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FOCUSING ON LEGAL, SAFETY & SECURITY SOLUTIONS

FEBRUARY 10th - 12th, 2014

SURVEY OF FRANCHISE LITIGATION AND LATEST TRENDS

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SURVEY OF FRANCHISE LITIGATION AND LATEST TRENDS

FRANCHISE PARADIGM

System-wide gross receipts
as basis to calculate continuing
fees to franchisor

\$\$\$\$\$\$\$\$
\$\$\$\$\$\$\$\$
\$\$\$\$\$\$\$\$

VS.

Unit economics as basis
to calculate profitability to franchisee

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FRANCHISE DISPUTES REFLECT PARADIGM

- Franchisor interest in brand dominance/equity
vs.
- Franchisee interest in exclusivity in market/encroachment

- Franchisor interest in enforcing standards/uniformity
vs.
- Franchisee interest in minimizing cap ex

FRANCHISE DISPUTES REFLECT PARADIGM

- Franchisor interest in liquidated damages
vs.
- Franchisee interest in new flag opportunity
- Franchisor interest in driving top-line revenues
vs.
- Franchisee interest in bottom-line profits

THE MAINE SMALL BUSINESS INVESTMENT PROTECTION ACT (LD 1458)

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- Establishes jurisdiction in the courts of Maine for any violations of the Act;
- Establishes a standard of reasonableness and good faith for all Franchise Agreements;
- Provides limits on termination, cancellation or failure to renew a franchise without good cause, prior notice and the opportunity to cure;
- Includes protections for a franchisee's right to transfer or assign an interest in a franchise, as well as vested rights in the franchise;
- Provides for survivorship rights for a designated family member of a deceased or incapacitated franchisee; and
- Contains a public policy section that states that a contract or part of a contract or activity undertaken pursuant to a contract in violation of this chapter is deemed against public policy and is void and unenforceable.

NEW HAMPSHIRE SMALL BUSINESS INVESTMENT PROTECTION ACT (HB 1215)

Establishes penalties for fraud and material misrepresentations made by a franchisor in the sales and disclosure process

Restricts a franchisor's right to terminate, cancel, or fail to renew a franchise for the failure or refusal of the franchisee to:

- **Take part in promotional campaigns for the products or services of the franchise which are not reasonable and in good faith expected to promote the profitability of the franchisee's business**
- **Sell any products or services at a price suggested or required by the franchisor, an affiliate of the franchisor, or any supplier approved by the franchisor**
- **Keep the franchised premises open and operating during hours which are unprofitable to the franchisee or to preclude the franchisee from establishing its own hours of operation or nonoperation between the hours of 10:00 p.m. and 6:00 a.m.**
- **Give the franchisor or any supplier financial records of the operation of the franchise which are not related or unnecessary to the performance of franchisee's express obligations under the franchise agreement**

NEW HAMPSHIRE SMALL BUSINESS INVESTMENT PROTECTION ACT (HB 1215)

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- Prohibits franchisors from:
 - Restricting free association by and among franchisees;
 - Requiring or prohibiting any change in franchise management of any franchise unless good cause is established;
 - Imposing standards of conduct or performance unless reasonable, necessary and uniformly enforced and applied;
 - Failing to deal fairly and in good faith or fail to exercise due care with a franchisee;
 - Selling products or service to franchisees for more than a fair and reasonable price;
 - Discriminating between franchises for royalties, goods, services, equipment, etc.
- Imposes on franchisors a limited fiduciary duty
- Obligates each party to a Duty of Good Faith and Fair Dealings
- Restricts encroachment of competing units unless exceptions are met

MASSACHUSETTS FAIR FRANCHISING ACT (S.73)

- Prohibits termination without good cause, notice and opportunity to cure
- Restricts right of franchisors to not renew a franchise agreement
- Restricts unfair methods of competition and unfair or deceptive acts or practices, including termination, canceling or failing to renew a franchise where the franchisee:
 - Failed to meet sales quotas suggested or required by the franchisor not expressly set forth in the franchise agreement
 - Refused to maintain required operating hours
 - Refused to provide to franchisor unnecessary financial records

MASSACHUSETTS FAIR FRANCHISING ACT (S.73)

Establishes as an unfair practice a franchisor who:

- Prevents franchisees from freely associating with each other
- Imposes standards of conduct or performance where the franchisor cannot establish that they are reasonable, necessary and uniformly enforced and applied throughout the system
- Fails to deal fairly and in good faith or fail to exercise due care with a franchisee or an association
- Discriminates between franchisees in the charges for royalties, goods, services, etc.
- Requires a franchisee to sell any product or service for a price at a loss or otherwise not reasonably acceptable to the franchisee in the franchisee's good faith discretion

CALIFORNIA FRANCHISE RELATIONS ACT (SB 610)

- The CFRA would be amended as follows:
 - Would obligate the parties to deal in good faith with each other;
 - Would protect the right of free association among franchisees
- Allows franchisees to sue franchisors who offer to sell, fail to renew or transfer, or terminate a franchise in violation of the above requirements, for damages caused thereby, or for rescission or other relief deemed appropriate by the court
- Would permit a court to increase the award of damages to an amount not to exceed three times the actual damages sustained and award reasonable costs and attorney's fees to a prevailing plaintiff for a violation of the Act
- Would allow a franchisor or who is found liable to recover contributions from any person who, if sued separately, would have been liable to make the same payments

VICARIOUS LIABILITY

- Third-party

- VS.

- Franchisor

-

VS.

Franchisee

Tort liability for control

Trademark controls

VS.

Day to day controls

VICARIOUS LIABILITY

- Vicarious Liability -- always an issue in franchising and for good reason in business model that is built on scale
- Progression over years from imposition of liability on franchisor for franchisee's use of trademark -- "You can trust your car to the man who wears the star"
- To examination of control/right to control over franchise system in general
- To examination of control over the instrumentality that caused the harm
- Admitted and necessary control as backdrop

VICARIOUS LIABILITY

- ***Licari v. Best Western International*** (USDC Utah July 2013)
 - No direct liability flowing from license of trademark
 - Vicarious liability theories go to jury as fact questions:
 - Specific detailed instructions on how to keep lobby, front office, buildings, grounds, public areas; regulate housekeeping functions; maintain bathrooms, guestrooms (“alarm clocks, snow removal and breakfast food”)
 - Consider “control in relation to instrumentality that causes harm”
 - Evidence is buildup of legionella bacteria is long-term failure of maintenance of outdated water system
 - Because trademark licensor inspected and graded maintenance a jury could reasonably find enough control for vicarious liability on licensor as principal and franchisee as agent

VICARIOUS LIABILITY

- ***Licari v. Best Western International*** (USDC Utah July 2013)
 - Apparent agency -- what did licensor do to lead guests to believe they were staying at hotel owned and operated by Best Western?

But wait, reservation system says hotels are independently owned/operated

Not enough, because highway sign does not say independently owned/operated, and sign brings them in

Moral of story – insure, insure, insure

PRELIMINARY INJUNCTIONS

- **Injunctions and Restraining Orders Governed by FRCP 65**
- **For an injunction to issue, a plaintiff must demonstrate:**
 - **Likelihood of success on the merits;**
 - **that it has suffered an irreparable injury;**
 - **a balance of hardships between the plaintiff and defendant warrant the imposition of a preliminary injunction;**
 - **the public interest would not be disserved by a permanent injunction.**
- ***eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006)**
 - **patent infringement case**
 - **Court of Appeals Reversed Lower Court, and reaffirmed long-standing general rule that courts will issue injunctions against patent infringers absent exceptional circumstances;**
 - **U.S. Supreme Court Reversed Lower Court, and replaced it with the traditional four elements for preliminary or permanent injunctive relief**

PRELIMINARY INJUNCTIONS

- ***North Am. Med. Corp. v. Axiom Worldwide, Inc.*, 522 F.3d 1211, 1228 (11th Cir.2008)** (the Eleventh Circuit has suggested “a strong case can be made that *eBay*’s holding necessarily extends to the grant of preliminary injunctions” in contexts other than patent infringement cases.”)
- After *e-Bay*, a court may grant preliminary injunctive relief “without the benefit of a presumption of irreparable injury” or may “decide that the particular circumstances of the instant case bear substantial parallels to previous cases such the a presumption or irreparable injury is an appropriate exercise of discretion”
- ***Seed Servs., Inc. v. Winsor Grain, Inc.*, 868 F.Supp.2d 998, 1005 (E.D.Cal.2012)** (refusing to “assume the existence of irreparable injury” in a trademark infringement case based on *eBay*)

PRELIMINARY INJUNCTION

- ***Novus Franchising, Inc. v. Dawson*, 725 F.3d 885, 894 (8th Cir. 2013)**(affirming lower court’s denial of a preliminary injunction where the franchisor failed to show irreparable harm- “In order to demonstrate irreparable harm, a party must show that the harm is certain and great and of such imminence that there is a clear and present need for equitable relief”)
- ***Swarovski Aktiengesellschaft v. Bldg. No. 19, Inc.*, 704 F.3d 44, 48 (1st Cir. 2013)**(noting, without deciding, that eBay may bar presumption of irreparable harm in trademark infringement cases)

NON-COMPETES AND RESTRICTIVE COVENANTS

Non-Compete/Restrictive Covenants Enforced

- ***Ledo Pizza Sys., Inc. v. Singh*, 2013 WL 5781580 (D. Md. Oct. 24, 2013)**

- ***Golden Krust Patties, Inc. v. Bullock*, 2013 WL 3766551 (E.D.N.Y. July 16, 2013)**
 - Misappropriation of trade secrets not established
 - Geographic Scope of Restrictive Covenant too broad
 - Court Blue Pencils the geographic scope

- ***Cottman Transmissions Sys., LLC v. Gano*, 2013 WL 842709 (E.D. Pa. Mar. 7, 2013)**
 - Non-compete enforced after Court “Blue Penciled” the geographic scope

NON-COMPETES AND RESTRICTIVE COVENANTS

Non-Compete/Restrictive Covenants Not Enforced

- ***Hamden v. Total Car Franchising Corp.*, 12-2085, 2013 WL 6136436 (4th Cir. Nov. 22, 2013)**
 - Difference between the term “expiration” and “termination”
- ***Lifestyle Imp. Centers, LLC v. E. Bay Health, LLC*, 2013 WL 5564144 (S.D. Ohio Oct. 7, 2013)**
 - Dispute regarding application of Ohio or California
- ***Novus Franchising, Inc. v. Dawson*, 725 F.3d 885, 895 (8th Cir. 2013)**
 - failure to seek injunctive relief for 17 months after franchisee quit paying royalties vitiates allegations of irreparable harm
- ***Tutor Time Learning Centers, LLC v. KOG Indus., Inc.*, 2012 WL 5497943 (E.D.N.Y. Nov. 13, 2012)**
 - Irreparable injury not found
- ***Curves Int'l, Inc. v. Shapes Fitness, LLC*, 2013 WL 1799855 (E.D. Mich. Apr. 29, 2013)**
 - Money damages available to address harm suffered by franchisor