The court determined that it could not determine, as a matter of law, that the alleged conduct of the employee was in the course and scope of his employment, so it denied defendant's motion for summary judgment on this point.

In *Mays v. TSI Staffing, Inc.*,<sup>214</sup> the district court granted the franchisor's motion to dismiss a section 1985(3) claim that franchisor had conspired with a franchisee to deprive African-American employees and customers of their rights. The employee of a franchisee complained that franchisee had discriminated against him and had reserved certain sub-standard rooms for African-American guests, and that franchisor failed to respond to these issues. The court found that the licensing agreement prohibited such discriminatory acts and that there was not sufficient

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210. *Id.* at 807 (citing *Gen. Bldg. Contractors Assoc. v. Pa. United Eng'rs and Constructors*, 458 U.S. 375, 393 (1982)).

211. *Id.* at 807.

212. *Id.* at 807-08 (omission in text).

213. *Id.* at 810 (citing *Domar Ocean Transp., Ltd. v. Indep. Ref. Co.*, 783 F.2d 1185, 1190 (5th Cir. 1986)).

214. 56 F. Supp. 2d 738 (E.D. Tex. 1999).

pleading or any evidence that franchisor even knew of any alleged discriminatory acts by franchisee. The court held that plaintiff had failed to present facts upon which the court could find that co-defendant Days Inns of America, Inc. was engaged in a conspiracy with its franchisee, and it dismissed plaintiff's action against the franchisor.<sup>215</sup>

## X. ANTITRUST

The Supreme Court's decision in *Eastman Kodak Co. v. Image Technical Servs., Inc.*<sup>216</sup> still provides the analysis by which a court will review cases involving tying arrangements, and it is still a source for substantial litigation with regard to franchising practices that require a franchisee to utilize or purchase specific supplies or sources. Since *Kodak*, the issue of whether the franchisor supply arrangements were disclosed pre-contract or implemented as a post-contractual restriction often determines the outcome of an antitrust case.

In *Chawla v. Shell Oil Co.*,<sup>217</sup> plaintiffs, retail gasoline dealers, brought suit against Shell alleging various antitrust violations. Specifically, plaintiffs alleged that Shell's requirement that the plaintiffs (franchisees) utilize and lease its "pay-at-the-pump" credit card machines constituted illegal tying.<sup>218</sup> In holding that no tying arrangement existed, the court held that neither Shell Gasoline, nor the Shell trademark, are legally recognized unique products for antitrust purposes.<sup>219</sup>

Also in *Chawla*, plaintiffs complained that the "pay-at-the-pump" condition was forcing them out of business because they were "locked in" to these policies in order to continue their supply of Shell gasoline.<sup>220</sup> The court found that the "lock in" theory was inapplicable and that plaintiffs had a "pre-existing and continuing contractual relationship [ ] with [the] [d]efendant[ ]."<sup>221</sup> The court concluded that Shell was merely exercising its contractual rights and was not attempting to assert "market power" over a viable relevant market product.<sup>222</sup>

In *Subsolutions, Inc. v. Doctor's Assocs., Inc.*,<sup>223</sup> the court found that plaintiff had satisfied the elements of a tying claim and that plaintiff was "locked in" to the franchise agreements. In *Subsolutions*, plaintiff sold "point-of-sale" (POS) computer systems to a chain of fast-food franchises (Subway Sandwich Shops). One of the defendants sold and serviced Subway Sandwich Shop franchises.<sup>224</sup> The franchisor's requirement that the Subway Sandwich Shop franchisees purchase a particular POS system

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215. *Id.* at 741.

216. 504 U.S. 451 (1992).

217. 75 F. Supp. 2d 626 (S.D. Tex. 1999).

218. *Id.* at 634.

219. *Id.* at 639 n.13.

220. *Id.* at 637.

221. *Id.* at 638.

222. *Id.* at 642.

223. 62 F. Supp. 2d 616 (D. Conn. 1999).

224. *Id.* at 619.

from a single vendor constituted an illegal tying and antitrust conspiracy.<sup>225</sup> In finding that the plaintiff satisfied the elements of the tying claim, the court held that the Subway trademark and the POS system were two distinct products with two distinct product markets.<sup>226</sup> The court further found that plaintiff had alleged sufficient facts to make out a "lock-in" claim.<sup>227</sup> In holding that plaintiff could continue with a lock-in claim, the court found that Subway did not require the plaintiff to use the defendant's POS systems until after they were "locked in" to these franchise agreements.<sup>228</sup> The court further found that the plaintiff had satisfied the liberal pleading requirements by alleging that defendant's tying arrangement had forced franchisees to purchase defendant's POS, despite the fact that many of the franchisees preferred other POS systems.<sup>229</sup> In concluding that the plaintiff had actually been harmed by defendant's actions, the court found that by requiring purchases exclusively from defendant, other competitive point-of-sale system vendors who were capable of providing systems to Subway franchisees were injured.<sup>230</sup>

## XI. FRANCHISING ON THE INTERNET

Franchisors utilizing agreements which predate the boom in Internet marketing and selling should be particularly concerned about provisions which grant exclusive territories. Franchisors who market and sell on the Internet may run afoul of exclusive territory provisions and open themselves up to encroachment claims. In a recent arbitration matter, *Emporium Drug Mart, Inc. v. Drug Emporium, Inc.*,<sup>231</sup> the Arbitration Panel decided two to one to grant franchisees' application for a preliminary injunction against the franchisor based on franchisees' internet encroachment claims. The franchisees alleged that the franchisor's internet operations violated the franchisees' exclusive territory as provided in the franchise agreement. The franchisor's website included such taglines as "Your neighborhood pharmacy for over 20 years." The franchisor argued, unsuccessfully, that it was not considered as a store but an alternative form of distribution. The injunction provided Drug Emporium with a phase out period with which to shut down the operations that violated of the franchisees' contractual rights of exclusivity.

Internet encroachment will likely be a growing concern for franchisors. Franchisors should examine their franchise agreements to insure that no internet activities are in violation of any exclusivity provisions in franchise agreements. Franchisors who intend to engage in internet operations should ensure that new franchise agreements will permit such activities.

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225. *Id.* at 627, 628.

226. *Id.* at 623-24.

227. *Id.* at 626.

228. *Id.*

229. *Id.* at 627.

230. *Id.* at 628.

231. American Arbitration (Dallas, Texas), Case No. 711140012600.

## XII. REMEDIES: DAMAGES &amp; INJUNCTIVE RELIEF

## A. THE LANHAM ACT

The Lanham Act was enacted to provide protections to businesses from false, misleading, and/or deceptive practices by its competitors. Section 43(a) of the Lanham Act addressed the issue of false advertising in a commercial setting.<sup>232</sup> When an action under Section 43(a) of the Lanham Act is brought, to establish a prima facie case of false advertising the plaintiff must prove the five elements set forth in *Taquino v. Teledyne Monarch Rubber*.<sup>233</sup> Failure to do so can be fatal to plaintiff's claim.

In *Pizza Hut, Inc. v. Papa John's Int'l, Inc.*,<sup>234</sup> the Fifth Circuit issued a significant opinion under Section 43(a) of the Lanham Act. Pizza Hut complained of Papa John's \$300 million advertising campaign, which was built around the tag line, "Better Ingredients. Better Pizza."<sup>235</sup> In Pizza Hut's view, Papa John's tag line was false on its face. Pizza Hut complained that Papa John's claim was particularly egregious when used in certain ads comparing the two pizza-mongers' tomato sauce and dough.<sup>236</sup> Pizza Hut introduced evidence that there was no substantive difference in the products when they went into the oven or in the taste test, and the jury found that the statements in Papa John's ads were misleading though literally true.<sup>237</sup> The trial court concluded that the misleading ads—even though they numbered only a small portion of the total campaign—had so tainted the slogan that it enjoined the slogan's further use.<sup>238</sup>

On appeal, the Court of Appeals held that the slogan "Better Ingredients. Better Pizza," standing alone, was non-actionable puffery because it was not an objectifiable statement of fact on which consumers could justifiably rely.<sup>239</sup> But the court did find sufficient evidence to support the

232. Section 43(a) of the Lanham Act, codified at 15 U.S.C. § 1125, provides in relevant part:

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

15 U.S.C. § 1125(a)(1)(B) (1994).

233. 893 F.2d 1488 (5th Cir. 1990). A prima facie case of false advertising under Section 43(a) requires the plaintiff to establish: (1) a false or misleading statement of fact about a product; (2) such statement either deceived, or had the capacity to deceive, a substantial segment of potential customers; (3) the deception is material in that it is likely to influence the consumer's purchasing decision; (4) the product is in interstate commerce; and (5) the plaintiff has been or is likely to be injured as a result of the statement at issue. *Id.* at 1500.

234. 227 F.3d 489 (5th Cir. 2000).

235. *Id.* at 491.

236. *Id.* at 492 ("[Our sauce is] is made with 'fresh, vine-ripened tomatoes;' . . . [theirs is] remanufactured tomato paste." "[For our dough, we give yeast] several days to work its special magic . . . [while theirs is] frozen dough . . ." "[We use] clear, filtered water . . . [as opposed to] whatever comes out of the tap.").

237. *Id.* at 492-93.

238. *Id.* at 493-94.

239. *Id.* at 498-99.



jury's verdict that the sauce and dough ads were misleading, and it held that when used in conjunction with those ads, the slogan *became* objectifiable and misleading, because it gave consumers two objectifiable (and wrong) reasons to conclude Papa John's pizza was "better."<sup>240</sup>

The court observed, however, that in order to be actionable under Section 43(a), misrepresentations must be material—that is, they must effect the consumer's purchasing decision.<sup>241</sup> Where a statement is literally false on its face, materiality is presumed, but where falsity is merely implied, the plaintiff must present evidence. The court found no evidence that the slogan and the tendency to deceive consumers would effect purchasing decisions; thus, Pizza Hut failed to produce evidence of a Lanham Act violation, and the court remanded the case with instructions to enter judgment for the defendant Papa John's.<sup>242</sup>

In the past year, the Fifth Circuit also addressed the standards which should be applied to a claim brought under the Federal Trademark Dilution Act ("FTDA"), an amendment to the Lanham Act. In *Westchester Media v. PRL USA Holdings, Inc.*,<sup>243</sup> PRL USA Holdings, Inc. ("Polo") brought suit against a magazine publisher to prohibit its use of the word "POLO" as a title to one of the magazines it published.<sup>244</sup> Polo alleged that its mark was famous and distinctive and that Westchester had adopted and diluted the Polo mark.<sup>245</sup> Westchester, relying on a recent Fourth Circuit opinion, argued that proof of dilution under the FTDA required "actual, consummated harm."<sup>246</sup> On the other hand, Polo contended that the FTDA requires only proof of the likelihood of dilution.<sup>247</sup> In endorsing the Fourth Circuit's holding that the FTDA requires proof of actual harm, the Fifth Circuit held that "proof of actual harm . . . best accords with the plain meaning of the statute."<sup>248</sup> The Fifth Circuit found that the "likelihood of dilution" or threatened use of a mark is insufficient to support a dilution claim.<sup>249</sup> The court further held that the FTDA prohibits any commercial use of a famous mark that actually "causes dilution," not a possibility or likelihood of dilution.<sup>250</sup>

## B. LIQUIDATED DAMAGES

Many franchise agreements stipulate that a franchisor may recover liquidated damages for a franchisee's breach of contract. These liquidated damages clauses are generally enforceable, unless proven to be a penalty

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240. *Id.* at 501-02.

241. *Id.* at 502.

242. *Id.* at 503-04.

243. 214 F.3d 658 (5th Cir. 2000).

244. *Id.* at 660.

245. *Id.* at 661, 669.

246. *Id.* at 670 (citing *Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Utah Div. of Travel Dev.*, 170 F.3d 449, 464 (4th Cir. 1999)).

247. *See Nabisco, Inc. v. PF Brands, Inc.*, 191 F.3d 208, 224-25 (2d Cir. 1999).

248. *Westchester*, 214 F.3d at 670.

249. *Id.* at 670-71.

250. *Id.* (citing 15 U.S.C. § 1125(c)(1) (Supp. V 1999)).

provision.<sup>251</sup>

While no Texas or Fifth Circuit cases address the availability of liquidated damages in franchise cases, courts in other jurisdictions have addressed the enforceability of such clauses and have come to differing results.<sup>252</sup>

In *Days Inn of Am., Inc. v. Patel*,<sup>253</sup> the franchise agreement contained a liquidated damages clause that the franchisor (Days Inn) could invoke in the event the franchisee breached the contract. In holding that the liquidated damages clause was enforceable, the court examined whether the clause was “reasonable under the totality of the circumstances” and whether the clause could be viewed as punitive in nature.<sup>254</sup> The court looked to the express language of the clause which provided that the liquidated damages were not a penalty; therefore, the franchisee was estopped from arguing that the clause was punitive.<sup>255</sup>

While the liquidated damages provision in *Days Inn* was held to be valid, in *Honey Dew Assocs., Inc. v. M & K Food Corp.*,<sup>256</sup> the court found a liquidated damages clause was an unenforceable penalty. While the court acknowledged that “considerable deference is given to the parties’ reasonable determination of liquidated damages,” the court still has discretion in determining whether the clause is enforceable.<sup>257</sup> The court found that the liquidated damages provision, as an acceleration clause, was an unenforceable penalty under Massachusetts law.<sup>258</sup>

### C. INJUNCTIVE RELIEF

Termination does not necessarily mark the end of the franchisor/franchisee relationship. Often an involuntarily terminated franchisee may refuse to remove signage, promotional materials, or other items which identify the franchisee with the franchise system. Injunctions are an important remedy to help prevent public confusion and dilution of the franchisor’s marks.<sup>259</sup> The Lanham Act provides the federal statutory

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251. *Thanksgiving Tower Partners v. Anros Thanksgiving Partners*, 64 F.3d 227 (5th Cir. 1995).

252. See *Days Inns of Am., Inc. v. Patel*, 88 F. Supp. 2d 928 (C.D. Ill. 2000); *Honey Dew Assocs., Inc. v. M & K Food Corp.*, 81 F. Supp. 2d 352 (D.R.I. 2000).

253. 88 F. Supp. 2d 928 (C.D. Ill. 2000).

254. *Id.* at 935-36.

255. *Id.* at 936.

256. 81 F. Supp. 2d 352 (D.R.I. 2000).

257. *Id.* at 357.

258. *Id.* at 358.

259. The intent of the Lanham Act is to:

regulate commerce within the control of Congress by making actionable the deceptive and misleading use of marks in such commerce; . . . to protect persons engaged in such commerce against unfair competition; to prevent fraud and deception in such commerce by the use of reproductions, copies, counterfeits, or colorable imitations of registered marks. . . .

15 U.S.C. § 1127 (Supp. V 1999). See also *Ocean Garden, Inc. v. Marktrade Co.*, 953 F.2d 500, 503 (9th Cir. 1991).

foundation for injunctions against terminated franchisees.<sup>260</sup> Three potential claims are available to a franchisor under the Lanham Act when there is a continued, unauthorized use of its marks. Under section 32(1), the commercial use of a registered mark that “is likely to cause confusion, or to cause mistake, or to deceive” and that is “without consent of the registrant” forms the basis of a Lanham Act claim.<sup>261</sup> On the other hand, section 43(a) protects both registered and unregistered marks and makes unlawful “false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which—[A] is likely to cause confusion, or to cause mistake, or to deceive as to . . . the origin, sponsorship or approval of” goods or services.<sup>262</sup> Finally, section 43(c) prohibits a party from using and diluting the quality of another party’s famous and distinctive marks.<sup>263</sup>

To obtain a preliminary injunction, many courts require a franchisor to establish the following elements of the so-called “traditional” test: (1) there is a substantial likelihood that the franchisor will prevail on the merits; (2) the franchisor will suffer irreparable injury if the injunction is not granted; (3) the injury to the franchisor greatly outweighs any injury the franchisee may suffer under the injunction; and (4) any injunction would not be adverse to the public interest.<sup>264</sup> Other courts may apply an

260. The Lanham Act expressly provides for injunctive relief to prevent infringement. 15 U.S.C. § 1116(a) (Supp. V 1999); *see also* Century 21 Real Estate Corp. v. Sandlin, 846 F.2d 1175, 1180 (9th Cir. 1988) (“Injunctive relief is the remedy of choice for trademark and unfair competition cases, since there is no adequate remedy at law for the injury caused by a [franchisee’s] continuing infringement.”).

261. 15 U.S.C. § 1114(1)(a) (1994 & Supp. V 1999). The pertinent part of Section 32 provides that:

(1) any person who shall, without the consent of the registrant - (a) use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive . . . shall be liable in a civil action by the registrant . . . .

*Id.*

262. 15 U.S.C. § 1125(a)(1) (1994). Section 43(a) provides in part, as follows:

(1) Any person who, on or in connection with any goods or services . . . uses in commerce any word, term, name, symbol, or device, . . . or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which—

(A) is likely to . . . deceive as to the affiliation, connection, or association of such person with another person . . . shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

*Id.* As for unregistered marks, see *Controls Int’l, Inc. v. Kinetrol, Ltd.*, No. 3:97-CV-2504-D, 1998 U.S. Dist. LEXIS 4794 at \*9 (N.D. Tex. Mar. 25, 1998).

263. 15 U.S.C. § 1125(c) Supp. IV (1998). Section 43(c) provides, in part, the following:

(c) Remedies for dilution of famous marks.

(1) The owner of a famous mark shall be entitled, subject to the principles of equity and upon such terms as the court deems reasonable, to an injunction against another person’s commercial use in commerce of a mark or trade name, if such use begins after the mark has become famous and causes dilution of the distinctive quality of the mark.

*Id.*

264. *Pappan Enters., Inc. v. Hardee’s Food Sys., Inc.*, 143 F.3d 800, 803 (3d Cir. 1998); *Vision Ctr. v. Opticks, Inc.*, 596 F.2d 111, 114 (5th Cir. 1979).

“alternative” test wherein the injunction may be issued if the moving party demonstrates either: (1) a combination of probable success on the merits and the possibility of irreparable injury or (2) serious questions which tip the balance of hardships sharply in the movant’s favor.<sup>265</sup>

In *Snelling and Snelling, Inc. v. Ryvis, Inc.*,<sup>266</sup> the franchisor sought a preliminary injunction to require the franchisee to comply with certain post-franchise termination obligations under the franchise agreement.<sup>267</sup> In applying the “traditional” test for obtaining a preliminary injunction, the court held that the franchisor had failed to establish the irreparable harm element of the test.<sup>268</sup> In determining that the franchisor had failed to establish the elements necessary to obtain a preliminary injunction, the court found that the irreparable harm element must be satisfied by independent proof and that the irreparable harm injury is a “heavy burden to overcome.”<sup>269</sup>

In *Dunkin’ Donuts, Inc. v. Albirch Donuts, Inc.*,<sup>270</sup> a franchisor sought a preliminary injunction to require the franchisee to comply with the health and safety requirements of the franchise agreement.<sup>271</sup> In issuing the preliminary injunction, the court found that the failure of a franchisee to follow certain health and safety codes can have a detrimental impact on a franchisor’s name and goodwill, and that such damage is “not readily quantifiable and, thus, constitutes irreparable harm.”<sup>272</sup>

One Texas court also dealt with injunctive relief in the context of direct sales activities. *Graham v. Mary Kay, Inc.*<sup>273</sup> involved a request for injunctive relief to enjoin a former Mary Kay salesperson from selling Mary Kay cosmetics at her retail location after termination. Mary Kay Cosmetics is a manufacturer and distributor of cosmetics under its brand name, Mary Kay. The Mary Kay system involves marketing cosmetic products through independent beauty consultants who work out of their homes and sell to personal customers.<sup>274</sup> Graham was a Mary Kay consultant but was terminated when Mary Kay discovered she was selling Mary Kay cosmetics at a flea market. After her termination, Graham continued to sell Mary Kay products at flea markets and in a shopping mall. Because Graham purchased products from Mary Kay beauty consultants and resold them, Mary Kay asserted that Graham could only acquire Mary Kay products by inducing Mary Kay’s sales representatives to breach their distribution contracts with Mary Kay that prohibit the sale of its products at a retail business. The trial court ruled that Graham was liable for tortious interference with contract and unfair competition, and unauthorized utili-

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265. *First Brands Corp. v. Fred Meyer, Inc.*, 809 F.2d 1378, 1381 (9th Cir. 1987).

266. No. 3:99-CV-2028-D, 1999 U.S. Dist. LEXIS 17928 (N.D. Tex. Nov. 10, 1999).

267. *Id.* at \*3.

268. *Id.* at \*12.

269. *Id.* at \*6.

270. 96 F. Supp. 2d 146 (N.D.N.Y. 2000).

271. *Id.* at 147.

272. *Id.* at 149.

273. 25 S.W.3d 749 (Tex. App.—Houston [14th Dist.] 2000, *pet. denied*).

274. *Id.* at 752.

zation of the Mary Kay trademark.<sup>275</sup>

On appeal, the Court analyzed whether Mary Kay's claims for unfair competition and unauthorized trademark use could be sustained where Graham was selling genuine Mary Kay merchandise. The court of appeals stated that a distributor selling genuine merchandise could misappropriate a manufacturer's trademark if its use of the trademark mislead the public about its relationship with the manufacturer.<sup>276</sup> The Texas appellate court ruled that Graham traded on Mary Kay's goodwill and marketing methods that Mary Kay had built up over the years. In sustaining the trial court's ruling, the appellate court found that Graham's actions caused confusion among consumers about whether Mary Kay was ending its longstanding policy against marketing its products through retail locations.<sup>277</sup> The appellate court affirmed the grant of summary judgment and the injunction barring Graham from selling Mary Kay products at her retail location.

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275. *Id.*

276. *Id.* at 754.

277. *Id.*