



November Dinner Meeting
November 13, 2007

Legal and Legislative
UPDATE

Legislative

- **FDD - UFOC Delivery Changes. Must be in place as of July 1, 2008. Hello FDD.**
 - Cooling off period:
 - Old rule: had to deliver UFOC at earlier of first personal meeting or 10 business days before any payment or signing a contract. Final franchise agreement at least 5 business days before signing.
 - New rule: Must disclose not later than 14 calendar days before any payment or signing franchise agreement. Twist: if prospect makes a reasonable request for disclosure at any time, must deliver the FDD. "Reasonable request" is not defined: does it require that you qualify the prospect first? Does it require there be specific discussions about purchasing a unit?
 - Now the 14 day cooling off period is better defined. Date of delivery and date of signing are not counted. In addition to dates, it is only the signing of a franchise agreement that is relevant: signing an NDA is not relevant to the cooling off period.
 - Beware differing state requirements until the states catch up. RI, NY and MD retain the first personal meeting requirement. Some states use a 10-business day requirement (versus the 14 calendar days) (e.g. Wisconsin).
 - Re-disclosure if *franchisor makes* "material" changes to the agreement: need to follow with a 7-day cooling off period. This does not apply if *franchisee initiates the negotiations* even if some changes favor the franchisor.
 - E-Disclosure: Major benefit even if using UFOC. Any of hardcopy, fax, email, website access. Now know when delivery is deemed effective: actual delivery (fax, email, hand delivery, or giving directions for accessing FDD on the web). At least 3-calendar days after mailing first class mail.
 - New rule requires that the FDD be in a form that can be stored, downloaded, printed or otherwise maintained for future use. No audio,

video, pop-ups or external links. Can have search features and internal links.

- Before delivery, franchisor must advise the prospect of the formats in which the FDD is available and any conditions for obtaining or reviewing it in specific formats. Adobe Acrobat is good!

COURT DECISIONS



- **Massachusetts: Boston Duck Tours, LP v. Super Duck Tours, LLC** (U.S. District Court; July 13, 2007)
 - Super Duck Tours, which originally provided land-water sightseeing tours in Maine, expanded into Boston and began operations in May 2007. Boston Duck Tours, having provided such sightseeing services in Boston since 1994 and owning a federal registration for “Boston Duck Tours” and for its cartoon duck logo, was successful in obtaining an injunction against its new competitor.
 - Case shows the condensed nature of injunctive relief cases - case is tried right up front as you must show a likelihood of success on the merits. This meant the court had to decide that Duck Tours was likely to succeed on the merits of the case even before the case is fully developed.

- Court looked at 8 factors to determine likelihood of confusion of the marks: (i) similarity of marks, (ii) similarity of the goods; (iii) relationship between the parties' channels of trade; (iv) relationship between the parties' advertising; (v) the classes of the respective purchasers; (vi) the existence of actual confusion; (vii) defendant's intent in adopting its mark; and (viii) strength of moving party's mark.
 - As part of the final element of the analysis, the court examined the strength of trademarks: generic, descriptive, suggestive arbitrary and fanciful. The less strong the mark, the more necessary to show secondary meaning to prove infringement. The court concluded "Duck Tours" is not merely generic but refused to decide whether it was descriptive, suggestive or arbitrary. Instead, the court found persuasive evidence that "Duck Tours" had acquired a secondary meaning in Boston during the last 13 years of use.
 - The court noted, among other things: (1) the similarity between the logos of the two companies ("*Boston Duck Tours*" versus "*Super Duck Tours*") and between the two cartoon duck logos, one with a hat versus one with a cape); (2) the similarity between the services provided by the companies; and (3) the 30 or so instances of confusion of customers over only two months.
 - The court ruled that the defendant may not use "Super Duck Tours" nor a cartoon duck in its logo in the greater Boston area.
 - Large experienced law firms were on both sides. With proper risk management by Super Duck Tours' lawyers, this case did not need to reach the courtroom.
- **California: Class Action Suit Against United Parcel Service (UPS)** (Los Angeles County Super. Ct. No. BC294647)
 - A Court of Appeals on October 17 reversed a Los Angeles trial court and certified a national class action against UPS. The original case started in 2003. Approximately 2,400 MBE stores were converted. Chief among

the complaints is that UPS' pricing favors direct pick-up customers, creating channel conflict.

- UPS franchisees alleged misrepresentation and several statutory violations. Franchisees claim that UPS misled them into believing that the UPS model would be more successful than the Mail Boxes Etc. model already used by the franchisees. UPS allegedly withheld information from its franchisees resulting from tests of the UPS Store model that would have been material to the franchisees' decisions about converting their stores. UPS bought MBE after it concluded that it would be too expensive to grow its own retail presence.
- If the franchisees are successful, they will have the right to rescind their UPS store contracts and to seek damages, which would have a substantial effect on UPS.
- The decision is not to be published - no precedent value.
- **Connecticut: Hillegas Brothers Distributors v. V.B.C., Inc.** (Connecticut Superior Court; October, 15, 2007)
 - Plaintiff and Defendant had entered into a "Wholesale Distribution Agreement" for bakery products under which plaintiff received an "exclusive wholesale franchise" for Connecticut. The agreement stipulated that Plaintiff was not an agent or employee of defendant.
 - Bakery/Licensors had the right to terminate the agreement at any time without cause. When Defendant attempted to terminate Plaintiff under this section (after the bakery had been purchased by a private equity firm), Plaintiff brought suit, claiming that Defendant had violated the Connecticut Franchise Act (CFA), which prohibits a franchisor from terminating a franchise without good cause. Defendant argued that the CFA did not apply, because a franchise relationship did not exist between it and the Plaintiff.
 - The Court found that the contract gave the Bakery sufficient control over the Plaintiff to make Plaintiff a franchise: bakery provided training to distributor and its delivery drivers, controlled billing to retailers, controlled

its product line and packaging, and "encouraged" use of bakery trademark. Bakery sales were 15% of distributor's business.

- Connecticut statute defines a franchise as (i) the right to engage in the business offering goods or services under a marketing plan/system prescribed "in substantial part" by the franchisor, and (ii) the operation is "substantially associated" with the licensor's mark. No single factor determined the case.
 - In the contract, the bakery granted limited rights to use the name but did not require use of that name. The court did not go into detail on this part of the language, which is surprising.
 - Termination was enjoined as good cause is required in Connecticut to terminate a franchisee under the statute.
- **Connecticut: Gallasso v. D.E.I. Franchise Systems** (Connecticut Superior Court; September 6, 2007)
 - The franchise agreement included a broad arbitration clause which subjected to arbitration issues of "formation" of the contract. Plaintiff argued that the franchise agreement was void, because (i) it violated the Business Opportunity Investment Act and because (ii) Defendant made false representations. Plaintiff argued that the agreement was void, the arbitration provision did not apply.
 - The court found that even though violation of a statute was alleged, the dispute was subject to arbitration given the language of the contract. As for the misrepresentation, the plaintiff never alleged that it was falsely induced into entering into the arbitration clause. Therefore, the arbitrator could decide whether there was fraudulent inducement to enter the contract. Under the Connecticut statute, the arbitrator had the power to decide violations of the Business Opportunity Investment Act - since that act did not supersede the arbitration clause.

- **Rhode Island: D&D Barkan LLC v. Dunkin' Donuts, Inc. and Baskin-Robbins USA, CO.** (U.S. District Court, RI; October 30, 2007) .
 - Case arose in 2005 out of efforts of franchisee to sell its franchises units when it failed to meet its agreed development schedule and settlement agreement with Dunkin. When the franchisee failed to open new stores as agreed, it entered a settlement agreement where Dunkin agreed to *help* modify the franchisee's financing arrangements and modified the timetable for the franchisee to open its remaining stores. When the refinancing with CIT failed to go through, the franchisee tried to sell its units to another Dunkin franchisee, but that sale fell through when Dunkin told the prospective buyer that the purchase could downgrade its overall rating within Dunkin. When those sale discussions ended, franchisee failed to perform under its settlement agreement with Dunkin, which led Dunkin to default the settlement agreement and then terminate the franchise agreements. There was a bankruptcy and then further procedural twists.
 - Franchisee alleged (among other things) violations of Massachusetts Chapter 93A (Regulation of Business Practices for Consumer Protection), fraud and breach of the settlement agreement and covenant of good faith and fair dealing regarding Dunkin's assistance on refinancing the CIT debt. The court dismissed the 93A claim, reminding the parties that, in their agreement, they had chosen Rhode Island law to govern their contract, and therefore, Massachusetts 93A did not apply. The court allowed the claims of breach of contract and the covenant of good faith to proceed to see if the franchisee could show that Dunkin had no intention of helping franchisee obtain its refinancing.
- **New York: Century Pacific, Inc. v. Hilton Hotels Corp.** (U.S. District Court, SD NY; October 17, 2007)
 - In early 2001, Plaintiffs entered into agreements with defendants to convert Plaintiffs' hotels into Red Lion Hotel franchises. At the time and unknown to franchisee, Hilton was exploring strategic options over Red Lion. Plaintiffs claimed they were given verbal assurances by Hilton's

personnel that Hilton would not sell Red Lion. However, in the final contract between the parties, Hilton retained the right to sell Red Lion and Plaintiff negotiated the right to terminate 3-5 years out if Hilton no longer controlled Red Lion. Red Lion was sold by Hilton on December 31, 2001.

- Plaintiffs sued, claiming among other things that Hilton committed fraud is making materially false representations (when it verbally assured Plaintiffs that it would not sell the Red Lion brand). Franchisee had specifically said that it did not want to buy a Red Lion franchise if Hilton was going to sell Red Lion. The franchise salesperson said "don't worry, everything is going to be fine." Other Hilton executives conveyed the same general sense of comfort to the franchisee in late 2000.
- To show fraud, franchisee had to show (i) misrepresentation, (ii) intent to defraud, (iii) franchisee reasonably relied on the representation, and (iv) damages resulted from such reliance. The court said that to be a misrepresentation, a promise must be made with an undisclosed intention not to perform it. The court found that franchisee had barely shown enough evidence to proceed to trial over the misrepresentation claim. The Court noted the difference between a representation and a misrepresentation. Here, the court noted that verbal general assurances were made, but it was not clear whether the statements constituted a material false representation. The Court responded that "To borrow language from songwriter Dusty Springfield, '[w]ishing and hoping and thinking and praying, planning and dreaming, each night of [Hilton's] charms' cannot constitute a material false representation."
- As to intent to defraud, the court found the franchisee failed to show enough evidence of fraud or that the franchisee reasonably relied on the verbal assurances in light of Hilton's right to terminate in the agreement.
- The right of Hilton to sell Red Lion in the Agreement, and the negotiated window for franchisee to terminate, basically destroyed any reliance under any franchisee claim. Result - franchisee lost.

- **New York: Dunhill Franchisees Trust – against – Dunhill Staffing Systems, Inc.** (U.S. District Court; October 29, 2007)
 - During negotiations, franchisor gave franchisees a marketing brochure describing the franchisor and including a disclaimer about the high risks of the business. After disputes between franchisor and plaintiff franchisees, the parties went to an arbitrator as called for in their agreement. Plaintiff franchisees asserted a breach of contract. However, evaluating the parties relationship in general, the arbitrator on his own found that in the marketing brochure, franchisor had omitted material facts known to it (namely, that to be successful, a franchisee had to already be in the permanent placement business) - which the arbitrator on its own said operated as a fraud upon the franchisees.
 - Franchisor sought relief from the court, claiming that franchisees did not assert any claim relating to omission of material facts and that the arbitrator had decided an issue that the parties never put before him. Franchisor sought to set aside arbitrator's award as beyond the scope of his authority.
 - The court read the arbitrator's decision in great detail, and then applied the legal analysis for fraud to support the arbitrator's conclusion. The court found that because federal policy promotes arbitration, and since there was no manifest disregard of the law, the Court upheld the arbitrator's authority.
- **New York: Martinez v. Papa John's International, Inc.** (N.Y. Supreme Court, Appellate Division; September 13, 2007)
 - Pizza delivery employee struck plaintiff with a bicycle while making deliveries for a Papa John's franchisee. To be liable, Papa John's had to control the day-to-day operations of franchisee. Here, the Franchise Agreement said that the franchisee has full responsibility for its employment matters and day to day operations. The agreement allowed the franchisor to control standards of food quality, hours of operation, menu, employee uniform guidelines and packaging. Papa John's

reserved no control over the delivery process or personnel of the franchisee. Franchisor was found not liable.

- **Ohio: Davco Acquisition Holding Inc. v. Wendy's International, Inc.**

(Complaint filed in U.S. District Court; Southern District, Ohio; October 17, 2007)

- Multi-unit operator (159 stores). Here is what we know from the complaint: Franchise agreement stated that franchisee would purchase all food and similar items from suppliers meeting franchisor's standards. Franchisee could request approval of alternate suppliers. Franchisor could, but was not required to, inspect and approve the suggested alternate suppliers.
- Prior to 1998, Wendy's allowed franchisees to conduct an open-bid process for fountain syrup, leading to multiple suppliers over time. In 1997, Franchisee entered an exclusive contract with Coke for an unspecified duration. In 1998, Wendy's was acquired. In 1998, Wendy's disapproved Pepsi for certain units and mandated Coke: franchisees with existing Pepsi contracts were allowed to continue to purchase Pepsi.
- In 2006, franchisee notified Wendy's that it intended to issue an rfp for an open-bid process. Wendy's responded that Coke was the only approved beverage provider, and only remaining Pepsi contracts were being allowed to burn off.
- Franchisee sought permission from Franchisor to go to open-bid and noted that Pepsi was still being sold by some units. Wendy's denied the request. A few months later, Wendy's sent a letter saying Pepsi and Coke were not equivalent and refused to approve Pepsi. Wendy's refused to consider Pepsi – and did not do any of the supplier-review items listed in the Franchise Agreement as part of approving an alternative supplier.
- The agreement also required franchisees to expend 4% of gross for marketing, with 2-3%% for the national advertising program as directed by Wendy's. For 25 years, Wendy's had mandated that 2% of gross go to the national program. Starting in 1998, the 2% was increased to 3% for the national advertising program. This franchisee had an agreement with

Wendy's delaying the increase of contributions to the national advertising program.

- Franchisee alleges that Wendy's and Coca-Cola had an undisclosed agreement whereby Coca-Cola contributed to Wendy's national advertising fund based on each gallon of fountain beverage syrup franchisees purchased. This allegedly led to an artificial inflation of franchisee's cost of fountain beverage syrup, which allegedly has been transferred (at least in part) by Coke to the advertising fund resulting in a contribution above the 3% Wendy's is allowed to target for the national advertising fund. The franchisee has asserted that Wendy's had a duty to disclose this relationship with Coke – which was not done properly in the UFOC.
- Franchisee has asserted a breach of contract claim against Wendy's for (i) failing to consider Pepsi as an alternate supplier, and (ii) overpaying the national ad fund by more than \$2,000,000.
- Franchisee sued the NAP as participating and receiving the excess contributions.
- The parties have stipulated to Wendy's having additional time to answer the complaint, and as of last week, no answer had yet been filed by Wendy's.

For more information, contact:



Michael J. Radin

Attorney at Law

101 Huntington Avenue, Suite 500

Prudential Center

Boston, MA 02199

617.218.2000

mradin@tbhr-law.com