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I. INTRODUCTION

THIS Article provides an update of case law and legislative efforts that have had, or will have, a significant impact on franchise and dealership law in Texas and the Fifth Circuit. This past year saw several significant decisions in Texas in the areas of jurisdiction, forum selection, and venue. Interestingly, the cases were almost equally split among parties seeking to bring actions in Texas and parties seeking to avoid having to appear and litigate in Texas. Another area that saw noteworthy developments was the applicability and enforceability of jury-trial waivers. In franchise and dealership law, perhaps the most noteworthy aspect was the lack of any material movement towards the Federal Trade Commission's issuance of a final amended federal franchise law.[1]

II. PROCEDURE

A. JURISDICTION

Attempts to use the concept of fraudulent joinder to defeat diversity jurisdiction arose in several Texas federal courts during this Survey period. In *De La Hoya v. Coldwell Banker Mexico, Inc.*,[2] Coldwell Banker Mexico, Inc. and Coldwell Banker Real Estate Corporation contracted, agreeing that CB Mexico, Inc. would act as Coldwell Banker's sub-franchisor in Mexico. CB Mexico, Inc., "with [Coldwell Banker's] con-

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1. 16 C.F.R. §§ 436.1 *et seq.* (2006). The history and proposed changes to the Trade Regulation Rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures," commonly referred to as the FTC Rule, were thoroughly discussed in last year's franchise update. *See* Deborah S. Coldwell et al., *Franchise Law*, 57 SMU L. REV. 1035, 1055-57 (2004).
2. 125 F. App'x 533 (5th Cir. 2005).

sent, . . . assigned its rights and duties under the subfranchise contract to [Coldwell Banker Affiliates de Mexico] in 1998."[3] In 1999, CB Affiliates de Mexico entered into a franchise agreement with Mañana Today S. de R.L. de C.V., granting Mañana and its president, Luetta "LuLu" Jacobsen, the right to operate a Coldwell Banker franchise in Cabo San Lucas, Mexico. The franchise agreement prohibited Mañana from offering or performing real-estate services, including escrow, but Mañana could provide ancillary services as a separate business.[4]

Oscar de la Hoya and several other plaintiffs allegedly engaged Mañana's services to buy and sell real estate in Baja Mexico. Plaintiffs allegedly sent funds to an escrow account that Mañana maintained pursuant to Mañana's instructions. LuLu allegedly misappropriated funds from this account. Plaintiffs alleged that CB Mexico, Inc., CB Affiliates de Mexico, and Coldwell Banker knew that LuLu had mishandled client funds in the past and that she had misappropriated funds during the time that plaintiffs sent money to Mañana. Plaintiffs brought suit in Texas state court against CB Mexico, Inc., CB Affiliates de Mexico, Coldwell Banker, Richard Smith of CB Mexico, Inc., and CB Affiliates de Mexico's president. "Defendants removed [to federal district court,] claiming that CB Mexico, Inc., Coldwell Banker, and Smith had been improperly joined to defeat diversity."[5] The district court agreed and denied plaintiffs' motion to remand to state court. The district court then granted CB Affiliates de Mexico's motion to dismiss for lack of personal jurisdiction. Plaintiffs challenged the district court's findings that CB Mexico, Inc. and Smith were improperly joined.[6]

In determining whether improper joinder has occurred, defendants bear a "heavy burden"—they must show that "(1) plaintiffs fraudulently pleaded false jurisdictional facts, or (2) there is no reasonable basis on which the district court can predict that plaintiffs might be able to recover against the non-diverse defendants."[7] In *Coldwell Banker*, the Fifth Circuit had to decide "whether defendants . . . carried their burden of showing that there [was] no reasonable basis on which the court [could] predict that plaintiffs might recover against [CB Mexico, Inc.] and [Smith]."[8]

The Fifth Circuit considered that a court "may resolve whether a plaintiff has a reasonable basis of recovery under state law by conducting a Rule 12(b)(6)-type analysis to determine whether the complaint states a claim . . . against the non-diverse defendant."[9] The appellate court concluded that if a plaintiff can survive a Rule 12(b)(6) challenge, there is no improper joinder. In *Coldwell Banker*, plaintiffs claimed that CB Affili-

3. *Id.* at 534.
4. *Id.* at 533-34.
5. *Id.*
6. *Id.* at 534-35.
7. *Id.* at 536.
8. *Id.*
9. *Id.* (quoting Smallwood v. Ill. Cent. R.R. Co., 385 F.3d 568, 573 (5th Cir. 2004)).

ates de Mexico (the Mexican, and thus diverse defendant) was liable for failing to control Mañana's escrow activities despite its power to do so and its knowledge that LuLu misappropriated funds. Plaintiffs then argued that CB Mexico, Inc. and Smith were liable for CB Affiliates de Mexico's failure to act under the "single business enterprise" theory. Although the Fifth Circuit agreed that plaintiffs presented sufficient evidence to establish a reasonable basis for recovery against CB Mexico, Inc. and Smith—including the fact that Smith owned 100% of CB Mexico, Inc. and 1% of CB Affiliates de Mexico, and that CB Mexico, Inc. owed the remaining 99%—the appellate court's analysis did not end there. The Fifth Circuit had to analyze whether plaintiffs could recover against CB Affiliates de Mexico—the party at the center of the single-enterprise theory. The Fifth Circuit concluded that CB Affiliates de Mexico had sufficient control over Mañana and LuLu from the franchise agreement and knowledge of Mañana and LuLu's misappropriations. Consequently, the appellate court vacated the order, dismissed CB Affiliates de Mexico for want of personal jurisdiction, and remanded the action to state court since the defendants failed to carry the burden of establishing the improper joinder of CB Mexico, Inc. and Smith.[10]

In *Kardell v. Century 21 Real Estate Corp.*,[11] plaintiff Patricia Kardell entered into a five-year franchise agreement with Century 21 on September 30, 1999. In July 2002, Kardell attempted to sell her real property and her Century 21 franchise to Stephen Hill, for which she had to obtain Century 21's consent. Kardell informed Lowery Nabb, Century 21's Regional Service Director, that she wanted to sell her franchise, and Nabb informed Kardell that he could not assist her and that she would instead need to communicate with the managers of Century 21. When Kardell contacted the Century 21 managers, they required Hill to accept a ten-year franchise agreement rather than the remaining two years on Kardell's franchise agreement. As a result, Hill refused to purchased Kardell's franchise. Kardell, therefore, sued Century 21 Real Estate Corporation and Lowery Nabb for breach of contract and tortious interference with an existing contract.[12]

Century 21 and Nabb alleged that Kardell fraudulently joined Nabb for the sole purpose of defeating diversity jurisdiction. The district court used the same analysis as the *Coldwell Banker* court did to recognize improper joinder: (1) actual fraud in the pleading of jurisdictional facts, or (2) inability of the plaintiff to establish a cause of action against the nondiverse party in state court. The district court declared that because the only cause of action asserted against Nabb was tortious interference with an existing contract, Kardell must be able to recover against Nabb for that cause in state court in order to have her suit remanded.[13]

10. *Id.* at 538-41.
11. No. SA-04-CA-510-RF, 2004 WL 2550591 (W.D. Tex. Nov. 1, 2004).
12. *Id.* at *1.
13. *Id.* at *2.

The district court noted that to prove a claim for tortious interference against Nabb, Kardell "would have to show (1) the existence of a contract subject to interference, (2) the occurrence of an act of interference that was willful and intentional, (3) that the act was a proximate cause of plaintiff's damage, and (4) that actual damage or loss occurred."[14] The district court held that Kardell pled sufficient facts to recover against Nabb on this claim. The district court concluded that Century 21 and Nabb's defense argument that he (as an agent) was acting on Century 21's behalf was irrelevant since Kardell alleged that Nabb interfered with the contract between Kardell and Hill, not the franchise agreement. Moreover, because Kardell pled sufficient facts to show that a contract existed between Kardell and Hill, Kardell had established a "possibility" of recovering against Nabb.[15]

Several Texas courts analyzed personal-jurisdiction issues this past year. In *Michiana Easy Livin' Country, Inc. v. Holten*,[16] James Holten purchased a Coachmen RV from Michiana Easy Livin' Country, Inc. Seeking a cheaper price than he could get from any of Coachmen's many Texas dealers, Holten contacted the Coachmen factory and was informed that a lower price could be obtained from Michiana, a Coachmen "factory outlet." Holten initiated the transaction by calling Michiana to purchase the $64,000 RV. The Texas Supreme Court addressed whether Holten could bring suit in Texas against Michiana based on this nonresident's alleged misrepresentations in a telephone call with Holten.[17]

The supreme court held that Michiana's conduct did not meet the standards for purposefully availing itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws. First, the supreme court noted that Michiana was located in Indiana, a few miles from the Michigan border. Next, Michiana had neither employees nor property in Texas and was not authorized to do business here. The supreme court, however, noted that a nonresident need not have offices or employees in a forum state in order to meet the purposeful-availment test. Advertising in telephone directories in Texas cities, operating an office for sales information and support, and certain activities over the Internet all meet this standard. Michiana did not advertise in Texas or on the Internet, and thus did not solicit business from Holten or anyone else in Texas. The supreme court further found that "Michiana did not place large numbers of RVs in a 'stream of commerce' flowing to Texas," emphasizing that stream-of-commerce jurisdiction required a "stream, not a dribble."[18] The supreme court observed that both the United States Supreme Court and the Texas Supreme Court had

14. *Id.* at *3.
15. *Id.* at *2-3 ("The job of the Court is not to conduct a mini-trial of [Kardell's] claims but rather determine if there was . . . a possibility that [Kardell] had set forth a valid cause of action against Nabb.") (internal quotation marks omitted) (footnote omitted).
16. 168 S.W.3d 777 (Tex. 2005).
17. *Id.* at 778-79.
18. *Id.* at 768.

"found no purposeful availment in cases involving isolated sales solicited by consumers who proposed to use the product in a state where the defendant did no business."[19] Therefore, the supreme court reversed the court of appeals' judgment and rendered judgment dismissing the claims against Michiana for want of jurisdiction.

In *MJCM, L.L.C. v. Sky Bank*,[20] the Southern District of Texas determined that conduct of a merged non-existent company, and now may be considered when deciding jurisdiction. MJCM L.L.C., d/b/a Pinnacle Financial Strategies, entered into three contracts with MB & T. In one of the contracts, a marketing-materials license agreement, Pinnacle allowed MB & T to use, among other things, its trademarks, service marks, and copyrighted marketing materials in advertising aspects of a banking program. MB & T subsequently merged with Sky Financial Group, Inc., with Sky Bank as the surviving entity. Pinnacle sued Sky Bank, alleging that MB & T, in violation of the contracts, disclosed confidential and proprietary information and trade secrets before the merger. Pinnacle sued for breach of contract, tortious interference with contract, trademark infringement, theft of trade secrets and confidential and proprietary information, unfair competition, conspiracy, and for damages under the Texas Theft Liability Act. Sky Bank moved to dismiss for lack of personal jurisdiction.

Sky Bank challenged the district court's exercise of personal jurisdiction on two bases. First, Sky Bank argued that it had insufficient contacts with Texas. Second, it argued that MB & T's contacts could not be imputed to Sky Bank because MB & T no longer existed. The district court disagreed. The district court held that although Sky Bank was an Ohio corporation and did not have any contacts with Texas, MB & T had sufficient contacts when executing the contracts with Pinnacle to support specific jurisdiction. The district court, moreover, held that MB & T's contacts (although a predecessor) could be imputed to Sky Bank since Pinnacle asserted specific personal jurisdiction over a company that, after signing the contracts from which the dispute arose, merged into another entity and ceased to exist. The district court noted that the "Fifth Circuit has counseled imputation of jurisdictional contacts of a predecessor corporation to its successor corporation . . . ."[21] The district court, therefore, denied Sky Bank's motion to dismiss.

It is crucial to remember that while subject-matter jurisdiction may be raised at any time, challenges to personal jurisdiction may be waived if not timely asserted. In *Phoenix Network Technologies (Europe) Ltd. v. Neon Systems, Inc.*,[22] the plaintiff challenged the trial court's dismissal of a state lawsuit based on a forum-selection clause. The plaintiff alleged

19. *Id.* (citing World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 295 (1980)).
20. No. Civ.A. H-05-0664, 2005 WL 2121549 (S.D. Tex. Aug. 31, 2005).
21. *Id.* at *6.
22. 177 S.W.3d 605, 609 (Tex. App.—Houston [1st Dist.] 2005, no pet. h.) (noting that both defendants stipulated in the trial court that they would not contest jurisdiction if suit were brought in the proper forum).

that the trial court erred in dismissing its claims without including a "return jurisdiction clause" in the dismissal orders. The appellate court explained that a "return jurisdiction clause" would ensure that the defendants would not be allowed to use a forum-selection clause as a shield to litigation in one forum, and then be allowed to assert it as a jurisdictional defense in the second forum. The appellate court held that the plaintiff waived this challenge to include a return jurisdiction clause since it did not assert this defense in the trial court.[23]

B. Choice of Law

In *El Pollo Loco, S.A. de C.V. v. El Pollo Loco, Inc.*,[24] a Mexican and a U.S. entity entered into an intellectual property acquisition agreement on February 22, 1996. Before the agreement, EPL-Mexico owned the rights in Mexico to the El Pollo Loco trademarks, trade names, copyrights, trade secrets, trade practices, and the right to a number of franchise and license agreements with Mexican franchisees. Under the agreement, EPL-Mexico agreed to transfer to EPL-USA all of its rights to the intellectual property, and EPL-USA gave EPL-Mexico an exclusive, royalty-free license within specified Mexican territories to use the intellectual property. EPL-Mexico also agreed to open twenty-five EPL stores (and exploit the intellectual property) in Mexico over ten years and pay the franchise fees to EPL-USA. EPL-Mexico sued EPL-USA based on contract and tort claims; EPL-USA counterclaimed for breach of contract.[25]

The agreement provided that Mexican law applied to all disputes that arose in connection with contract performance. The district court noted that the "[p]arties may agree that the law of a certain nation shall govern their rights and duties with respect to a transaction, so long as the transaction bears a reasonable relation to such nation."[26] Further, the U.S. Supreme Court presumes that choice-of-law clauses are valid "and has 'instructed American courts to enforce such clauses in the interests of international comity and out of deference to the integrity and proficiency of foreign courts.'"[27] The district court, therefore, held that there was a reasonable relationship between the agreement and Mexico and that there was "no evidence that Mexican law was contrary to a fundamental policy of Texas," so the choice-of-law clause was valid and applicable to the contract and tort claims.[28] Moreover, even if the choice of law did not apply to the tort claims, Texas's choice-of-law rules and "most significant relationship" test required that Mexican law governed EPL-Mex-

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23. *Id.* at 609.
24. 344 F. Supp. 2d 986 (S.D. Tex. 2004).
25. *Id.* at 986-88.
26. *Id.* at 988 (citing Tex. Bus. & Com. Code Ann. § 1.301(a) (Vernon 2004)).
27. *Id.*
28. *Id.*

ico's tort claims.[29]

In *Memon v. Baskin-Robbins Inc.*,[30] plaintiffs Manzoor Memon, Aamir Memon, Sanam Memon, and Memon Corp. filed a lawsuit against Baskin-Robbins, Inc., alleging various state claims stemming from a franchise agreement between Memon Corp. and Baskin-Robbins. Baskin-Robbins timely removed the action based on diversity and moved to dismiss all claims against it. About four months later, plaintiffs filed a motion to dismiss, seeking dismissal without prejudice until they could afford to retain counsel. The district court granted Baskin-Robbins' motion to dismiss. Plaintiffs, thereafter, retained counsel and appealed the dismissal. The Fifth Circuit found that Memon Corp.'s claims should not have been dismissed with prejudice, and the district court, upon remand, dismissed Memon Corp.'s claims without prejudice.[31]

Baskin-Robbins then sought to recover attorney's fees from Memon Corp. and Aamir Memon under the franchise agreement's fee provision. The franchise agreement provided that the agreement: "shall be interpreted and construed under the laws of the state in which [Baskin-Robbins] has its principal place of business. . . ."[32]

In determining which state's law governed the franchise agreement, Baskin-Robbins indicated that it shifted its principal place of business from California, where it was located when the parties executed the franchise agreement, to Massachusetts, where it was located when plaintiffs filed suit. Because Baskin-Robbins' primary place of business changed after the franchise agreement's execution, the district court had to determine the meaning of the "primary place of business" provision.[33]

Although Baskin-Robbins' primary place of business was in California when the parties entered into the franchise agreement, language in the franchise agreement indicated that the parties chose not to require California law to govern the contract. The franchise agreement provided that the "choice of law shall not include the California Franchise Relations Act or the California Franchise Investment Law. . . ." The district court noted that this language evidenced the parties' intent to leave open the possibility that the law governing the contract might change after the franchise agreement was executed. As such, the district court determined that the parties intended Massachusetts law to govern the franchise agreement because that was where Baskin-Robbins had its primary place of business.[34]

29. *Id.* at 989 (noting that the choice-of-law clause applied to the tort claims because the clause was broad); *see also* Tex. Bus. & Com. Code Ann. § 1.301(a) (Vernon Supp. 2005); Mitsui & Co. (USA), Inc. v. Mira M/V, 111 F.3d 33, 35 (5th Cir. 1997).

30. No. Civ. A. H-03-1944, 2005 WL 1606930 (S.D. Tex. July 6, 2005).

31. *Id.* at *1.

32. *Id.*

33. *Id.*

34. *Id.* at *2 (noting that the district court did not need to determine whether the choice-of-law provision was valid because Texas and Massachusetts law similarly interpreted the term "prevailing party").

C. Forum Selection

In *Phoenix Network Technologies (Europe) Ltd. v. Neon Systems, Inc.*,[35] Phoenix Network Technologies, Inc. (Computer Associates International, Inc.'s predecessor ("CAI")) and Diplomat Systems Limited (Phoenix Network Technologies (Europe) Ltd.'s predecessor) entered into an agreement that granted Diplomat the "non-exclusive right to license, sub-license, market, distribute and support" particular software within certain European countries. Phoenix and Diplomat had entered into this agreement in 1996. In 1997, Sterling Silver, Inc., which later merged with CAI, purchased Phoenix assets, including the agreement. Three years later, Neon Systems, Inc. contracted with Sterling to acquire certain rights to the software. Because Phoenix declared that it had superior rights to Neon in the agreement, Phoenix sued Neon and CAI in January 2003, alleging tortious interference with the agreement and with Phoenix's prospective business relations and unfair competition.[36]

Neon and CAI moved to dismiss Phoenix's claims since Phoenix had filed the lawsuit in Fort Bend County, Texas. Neon and CAI asserted that the agreement's forum-selection clause mandated that any dispute be construed under English laws. The trial court granted both Neon and CAI's motions and dismissed all claims without prejudice. Phoenix appealed.[37]

The agreement contained the following forum-selection clause: "The parties hereby agree that this Agreement and the provisions hereof shall be construed in accordance with English law and the venue for resolution of any disputes arising out of this Agreement shall be the United Kingdom."[38]

Phoenix, an English company headquartered in the U.K., asserted that this clause was either invalid or unenforceable. Phoenix argued that: (1) Neon and CAI did not carry their burden of showing that Phoenix and CAI agreed that the U.K. would be the exclusive jurisdiction; (2) parol evidence indicated that the forum-selection clause did not show the parties' intent to litigate exclusively in the U.K.; (3) alternatively, if the forum-selection clause provided for exclusive jurisdiction in the U.K., the clause was invalid for having been the result of mutual mistake; (4) Neon and CAI did not show that various jurisdiction would enforce forum-selection clauses; (5) the forum-selection clause was vague; and (6) the forum-selection clause violated Texas public policy. The appellate court first outlined the two tests for determining forum-selection clauses' enforceability.[39]

Since the U.S. Supreme Court's landmark decision in *M/S Bremen v.*

35. 177 S.W.3d 605 (Tex. App.—Houston [1st Dist.] 2005, no pet. h.).
36. *Id.* at 609.
37. *Id.* at 609-10.
38. *Id.* at 610.
39. *Id.* at 614.

Zapata Off-Shore Co.[40] and its later refining pronouncements in *Carnival Cruise Lines, Inc. v. Shute*,[41] Texas courts have been more apt to enforce forum-selection clauses. Under the test of *M/S Bremen* and *Shute*, forum-selection clauses "are prima facie valid and should be enforced unless enforcement is shown by the resisting party to be 'unreasonable' under the circumstances." In contrast, Texas appellate courts had recognized a two-part test to determine whether a forum-selection clause was valid and enforceable: the clause was enforceable if (1) the parties contractually consented to submit to the exclusive jurisdiction of another jurisdiction and (2) the other jurisdiction generally recognized the validity of such provisions. Even if these two threshold criteria were met, however, a forum-selection clause would not bind a Texas court if the interests of witnesses and public policy strongly favored that the suit be maintained in a forum other than the one to which the parties had agreed. The *Phoenix* court noted that the principal differences between the *M/S Bremen* and *Shute* test and the Texas appellate court test were that (1) the former test viewed the clause as prima facie valid, while the Texas test required the clause's proponent to establish that the forum recognized the validity of the general type of forum-selection clause, and (2) the former test allowed the opponent to defeat the clause if the enforcement was unreasonable and unjust, while the Texas test did not expressly recognize this enforcement exception. The supreme court has since clarified the enforceability of forum-selection clauses in Texas.[42]

In *In re AIU Ins. Co.*,[43] the supreme court approved the *M/S Bremen* and *Shute* test when it held that the party opposing enforcement of the forum-selection clause had the "heavy burden" of showing that the clause should not be enforced under the *M/S Bremen* and *Shute* test. In the same year, the supreme court affirmed application of the *M/S Bremen* and *Shute* test in *In re Automated Collection Technologies, Inc.*[44] In that case, the supreme court held that enforcement of forum-selection clauses is mandatory unless the party opposing enforcement clearly shows that enforcement would be unreasonable or unjust.[45]

In *Michiana Easy Livin' Country, Inc. v. Holten*,[46] which was discussed above, the Texas Supreme Court again affirmed the application of the *M/S Bremen* and *Shute* test. Holten and Michiana signed a one-page contract that provided that any litigation between them would occur in Indiana. Holten, nevertheless, sued Michiana in a Texas state court. The

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40. 407 U.S. 1 (1972).
41. 499 U.S. 585 (1991).
42. *Id.* (citing My Café-CCC, Ltd. v. Lunchstop, Inc., 107 S.W.3d 860, 864-65 (Tex. App.—Dallas 2003, no pet.); Holeman v. Nat'l Bus. Inst. Inc., 94 S.W.3d 91, 97 (Tex. App.—Houston [14th Dist.] 2002, pet. denied); Barnett v. Network Solutions, Inc., 38 S.W.3d 200, 203 (Tex. App.—Eastland 2001, pet. denied); Mabon Ltd. v. Afri-Carib Enters., Inc., 29 S.W.3d 291, 296-97 (Tex. App.—Houston [14th Dist.] 2000, no pet.)).
43. 148 S.W.3d 109, 111 (Tex. 2004).
44. 156 S.W.3d 557 (Tex. 2004).
45. *Phoenix Network Techs.*, 177 S.W.3d at 613-14.
46. 168 S.W.3d 777 (Tex. 2005).

supreme court, using the analysis in *Shute*, held that insertion of a clause designating a foreign forum suggested that the parties intended no local availment.[47] Holten challenged application of the forum-selection clause. First, Holten asserted that Michiana waived the forum-selection clause because Michiana did not initially raise this issue. The supreme court held that Holten was not prejudiced by the delay since nothing had taken place in the first two years of the lawsuit except for the special appearance. Second, the supreme court held that the clause applied to *any* dispute, not just to disputes interpreting the terms of the contract as Holten alleged. Lastly, the supreme court held that because Holten did not assert that the clause was fraudulently induced, Michiana was not required to show that enforcement of the clause would be unreasonable and unjust. As such, the *Phoenix* court analyzed enforceability of the forum-selection clause using the *M/S Bremen* and *Shute* test.[48]

The appellate court held that the forum-selection clause in the distribution agreement could not more plainly require that any disputes arising out of the agreement be litigated in the U.K. The appellate court concluded that parol evidence would not be considered in interpreting the clause since it was not ambiguous and included a merger clause. Moreover, the appellate court did not require Neon and CAI to show that the U.K. recognized the validity of forum-selection clauses in general. Current Texas precedent established that the forum-selection clause would be prima facie valid. Lastly, the appellate court held that Phoenix, which had a "heavy burden" to make a "strong showing" that the clause should be set aside, presented no evidence that Texas's public policy is violated by enforcing the clause. Consequently, the appellate court affirmed the dismissal of Phoenix's claims and required the parties to litigate in the U.K.[49]

In *Klinghoffer v. Mama Fu's Noodle House, Inc.*,[50] Larry Klinghoffer and James Hammond, through their limited partnership, Asian-American Casual Dining, L.P., executed a market-development agreement with Mama Fu's Noodle House, Inc. The agreement contained a forum-selection that provided: "[AACD] hereby submits to the non-exclusive jurisdiction of the courts having jurisdiction in the County of Fulton State of Georgia, and agrees not to raise and waives any objection based upon *forum non conveniens*."[51] The limited partnership and Mama Fu's also entered into a franchise agreement, agreeing that: "Except to the extent Mama Fu's seeks injunctive or other equitable relief . . . , any dispute between Mama Fu's and Franchisee arising out of or relating to this Agreement shall, on request of Mama Fu's or Franchisee, be determined by arbitration . . . in Atlanta, Georgia . . . ."[52] On the same day, an

47. *Id.* at 792.
48. *Phoenix Network Techs.*, 177 S.W.3d at 614-22.
49. *Id.* at 621.
50. No. 3-04-CV-1695-L, 2004 WL 2583632 (N.D. Tex. Nov. 12, 2004).
51. *Id.* at *1.
52. *Id.*

amendment to the franchise agreement clarified that the market-development agreement and franchise agreement were subject to the terms and conditions of an earlier agreement between plaintiffs and Mama Fu's affiliate. This supplemental agreement also contained a forum-selection clause: "Each party agrees that any legal action . . . that arises out of or is related to this Agreement may only be brought in the courts of the State of Georgia or of the United States of America for the Northern District of Georgia . . . ."[53] The amendment specifically provided that the supplemental market-development agreement superseded any inconsistent provisions in the franchise agreement and market-development agreement.[54]

In June 2004, plaintiffs filed a demand for arbitration in Atlanta, Georgia against Mama Fu's for claims including violations of the Texas Business Opportunity Act, fraud, negligent misrepresentation, and breach of contract. In August 2004, plaintiffs asserted "nearly identical" claims against Mama Fu's in the instant lawsuit. Mama Fu's moved to dismiss, asserting that Texas was not a proper venue since the supplemental market-development agreement required the parties to litigate in Georgia. Conversely, plaintiffs moved to stay the Texas lawsuit and compel arbitration. Plaintiffs asserted that the provision in the supplemental agreement did not apply since it only applied to claims arising from or out of that agreement. Plaintiffs argued that their claims arose from and related to the original market-development agreement and franchise agreement. The district court considered whether the forum-selection clause in the supplemental agreement applied to claims brought under the original market-development agreement and franchise agreement.[55]

The district court noted that the supplemental agreement provided that it superseded any inconsistent provisions in the franchise agreement and original market-development agreement. The district court found that the dispute-resolution provision of the supplemental agreement plainly conflicted with the one in the franchise agreement—the supplemental agreement contemplated litigation in Georgia state or federal court and the franchise agreement contemplated arbitration. The district court, therefore, held that the forum-selection clause in the supplemental market-development agreement applied to the Texas dispute and trumped the arbitration provision in the franchise agreement.[56]

After the district court determined that the forum-selection clause in the supplemental market-development agreement controlled, the court decided whether the clause was enforceable. In making this determination, the district court noted that the deference accorded to a forum-selection clause depends on whether the movant files a motion to dismiss for improper venue or a motion to transfer. Using the analysis in *M/S Bremen*, the district court held that a forum-selection clause is "prima

53. *Id.*
54. *Id.* at *1-2.
55. *Id.* at *2.
56. *Id.*

facie valid and should be enforced unless enforcement is shown by the resisting party to be 'unreasonable' under the circumstances."[57]

The district court held that enforcement of a forum-selection clause may be unreasonable when: (1) incorporation of the clause into the agreement was the product of fraud or overreaching; (2) the party seeking to escape enforcement will be deprived of his day in court because of the grave inconvenience or unfairness of the selected forum; (3) the fundamental unfairness of the chosen law will deprive the plaintiff of a remedy; or (4) enforcement of the forum-selection clause would contravene a strong public policy of the forum state. Because plaintiffs failed to argue and present evidence that the forum-selection clause was unreasonable, the district court held that the plain language of the clause required the parties to litigate their dispute in a Georgia state or federal court.

D. Jury-Waiver Provisions

In *In re C-Span Entertainment, Inc.*,[58] Blockbuster, C-Span Entertainment, Inc., and Sunil Dharod negotiated an asset-sale agreement whereby C-Span would purchase the assets and operations of eleven of Blockbuster's company-owned stores in East Texas. Three days later, the parties executed Blockbuster's standard-form franchise agreements for the eleven stores. Each franchise agreement provided that the parties waived their right to a jury trial: "COMPANY AND FRANCHISEE AND EACH OWNER BY EXECUTION OF THIS AGREEMENT IRREVOCABLY WAIVE TRIAL BY JURY ON ANY ACTION, PROCEEDING OR COUNTERCLAIM, WHETHER AT LAW OR EQUITY, BROUGHT BY EITHER OF THEM."[59] The asset-sale agreement, however, did not contain a jury waiver.

On June 8, 2001, C-Span sued Blockbuster, asserting both tort and contract claims. C-Span alleged that Blockbuster did not provide accurate financial information during the negotiations. C-Span eventually joined its attorneys during these transactions, Akin Gump, and filed a claim against them for malpractice. During the litigation, the trial court entered seven scheduling orders that included a date for a jury trial setting. After the Texas Supreme Court issued its opinion in *In re Prudential*,[60] Blockbuster moved to quash C-Span's jury demand, relying on the jury-waiver provisions in the franchise agreements and *In re Prudential*'s pronouncement that the supreme court would enforce pre-litigation jury waivers. Akin Gump also filed a motion to quash C-Span's jury demand, seeking that all claims be tried together in a single proceeding. The trial court granted Blockbuster's motion to quash and denied Akin Gump's

57. *Id.* at *3 (quoting *M/S Breman*, 407 U.S. at 10).
58. 162 S.W.3d 422 (Tex. App.—Dallas 2005, no pet. h.). Haynes and Boone, LLP is lead counsel for Blockbuster in this matter.
59. *Id.* at 424 (emphasis in original).
60. *See In re* Prudential Ins. Co. of Am., 148 S.W.3d 124 (Tex. 2004).

motion, and C-Span and Akin Gump sought mandamus relief.[61]

First, C-Span argued that Blockbuster had waived its right to enforce the jury-waiver provision since over two years had passed. The appellate court, however, held that the facts did not yield the conclusion that Blockbuster had waived its right to enforce the contractual jury waiver. The appellate court further held that it was not unreasonable for Blockbuster to wait to enforce the contractual jury waiver, since the issue of pre-litigation jury waivers was a matter of first impression for the supreme court.

Second, C-Span argued that the district court abused its discretion by concluding that jury-waiver provisions in the franchise agreements applied to claims arising under the asset-sale agreement. The appellate court disagreed. The appellate court held that although it contained an integration clause, the asset-sale agreement clearly contemplated and participated in the franchise agreements. The appellate court concluded that the asset-sale agreement and the franchise agreements "were part of the same transaction and, therefore, must be construed together." The appellate court further concluded that the asset-sale agreement incorporated the jury waiver in the franchise agreements.[62]

Akin Gump argued that it should be able to rely on the jury-waiver provision for contractual and equitable reasons. First, Akin Gump asserted that as C-Span's attorney and agent, Akin Gump should be bound to the jury-waiver provision. Akin Gump relied on several arbitration cases, "wherein an agent was bound by the same agreement to arbitrate that bound the agent's principal."[63] The appellate court, however, held that the arbitration cases were distinguishable. The appellate court held that in the arbitration cases, the agent was held to the principal's agreement since the agent acted on the principal's behalf in the conduct at issue in the case. Second, Akin Gump argued that it should benefit from the jury waiver since any other result would "set the stage for the inevitable consequence of inconsistent results at trial."[64] The appellate court held that the trial court could properly determine the issue differently using different procedures. Hence, the appellate court denied Akin Gump's relief.[65]

61. *C-Span*, 162 S.W.3d at 425.

62. *Id.* at 427.

63. *Id.* at 428.

64. *Id.*

65. *Id.* at 428-29; *see also* McMillan v. Computer Translation Sys. & Support, Inc., 66 S.W.3d 477, 482-83 (Tex. App.—Dallas 2001, no pet. h.) (arbitration case wherein agent would be entitled to arbitrate disputes arising out of specific conduct since the principal would be entitled to do the same).

III. THE FRANCHISE RELATIONSHIP, TERMINATION, AND NON-RENEWAL

A. The Franchise Relationship

In *Texas Motor Coach, L.C. v. Blue Bird Body Co.*,[66] the court reaffirmed previous Texas court decisions, holding that the relationship between a franchisee and a franchisor will be limited to the terms and provisions contained in the franchise agreement if the agreement includes a merger clause that the parties negotiated at arm's length. In this case, a recreational vehicle franchisee, Texas Motor, sued its franchisor, Blue Bird, alleging breach of contract, fraudulent inducement, fraud, violations of the Texas Deceptive Trade Practices Act, and negligent misrepresentation. These claims stemmed from numerous statements allegedly made by Blue Bird before it executed a franchise agreement with Texas Motor. Texas Motor claimed that its decision to sign the franchise agreement was based on Blue Bird's false or misleading statements, including statements by Blue Bird's representatives regarding the marketing assistance, technical support, product improvements, training, and customer service provided by the franchisor. Blue Bird also allegedly told Texas Motor that the company had built a new factory, hired new engineers, converted to a Japanese-type production process, abandoned the school-bus chassis, and would comply with ISO 9000 standards, but it failed to mention that it was not currently producing vehicles.[67] The first shipment of purportedly new manufactured recreational vehicles sent to Texas Motor by Blue Bird were in fact old models and contained numerous defects, including, among other things, structural cracks in the side walls, old tires, engine rust, and electrical malfunctions.[68] Texas Motor rejected the defective vehicles, ceased operation shortly thereafter, and filed suit against Blue Bird.

Blue Bird filed a motion for summary judgment on the tort claims, arguing that Texas Motor could not rely on the alleged pre-contractual statements and representations made by Blue Bird's agents because the merger clause in the franchise agreement clearly stated that there were no representations except as expressly set forth in the agreement and that no one was authorized by Blue Bird to make additional representations.[69] The court looked to the merger-clause analysis set out in the Texas Supreme Court's decision in *Schlumberger Technology Corp. v. Swanson*[70] for guidance in determining whether the merger clause precluded reliance by Texas Motor. The *Schlumberger* analysis included the following factors: (a) whether counsel represented the parties, (b) whether the agreement was negotiated at arm's length, and (c) whether the parties were sophisticated business people. The court found that the evidence in

66. No. 4:05CV34, 2005 WL 3132482 (E.D. Tex. Nov. 22, 2005).
67. *Id.* at *1.
68. *Id.* at *2.
69. *Id.* at *7.
70. 959 S.W.2d 171 (Tex. 1997).

this case supported the conclusion that the merger clause effectively prevented reliance by Texas Motor. The court pointed to the fact that Texas Motor was represented by counsel in negotiating the agreement and that the merger clause was not boiler-plate language in a form contract. Texas Motor also acknowledged that it was wary of entering into an agreement with Blue Bird because of the decline in Blue Bird's reputation resulting from changes in the way it constructed its vehicles, and Texas Motor inspected, and pointed out several defects in, a prototype of Blue Bird's new vehicle (Blue Bird indicated that the prototype's defects would be worked out in the final production model). These incidents led Texas Motor to seek out alternatives to becoming a Blue Bird franchisee, but ultimately, the company decided to sign the franchise agreement. Given these facts, the court recommended that Blue Bird's motion for summary judgment be granted and that the cause of action be dismissed with prejudice.[71]

In *Texas Taco Cabana L.P. v. Taco Cabana of New Mexico, Inc.*,[72] a Taco Cabana franchisee claimed that its 1994 license agreement granted it exclusivity for the operation of Taco Cabana restaurants throughout the entire city of Albuquerque, New Mexico. The franchisor maintained that the exclusivity granted under the license agreement granted only a two-mile exclusive area around the franchisee's restaurant. The agreement's granting clause stated that the "location" of the "site" was Albuquerque, New Mexico, as more particularly described in "Exhibit B" to the agreement. However, no "Exhibit B" was attached to the agreement. The agreement contained an exclusivity provision prohibiting the franchisor from operating or allowing others to operate a Taco Cabana restaurant within a radius of two miles of the site of the licensed business. The court noted, however, that there were "numerous word processor 'strike outs' and additions" throughout the executed agreement.[73] Subsequently, a license agreement was prepared that eliminated the strike outs and included the additions marked in the 1994 license agreement. This finalized draft included a granting clause that listed the site's location as 6500 San Mateo, Albuquerque, New Mexico; however, the completed agreement was never executed, and no attempt was made to execute it.[74]

The franchisee opened a Taco Cabana restaurant at 6500 San Mateo and by the end of 1995 opened a second restaurant in Albuquerque. No license agreement was executed in connection with the second restaurant's opening. From 1988 to 2001, the franchisee had certain development rights for New Mexico under a development agreement with the franchisor, but all such development rights terminated in November 2001. In 2004, the franchisor opened a company-operated Taco Cabana restaurant in Albuquerque, but it was not located within two miles of either of

71. *Tex. Motor Coach*, 2005 WL 3132482, at *8.
72. No. Civ.A. SA-02-CV-1209, 2005 WL 1397032 (W.D. Tex. June 10, 2005).
73. *Id.* at *3.
74. *Id.* at *4.

the franchisee's restaurants. The franchisee brought suit claiming that the 1994 license agreement granted exclusivity for a two-mile radius around the city of Albuquerque.[75] The franchisee claimed that such an interpretation was consistent with the parties' intent when the agreement was signed and was warranted based on the agreement's plain language. The franchisor countered that the license agreement made clear that it provided for the operation of only one restaurant at a given location and was not meant to grant any rights to an entire city. The franchisor argued that the agreement's only reasonable interpretation was that the restaurant's location was meant to be filled in at a later date, and the exclusivity provision was meant to extend only to the two-mile area surrounding the restaurant.[76]

In reaching its decision, the district court pointed out that under Texas law, "[a] contract is ambiguous only if there is uncertainty as to which of two reasonable interpretations is correct."[77] Here, the court found that the contract's only reasonable interpretation was the one that the franchisor proposed. The court noted that the 1994 license agreement's language indicated in several places that it was meant to cover only one restaurant at a given location. In addition, the 1994 development agreement (which was prepared at the same time as the 1994 license agreement) references the "License Agreement executed concurrently herewith for the previously approved location at 6500 San Mateo, Albuquerque, New Mexico."[78] The language of the development agreement also made clear that each Taco Cabana restaurant contemplated thereunder was to be operated under a separate license agreement (even though in practice the franchisor did not always enforce this provision). Furthermore, the license agreement's granting clause included a blank before the words "Albuquerque, New Mexico," indicating that the parties anticipated something more. The court also opined that a franchisor would be unlikely to grant exclusivity for an entire city for the relatively low $50,000 initial fee charged under the license agreement. Based on the agreement's language and the parties' course of conduct, the court entered judgment in favor of the franchisor and dismissed franchisee's action on the merits.

B. Termination and Non-renewal

Buddy Gregg Motor Homes, Inc. v. Motor Vehicle Board of the Texas Department of Transportation[79] addressed a motor-home franchisee's claims against its franchisor brought in connection with the termination of their franchise agreement. Buddy Gregg operated as a franchisee of Liberty for seven years. When the relationship soured, Liberty attempted

75. *Id.* at *5.
76. *Id.* at *6.
77. *Id.* (citing Tex. Farm Bureau Mut. Ins. Co. v. Sturrock, 146 S.W.3d 123, 126 (Tex. 2004)).
78. *Id.* at *7-8.
79. 179 S.W.3d 589 (Tex. App.—Austin 2005, pet. denied).

to terminate the franchise agreement but failed to comply with the termination requirements (including sixty days' notice to the dealer/franchisee setting forth the grounds for termination) provided for in the Texas Occupations Code for terminating a motor-vehicle franchise agreement.[80] Subsequently, Buddy Gregg demanded that Liberty repurchase all of Buddy Gregg's unsold inventory pursuant to its rights under the Texas Occupations Code.[81] Liberty complied with the demand, but Buddy Gregg later filed a formal complaint with the Motor Vehicle Board of the Texas Department of Transportation. After considering the evidence, the Board determined that both parties had breached their duty of good faith and fair dealing, that Liberty should be penalized for failing to comply with the Texas Occupations Code's termination requirements (the Board assessed a $1,000 penalty against Liberty), that Buddy Gregg's demand for repurchase constituted a de facto termination of the franchise agreement, and that Liberty's repurchase of the inventory was timely. Both parties appealed the Board's order. [82] The appellate court agreed with the Board and upheld its order in full. In affirming the Board's order, the court pointed out that despite Buddy Gregg's arguments to the contrary, the Board has broad and exclusive jurisdiction to regulate the sale of motor vehicles, and while courts may review the Board's orders if the parties request it, the court "cannot modify an agency order without usurping the agency's authority and thereby violating the separation of powers doctrine."[83]

Franchisors are frequently confronted with legal challenges from franchisees when they attempt to terminate a franchise too quickly or without just cause, but in *De La Hoya v. Coldwell Banker Mexico, Inc.*,[84] a franchisor was brought into a lawsuit as the result of its failure to timely terminate a troublesome franchisee. *De La Hoya* involved claims by several real-estate purchasers against Coldwell Banker Real Estate Corporation, an American real-estate-brokerage franchisor, its Mexican subfranchisor (and its assignee), a Mexican franchisee, and the subfranchisor's President and owner for Mañanas misappropriation of customer's money.

On appeal, the plaintiffs alleged that CB Affiliates de Mexico exercised control over Mañana and thus could be held liable for Mañana's actions. Under the franchise agreement, Mañana was required to keep records of its escrow activities, and the agreement gave CB Affiliates de Mexico the right to inspect those records and terminate the franchise for good cause. Defendants argued that the franchise agreement did not permit CB Affiliates de Mexico to control Mañana's escrow activities, so the defendants could not be held liable for those activities. However, the court noted

80. *Id.* at 593; *see* TEX. OCC. CODE ANN. § 2301.453(c) (West 2004).
81. *Gregg*, 179 S.W.3d at 593; *see* TEX. OCC. CODE ANN. § 2301.465(b) (Vernon 2004).
82. *Gregg*, 179 S.W.3d at 598-601.
83. *Id.* at 603 (citing City of Stephenville v. Tex. Parks & Wildlife Dep't, 940 S.W.2d 667, 678 (Tex. App.—Austin 1997, pet. denied)).
84. 125 F. App'x 533 (5th Cir. 2005) (see discussion *supra* note 2).

that evidence presented by the plaintiffs showed that "Coldwell Banker" (presumably the subfranchisor) had exercised control over the escrow services by requiring Jacobsen to sign an agreement requiring her to use only third party escrow services after Coldwell Banker learned of her prior misappropriations. Plaintiffs also presented evidence that CB Affiliates de Mexico had received customer complaints alerting them to Jacobsen's activities more than one year before the franchise agreement was finally terminated in December 2001. In light of CB Affiliates de Mexico's knowledge of Mañana's activities, the court held that CB Affiliates de Mexico arguably had a right of control resulting from the terms of the franchise agreements, CB Affiliates de Mexico's attempt to exercise control over the escrow activities, or a combination of the two. As a result, CB Affiliates de Mexico arguably breached its duty to act to protect the plaintiffs and its failure to act could possibly point to negligence.[85] The court also found that the plaintiffs had adequately alleged a "single business enterprise" theory involving the other defendants, so joinder of all parties was proper.

IV. INTELLECTUAL PROPERTY

A. Trademarks

In re Schlotzsky's, Inc. v. Titterington's Deli Co.[86] exemplifies the importance of trademarks and other proprietary information in the context of the franchise relationship. The case involved a bankrupt restaurant franchisor's motion for a preliminary injunction against a group of Denver based former franchisees that continued to use the franchisor's trademark, tradename, proprietary information, and operating system after unilaterally terminating their agreements with the franchisor. Although the twelve restaurants continued to operate under the franchisor's marks, several displayed a flier indicating that they were converting from the franchisor's brand of restaurants into a new restaurant chain. These actions specifically violated the non-competition covenants in their franchise agreements.

After a hearing, the federal bankruptcy court concluded that the franchisor would be irreparably harmed by the continued use of the trademarks. Amounting the former franchisee's actions to simple theft, the court granted the preliminary injunction, opining that the franchisor was likely to succeed on the merits of its claim that the franchisees were violating the non-competition covenants.

85. *Id.* at 540-41.

86. No. 04-54504-LMC, Bus. Franchise Guide (CCH) ¶ 12,941 (W.D. Tex. Nov. 5, 2004). Haynes and Boone, LLP was lead bankruptcy counsel for Schlotzsky's, Inc. and its affiliates and subsidiaries; co-author Robert A. Lauer served as Corporate Counsel for Schlotzsky's, Inc. before and during the bankruptcy proceedings, including during this action's pendency.

V. COMMON-LAW CLAIMS

A. Contract Issues

Because the franchise relationship relies heavily on the parties' written franchise agreement, each provision requires particular attention to detail. *Miron v. Sloan*[87] is a good example of the negative effects of a broadly constructed arbitration clause. In this case, a group of franchisees sued a dry cleaning franchisor for fraud in the inducement, negligent misrepresentation, breach of the franchise agreement, and violation of state consumer-protection statutes. Specifically, plaintiffs alleged that they entered into franchise agreements for dry-cleaning businesses based on offering circulars that misrepresented and omitted material information about the franchises. Defendant responded by moving to stay the action under the Federal Arbitration Act and filing a demand for arbitration with the American Arbitration Association.

The franchise agreements contained the following arbitration provision:

> The parties agree that, except as precluded by applicable law, any controversy or claim that arises out of or relates to this Agreement, or any breach of this Agreement, including but not limited to, any claim that any of this Agreement is invalid, illegal, voidable or void, shall be submitted to a sole arbitrator in accordance with the rules of the American Arbitration Association and judgment upon the award may be entered in any court with jurisdiction thereof.[88]

Plaintiffs made several arguments in opposition to the motion.[89] Plaintiffs first argued that they were not required to arbitrate under the franchise agreements because the franchisor under those agreements was a dissolved corporation at the time of contracting and therefore did not have the power to enter into contract. Responding to this argument, the court relied on the Fifth Circuit's analysis in *Will-Drill Resources, Inc. v. Samson Resources Co.*[90] If plaintiffs had argued that the arbitration clause alone was voidable, it would have been within the court's authority to determine whether there was an agreement to arbitrate. But according to *Will-Drill*, an attempt to have an entire agreement declared voidable or void is a decision for the arbitrator.[91]

Plaintiffs' argued secondly that their claims arose out of the disclosure circulars rather than the franchise agreements and were not covered by the arbitration clause. The court, however, interpreted the arbitration clause in the franchise agreement broadly. Specifically, it held that because the clause covered "any controversy or claim that arises out of or relates to the [f]ranchise [a]greements or any breach of the

87. No. H-04-4289, Bus. Franchise Guide (CCH) ¶ 13,101 (S.D. Tex. May 13, 2005).
88. *Id.*
89. *Id.*
90. 352 F.3d 211 (5th Cir. 2003).
91. *Id.* at 218.

[a]greements," it did in fact cover the asserted claims.[92]

Plaintiffs' final argument centered on the fact that defendant Sloan founded the dry-cleaning business and later incorporated it in Florida. After operating as a corporation for several years, Sloan dissolved the Florida corporation and continued the business as a sole proprietor before incorporating again three years later. Because the original franchise agreements were with the dissolved corporation, plaintiffs argued that there was not a contractual obligation to arbitrate with either Sloan or the newer corporation because neither were signatories to the agreements.

Whether parties who did not sign the contract containing the arbitration provision may invoke the agreement against a party is a matter for the court to decide.[93] There is a two-prong test for determining whether a nonsignatory can compel arbitration: (1) When a signatory to the agreement containing the arbitration clause must rely on the terms of the written agreement in asserting its claims against the nonsignatory; and (2) when the signatory raises allegations of substantially interdependent and concerted misconduct by both a nonsignatory and one or more signatories to the agreement.[94] In this case, the court recognized that because plaintiffs were relying on the franchise agreements with the arbitration clause as a basis for recovery, the first prong was satisfied. Also, the court held that the second prong could be established. Recognizing that neither Sloan nor the newer corporation were signatories, the court ruled that because Sloan operated essentially a single business throughout the course of the franchise relationship, the signatory plaintiffs were alleging interdependent and concerted misconduct by both a nonsignatory and one or more signatories to the contract. Therefore, the court concluded that the arbitration clause was enforceable by all defendants.

B. Vicarious Liability

Franchisors remain cautious regarding the amount of control exercised over franchisee operations due to the potential exposure to third-party claims, particularly vicarious-liability claims. Unlike most vicarious-liability cases, *Acosta v. Drury Inns, Inc.*[95] recently addressed the agency-law issues on a motion to remand. In this case, the plaintiff was a Texas citizen who filed a state law claim against Drury Inns, a hotel-management company, and Drury Southwest, a hotel franchisor, alleging discrimination and retaliation in violation of the Texas Commission on Human Rights Act arising from her pregnancy. Defendants removed the case to federal court based on diversity, despite the fact that Drury Southwest maintained its principal place of business in Texas. On plaintiff's motion

92. *Miron*, Bus. Franchise Guide (CCH) ¶ 13.101.
93. *Id.* (citing John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 546-47 (1964)).
94. *Id.* (citing Grigson v. Creative Artists Agency L.L.C., 210 F.3d 524, 526 (5th Cir. 2000), *cert. denied*, 531 U.S. 1013 (2000)).
95. 400 F. Supp. 2d 916 (W.D. Tex. 2005).

to remand, defendants argued that Drury Southwest was fraudulently joined and, therefore, once removed, complete diversity existed.

Plaintiff's motion for remand was based on the theory that Drury Inns and Drury Southwest were "joint employers." Determining whether distinct entities are "joint employers" of an individual requires the court to consider "(1) the interrelation of operations; (2) centralized control of labor relations; (3) common management; and (4) common ownership or financial control."[96] Of critical importance is which entity made the final decision regarding employment matters. While Drury Southwest owned the real estate, building, and franchise rights of the hotel at issue, it contracted with Drury Inns to manage and operate every aspect of the hotel. In light of this evidence and because plaintiff failed to plead any facts showing that Drury Southwest had the right to hire or fire her, the right to supervise or set her work schedule, or that Drury Southwest paid her salary, withheld any taxes, provided any benefits, or set any terms and conditions of her employment, the court determined that Drury Southwest was fraudulently joined and denied plaintiff's motion for remand.

C. Tortious Interference

In response to an application for a preliminary injunction, a federal district court analyzed the merits of a counterclaim alleging that a restaurant franchisor tortiously interfered with a supply-chain manager's supplier and distributor contracts.[97] Plaintiff Schlotzsky's became the new Schlotzsky's Deli franchisor and owner of all Schlotzsky's trademarks and associated rights following an auction of Schlotzsky's, Inc.'s bankruptcy estate. As the new franchisor, the plaintiff had the right to set quality standards for the franchise system as well as the right to approve all suppliers and distributors of Schlotzsky's-branded products. After the plaintiff designated two other primary distributors, the defendant misrepresented itself to be the exclusive representative in the purchasing of products for Schlotzsky's Inc. and Schlotzsky's Independent Franchise Association. The plaintiff argued that the defendant's behavior threatened to dilute Schlotzsky's trademarks by introducing inconsistency and inferior products into the franchise system. In response, the defendant moved for a preliminary injunction to prevent the plaintiff from continuing its efforts to exclude the defendant from participating in the Schlotzsky's distribution chain.

In one of several counterclaims, the defendant alleged that Schlotzsky's tortiously interfered with its supplier and distributor contracts. The elements of tortious interference with an existing contract are: (1) the plaintiff had a valid contract; (2) the defendant willfully and intentionally interfered with the contract; (3) the interference was a proximate cause of the plaintiff's injury; and (4) the plaintiff incurred actual damage or

96. *Id.* (citing Trevino v. Celanese Corp., 701 F.2d 397, 404 (5th Cir. 1983)).
97. Schlotzsky's, Ltd. v. Sterling Purchasing & Nat'l Distrib. Co., No. A-05-CA-95-SS, Bus. Franchise Guide (CCH) ¶ 13,089 (W.D. Tex. May 24, 2005).

loss.[98] The defendant to such a claim can assert the affirmative defenses of privilege or legal justification in the interference of contractual relations. Determining the validity of these defenses is a question of law.[99]

A defendant is justified in interfering with a plaintiff's contract if it exercises: (1) its own legal rights; or (2) a good-faith claim to a colorable legal right, even though that claim ultimately proves to be mistaken. Determining justification can be established as a matter of law when the acts that plaintiff complains of as tortious interference are merely the defendant's exercise of its own contractual rights. Intent is irrelevant.[100] Relying on this analysis, the court found that Schlotzsky's exercised its authority as franchisor and trademark owner to designate two primary sources from which franchisees could purchase Schlotzsky's branded, proprietary, and logoed products and, therefore, the defendant's counterclaim did not sufficiently demonstrate a likelihood of success on the merits.

In addition to its counterclaim for tortious interference with an existing contract, the defendant also claimed that the plaintiff tortiously interfered with prospective business relations. The elements of this cause of action are: (1) there was a reasonable probability that the plaintiff would have entered into a business relationship with a third person; (2) the defendant intentionally interfered with the relationship; (3) the defendant's conduct was independently tortious or unlawful; (4) the interference was the proximate cause of the plaintiff's injury; and (5) the plaintiff suffered actual damages or loss.[101] The court similarly rejected this claim on grounds that it was not apparent that Schlotzsky's committed any independently tortious or unlawful act, but had only exercised its rights as a franchisor.[102]

VI. STATUTORY CLAIMS

A. Texas Deceptive Trade Practices-Consumer Protection Act

Last year saw rounds three and four of *Texas Taco Cabana L.P. v. Taco Cabana of New Mexico, Inc.*[103] The franchisor of the Taco Cabana franchise system previously entered into a series of agreements with a New Mexico franchisee, including a 1988 development agreement, a 1994 development agreement, a 1994 license agreement, and a 2000 amendment-to-development agreement. However, the franchisee had only developed two restaurants and the franchisor ultimately declared that all

98. *Id.* (citing Butnaru v. Ford Motor Co., 84 S.W.3d 198, 207 (Tex. 2002)).
99. *Id.* (citing Prudential Ins. Co. of Am. v. Fin. Review Servs., 29 S.W.3d 74, 77-78 (Tex. 2000)).
100. *Id.* (citing Calvillo v. Gonzalez, 922 S.W.2d 928, 929 (Tex. 1996)).
101. *Id.* (citing Allied Capital Corp. v. Cravens, 67 S.W.3d 486, 490-91 (Tex. App.—Corpus Christi 2002, no pet. h.)).
102. *Id.*
103. Tex. Taco Cabana, L.P. v. Taco Cabana of N.M., No. Civ. A. SA-02-CV-1209, 2005 WL 356829 (W.D. Tex. Feb. 2, 2005); *Tex. Taco Cabana, L.P.*, 2005 WL 1397032, at *1.

development rights had expired. The franchisor then brought suit for declaratory judgment as to the agreements' validity, and the franchisee in turn filed counterclaims for, among other things, breach of the implied covenant of good faith and fair dealing, tortious interference with contract and prospective contractual relationships, breach of contract, and violations of the New Mexico Unfair Practices Act and the Texas Deceptive Trade Practices Act ("DTPA"). In round one, the court dismissed the franchisee's claims under the New Mexico Unfair Practices Act and its claims for tortious interference with contract and prospective contractual relations claims. But it elected not to dismiss the franchisee's claims under the Texas DTPA on grounds that (a) the franchisee's claims were based on alleged deceptive acts of the franchisor beyond just a disagreement of interpretation, and (b) reliance had not been waived.[104] In round two, however, the court found that there was simply a disagreement over the interpretation of the contract, which was not actionable under the Texas DTPA, and granted summary judgment in favor of the franchisor.[105]

In round three, the court heard the remaining declaratory-relief and contract claims.[106] The franchisor sought a declaration that all of the agreements had expired or were invalid, and the franchisee sought a declaration that the agreements remained in full force and effect.[107] The court analyzed the history of the relationship beginning with the execution of a three-store development agreement in 1988 that never led to the development of any restaurants and was later superseded by a 1994 three-store development agreement that expressly stated that it superseded and replaced the 1988 development agreement. Also, as explained previously, the parties executed a license agreement that was purportedly for a single restaurant to be operated in Albuquerque, New Mexico. The franchisee developed two restaurants in the Albuquerque area during the ensuing twelve-month period, but never signed a second license agreement. In 2000, the parties executed an amendment to the development agreement, which stated that it was an amendment to the 1988 agreement and extended the franchisee's development rights to November 2001. The franchisee failed to pursue additional development and sought an extension of its development rights as it got closer to November 2001. The

104. Tex. Taco Cabana, L.P. v. Taco Cabana of N.M., Inc., 304 F. Supp. 2d 903, 906 (W.D. Tex. 2003) (explaining the court's rulings on motion to dismiss). For a thorough discussion of round one, *see* Deborah S. Coldwell et al., *Franchise Law*, 57 SMU L. Rev. 1035, 1055-57 (2004).

105. Tex. Taco Cabana L.P. v. Taco Cabana of N.M., Inc., No. Civ. A. SA-02-CV-1209, 2004 WL 2106527, at *1 (W.D. Tex. Sept. 20, 2004). For a discussion of round two, *see* Deborah S. Coldwell et al., *Franchise Law*, 58 SMU L. Rev. 919, 942-43 (2005). The franchisee argued violations of the DTPA based on the franchisor refusing to cooperate in development under an amendment to one of their franchise agreements, falsely claiming that a development agreement did not exist, refusing to acknowledge franchisees' continuing development rights, and defaulting under and threatening to terminate a license agreement.

106. *Tex. Taco Cabana L.P.*, 2005 WL 356829, at *1.

107. *Id.*

franchisor refused to grant an extension and litigation ensued. The court ultimately found in round three that no valid development rights existed under the 1988 or 1994 development agreements, but there was an issue of fact concerning whether any development rights existed under the existing license agreement, which the court found was still valid.[108]

In round four, the court focused on the 1994 license agreement, which provided that the franchisor would not operate a restaurant within a two-mile radius of the licensed business "site" in Albuquerque.[109] However, since there was a blank preceding "Albuquerque, New Mexico" in the license agreement and the franchisee had ostensibly been permitted to operate two restaurants in Albuquerque under the single license agreement, the franchisee argued that the license agreement gave it the exclusive right to operate restaurants within all of Albuquerque. The court rejected this argument, finding that the blank was included to eventually provide a specific address for a restaurant, and the fact that the franchisor did not fill in the blank or obtain the execution of another franchise agreement for the second restaurant did not constitute a waiver or prove that the single license agreement was intended to cover all restaurants in an entire city.[110]

B. Antitrust

In *Schlotzsky's, Ltd. v. Sterling Purchasing & National Distribution Co.*,[111] which was discussed earlier, a restaurant-supply chain manager brought suit against the new owners of the Schlotzsky's Deli restaurant system alleging, among other things, antitrust violations following Schlotzsky's termination of the supply chain manager's right to serve as a non-exclusive supply chain manager for the Schlotzsky's Deli restaurant system. The assets associated with the Schlotzsky's Deli restaurant system had been sold to the new owners through a bankruptcy-court-approved sale in December 2004. Before the sale, Schlotzsky's management had approved Sterling as a non-exclusive supply-chain manager for the Schlotzsky's Restaurant system, but stated in the approval letter that Schlotzsky's alone had "full right and authority to review and approve all Products to be used in the Schlotzsky's restaurant system and all Suppliers and distributors of Products who sell Products to Franchisees for use in the Schlotzsky's Restaurant system," and that the approval of Sterling was revocable at any time.[112]

The new owners of Schlotzsky's sought to restructure their purchasing and distribution system following the acquisition, and in April 2005 notified Sterling that their designation as an approved supply-chain manager for the Schlotzsky's franchise system would be revoked effective in June

108. *Id.* at *1-7.
109. *Tex. Taco Cabana L.P.*, 2005 WL 1397032, at *7.
110. *Id.* at *17-24.
111. Bus. Franchise Guide (CCH) ¶ 13,089.
112. *Id.*

2005. Schlotzsky's also brought suit against Sterling claiming damages related to certain aspects of the existing and prior relationship between the two parties. Sterling filed counterclaims and an application for a preliminary injunction to stop Schlotzsky's from revoking its status as an approved supply-chain manager. Among the counterclaims was an action for declaratory judgment that Sterling was free to act as a distribution and purchasing agent for the Schlotzsky's franchisees without Schlotzsky's approval, and that the Schlotzsky's franchisees were free to purchase products and arrange delivery through any distributor they choose. The court reviewed the supplier provisions from a sampling of Schlotzsky's franchise agreements and found that Schlotzsky's, as franchisor, had the right to set quality standards for the supplies used in the franchise system, and that the franchisees were required to purchase supplies only from the franchisor or from approved sources of supply. Accordingly, the court ruled that Sterling was not likely to succeed on the merits of its declaratory-judgment counterclaim.[113]

C. Covenants Not to Compete

1. *Non-Competition Agreement Enforced*

In *In re Schlotzsky's Inc., v. Titterington's Deli Co.*,[114] a federal bankruptcy court in San Antonio granted a preliminary injunction in favor of the Schlotzsky's Deli restaurant system franchisor, prohibiting a group of former Colorado franchisees from operating restaurants in violation of their post-termination non-competition obligations. Schlotzsky's and its affiliates had filed for protection under Chapter 11 of the U.S. Bankruptcy Code in August 2004. Shortly thereafter, a group of eight franchisees operating twelve Schlotzsky's restaurants in the Denver, Colorado area gave Schlotzsky's notice that they were unilaterally terminating their franchise agreements. Despite the attempted unilateral termination, Schlotzsky's submitted evidence at the preliminary-injunction hearing in the bankruptcy court that each of the former restaurants continued using all or a portion of the Schlotzsky's trademarks, tradenames, proprietary information, and operating system after terminating their agreements, and were also advertising in their restaurants that they were converting from the Schlolzsky's brand to a new restaurant chain named "Denver Deli."

The court found that Schlotzsky's satisfied all four prerequisites for the issuance of a preliminary injunction: (1) a showing of immediate and irreparable harm that may not be remedied through monetary damages, (2) a showing that there is a likelihood that the plaintiff will prevail on the merits, (3) a showing that in balancing the equities, the harm to the plaintiff in not granting relief is greater than the harm to the defendant in granting it, and (4) a showing that injunctive relief is supported by public

113. *Id.*
114. Bus. Franchise Guide (CCH) ¶ 12,941.

policy.[115] First, the court noted that the irreparable harm to Schlotzsky's was worse with each passing day because the community was getting accustomed to the idea that the restaurants were part of a new restaurant chain and that they were authorized to use the franchisor's trademark and proprietary information.[116] The court also found that the harm was not compensable in monetary damages and was increased because the franchisor was undergoing a reorganization in bankruptcy.[117] Second, the court found that Schlotzsky's was likely to succeed on the merits of its claim that the former franchisees were violating non-competition covenants in their agreements by continuing to offer and sell similar food products and to display the franchisor's trademarks and trade dress after terminating their agreements.[118] Third, the court found that the balancing of the harms favored granting the injunction because the continued display of Schlotzsky's intellectual property and use of its proprietary information amounted to simple theft, and although the former franchisees would be put out of business by an injunction, the court focused on the tenuous status of the Schlotzsky's system while in bankruptcy to find the balance favored Schlotzsky's.[119] Finally, the court noted that the former franchisees could make a living without using Schlotzsky's trade dress and property, but public policy could not allow the franchisees' actions to endanger the bankruptcy reorganization prospects for the entire Schlotzsky's franchise system.[120]

In *Loye v. Travelhost, Inc.*,[121] a former distributor of the Travelhost magazine appealed the grant of a preliminary injunction in favor of Travelhost enjoining the former distributor from violating a non-compete clause in their distribution agreement. Loye was the sole shareholder and director of Little Bit Productions, which signed a distributorship agreement with Travelhost in December 2002 to distribute Travelhost magazines in the Bossier City and Shreveport area. Loye had several independent contractors working with him to help distribute the Travelhost magazine, but stopped distributing it in September 2003 and started publishing a new magazine, *On the Go in the Ark-La-Tex*, which began publication from the same office space occupied by the Travelhost operation and was manned by several of the same independent contractors. These independent contractors also switched several advertisers and magazine carriers from Travelhost magazine to *On the Go in the Ark-La-Tex*. Travelhost brought an action for injunctive relief under the agreement's non-competition provisions. The injunction was granted and, on appeal, Loye argued that, among other things, the covenant not to com-

115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.*
121. 156 S.W.3d 615 (Tex. App.—Dallas 2004, no pet. h.).

pete was unenforceable as a matter of law.[122] The Dallas Court of Appeals declined to decide the merits of whether the covenant was enforceable, but found a substantial likelihood of success on the merits and declined to overrule the trial court's granting of the injunction.[123]

VII. REMEDIES: DAMAGES AND INJUNCTIVE RELIEF

A. Compensatory Damages

In *Springs Window Fashions Division, Inc. v. Blind Maker, Inc.*,[124] Springs Window Fashions Division, Inc., Springs Window Fashions, L.P., and SWF, Inc. appealed a judgment awarding Blind Maker $5,167,240 in actual damages and $2,090,000 in exemplary damages. Springs manufactured blinds and similar window coverings. Springs distributed its products through two methods: (1) large retail outlets, such as Home Depot and Lowe's; and (2) distributors and fabricators. The underlying dispute arose from Springs' relationship with one of its fabricators, Blind Maker.[125]

For over fourteen years, Springs and Blind Maker did business without a written contract—Blind Maker would order Springs' components as needed, Springs would invoice Blind Maker, and Blind Maker would pay. Blind Maker did not pay timely, yet Springs always allowed Blind Maker a discount as if it had paid on time. In 1997, Springs and Blind Maker entered into their first formal credit agreement at Springs' request. The credit agreement provided that Blind Maker would make payments necessary to keep the account balance within the terms that Springs established. In 1998, Springs introduced its fabricator license agreement, which granted fabricators a limited license to use one of Springs' brand name trademarks, provided they adhered to quality standards.[126]

Blind Maker believed (and tried its cased against Springs on the theory) that Springs committed a variety of fraudulent acts in furtherance of a plan to take over existing fabricators, move the fabrication process to Mexico, and utilize the prior fabricators as distributors. This plan was termed Project Overlord. Blind Maker alleged that Springs' plan to implement Project Overlord (and therefore extract business from the fabricators) was so evident that Springs' even advertised it in a review form following a fabricator's conference. The review form stated that "We will be driven to execute OVERLORD on an accelerated basis."[127]

After Springs terminated Blind Maker's agreement, Blind Maker filed suit against Springs, asserting fraud, breach of contract, negligence, and a host of other claims. Springs counterclaimed under the agreement for $2.3 million, Blind Maker's remaining credit balance. Before submission

122. *Id.* at 619-20.
123. *Id.* at 620-22.
124. 184 S.W.3d 840 (Tex. App.—Austin 2006, pet. granted).
125. *Id.* at 851.
126. *Id.* at 852.
127. *Id.* at 856-57.

to the jury, Blind Maker dismissed with prejudice all of its claims except fraud. Blind Maker submitted only past and future lost profits. The jury found that Springs had committed fraud and awarded Blind Maker $5,157,240 in past lost profits; it awarded no future lost profits. The jury further found that the harm to Blind Maker resulted in fraud and awarded $2,090,000 in exemplary damages (analyzed below). The jury also found that Blind Maker failed to comply with its payment obligations under the agreement and awarded Springs $2,043,660. Springs appealed.[128]

Springs asserted that the evidence did not legally or factually support the jury's finding of fraud. In reviewing the factual challenge, the appellate court considered, weighed, and examined all the evidence presented at trial. Springs' argument was predicated on the jury's failure to find in Blind Maker's favor on its fraudulent-inducement defense to Springs' counterclaims. The appellate court, consequently, considered only potential evidence that was not "inducement-related" to determine whether fraud could be found without inducement. Blind Maker suggested that Springs was attempting to revive an argument, waived at trial, that the jury's findings in Question 1 (fraud) and Question 6 (fraudulent inducement) fatally conflicted. The appellate court agreed that Springs had waived this argument.[129] The appellate court, likewise, rejected Springs' contract, tort, white-sale, and customer-list arguments to support its theory that the evidence was factually insufficient.[130]

Springs also challenged the legal and factual sufficiency of the jury's $5,167,240 award as actual damages. The appellate court explained that after the jury received its instructions, it was asked to consider only a single element of damages—lost profits. The appellate court observed that "lost profits may be recovered as fraud damages either as direct damages or consequential damages."[131] Blind Maker sought lost profits solely as consequential damages, that is, damages arising from business opportunities due to Springs' fraud. The appellate court held that when determining whether legally and factually sufficient evidence of past consequential lost-profits damages supports the jury's award, the court was mindful of the following: (1) lost profits must not be confused with economic gains or losses that are a mere component of a lost-profits calculation; (2) recovery of lost profits must be predicated on one complete calculation, although there is no one correct method for calculating lost profits; and (3) to recover lost profits, by whatever method calculated, "the amount of the loss must be shown by competent evidence with reasonable certainty."[132]

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128. *Id.* at 862.
129. *Id.* at 866.
130. *Id.* at 864-67.
131. *Id.* at 882.
132. *Id.* at 883-84.

The appellate court held that because it did not make one complete calculation to determine lost profits, Blind Maker's calculation was legally and factually insufficient to support the jury's award. Blind Maker mistakenly relied on the principle that a business operating at a loss could recover lost profits from specific lost business opportunities, regardless of whether the company is making an overall profit. The appellate court noted that while Blind Maker conceivably could have recovered lost profits from specific lost business opportunities in an amount that exceeded its overall average net profits, that was not the "one complete calculation" that Blind Maker made.[133] The appellate court held that it could not speculate that any of Blind Maker's loss figures were comprised of lost profits from specific lost sales and business opportunities, as Blind Maker made no attempt to distinguish the portion of its losses attributable to lost profit on sales from other damages.[134] Consequently, the appellate court held that Blind Maker had incurred lost profits based on two measures—$616,510 in lost executive salaries and lost overall profits and $1,270,952 in lost sales attributable to Blind Maker's customer-list claim.[135]

B. Punitive Damages

In *Springs Window Fashions*, the appellate court suggested a remittitur after finding that the evidence did not support an award of over $5 million in actual damages.[136] The appellate court held that when suggesting a remittitur regarding actual damages, the court must reevaluate the jury's award of exemplary damages.[137] To ensure that exemplary damages were not "grossly disproportional," the appellate court considered (1) the degree of reprehensibility of the defendant's misconduct, (2) the disparity between the actual and potential harm suffered by the plaintiff and the punitive damages award, and (3) the difference between the punitive damages awarded by the jury and the civil penalties awarded or imposed in other comparable cases.[138] The appellate court stated that the most important of these considerations was the degree of reprehensibility of the defendant's misconduct.[139]

In evaluating the jury's award of exemplary damages, the appellate court observed that Blind Maker sufficiently proved that Springs implemented Project OVERLORD and sustained its implementation over the course of several years. Moreover, the jury found existence of fraud concerning the agreement, and the evidence connected that fraud to Project OVERLORD and Springs' subsequent activities. Further, there was evidence of Springs' misuse of Blind Maker's customer list after Springs

133. *Id.* at 884.
134. *Id.*
135. *Id.* at 887-88.
136. *Id.* at 890.
137. *Id.*
138. *Id.*
139. *Id.*

gave assurances that the information would be kept confidential and would only be used by a third-party administrator. As such, the appellate court found that the award of $2,090,000 to be reasonable.[140]

C. Injunctive Relief

Courts not only enforce settlement agreements, but also enforce injunctive relief agreed to by the parties. In *C & C Franchising, Inc. v. Poindexter*,[141] the district court ordered that defendants Norred Poindexter, Julia Palmer, and Piedmont Eastern, Inc. be permanently enjoined from violating any post-termination provisions in the franchise agreement to which the defendants were a party.[142]

140. *Id.* at 891.
141. No. 04-02307, 2004 WL 3328890 (Tex. Dist. Nov. 4, 2004, no pet. h.).
142. *Id.* at *1.