

January 2004

Franchise Law

Deborah S. Coldwell

Clay M. Steely

Heather L. Radliff

Monica S. Raines

Recommended Citation

Deborah S. Coldwell et al., *Franchise Law*, 57 SMU L. REV. 1035 (2004)
<https://scholar.smu.edu/smulr/vol57/iss3/20>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

FRANCHISE LAW

*Deborah S. Coldwell**

*Clay M. Steely***

*Heather L. Radliff****

*Monica S. Raines*****

I. INTRODUCTION

THIS article provides an update of certain significant developments in franchise law in Texas and in the Fifth Circuit during the Survey period. It also highlights important cases from outside Texas, some involving dealerships and distributorships that, in the authors' judgment, provide a relevant backdrop for franchising. Cases during the Survey period dealt with a range of provocative issues—from the now almost pedestrian analysis of jurisdiction connected to internet sites to the “newly discovered” duty of good faith and fair dealing in franchise agreements under Texas law. In addressing the specific areas that affect franchise and distribution systems, however, the update has not attempted to explain the entire body of franchise law but, instead, has focused on particularly instructive cases.

II. PROCEDURE

A. JURISDICTION

At least three noteworthy personal jurisdiction cases fell within this Survey period. Two cases focus on the newly charted territory of personal jurisdiction and internet websites. Based on those cases, it is becoming increasingly difficult to establish jurisdiction, specific or general, by basing your claim on the interactivity of a website. The third case strays from internet websites and instead focuses on the more charted territories of prior negotiations, contemplation of future consequences, terms of contracts, and the parties' actual course of dealing.

In Mothers Against Drunk Driving v. Dads and Mad Moms Against

* B.A., Colorado State University, 1974; M.A.T., The Colorado College, 1979; J.D., University of Texas, 1990. Partner, Haynes and Boone, LLP, Dallas, Texas.

** B.A., Texas A&M University, 1991; J.D., South Texas College of Law, 1994. Shareholder, Jenkins & Gilchrist, P.C., Houston, Texas.

*** B.A., University of Illinois at Champaign-Urbana, 1995; J.D. University of Texas, 1998. Associate, Jenkins & Gilchrist, P.C., Dallas, Texas.

**** B. A., Southern Methodist University, *cum laude*, 2000; J.D., Southern Methodist University, 2003. Associate, Jenkins & Gilchrist, P.C., Dallas, Texas.

Drug Dealers,¹ the court dismissed the complaint finding the website lacked enough interactivity to confer specific jurisdiction. In this case, Mothers Against Drunk Driving (MADD) alleged claims of trademark infringement, trademark dilution, and unfair competition in violation of federal and state law. MADD is a non-profit, District of Columbia corporation headquartered in Irving, Texas. Dads and Mad Moms Against Drug Dealers (DAMMADD) is a non-profit corporation with its principal place of business in Tioga Center, New York, and all of DAMMADD's employees are New York residents. DAMMADD responded to MADD's claims by filing a motion to dismiss for lack of personal jurisdiction and improper venue. Since the Texas long-arm statute confers jurisdiction to the limit of the federal constitution, the court only discussed the federal due process inquiry.²

To exercise personal jurisdiction over a non-resident defendant, due process requires two elements be met. First, the non-resident must have some minimum contact with the forum state. Second, it must be fair or reasonable to require the non-resident to defend the suit in that forum state.³ Minimum contact means that a non-resident defendant must do something to purposefully avail himself of the privilege of conducting activities within the forum state. If a defendant purposefully avails himself, he invokes the benefits and protections of that state's laws. Courts make it clear that the unilateral activity of one asserting a relationship with the non-resident defendant does not satisfy this requirement.⁴

Based on a defendant's contacts with the forum state, either specific or general jurisdiction may be exercised on the defendant. Specific jurisdiction exists if the cause of action is related to, or arises out of, the defendant's contacts with the forum and those contacts meet the due process standard. General jurisdiction, on the other hand, may be found when the claim is unrelated to the non-resident's contacts with the forum but where those contacts are continuous and systematic.⁵

In this case, MADD argued that DAMMADD had sufficient minimum contacts with Texas for the court to exercise personal jurisdiction over DAMMADD. MADD pointed to DAMMADD's website and its use of the website to solicit and collect donations as well as sell products to satisfy specific jurisdiction. Further, MADD argued that DAMMADD's website provided contacts with the forum that were significant enough that DAMMADD should reasonably have anticipated being sued in Texas. The court was not convinced.⁶

In supporting its decision, the court relied on the Fifth Circuit's sliding scale test to determine whether defendant's operation of an internet web-

1. *Mothers Against Drunk Driving v. Dads and Moms Against Drug Dealers*, No. 3:02-CV-1712-G, 2003 U.S. Dist. LEXIS 1800 (N.D. Tex. Feb. 7, 2003).

2. *Id.* at *2, 5, 8, 10-11.

3. *Id.* at *11.

4. *Id.* at *126.

5. *Id.* at *13-14.

6. *Id.* at *15-16.

site provides the requisite minimum contacts for personal jurisdiction. In *Zippo Manufacturing Co. v. Zippo Dot Com, Inc.*,⁷ the court established a sliding scale test to evaluate the nature and quality of commercial activity that an entity conducts over the internet. This sliding scale analysis categorizes internet use into a three-point spectrum. At one end is a completely passive website where jurisdiction would be inappropriate. The other end of the spectrum is where a defendant clearly does business over the internet by entering into contracts with residents of other states. This involves the knowing and repeated transmission of computer files over the internet. In that situation, jurisdiction is proper. In the middle of the spectrum is an interactive website. An interactive website allows a visitor to exchange information with a host computer.⁸ The court classified DAMMADD's website as an interactive website falling somewhere in the middle of the spectrum. In determining how interactive DAMMADD's website was, the court looked at the level of inter-activity and commercial nature of the exchange of information that occurs on the website.⁹

The court, while noting that DAMMADD's website clearly allowed a visitor to interact and exchange information with a host computer by submitting anonymous drug activity tips, making donations, and purchasing products, still found that the level of interactivity and commercial nature of DAMMADD's website were not sufficient to warrant an exercise of specific jurisdiction. The court pointed to numerous facts that differentiated this case from others where the court found personal jurisdiction. First, of the 786 anonymous tips the website received, only twenty came from Texas, which was less than three percent. Plus, none of these tips were ever used by law enforcement, much less given a reward, for the receipt of the tip. Second, less than two percent of donations DAMMADD received came from Texas.¹⁰

Finally, while DAMMADD's website offered a few products for sale, it was not a virtual store. Rather, only a very small portion of the website sold products. In fact, the website sales only included two main items—certain drug kits and posters. MADD's argument is weakened even more considering that only two Texas consumers had actually chosen to purchase a product offered over the DAMMADD website.¹¹ The court found that "these web-based contacts simply fail[ed] to paint the picture of a significantly commercial website that is visited regularly by Texas residents."¹²

While the court in *Mothers Against Drunk Driving* grappled with specific jurisdiction, in *Reiff v. Roy*,¹³ the court tackled general jurisdiction

7. *Zippo Mfg. Co. v. Zippo Dot Com, Inc.*, 952 F. Supp. 1119 (W.D. Pa. 1997).

8. *Id.* at 1124.

9. *Mothers Against Drunk Driving*, 2003 U.S. Dist. LEXIS 1800, at *19.

10. *Id.* at *20-23.

11. *Id.* at *21-22.

12. *Id.* at *22.

13. *Reiff v. Roy*, 115 S.W.3d 700 (Tex. App.—Dallas 2003, pet. denied).

and internet websites. The court addressed whether the internet website in question met the even more demanding minimum contacts analysis required to assert general jurisdiction than that required for specific jurisdiction. To establish general jurisdiction, a nonresident must engage in systematic and continuous contacts with the forum state. An important distinction is that the events in general jurisdiction that give rise to the suit do not have to occur in that state.¹⁴

In *Reiff*, the plaintiff argued that the court had general jurisdiction over the defendants based mostly on a website that the defendants maintained. When analyzing internet websites and general jurisdiction, the court used a sliding-scale analysis identical to the one discussed above in *Zippo*. The same three categories are used in the analysis of this case. At one end you have a passive website that will not confer jurisdiction, and at the other end is a website clearly used for business purposes that will confer jurisdiction. The website in this case fell in the middle of the spectrum as an interactive website that, depending on the amount of interaction, could swing either way.¹⁵

Plaintiff argued that the court had general jurisdiction because the website was clearly interactive. In support of this, he claimed that the defendants' website advertised and solicited business on the Internet, gave driving directions, provided a map, and allowed guests to make reservations through the website. The court, while considering these were true, noted they did not show systematic and continuous contacts between the defendant and Texas. The court also considered other factors. Defendants were residents of Colorado and they operated their hotel in Colorado. Defendants had never directly engaged in any business activities in Texas, had no employees, office, registered agent, or property in Texas, and were not authorized to do business in Texas. Plus, the franchisor was responsible, rather than the defendants, for operation of the website. Finally, there was no evidence that the plaintiff ever made a reservation at the defendants' hotel through the website or that the website was directed towards Texans.¹⁶

Unlike the two prior cases, the third noteworthy personal jurisdiction case found personal jurisdiction. In *ICEE Distributors, Inc. v. J & J Snack Foods Corp.*,¹⁷ the court exercised personal jurisdiction by looking to the defendant's prior negotiations, contemplation of future consequences, terms of contracts, and the parties' actual course of dealing.¹⁸

In *ICEE*, a regional distributor brought a suit against a trademark owner, alleging breach of a licensing agreement; against another distributor which sold the same product but in a slightly different form within plaintiff's territory; and against a store where the slightly different prod-

14. *Id.* at 704-05.

15. *Id.* at 705-07.

16. *Id.* at 706.

17. *ICEE Distrib., Inc. v. J & J Snack Foods Corp.*, 325 F.3d 586 (5th Cir. 2003).

18. *Id.* at 591-92.

uct was sold, alleging trademark infringement and dilution. The question was whether the Louisiana court could exercise jurisdiction over the trademark owner, a Texas corporation, with its principal place of business in California. The court found that the trademark owner had sufficient minimum contacts with Louisiana to support an exercise of jurisdiction. Specifically, the trademark owner's predecessor granted the distributor an exclusive license within a region that included most of Louisiana. The predecessor accepted the long-term relationship that contemplated its oversight of the distributor's actions in that territory. The owner's licensing of another distributor in the territory overlapped geographically with the regional distributor's territory and caused foreseeable injuries to the distributor. All of these factors made it clear to the court that personal jurisdiction was proper.¹⁹

B. CHOICE OF LAW

In analyzing which state's law to apply to an issue, courts typically give weight to the parties' choice-of-law provision in the franchise agreement. But when there is a dispute over the applicability of such a provision, the court will look in other directions. The first case involving choice of law applies a substantial relationship test to decide which state law applies, and the second case shows what can happen when a plaintiff argues for a choice-of-law provision that ultimately dismisses two of the plaintiff's claims.

In *Texas Taco Cabana, L.P. v. Taco Cabana of New Mexico, Inc.*,²⁰ the court used a substantial relationship test to determine which forum governed. In their motion to dismiss, counter-defendants claimed that counter-plaintiffs had failed to state a claim for violation of the New Mexico Unfair Practices Act because New Mexico's law did not apply to the dispute. The court ultimately concluded that Texas law, not New Mexico law, applied and dismissed counter-plaintiff's claims.²¹

In deciding this case, the court analyzed the Texas choice-of-law provision, noting that a federal court in a diversity case applied the choice-of-law rules of the forum state. "Under Texas law, the parties' choice of law will be enforced unless the chosen law has no substantial relationship to the parties or the transaction or application of the law chosen would be contrary to a fundamental policy of a state that has a materially greater interest than the chosen state in the determination of a particular issue."²² The agreement at issue contained a choice-of-law provision that stated: "The Agreement takes effect upon its acceptance and execution by Licensor in the State of Texas, and shall be construed under the laws

19. *Id.* at 592-93.

20. *Tex. Taco Cabana, L.P. v. Taco Cabana of N.M., Inc.*, 304 F. Supp. 2d 903 (W.D. Tex. 2003).

21. *Id.*

22. *Id.* at 907-08.

thereof, which law shall prevail in the event of any conflict of law.”²³ Counter-plaintiffs argued that this provision did not include their tort claims.²⁴

The court first analyzed the scope of the Agreement’s choice-of-law provision to decide whether the choice-of-law provision included the developer’s tort claims. The provision referred to “This Agreement,” which restricts the clause to the agreement itself. The provision did not extend to the general rights and liabilities of the parties. Therefore, the court applied Texas choice-of-law rules to determine which law applied to the developer’s tort claims.²⁵

Texas choice-of-law rules apply a significant relationship test when the parties have not agreed to the application of law. The significant relationship test considers where the injury occurred, where the conduct causing the injury occurred, the domicile, residence, nationality, place of incorporation and place of business of the parties, and where the relationship is centered. Applying the test, the court concluded that the injury occurred in New Mexico, the conduct causing the injury occurred in Texas and New York, the domiciles and residences differed and offered no help, and that the relationship was centered in Texas. If the court looked at these considerations only, then Texas law would dominate. The court, however, must consider another element.²⁶

The final element implicated in this case was the certainty, predictability, and uniformity of result factor. The court noted that this factor was important in this case because the other factors, if considered alone, could create different results stemming from the same contract with the same Franchisor but with different Franchisees. This last element would protect the Franchisor by focusing on the single state which had a substantial relationship to every contract. After considering the certainty, predictability, and uniformity of result factor, the court still concluded that Texas law would apply because the franchisor was located there.²⁷

In *Brock v. Baskin Robbins, USA Co.*,²⁸ a group of more than forty franchisees brought an action against their franchisor. “The crux of the [franchisees’] complaints [was] that Baskin Robbins . . . [had] decided not to renew their franchise agreements and that Baskin Robbins [allegedly] mishandled funds in a common advertising fund.”²⁹ The franchisees operated in several states, including Alabama, Mississippi, Texas, Arkansas, and Louisiana. None of the franchisees operated or resided in California. This alone was enough for the court to conclude that the California choice-of-law provision should fail because California Franchise Acts do

23. *Id.*

24. *Id.*

25. *Id.* at 909-10.

26. *Id.* at 908-10.

27. *Id.*

28. *Brock v. Baskin Robbins, USA, Co.*, No. 5:99-CV-274, 2003 WL 21309428 (E.D. Tex. Jan. 17, 2003).

29. *Id.* at *1.

not apply to franchisees who neither operate nor reside in California. Nevertheless, the franchisees still argued that California law should apply. Specifically, the franchisees claimed two California statutes were incorporated into the contract's terms. After reviewing the choice-of-law provision, the court found that the provision clearly excepted the statutes from applying. The court dismissed all of the franchisees' claims based on the two California statutes.³⁰

C. FORUM SELECTION

Under the topic of franchise law and forum selection, there was one pivotal case during this Survey period that encompassed a wide variety of forum selection issues. In *My Café-CCC, LTD v. LunchStop, Inc.*,³¹ the court analyzed three different forum selection issues: (1) the enforceability of forum selection clauses under Section 35.53 of the Texas Business and Commerce Code,³² (2) what a movant must prove to have a forum selection clause voided because it was procured by fraud, and (3) the application of forum selection clauses to fraudulent inducement claims.³³

My Café executed four franchise agreements with LunchStop. After My Café alleged a breach of the agreements, it filed suit in Dallas County, Texas against LunchStop seeking to recover damages based on fraudulent inducement and breach of contract. My Café alleged that venue was proper in Dallas County because LunchStop committed a tort in Texas and also because the forum selection clauses in the franchise agreements did not comply with Section 35.53(b) of the Texas Business and Commerce Code.³⁴ My Café contended that it was exercising its right under the code to void the forum selection clauses in the agreements. LunchStop filed an answer and a motion to dismiss, stating the court did not have jurisdiction because of the valid forum selection clauses in the offering circulars. The trial court granted the motion to dismiss because of the contractual forum selection requirement in the agreement to litigate in California. My Café appealed.³⁵

My Café claimed that the trial court erred in dismissing its suit because the forum selection clauses were unenforceable by not complying with Section 35.53 of the Texas Business and Commerce Code, they were procured through fraud, and they were not applicable to causes of action for fraudulent inducement. LunchStop first responded that Section 35.53 did not apply to the franchise agreement because it had complied with Section 41.104(b)(8) of the Texas Business and Commerce Code and the forum selection clause was disclosed in the offering circular.³⁶

30. *Id.* at *1, 4.

31. *My Café-CCC, Ltd. v. LunchStop, Inc.*, 107 S.W.3d 860 (Tex. App.—Dallas 2003, no pet.).

32. *See* TEX. BUS. & COM. CODE ANN. § 35.53 (Vernon 2002).

33. *My Café-CCC, Ltd.*, 107 S.W.3d at 865-67.

34. *See* § 35.53.

35. *My Café-CCC, Ltd.*, 107 S.W.3d at 863 n.4.

36. *Id.* at 864.

Forum selection clauses are enforceable in Texas, provided (1) the parties have contractually consented to submit to the exclusive jurisdiction of another state, and (2) the other state recognizes the validity of such provisions. Texas courts are not bound by the parties' selection of a forum with regard to any cause of action if the interests of the public and potential witnesses strongly favor jurisdiction in a forum other than the forum selected by the parties.³⁷

My Café argued, and the court analyzed, whether the parties contractually consented to submit to the exclusive jurisdiction of another state. Section 35.53 of the Texas Business and Commerce Code allows a party to declare a forum selection clause void if certain conditions are met.³⁸ My Café met most of those conditions. The franchise contracts were for less than \$50,000, and My Café was a limited partnership having its principal place of business in Texas.³⁹ My Café did not, however, prove that Section 1.105 did not apply to the contract.⁴⁰

Section 1.105 allows parties of a multi-state transaction the right to choose their own law when a transaction bears a reasonable relation to different states.⁴¹ The court held that Section 1.105 was applicable to this contract because LunchStop's corporate headquarters are in Morgan Hill, California. That gave LunchStop a reasonable relation to the State of California. Therefore, the court found that Section 35.53(b) did not apply to this transaction, the forum selection clauses were not void, and My Café contractually consented to the forum selection clauses.⁴²

Next, the court considered My Café's argument that the forum selection clauses were unenforceable because they were procured by fraud. In order to prove unenforceability because of procurement by fraud, the movant must present evidence on each element of fraud in the inducement of the execution of the forum selection clause. The elements of fraud that apply are (1) a material misrepresentation, (2) which was false, (3) which was either known to be false when made or was asserted without knowledge of the truth, (4) which was intended to be acted upon, (5) which was relied upon, and (6) which caused injury. My Café did not present evidence on each of these elements. The only facts My Café presented were that the representations in the offering circular were not identical to the forum selection clauses in the agreements. The only differences were the places designated to resolve the agreements. Some named San Francisco, California, while others named Morgan Hill, California. My Café did not meet its burden of showing fraud in the inducement because it failed to explain what the material misrepresentation was or how it relied upon it to secure the forum selection clauses.⁴³

37. *Id.* at 864-65.

38. § 35.53.

39. *My Café-CCC, Ltd.*, 107 S.W.3d at 865.

40. *Id.*

41. TEX. BUS. & COM. CODE ANN. § 1.105 (Vernon 2002).

42. *My Café-CCC, Ltd.*, 107 S.W.3d at 865.

43. *Id.* at 865-66.

Third, the court addressed the applicability of forum selection clauses to particular causes of action. The application of a forum selection clause to an asserted cause of action depended on the cause of action asserted and the actual writing of the clause itself. When a forum selection clause encompassed all causes of action concerning the contract, the claim that a party was fraudulently induced to enter the contract does not avoid the forum selection clause. Here, the court found that the forum selection clause in the agreements applied to “[a]ny dispute arising under or in connection with” the agreements and “any claim affecting [their] validity, construction, effect, performance, or termination.”⁴⁴ Because the clause encompassed all causes of action concerning the contract, a claim of fraudulent inducement did not avoid the forum selection clause.⁴⁵

D. CLASS ACTIONS

During this Survey period, in a case of first impression, the Fifth Circuit addressed whether, under the Petroleum Marketing Practices Act (PMPA),⁴⁶ all named plaintiffs in a class action must be located in the district where they filed suit for venue to be proper. In *Abrams Shell v. Shell Oil Co.*,⁴⁷ the court held that they did. In deciding this question, the court first looked to the wording of the PMPA.⁴⁸

The PMPA contains a specific venue provision that authorizes a franchisee to bring suit in either of two different venues: (1) the district in which the franchisor has its principal place of business, or (2) the district in which the franchisee is doing business.⁴⁹ In this case, the first option was satisfied because all defendant franchisors had their headquarters and principal places of business in Houston, Texas. Plaintiffs, however, still sought to have the case moved to California under option two even though plaintiffs were located in three different states and up to five judicial districts.⁵⁰

In deciding against plaintiffs, the court looked to several sources, including past Fifth Circuit district courts. Fifth Circuit district courts “have consistently held that all named plaintiffs to a class action must satisfy the venue requirements.”⁵¹ Following the district court decisions in other cases, the court found that all named plaintiffs must be in the same district for venue to be proper under the PMPA. Therefore, in this case, venue was only proper in the Southern District of Texas, the district in which the franchisor had its principal place of business.⁵²

44. *Id.* at 866.

45. *Id.* at 866-67.

46. See 15 U.S.C.A. § 2801 (2003).

47. *Abrams Shell v. Shell Oil Co.*, 343 F.3d 482 (5th Cir. 2003).

48. See *id.* at 489.

49. 15 U.S.C.A. § 2805(a).

50. *Abrams Shell*, at 484-85.

51. *Id.* at 490.

52. *Id.* at 489-90.

E. ARBITRATION

The Fifth Circuit reinforced the strong federal policy favoring arbitration in *Saturn Distribution Corp. v. Paramount Saturn, Ltd.*⁵³ An automobile franchisor sought to compel arbitration of a dispute with its franchisee, in which the franchisee alleged the franchisor breached its statutory duty of good faith and fair dealing when it refused to sell three dealerships to the franchisee. Although the franchise agreement contained a broad arbitration provision, the franchisee argued that the dispute was not arbitrable because the Texas Motor Vehicle Board (TMVB) had exclusive jurisdiction over the dispute.⁵⁴ The court disagreed. If the Texas statute did happen to give the TMVB exclusive jurisdiction over contractual disputes between franchisors and franchisees in the motor vehicle industry, then the statute would be preempted by the Federal Arbitration Act (FAA),⁵⁵ to the extent that it limited availability of arbitration over such disputes. The court reemphasized the importance of the strong federal policy favoring arbitration. The FAA will continue to preempt state laws that act to limit the availability of arbitration.⁵⁶

III. THE FRANCHISE RELATIONSHIP, TERMINATION AND NON-RENEWAL

A. THE FRANCHISE RELATIONSHIP

Since Texas does not have a franchise relationship law that regulates relationships between a franchisor and franchisee, it is often difficult distinguishing between different franchise claims. One case during this period helped to clarify some points. The Fifth Circuit, in *Abrams Shell v. Shell Oil Co.*,⁵⁷ accomplished two important goals. First, *Abrams Shell* distinguished between the often confused franchise topics of constructive termination and constructive non-renewal. Second, *Abrams Shell* supported cases from other jurisdictions that held that absent evidence that a franchisors failed to actually renew a contract, constructive non-renewal did not exist.⁵⁸

In *Abrams Shell*, the court makes an important distinction between claims for constructive termination and claims for constructive non-renewal, noting that the two terms are often confused. To differentiate between these two claims, the court examined three ways that the PMPA distinguished between the two claims.⁵⁹ The PMPA is often used by franchisors and franchisees to help regulate the franchise relationship.

53. *Saturn Distribution Corp. v. Paramount Saturn, Ltd.*, 326 F.3d 684, 687 (5th Cir. 2003).

54. *Id.* at 686 (citing TEX. REV. CIV. STAT. ANN. art. 4413 (36), § 1.02, 3.01(a) (Vernon Supp. 2001)).

55. *See* 9 U.S.C.A. § 1 (2003).

56. *Saturn Distribution Corp.*, 326 F.3d at 687.

57. *Abrams Shell v. Shell Oil Co.*, 343 F.3d 482 (5th Cir. 2003).

58. *Id.* at 486-89.

59. *See id.* at 486.

The PMPA is a federal statutory scheme created to regulate the termination and non-renewal of petroleum franchise relationships.⁶⁰

The court first noted that the PMPA distinguished between terminations of franchises and nonrenewals of franchise relationships. This distinction is meaningful because a franchise consists of "specific rights and obligations under the franchise agreement," but the term "franchise relationship" refers to the actual "relationship between the parties."⁶¹

The court then noted that the grounds upon which a franchise may be terminated are not coextensive with the grounds for nonrenewal of a franchise relationship.⁶² The grounds listed under the PMPA differ for terminations and non-renewals. For example, the PMPA lists ten grounds on which a franchise or franchise relationship may be ended; five are available either to terminate or non-renew, five can be invoked only to non-renew.⁶³

Third, the court noted that termination occurs prior to the conclusion of the term, or the expiration date, stated in the franchise agreement. In contrast, nonrenewal can only take place at the conclusion of the term, or on the expiration date.⁶⁴ In other words, termination can happen at any time, but nonrenewal typically occurs within a narrower temporal context.⁶⁵

The court in *Abrams Shell* also analyzed whether there could be a claim for constructive non-renewal absent evidence that a franchisor failed to renew a contract. In the case, gasoline station franchisees brought suit alleging that the franchisor violated the PMPA by presenting a new and altered set of franchise agreements in a "take it or leave it" manner. The cover letter to the new Agreements stated, "If you do not sign and return the Lease and other enclosed documents in a timely manner, be advised that Equilon will issue without further warning a non-rescindable notice of non-renewal pursuant to the terms of the [PMPA]."⁶⁶ Sales consultants for one or more of the defendants allegedly indicated to plaintiffs that the new agreements had to be signed "as is," without making any changes to the agreements. The plaintiffs objected to the content of the New Agreements but eventually signed them without making any changes and continued to operate their gasoline service stations.⁶⁷

The court noted that the defendants never actually terminated or refused to renew their franchise agreements with the plaintiffs.⁶⁸ In fact, the opposite occurred. The plaintiffs signed the new agreements and con-

60. 15 U.S.C.A. § 2801 (2003).

61. *Abrams Shell*, at 486.

62. *Id.* at 486.

63. *Id.* (citing *Bridges Enters., Inc. v. Exxon Co., U.S.A.*, 820 F.2d 123,124 (5th Cir. 1987)).

64. *Id.* at 486 (citing 15 U.S.C. § 2802(a) (2003)).

65. *Id.*

66. *Id.* at 485.

67. *Id.*

68. *Id.* at 486.

tinued to operate as franchisees. For this reason, plaintiffs only alleged that their franchise agreements were constructively nonrenewed.⁶⁹ Since the plaintiffs did not provide any evidence that the defendants failed to renew the agreements, the plaintiffs did not show a breach in the franchise relationship and the claims were dismissed.⁷⁰

B. TERMINATION AND NON-RENEWAL

In another Fifth Circuit case, a plaintiff unsuccessfully looked to a Louisiana statute to provide relief after a franchisor terminated the franchise relationship. This case shows that in a case where one party claims that termination was in violation of a state law, courts tend to analyze the state statute and look to the legislature's intent for applicability considerations.⁷¹

Lake Charles Diesel, Inc. v. General Motors Corp. involves a challenge to the applicability of the Louisiana Repurchase of Farm, Industrial, and Lawn and Garden Equipment by Wholesaler Act (Repurchase Act)⁷² to an AC Delco distributorship agreement. The conflict arose when Delco purported to terminate the parts agreement by having a letter hand-delivered to Lake Charles Diesel, Inc. (LCD). The letter notified LCD that Delco was terminating the contract, effective thirty days after delivery. The notice did not state or imply that the relationship was being terminated for cause or offer any reason for termination. Shortly after receiving Delco's termination notice, LCD filed suit complaining that Delco's termination of the parts agreement violated the Repurchase Act. The District Court agreed, Delco appealed, and the Fifth Circuit Court reversed.⁷³

On appeal, the court studied the Repurchase Act. The court first looked to the purpose behind the Act, concluding that the Act serves to protect dealers from arbitrary and precipitous termination or cancellation of dealership relationships without being furnished adequate advance notice that specifies good cause and gives the dealer an opportunity to cure the cause. After establishing the Act's purpose, the court looked to the applicability provision of the Act. After extensive analysis of the statute, the court concluded that the Act did not apply to the parts agreement because the statute did not demonstrate an intention to protect dealers like LCD that stock and sell or distribute generic repair parts only. Therefore, the court reversed the district court's decision and dismissed LCD's Repurchase Act.⁷⁴

69. *Id.*

70. *Id.* at 489.

71. *See* *Lake Charles Diesel, Inc. v. Gen. Motors Corp.*, 328 F.3d 192 (5th Cir. 2003).

72. LA. REV. STAT. ANN. 51:481-490 (West 2003).

73. *Lake Charles Diesel, Inc.*, 328 F.3d at 193-95.

74. *Id.* at 197-203.

IV. INTELLECTUAL PROPERTY

A. TRADEMARKS

1. Enforcement

The United States Supreme Court released an important decision during the Survey period interpreting the Federal Trademark Dilution Act—an act frequently used by franchisors to protect their trademark rights.⁷⁵ In *Moseley v. V Secret Catalogue, Inc.*,⁷⁶ Victoria's Secret brought an action under the Federal Trademark Dilution Act (FTDA) against Victor and Cathy Moseley—the owners and operators of Victor's Little Secret, an adult novelty store located in Kentucky. The respondents, affiliated corporations that owned the Victoria's Secret trademark, alleged that their famous mark was being diluted by the Moseleys.⁷⁷ The respondents alleged in their complaint, among other claims, that their mark was being diluted in violation of the FTDA because the Moseleys' conduct was "likely to blur and erode the distinctiveness" and "tarnish the reputation" of the Victoria's Secret trademark.⁷⁸ The only evidentiary support that respondents provided for this claim was the affidavit of a marketing expert describing the value of the Victoria's Secret trademark. The expert did not express any opinion on the dilutive effect of the Moseleys' use of the name "Victor's Little Secret." The district court did not find that any blurring had occurred, but ruled in favor of the respondents. The Sixth Circuit affirmed the district court, expressly rejecting the holding of the Fourth Circuit in *Ringling Brothers-Barnum & Bailey Combined Shows, Inc. v. Utah Division of Travel Development*, which held that a showing of actual economic harm was required to support a claim of trademark dilution.⁷⁹ On appeal, however, the U.S. Supreme Court unanimously held that the FTDA did, in fact, require a showing of actual dilution rather than only a likelihood of dilution.⁸⁰

The Court agreed with the Fourth Circuit's *Ringling Bros.* decision that, where the marks at issue were not identical, the mere fact that consumers mentally associated a junior user's mark with a famous mark is not sufficient to establish actionable dilution. Instead, the Court read the FTDA to require an actual showing of dilution. The Court clarified that their holding did not mean that the consequences of dilution, such as an actual loss of sales or profits, must also be proved. The Court recognized that consumer surveys and other means of demonstrating actual dilution were expensive and often unreliable, but held that plaintiffs must present evidence of a lessening of the capacity of the subject mark to identify and

75. See 15 U.S.C. § 1125 (1995).

76. *Moseley v. V Secret Catalogue, Inc.*, 537 U.S. 418 (2003).

77. *Id.* at 422.

78. *Id.* at 424.

79. *Id.* at 424-28 (citing *Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Utah Div. of Travel Dev.*, 170 F.3d 449 (4th Cir. 1999), *cert. denied*, 528 U.S. 923 (1999)).

80. *Moseley*, 539 U.S. at 418, 424-28 & 433.

distinguish the goods and services identified with that mark.⁸¹

2. *Unauthorized Use*

On the heels of the U.S. Supreme Court's decision, the Fifth Circuit also released an important decision interpreting the FTDA.⁸² In *ICEE Distributors, Inc. v. J & J Snack Foods Corp.*, ICEE Distributors initially brought suit against J & J Snack Foods Corp. and Wal-Mart Stores, Inc. for trademark infringement and dilution. The distributors had purchased several regional distributorships, gaining in the process those distributorships' trademark licensing agreements with a predecessor to ICEE of America (IOA), ICEEQUIP. Distributors and the ICEE Company, a subsidiary of J & J, formed IOA, which acquired ownership rights to the ICEE trademarks previously held by ICEEQUIP. J & J began manufacturing frozen squeeze-up tubes under the ICEE name and distributing these products through Wal-Mart stores on a nationwide basis, including those in distributors' territory. After this action was initially filed, J & J assigned the trademark application for the ICEE name on the squeeze-up tubes to IOA, which successfully registered the trademark. Therefore, Distributors added IOA as a defendant alleging IOA, as assignee of the trademarks formerly held by ICEEQUIP, was bound by and had breached licensing agreements that ICEEQUIP had entered into with distributors.⁸³

At the initial trial, the jury found IOA liable for breach of contract and J & J and Wal-Mart liable for willful trademark dilution. Based on the jury verdict, the court entered a permanent injunction against J & J and Wal-Mart forbidding the sale of the ICEE squeeze-up tubes within distributors' territory. Defendants appealed.⁸⁴

The district court's injunction against defendants was based upon the jury's findings (1) that IOA had breached its contract with the distributors and (2) that there was alleged dilution of the ICEE trademark caused by the defendants' actions. The Fifth Circuit did not find any error in the district court's implicit finding that the distributors were entitled to an injunction based on the breach of contract issue.⁸⁵

On the dilution issue, however, the Fifth Circuit looked at the licensing agreements and found that the distributors' agreement with IOA, under which it obtained rights in the ICEE trademarks, was only an exclusive license arrangement, with ultimate control and ownership of the trademarks resting with IOA. Consequently, the court held that IOA was the owner, rather than the distributors, of the ICEE trademarks and, therefore, the distributors had no standing to sue under the FTDA. The court held that the district court had abused its discretion in basing its injunc-

81. *Id.* at 433.

82. *See ICEE Distrbs., Inc. v. J & J Snack Foods Corp.*, 325 F.3d 586 (5th Cir. 2003).

83. *Id.* at 589-90.

84. *Id.* at 590.

85. *Id.* at 599.

tion in part on the dilution claim, but did not reverse the trial court's grant of the injunction requested by distributors, finding that the injunction was a proper remedy for IOA's breach of the licensing agreements.⁸⁶

3. Cybersquatting

During the Survey period, a federal district civil court released a decision regarding the Anti-Cybersquatting Consumer Protection Act (ACPA).⁸⁷ In *March Madness Athletic Assoc., L.L.C. v. Netfire, Inc.*, the court analyzed whether Netfire, Inc., acting on behalf of Sports Marketing International, Inc. (SMI), had a bad faith intent to profit from the March Madness Athletic Association's "march madness" trademark.⁸⁸

The court first considered the fair use defense, "which provides that '[b]ad faith intent. . . shall not be found in any case in which the court determines that the person believed and had reasonable ground to believe that the use of the domain name was a fair use or otherwise lawful.'" ⁸⁹ The court found that SMI's use of "marchmadness.com" was not fair use under the ACPA because no matter what defendants' subjective beliefs were, they "did not have 'reasonable grounds' to believe that their use of marchmadness.com was a fair use."⁹⁰ SMI's use, which associated its website with the NCAA Tournament, was a commercial use that sought to exploit the goodwill of MMAA's rights to the "march madness" trademark.⁹¹

The court continued with an analysis to determine SMI's bad faith intent. The court concluded that the nine factors set out in the ACPA applied to the facts of this case, including that (1) SMI had no intellectual property in march madness, other than its registration of the domain name of marchmadness.com; (2) SMI and the other defendants did not make any prior use of marchmadness.com in connection with the bona fide offer of goods and services; and (3) the defendants did not make any bona fide noncommercial or fair use of marchmadness.com. The court found that the defendants acted with a bad faith intent and that their use of marchmadness.com was in violation of the ACPA. In assessing damages, however, the court pointed out that under the statute, damages are not available for any violation occurring before November 29, 1999. The evidence showed that by the end of July 1999, the marchmadness.com website had been placed on hold, so that there was no evidence of "use" after November 29, 1999; therefore, no damages were awarded. In the end, the court provided redress for the violation under the statute by ordering the transfer of the domain name from the defendants to MMAA.⁹²

86. *Id.*

87. See *March Madness Athletic Ass'n, L.L.C. v. Netfire, Inc.* No. CIV.A.3:00-CV-398-R, 2003 WL 22047375 (N.D. Tex. Aug. 28, 2003); 15 U.S.C. § 1125(d) (2000).

88. *March Madness Athletic Ass'n, L.L.C.*, 2003 WL 22047375, at *25-26.

89. *Id.* at *25 (citing 15 U.S.C. § 1125(d)(1)(B)(ii)).

90. *Id.*

91. *Id.*

92. *Id.* at *26-29.

As the law continues to develop and people's use of the Internet continues to grow, it is likely that the ACPA will become a useful statute for franchisors fighting trademark infringement.

V. COMMON-LAW CLAIMS

A. CONTRACT ISSUES

During the Survey period, the Texas Supreme Court analyzed the principal-agent relationship in the context of a franchisee's attempt to sell his franchise twice.⁹³ In *Latch v. Gratty, Inc.*, Latch, as president and part owner of Fun Motors of Longview, Inc., signed an asset purchase agreement with Jim Gratton, president and owner of Gratty, Inc., providing for the purchase of Fun Motor's Kawasaki franchise and other assets. Approximately five months later, however, Latch entered into an agreement to sell the Kawasaki franchise and assets to a different buyer, Mr. Zhorne, signing in his own name without reference to Fun Motors. "Meanwhile, Kawasaki had instituted proceedings before the Texas Department of Transportation to terminate Fun Motors' Kawasaki franchise for reasons unrelated to the attempted sale."⁹⁴

After the termination of the Kawasaki franchise, Gratty, Inc. brought the suit which was on appeal in this case against Latch, alleging, among other things, breach of contract and tortious interference with a contract. The trial court determined that Latch's conduct interfered with the contract between Gratty and Fun Motors and awarded tort damages, which the court of appeals upheld. The court of appeals held that Latch was acting in his individual capacity when he interfered with the Fun Motors-Gratty asset purchase agreement by signing another contract with Zhorne. The Texas Supreme Court, however, disagreed.⁹⁵

Gratty offered evidence that Latch signed the Gratty-Fun Motors contract with a designation of his agency status, unlike his signature in the Zhorne agreement, and that he knew how to effect a corporate act. The acts of a corporate agent on behalf of his principal under Texas law are ordinarily deemed to be the corporation's acts, unless the plaintiff can prove that the agent acted to further his personal interests. The court concluded that the mere fact that Latch signed the agreement without indicating his agency was not evidence that he acted individually and, therefore, he could be liable for tortiously interfering with the contract of his principal, Fun Motors. Latch would have had to have acted so contrary to Fun Motors' interests that his actions could only have been motivated by personal interest in order to be liable on the tortious interference claim. Moreover, under Texas law, an agent cannot be held to have acted against the principal's interest unless the principal has objected and, in this case, there was no evidence that Fun Motors com-

93. See *Latch v. Gratty, Inc.*, 107 S.W.3d 543 (Tex. 2003).

94. *Id.* at 544.

95. *Id.* at 545.

plained of Latch's conduct. The Texas Supreme Court, therefore, reversed the lower court's judgment on Gratty's tortious interference claim and rendered judgment that Gratty take nothing.⁹⁶

B. FRAUD AND MISREPRESENTATION

In *Brock v. Baskin Robbins, USA, Co.*,⁹⁷ ice cream store franchisees sued their franchisor, asserting fraud and tortious interference, among other claims. The district court held that Baskin Robbins had not committed fraud by not disclosing that certain store formats were unviable and certain stores were to be phased out. The court began its discussion by noting that many of the franchisees' claims were an attempt to make breach of contract claims into a tortious act. This was problematic because it is generally accepted that a franchisor-franchisee relationship does not, by itself, create fiduciary duties between the parties—duties which are necessary in creating common-law tort liability.⁹⁸

The plaintiff franchisees claimed that Baskin Robbins had a duty to disclose to them that certain stores were unviable and that the franchisor intended to phase out “nonstrategic locations.”⁹⁹ The court, however, noted that the franchisees' presumption of such a duty was premised on the existence of a fiduciary relationship—a relationship that was not created by the parties' contractual relationship alone. The franchisor had created a trust for advertisement funds from the franchisees, but the court would not extend any fiduciary duties attached to that fund to other aspects of the parties' relationship not related to the maintenance of the advertisement fund. Even assuming that Baskin Robbins did have a duty to disclose, the court said that the franchisees could not show that Baskin Robbins had knowledge of prior or present facts regarding “nonstrategic market” decisions that it should have disclosed.¹⁰⁰ Baskin Robbins was saved from liability for fraud in this case by the nature of the franchise relationship. In some instances, however, other defenses may be used by the franchisor.

Fraud claims may be estopped by clear and unambiguous contract language. In *DRC Parts & Accessories, L.L.C. v. VM Motori, S.P.A.*, the Houston Court of Appeals gave great weight to the unambiguous terms

96. *Id.* at 545-46.

97. *Brock v. Baskin Robbins, USA, Co.*, No. 5:99-CV-274, 2003 WL 21309428 (E.D. Tex. Jan. 17, 2003).

98. *Id.* at *1, 3 (citing *Dr. Pepper Bottling Co. v. Del Monte Corp.*, 1990 WL 291495, (N.D. Tex. Jan. 30, 1990) (applying California law and Ninth Circuit cases)).

99. *Id.* at *3

100. *Id.* at *3-4. Plaintiffs failed to follow the Local Court Rules requiring a statement of all controverted facts and at the hearing only pointed to two pieces of evidence to support their claims, which the court found insufficient: a 1985 marketing plan created by company employees and franchisees for the Chicago area and Baskin Robbins' discontinuance of national advertising in favor of concentrating on larger metropolitan markets for a ten-year period. *See id.* at *4.

of a distribution agreement between the parties.¹⁰¹ The agreement between DRC and VM contained the following provision:

VM. . . grants on a non-exclusive basis. . . DRC. . . the right to purchase and sell VM diesel engine ORIGINAL SPARE PARTS for engine series and/or engine model versions not in-current production by VM and VM ORIGINAL ACCESSORIES for current and non-current series of engines, in the USA or Canada, hereinafter referred to as the TERRITORY. . . .¹⁰²

DRC, however, brought suit against VM asserting breach of contract and fraud when VM sold the parts covered by the provision above to other parties. The trial court entered summary judgment in favor of VM. DRC appealed.¹⁰³

DRC challenged summary judgment on its breach of contract claim on the ground that the contract was ambiguous. DRC contended that the term "non-exclusive" used in the provision set forth above could reasonably be interpreted to mean either that "(1) VM retained the right to sell parts for engines not in current production through entities other than DRC; or (2) DRC had the exclusive right to sell such parts."¹⁰⁴

The court reasoned that, under Texas law, the contract was not ambiguous. First, the language of the distribution agreement did not support an exclusive right to sell the parts at issue. Second, parol evidence about the circumstances surrounding the formation of the contract was not admissible under Texas law to create an ambiguity when the language of the distribution agreement was unambiguous. Parol evidence can only be considered to determine the meaning of the language of the contract when it is ambiguous, either on its face or when applied to the subject matter of the contract.¹⁰⁵

DRC also challenged summary judgment on its fraudulent inducement claim. DRC contended that "if the contract term 'non-exclusive' was unambiguous, [as the court concluded], then a fact issue was raised on its fraudulent inducement claim by evidence that VM falsely represented to DRC that it would have exclusive rights to distribute the subject engine parts under the agreement."¹⁰⁶ The court focused its attention on one element of a fraud claim—that a plaintiff must actually and justifiable rely on the misrepresentation to suffer injury. The court found that DRC was not justified, as a matter of law, in relying upon an oral representation that was directly contradicted by the express, unambiguous terms of the distributor agreement. To decide otherwise, the court believed, "would defeat the ability of written contracts to provide certainty and

101. DRC Parts & Accessories, L.L.C. v. VM Motori, S.P.A., 112 S.W.3d 854 (Tex. App.—Houston [14th Dist.] 2003, pet. denied).

102. *Id.* at 856.

103. *Id.*

104. *Id.* at 857.

105. *Id.* at 857-58.

106. *Id.* at 858.

avoid dispute.”¹⁰⁷ Therefore, the trial court’s summary judgment upon this point was also affirmed and DRC’s claim again denied.¹⁰⁸ It is worth noting that the dissent found DRC’s evidence to be sufficient to create a genuine issue of material fact, in spite of the language of the contract, and spent significant time discussing the difficulty in balancing the parol evidence rule with the proof required in a fraudulent inducement claim.¹⁰⁹

C. VICARIOUS LIABILITY

Going after the “deep pocket” is a common route for franchisees to take in litigation and so once again, during the Survey period, a Texas court made a decision on a franchisor’s vicarious liability for the acts or negligence of its franchisee. In *Fitz v. Days Inn Worldwide, Inc.*, Fitz appealed summary judgment granted in favor of Days Inn Worldwide, Inc. (DIW) in hopes that that DIW would be found vicariously liable for the negligence of its franchisee, San Antonio Hospitality Investments, Inc. (SAHI). Fitz was the victim of hit and run accident in the parking lot of a Days Inn hotel owned by SAHI.¹¹⁰

The court began by analyzing whether DIW, as a hotel franchisor, owed a duty to Fitz to control the safety of SAHI’s driveway.¹¹¹ The court noted that liability of a franchisor regarding negligence on a franchisee’s premises appeared to be limited to those activities, alleged to be negligent and over which the franchisor maintained control.¹¹²

The right of a franchisor to control the franchisee and thereby become vicariously liable for the franchisee’s actions can be proven in two ways:

- (1) by evidence of a contractual agreement that explicitly assigns the premises owner a right to control; and (2) in the absence of a contractual agreement, by evidence that the premises owner actually exercised control over the manner in which the independent contractor’s work was performed.¹¹³

Fitz argued that DIW exercised both contractual and actual control.

As evidence of the contractual right to control, Fitz contended that the license agreement between DIW and SAHI and the Days Inn System Standards Manual, considered together, took away almost all of SAHI’s discretion in determining how to run the hotel. Since the Days Inn System Standards Manual contained standards regarding parking lot design and pedestrian safety, areas where the hotel’s negligent design had been found to have proximately caused Fitz’s injuries, Fitz’s contention was that DIW should be vicariously liable for failing to shut down SAHI’s

107. *Id.* at 859.

108. *Id.*

109. *Id.* at 859 (Hudson, J., dissenting).

110. *Fitz v. Days Inn Worldwide, Inc.*, No. 04-02-00487-CV, 2003 WL 22238939, *1 (Tex. App.—San Antonio Oct. 1, 2003, no pet. h.) (not designated for publication).

111. *Id.* at *2.

112. *Id.* at *2 (interpreting *Risner v. McDonald’s Corp.*, 18 S.W.3d 903, 906 (Tex. App.—Beaumont 2000, pet. denied).

113. *Id.* (citing *Dow Chem. Co. v. Bright*, 89 S.W.3d 602, 605-06 (Tex. 2002)).

illegal and negligently maintained truck driveway.¹¹⁴ Upon examining the summary judgment evidence, however, the court found that "no provision in either the License Agreement or the [Days Inn] System Standards Manual gave DIW the contractual right to control either the means, methods, or details of SAHI's maintenance and operation of the parking lot or the methods by which SAHI complied with the minimum standards set by DIW."¹¹⁵ Moreover, DIW's setting of general minimum standards for franchisees did not negate the provision of the license agreement where the parties explicitly acknowledged that SAHI was an independent contractor.¹¹⁶

Fitz also failed to present evidence that DIW had an actual right of control over SAHI. Fitz again made the argument that the Days Inn System Standards Manual gave DIW actual control because DIW could enforce compliance with these standards by its franchisees. The court reiterated, however, that the manual did not give DIW the right to control either the means, methods, or details of SAHI's maintenance and operation of the parking lot at issue. The court also agreed with DIW's response that its ability to suspend operation if minimum standards were not followed was not a sufficient level of control to expose it to liability.¹¹⁷

Fitz's second argument was that DIW exercised control through its inspections of SAHI's premises and notices to cure. If SAHI failed to cure a defect, then DIW could suspend it from participating in the Days Inn Reservation System or terminate the license agreement. Again the court noted that there was no evidence that SAHI was not free to do its own work in its own way and there is no evidence that DIW controlled SAHI's method of work or its operative detail.¹¹⁸

Finally Fitz argued that DIW exercised actual control by waiving its right to require SAHI to make the truck entrance safe for the public. Specifically, Fitz alleged that DIW knew about the unauthorized and dangerous change for truck access, which was a proximate cause of Fitz's injuries through its inspections of the property. The inspections alone, however, were insufficient evidence that DIW knew of the alleged dangerous condition and approved the condition of the driveway. Therefore, the court of appeals upheld the trial court's grant of summary judgment in favor of DIW.¹¹⁹

D. TORTIOUS INTERFERENCE

The importance of a franchise agreement that provides flexibility to the franchisor was borne out in the *Brock v. Baskin Robbins, USA, Co.* case,

114. *Id.* at *3.

115. *Id.* at *4.

116. *Id.*

117. *Id.* at *5.

118. *Id.*

119. *Id.* at *5-6.

discussed above.¹²⁰ Plaintiff franchisees complained that Baskin Robbins had tortiously interfered with their contractual relations by not allowing the franchisees to sell their franchises to third parties by informing them that their franchises would not be renewed. The franchise agreement had a section explicitly providing Baskin Robbins the right to withhold consent to transfer the contract. Thus, the court found that "Baskin Robbins' conduct could not give rise to a tortious interference claim . . . because they had an absolute right not to allow the transfer."¹²¹ The plaintiff franchisees' tortious interference claim was denied and summary judgment granted on this claim in favor of Baskin Robbins.¹²²

In *Texas Taco Cabana, L.P. v. Taco Cabana of New Mexico, Inc.*, Taco Cabana of New Mexico and the other defendants counterclaimed alleging that Texas Taco Cabana and T.C. Management were interfering with Taco Cabana of New Mexico's relationships with its suppliers, employees, and other third parties, as well as with its prospective contractual relations with customers.¹²³ As a matter of Texas law, a parent corporation is incapable of tortiously interfering with its subsidiary's contracts because their financial interests are identical. Carrols, one of the defendants, was the corporate parent of T.C. Management, and, thus it could not interfere with the contract between T.C. Management and Taco Cabana of New Mexico. Consequently, Taco Cabana of New Mexico's claim against Carrols for tortious interference with contracts between T.C. Management and Taco Cabana of New Mexico were dismissed. The court would not dismiss, however, the claims of interference with suppliers, employees and other third parties.¹²⁴

E. COMMON-LAW DUTY OF GOOD FAITH AND FAIR DEALING

Franchisees commonly claim that their franchisor has violated a duty of good faith and fair dealing in the relationship. Under Texas law, however, there is ordinarily no duty of good faith and fair dealing in commercial contracts because the franchisor-franchisee relationship is not usually the kind of special relationship that would create such a duty.¹²⁵ In *Texas Taco Cabana, L.P. v. Taco Cabana of New Mexico, Inc.*, however, the court found that the franchisor's interactions with the franchisee had created such a duty. The court stated that the "duty may arise if one person trusts and relies on another."¹²⁶

120. See *Brock v. Baskin Robbins, USA, Co.*, No. 5:99-CV-274, 2003 WL 21309428 (E.D. Tex. Jan. 17, 2003).

121. *Id.* at *7.

122. *Id.* at *8.

123. *Tex. Taco Cabana, L.P. v. Taco Cabana of N.M., Inc.*, 304 F. Supp. 2d 903, 906-07 (W.D. Tex. 2003).

124. *Id.* at 912.

125. *Id.* at 911-23.

126. *Id.* at 911 (citing *Crim. Truck & Tractor Co. v. Navistar Int'l Transp. Corp.*, 823 S.W.2d 591, 594 (Tex. 1992)).

Here, the defendant franchisees pled facts to show that Mr. Sloan, apparently a principal of the franchisee entities who was diagnosed with brain cancer, relied on the promises of the franchisor that the franchisee's development rights under the agreements would not be jeopardized by any delay caused by Mr. Sloan's focus upon his health. Mr. Sloan focused on his health and delayed the construction of his restaurant. Texas Taco Cabana and T.C. Management subsequently sought a declaratory judgment that the defendants had no right to develop additional Taco Cabana restaurants and no rights of first refusal related to the development of Taco Cabana restaurants in New Mexico. The defendants pled that Mr. Sloan would have been able to proceed in a timely manner had it been necessary under the contract. He had, however, received assurances from the franchisor that it was not necessary to do so. Under these circumstances, the court found that the interactions between the franchisor and franchisee created a special relationship that gave rise to the duty of good faith under Texas law. Therefore, the court would not dismiss the defendants' claims against the franchisor.¹²⁷

VI. STATUTORY CLAIMS

A. THE TEXAS DECEPTIVE TRADE PRACTICES—CONSUMER PROTECTION ACT

In order to sustain a cause of action under the Texas Deceptive Trade Practices Act—Consumer Protection Act (DTPA), a party must be a consumer.¹²⁸ In *Brock v. Baskin-Robbins, USA Co.*, the district court held that a franchisee was not a consumer for purposes of the DTPA.¹²⁹ In *Brock*, a group of more than forty franchisees brought an action against Baskin-Robbins.¹³⁰ Plaintiffs complained that Baskin-Robbins misrepresented its intent to renew their franchise agreements and mishandled commercial advertising funds.¹³¹ In addressing the DTPA claim, the court held that the plaintiffs failed to show that they were "consumers" under either Texas' or Louisiana's Consumer Protection Acts.¹³² In doing so, the court noted that a claimant must be a consumer who sought or acquired goods or services by purchase or lease and demonstrate that these goods or services formed the basis for the complaint.¹³³ Plaintiffs relied on *Texas Cookie Co. v. Hendricks & Peralta* in arguing that the intangible rights conveyed under their franchise agreements carried a number of collateral services on which plaintiffs relied and, therefore,

127. *Id.*

128. *See* Melody Home Mfg. Co. v. Barnes, 741 S.W.2d 349, 351-52 (Tex. 1987).

129. *Brock v. Baskin-Robbins, USA, Co.*, No. 5:99-CV-274, 2003 WL 21309428, *5-6 (E.D. Tex Jan. 17, 2003).

130. *Id.* at *1.

131. *Id.*

132. *Id.* at *5-6.

133. *Id.*

plaintiffs were “consumers” under the purview of the statute.¹³⁴ The *Brock* court dismissed this reasoning and held that the purchaser in *Brock* bought an intangible right and that the underlying goods and services were merely collateral services that would not support a claim under the DTPA.¹³⁵

In *Texas Taco Cabana, L.P. v. Taco Cabana of New Mexico, Inc.*, plaintiffs sought a declaratory judgment establishing that defendants did not have a right to develop any additional Taco Cabana restaurants in New Mexico and that there was no right of first refusal for defendants in New Mexico.¹³⁶ Defendants countersued, asserting several claims including claims under the DTPA (Texas and New Mexico) as well as claims for breach of the duty of good faith and fair dealing.¹³⁷ The franchisor moved to dismiss the DTPA claims. The claims under the New Mexico Deceptive Trade Practices Act were dismissed because the court found Texas law, rather than New Mexico law, governed the tort claims.¹³⁸

The franchisor then argued for dismissal of the Texas claims asserting (1) they were fundamentally based only on a disagreement over the interpretation of the contracts at issue rather than on unconscionable acts, and (2) the reliance necessary under Texas law to sustain a DTPA action was not present because the franchisees acknowledged that they would conduct their own investigation concerning the volume, profits, or success of the business venture.¹³⁹ The court rejected both arguments. Although the court agreed that a disagreement over the interpretation of a contract was not actionable under the DTPA, the court held that the DTPA claims at issue were not only based on a disagreement of interpretation, but were also based on allegations of the existence of false pretenses.¹⁴⁰

The court then turned to the “lack of reliance” argument. The court stated that the necessary reliance existed because when a party to a contract contractually agreed that he or she was not relying on any representations, the stipulation might negate reliance, but only reliance on representations expressly excluded by the written disclaimer.¹⁴¹ Thus, the franchisee’s reliance on representations or information outside of the scope of the disclaimer were actionable.¹⁴²

134. *Id.* at *6 (citing *Tex. Cookie Co. v. Hendricks & Peralta*, 747 S.W.2d 873 (Tex. App.—Corpus Christi 1988, writ denied)).

135. *Id.*

136. *Texas Taco Cabana, L.P. v. Taco Cabana of N.M., Inc.*, 304 F. Supp. 2d 903, 906-07 (W.D. Tex. 2003).

137. *Id.*

138. *Id.* at 909-10.

139. *Id.*

140. *Id.* at 910-11.

141. *Id.* (citing *Ramada Franchise Sys., Inc. v. Tresprop, Ltd.*, No. 98-2511-DJW, 2000 WL 290349, at *11 (D. Kan. Mar. 10, 2000); *Commercial Prop. Invs., Inc. v. Quality Inns Int'l, Inc.*, 61 F.3d 639, 642 (8th Cir. 1995)).

142. *Id.*

B. COVENANTS NOT TO COMPETE

Although not a franchise case, a Texas appellate court recently overruled a prior franchise-related opinion out of the same court in *Cardinal Health Staffing Network, Inc. v. Bowen*.¹⁴³ Both opinions were issued and reported during the Survey period. Originally, the court held that under Texas law, a franchisor need not demonstrate irreparable harm to obtain a preliminary injunction against a franchisee violating a non-compete agreement.¹⁴⁴ In *Norlyn Enterprises, Inc.*, the trial court denied an injunction because the franchisor allegedly failed to demonstrate irreparable harm and an inadequate legal remedy.¹⁴⁵ Specifically, the court found that the franchise system was "neither unique nor proprietary," and thus, it did not constitute a trade secret.¹⁴⁶ Further, the trial court held that because the franchisor was not doing business in the franchisee's former territory, it was not harmed by the franchisee's competition.¹⁴⁷ On appeal, the court held that the Texas Covenants Not to Compete Act contained no precise standard for preliminary injunctive relief, and thus "[a] showing . . . of an irreparable injury for which [there is] no adequate legal remedy is not a prerequisite for obtaining injunctive relief under [the Act]."¹⁴⁸ In *Bowen*, the same court went to great lengths to review its prior reasoning, ultimately overruling the holding of *Norlyn Enters. Co.* and held that irreparable harm was a required showing under the Act.¹⁴⁹

In *Total Car Franchising Corp. v. Esh*, the court denied a franchisor's motion to enjoin its former franchisee from competing in a certain market and using its trade secrets because the franchisor failed to present evidence of irreparable harm.¹⁵⁰ Total Car Franchising Corp. (TCFC), a franchisor of the Colors on Parade paint restoration businesses, agreed to allow its Georgia franchisee to relocate to Dallas at the request of the franchisee.¹⁵¹ Once in Dallas, the franchisee worked for the TCFC area developer, David Jordan. The parties disputed whether the franchisee worked for Jordan as a franchisee or an employee. In 2001, the franchisee and Jordan had a dispute and dissolved their working relationship. The franchisee, however, retained the accounts that he had while working for Jordan. The franchise agreement included non-competition and con-

143. See *Cardinal Health Staffing Network, Inc. v. Bowen*, 106 S.W.3d 230 (Tex. App.—Houston [1st Dist.] 2003, no pet.).

144. See *Norlyn Enters., Inc. v. APDP, Inc.*, 95 S.W.3d 578 (Tex. App.—Houston [1st Dist.] 2002, no pet.), *overruled by* *Cardinal Staffing Network, Inc. v. Bowen*, 106 S.W.3d 230 (Tex. App.—Houston [1st Dist.] 2003, no pet.).

145. *Norlyn Enters., Inc.*, 95 S.W.3d at 581-82.

146. *Id.* at 582.

147. *Id.*

148. *Id.* at 585.

149. *Bowen*, 106 S.W. 3d at 238-41.

150. *Total Car Franchising Corp. v. Esh*, No. CIV.A.3:02-CV-0141R, 2002 WL 31757640, at *2 (N.D. Tex. December 4, 2002).

151. *Id.* at *1.

fidentiality clauses.¹⁵²

Based in part on these contractual obligations, TCFC sought a preliminary injunction to enjoin the franchisee's competition in the Dallas-Fort Worth metropolitan area, as well as its use of TCFC's trade secrets.¹⁵³ Focusing on the irreparable harm requirement of the preliminary injunction standard, the court held that TCFC was not entitled to injunctive relief because it failed to present evidence that the harm it suffered could not be addressed later in the proceedings.¹⁵⁴ The court denied the motion and stated "[t]he mere existence of an 'adverse effect' was insufficient to establish the 'irreparable harm' element of a preliminary injunction."¹⁵⁵

C. ANTITRUST

In *The Coca-Cola Company v. Harmar Bottling Co.*, a group of carbonated soft drink bottlers brought an action against Coca-Cola and its bottlers for restraint of trade, monopolistic practices, and interference with existing and prospective business relationships due to marketing agreements with retailers. The trial court entered judgment for plaintiffs on a jury verdict for \$13,800,000 in damages, awarded attorneys' fees, and issued a marketing injunction. Coca-Cola appealed.¹⁵⁶

The lawsuit centered on complaints made by several different carbonated soft drink bottlers who currently sold or had previously sold soft drinks in competition with Coca-Cola. The bottlers alleged Coca-Cola employed improper business methods and practices through the use of a vehicle called calendar marketing agreements (CMAs). The bottlers alleged that the CMA's prevented retailers from selling a competitor's carbonated soft drinks. Coca-Cola held the franchises for Coca-Cola, Dr. Pepper, and other beverages in the territory at issue.¹⁵⁷ The court found that Coca-Cola's own information showed that Coca-Cola maintained a seventy-five to eighty percent share of the area's carbonated soft drink market during the relevant time period. The bottlers' claims concentrated on the substance of the CMAs used by Coca-Cola in contracting with its retailers.¹⁵⁸

On appeal, Coca-Cola contended that "the trial court erred in its extra territorial application of the Texas Free Enterprise and Antitrust Act (hereafter the Act)" in awarding plaintiff both monetary damages and injunctive relief.¹⁵⁹ Coca-Cola argued that "none of [the] agreements—to the extent they were implemented in retail establishments outside the

152. *Id.*

153. *Id.* at *2.

154. *Id.*

155. *Id.*

156. *Coca-Cola Bottling Co. v. Harmar Bottling Co.*, 111 S.W.3d 287, 292 (Tex. App.—Texarkana 2003, pet. filed).

157. *Id.* at 293.

158. *Id.* at 293.

159. *Id.* at 294.

State of Texas—were actionable under [Texas] state statute.”¹⁶⁰ The court found, however, that the language of the Texas statute was clear in its intent to cover monopolistic practices in commerce “occurring wholly or partly within the State of Texas.”¹⁶¹ The court noted that the case “involve[d] anti-competitive conduct that occurred partly in Texas and which affect[ed] consumers in Texas and other states. A number of the retailers signed contracts with Coca-Cola that covered their entire area, including stores in and outside of Texas . . . [which] necessarily affect[ed] Texas commerce.”¹⁶² The court found that Coca-Cola’s position—that the effects of competition disappeared and dissipated at state lines—was not tenable. The court found that “each contract was prepared and executed in Texas and provide[d] that Texas law govern[ed] it and any disputes arising thereunder.”¹⁶³ The court held that “having chosen Texas law for these particular contracts, Coca-Cola could not avoid the protection to Texas consumers provided by that same law.”¹⁶⁴

Coca-Cola argued that the evidence presented to the jury was insufficient to support their findings that Coca-Cola’s conduct was an unreasonable restraint of trade under the Act.¹⁶⁵ In order to prevail under the Act, a plaintiff must prove (1) that the restraint of trade is unreasonable, and (2) that the restraint of trade has an adverse effect on competition in the relevant market.¹⁶⁶ “[Coca-Cola] argu[ed] that, because there [was] no or insufficient evidence to show that the other Bottlers were completely or at least predominantly ‘foreclosed’ from competition, the Bottlers [could not] recover under antitrust theories.”¹⁶⁷ Nonetheless, the court concluded that complete foreclosure was not essential to recovery.¹⁶⁸

Coca-Cola also contended that there was no or insufficient evidence to support the jury’s findings that Coca-Cola engaged in an unreasonable restraint of trade. The court found that even if it were to wholly disregard the bottlers’ expert testimony, which it did not, there would be some evidence to support the jury’s findings on restraint of trade. Although Coca-Cola argued that various factors were insufficient to allow the jury to conclude Coca-Cola had acted to restrain trade, the court found that due to the numerous factors presented in evidence, it was not appropriate to take this determination out of the hands of the jury. The court noted that this was a multi-week jury trial with considerable evidence about these issues. The court found that the evidence was both legally and factually sufficient to support the jury’s answer.¹⁶⁹

160. *Id.*

161. *Id.* at 296.

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.* at 301.

166. *Id.*

167. *Id.*

168. *Id.* at 302.

169. *Id.* at 302-03.

The case is now pending before the Texas Supreme Court. On October 3, 2003, Coca-Cola filed its petition for review. On January 29, 2004, briefing on the merits was requested by the supreme court.

VII. REMEDIES, DAMAGES AND INJUNCTIVE RELIEF

A. COMPENSATORY AND LIQUIDATED DAMAGES

The main issue in *Ramada Franchise Systems, Inc. v. Jacobcart, Inc.*,¹⁷⁰ involved the enforcement of a liquidated damages provision and personal guarantees under New Jersey law. Ramada Franchise Systems, Inc. (RFS) and Jacobcart, Inc. entered into a license agreement for the operation of a hotel in Denison, Texas. A contract dispute arose between RFS and Jacobcart, Inc., and two guarantors, Joy M. Cart and Chacko Cart, owners of the hotel. Cart and Jacob signed personal guarantees agreeing that all of the licensee's obligations under the license agreement would be performed in a timely manner.

From December 1999 to October 2000, RFS experienced problems with Jacobcart's performance under the license agreement. First, the hotel failed several quality assurance inspections. After each inspection, RFS gave Jacobcart written notice of the failed inspection and told Jacobcart that if the defaults were not cured, it would be in breach the license agreement. Next, RFS notified Jacobcart that it was in default of its financial obligations under the license agreement for failure to file its required monthly franchise reports and failure to pay its accounts receivable. Finally, on October 2, 2000, RFS sent Jacobcart a letter terminating the license agreement and advising Jacobcart that it must immediately stop using the Ramada trade name and service marks (the Ramada Marks). In addition, the letter advised Jacobcart that it was required to pay RFS \$200,000 in liquidated damages for premature termination of the agreement, and that it should de-identify its facility within ten days of receipt of the letter and pay RFS its outstanding recurring fees.

Jacobcart nonetheless continued to use the Ramada Marks and did not pay RFS liquidated damages or recurring fees. RFS then filed suit seeking damages and injunctive relief. The court granted injunctive relief in a separate opinion.¹⁷¹ RFS then moved for summary judgment on its damages claims.

The contract was governed by New Jersey law.¹⁷² Under New Jersey law, liquidated damages provisions are upheld when the amount of dam-

170. *Ramada Franchise Sys., Inc. v. Jacobcart, Inc.*, No. 3:01-CV-0306-N, (N.D. Tex. Feb. 21, 2003) BUS. FRANCHISE GUIDE (CCH) ¶ 12,609.

171. *Ramada Franchise Sys., Inc. v. Jacobcart, Inc.*, No. CIVA 3:05CV0306D, 2001 WL 540213 (N.D. Tex. May 17, 2001).

172. The court applied the choice-of-law rules of the forum state, Texas, because the case was in federal court based on diversity. Under Texas law, as long as the transaction bore a reasonable relationship to the state specified in the license agreement's choice-of-law provision, that state's laws would apply to the case. BUS. FRANCHISE GUIDE (CCH) at ¶ 12,609 (citing *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 677 (Tex. 1990)). Because RFS's principal place of business was New Jersey, the court found that the contract "bore a

ages was a reasonable forecast of just compensation for the harm caused by the breach and when the harm was very difficult or impossible to estimate.

The court found that the liquidated damages provision in the case was reasonable and was enforceable as a matter of law for several reasons. First, the court found that "damages from breach or early termination of the license agreement were difficult to estimate when the agreement was drafted because of variations in the travel industry."¹⁷³

From changing seasons to special events to the increased competition, it is virtually impossible to predict a hotel occupancy over an extended period of time. Along the same lines, because the license agreement covered a fifteen year period, it was difficult to predict Jacobcart's income that far into the future.¹⁷⁴

Finally, New Jersey law presumed that liquidated damages clauses were enforceable. Thus, the party protesting the clause had the burden to prove that it was unreasonable and that it should not be enforced. Jacobcart failed to challenge the enforceability of the clause as it did not plead the affirmative defense of penalty. Thus, the court held that "the liquidated damages provision of the license agreement was enforceable as a matter of law."¹⁷⁵

RFS also alleged that Jacobcart owed past recurring fees plus interest. Jacobcart did not deny that it owed RFS fees; however, it disagreed with RFS about the total amount owed. In its reply brief, RFS agreed to accept the amount of money Jacobcart believed it owed plus the contractual interest rate of 1.5% monthly. The court found that because RFS waived its claim for the larger figure and no other fact issue regarding the fees existed, judgment as a matter of law was appropriate regarding the payment of recurring fees.

Finally, the court found that Jacob and Cart were personally liable for Jacobcart's financial commitments under the license agreement because they both signed a guaranty to that effect. Because Jacob and Cart did not deny the existence of the guaranty or argue that it was somehow invalid, they failed to raise a fact issue regarding its application. Thus, the court granted RFS judgment as a matter of law regarding the guaranty claims.

The court also found that a provision of the license agreement granting attorneys' fees to the prevailing party was enforceable and that Jacob and Cart's personal guaranty included this portion of the contract. Thus, the court found that as a matter of law it was appropriate to allow RFS' claim for attorneys' fees.

reasonable relation to New Jersey" and New Jersey law governed the contract. BUS. FRANCHISE GUIDE (CCH) at ¶ 12,609.

173. *Ramada Franchise Systems, Inc.*, BUS. FRANCHISE GUIDE (CCH), at ¶ 12,609.

174. *Id.*

175. *Id.*

B. ATTORNEYS' FEES

In the *Coca-Cola Co. vs. Harmar Bottling Co.*, one of the issues on appeal was whether the evidence submitted at trial supported an award of attorneys' fees. In particular, Coca-Cola contended that there was no evidence to support the trial court's award of attorneys' fees for the injunctive proceeding because the only evidence of such fees was the affidavit of plaintiff's counsel. The court noted that it was clear from the record that the court did not rely on that affidavit for its award. The trial court, instead, took judicial notice of its file and the proceedings before it and found that a reasonable attorneys' fee was \$500,000.¹⁷⁶

The appellate court noted that the reasonableness of attorneys' fees was generally a question of fact to be determined by the trier of fact and must be supported by competent evidence. In general, "a trial court may not adjudicate reasonableness on judicial knowledge and without the benefit of evidence."¹⁷⁷ The court noted that, "while Chapter 38 of the Texas Civil Practice and Remedies Code contain[ed] an exception to this general rule, it [was] applicable only to the types of claims described in Section 38.001."¹⁷⁸ Because the claim for injunctive relief was not a claim described in Section 38.001, "the trial court erred in awarding attorneys' fees absent any evidence to support a finding that such fees were reasonable."¹⁷⁹ Thus, the "portion of the trial court's judgments awarding attorneys' fees [was] reversed and remanded to the trial court for further proceedings."¹⁸⁰

C. INJUNCTIONS

In *Total Car Franchising Corp. v. Esh*,¹⁸¹ as discussed above, the court denied a franchisor's motion to enjoin its former franchisee from competing in a certain market and from using its trade secrets because the franchisor failed to present evidence of irreparable harm.

In *Norlyn Enterprises, Inc. v. APDP, Inc.*,¹⁸² the franchisor sued its franchisee for breach of contract and sought a temporary injunction to enforce the noncompetition clause in the franchise agreement. The district court denied the injunction and the franchisor appealed. The Houston Appellate Court held that under the Covenants Not to Compete Act, the franchisor did not have to show irreparable injury to obtain a temporary injunction.¹⁸³ This ruling was later overruled by the same court in

176. *Coca-Cola Co. v. Harmar Bottling Co.*, 111 S.W.3d 287, 311-312 (Tex. App.—Texarkana 2003, pet. filed).

177. *Id.* at 312.

178. *Id.*

179. *Id.*

180. *Id.*

181. *Total Car Franchising Corp. v. Esh*, No. CIV.A.3:02-CV-0141R, 2002 WL 31757640, at *2 (N.D. Tex. Dec. 4, 2002).

182. See *Norlyn Enters., Inc. v. APDP, Inc.*, 95 S.W.3d 578 (Tex. App.—Houston [1st Dist.] 2002, no pet.), *overruled by* *Cardinal Staffing Network, Inc. v. Bowen*, 106 S.W.3d 230 (Tex. App.—Houston [1st Dist.] 2003, no pet.).

183. *Id.* at 583-84.

Cardinal Staffing Networks, Inc. v. Bowen.¹⁸⁴

184. See *Bowen*, 106 S.W.3d at 230.