



September Dinner Meeting  
September 18, 2007

**Legal and Legislative Update**

## LEGISLATIVE

- **Massachusetts Legislative Proposal** – Senate Docket 1981
  - Proposal: Prohibit franchisor from terminating, canceling, or failing to renew a franchise without “good cause.”
  - Good cause includes “franchisee’s refusal/failure to comply substantially with any material and reasonable obligation of the franchise agreement,” with certain exceptions
  - In Joint Committee on Community Development and Small Business as of June 20, 2007. Heard and eligible for executive session.
- **Rhode Island Fair Dealership Act** – Public Law No. 2007-36
  - RI enacted “Fair Dealership Act” on June 14, 2007
  - Requires the grantor of a dealership to provide a dealer at least 90 days’ prior written notice of the termination, cancellation, non-renewal or substantial change in competitive circumstances of a dealership and to provide the dealer with at least 60 days in which to rectify any claimed deficiency.
  - Act does not explicitly require “good cause” but does define “good cause.”
  - It is uncertain whether good cause will be implied as courts begin to interpret the act. In addition, the possibility exists that the RI legislature will revisit the Act to more clearly include “good cause” language. Finally, people should be aware that the obligation of good faith usually found in these agreements is not the equivalent of “good cause.”



# REGULATIONS

## COURT DECISIONS

- **Massachusetts – Cummings Properties, Inc. v. Aspeon Solutions, Inc.** (Mass. App. Div.)
  - A company president, not realizing he was signing a personal guaranty to a commercial lease, succeeded on his argument that the guaranty should be set aside because he was misled as to the contents of the document.
  - Although the President handled the lease and other tasks, it was known by the company that he was considering leaving it. The president asked whether his company's counsel had reviewed the documents and whether it reflected the final outcome of negotiations. Relying on the lessor's affirmations and believing he was signing in his representative capacity, president signed the lease.
  - The judge noted that no one in the president's position would have risked such large sums of his own money for the benefit of a company in which he had no stake and was thinking of leaving. Also, nothing in lease itself or in negotiations with the lender gave him any reason to believe that he would sign in a personal capacity.
  - Parties should know that the statements they make during negotiations do matter. In addition, both parties should ensure that they understand the written agreement and that it accurately reflects the agreements they have reached during negotiations.
- **Massachusetts – Coverall North America, Inc. v. Commissioner** (Mass. Sup. Jud. Ct.)
  - Court found that the purchaser of a janitorial cleaning business "franchise" was not an independent contractor or a franchisee but was an "employee." As a result, the "franchisor" was required to pay contributions to an unemployment compensation fund.
  - To be exempted from contributing to the unemployment compensation fund, an employer must show that the person is an independent contractor by proving that the services are performed (1) free from control or direction of the employing



enterprise, (2) outside of the usual course of business, (3) as part of an independently established trade, occupation, profession, or business of the worker.

- Here, the franchisor could not prove this because the franchisee had to allow the franchisor to negotiate contracts and pricing directly with clients, bill clients, and provide a daily cleaning plan to which the franchisee was required to adhere. Therefore, the franchisee was forced to rely heavily on the franchisor.
- It is important to ensure that the day-to-day activities of the parties reflect the agreement they have reached and their understanding of their relationship to one another, as such behavior has a substantial effect on liability.
- **Massachusetts – Dunkin Donuts Franchised Restaurants LLC v. Cardillo Capital, Inc.** (D.C. Fla.)
  - Franchisor argued that franchisee breached an agreement by failing to make required payments but continuing to operate its business as if still a franchisee. Franchisee did not succeed in its argument that franchisor had waived its claim by accepting payment of the unpaid fees over three months after the effective date.
  - Under Massachusetts law, a party who claims another has waived a contractual provision is required to show unequivocal conduct proving that the opposing party would not request that the contractual provision be performed.
- **Federal – Leegin Creative Leather Products, Inc. v. PSKS, Ins., dba Kay’s Kloset** (U.S. Supreme Court)
  - Minimum pricing floors are no longer per se illegal. Instead, the “rule of reason” will be used to evaluate such pricing restrictions.
  - The court noted the competitive benefits of pricing restrictions.
  - “As courts gain experience considering the effects of these restraints by applying the rule of reason over the course of decisions, they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses. Courts can, for example, devise rules over time for offering proof, or even presumptions where



justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones.”

- Businesses should proceed with caution in the aftermath of this case. While some pricing floors may be allowed, anticompetitive restraints will not, and courts will begin by making case by case determinations.
- **California – Radisson Hotels Int’l, Inc. v. Majestic Towers, Inc.** (D.C. Cal.)
  - Franchisor was allowed to recover liquidated damages despite the fact that franchisor had terminated the agreement with franchisee, because franchisee’s failure to pay past due royalties may have been the proximate cause of the franchisor’s lost future profits.
  - While a previous case with similar facts did not support such a finding, these parties included a specific provision in their agreement that required franchisee to indemnify the franchisor’s lost profits in the event that their agreement was terminated as a result of franchisee’s failure to pay past royalty fees.
  - This case is another illustration of the importance of carefully drafting to anticipate potential future issues. The more this type of planning and drafting occurs, the more predictability the parties will enjoy as their relationship proceeds.
- **California – Wagner Construction v. Pacific Mechanical.** (Cal. Sup. Ct.)
  - An arbitrator should be the one to decide where a party asserted an affirmative defense that the statute of limitations had run on a claim parties had agreed to arbitrate.
  - The defense was not justifiable reason for the court to deny the party’s request for arbitration. Because the state of limitations defense was within the scope of the parties’ agreement to arbitrate.
  - If there is uncertainty as to what issues are arbitrable, the decision will lean in favor of arbitration.



- **Connecticut – Doctor’s Associates, Inc. v. Downey.** (D.C. Conn.)
  - The franchisees contended that, because an association of franchises was not a party to the franchise agreements with the arbitration clause, the franchisor was not an aggrieved party who could compel arbitration with respect to claims brought by the association.
  - The court instead held that the issues presented in the association’s suit were the subject of the arbitration clause.
  - The same agreement provisions will usually limit an association suing on behalf of its members as limit those members themselves.
  
- **Florida – Lady of America Franchise Corp. v. Malone** (D.C. Fla)
  - Franchisee claimed to have properly relied on what it believed were intentional misrepresentations made by a franchisor in order to induce the franchisee to enter into a franchise agreement. Franchisee argued that the franchisor’s statements should be admissible, because they showed that the agreement was induced by fraud.
  - However, the agreement had a detailed provision expressly disclaiming any representations received regarding profits or success and disclosing the risk associated with entering into the franchise. The provision also gave franchisee an opportunity to expressly list any representations given by the franchisor, which franchisee did not do.
  - Court ruled that franchisee had disclaimed any reliance on franchisor’s statements.
  - Once again, addressing every foreseeable contingency with detailed provisions in the agreement will protect the parties’ expectations.
  
- **Illinois – Ramada Worldwide, Inc. v. Homewood Hotel, Inc.** (D.C. Ill.)
  - Liquidated damages provision found valid and enforceable: Hotel franchise agreement liquidation provision said the franchisor was entitled to \$160,000 in liquidated damages from the franchisee for premature termination of the agreement.



- Franchisee had successfully negotiated a lower liquidated damages amount in the franchise agreement in an informed compromise between the parties, creating a presumption of validity and shifting the burden of proof to the franchisee. The franchisee also failed to show that the liquidated damages were excessive, the court finding that the franchisor's 11-year loss of future revenues would be very difficult to determine.
- **Minnesota – Bores v. Domino's Piazza LLC** (D.C. Minn.)
  - A franchisor violated its agreements with its franchisees by requiring them to install the franchisor's PULSE computer system in their restaurants but refusing to provide the system's specifications in accordance with the agreement.
  - The parties' franchise agreement stated that the franchisor would provide the franchisees with specifications for equipment, fixtures, furniture, computer hardware and software, and decorations required to be used in franchisees' stores and that franchisees would then be free to purchase items meeting those specifications from any source.
  - Franchisor then required franchisees to purchase the PULSE computer system created for Domino's Pizza stores. PULSE hardware can only be purchased from IBM, while PULSE software can only be purchased from Domino's.
  - Franchisees argued that Domino's had mandated PULSE simply to generate additional revenue from its franchisees and insisted that Domino's provide them with PULSE's specifications so that they could purchase the components elsewhere.
  - Although the franchisor argued that its power to require the use of computer equipment justified this behavior, the court ruled against the franchisor, finding that Domino's was required to provide its franchisees with specifications for any required hardware and software.
  - The court also dismissed another of franchisor's arguments, which was based on its ability to require franchisees to purchase food, packaging, and other items only from the franchisor, as computer equipment was not mentioned in that provision, thus supporting franchisee's argument.



- This case is yet another good example of how influential drafting can be to the outcome of a dispute, again showing how important it is to carefully and accurately reflect the understanding of the parties.
- **Texas – Townsend v. Goodyear Tire and Rubber Co.** (D.C. Tex.)
  - A manufacturer was not liable for the injuries of one of its dealer’s employees, after the employee was injured attempting to install tires produced by the manufacturer.
  - Manufacturer owed no duty to the employee, because the manufacturer did not have the right to control the means, methods, and details of the employee’s work, and therefore did not have the necessary level of control.
  - This case involves another type of liability that is affected by the determination of the parties’ relationship to one another, again illustrating the importance of ensuring that the actions of the parties reflects the agreement they have reached.
- **Federal – Wine and Spirits Retailers, Inc. v. Rhode Island** (1<sup>st</sup> Circuit Court of Appeals)
  - 2004 amendments to the RI liquor franchises law did not unconstitutionally violate freedom of speech: The amendments prohibited the grant, renewal, or transfer of liquor store operator licenses (Class A liquor license) to or for the use of any liquor franchisor/ee and expressly prohibited such license holders from utilizing the provisions of the RI Franchise Investment Act.
  - The amendments also defined the term “chain store organization” to include licensees who engaged in certain common marketing or coordinated planning. Chain store organizations cannot sell alcoholic beverages in RI (retail).
  - The court dismissed the argument that the statute’s restrictions on coordinated marketing prohibited the advertisements themselves. Instead, the court found that the statute merely prescribed the launching of advertisements resulting from pre-agreed commercial strategies. Moreover, the conduct in question was not so inherently expressive as to warrant First Amendment protection.



- **Federal – Elkhatib v. Dunkin Donuts, Inc.** (U.S. Court of Appeals)
  - The court found that a franchisor could have committed racial discrimination in violation of federal civil rights law by denying a franchisee eligibility for relocation or renewal of his franchise agreements.
  - The franchisee refused to carry the franchisor's breakfast sandwiches, as handling the meat ingredients was against his religion. Although the franchise agreement required franchisees to carry the product, many other franchisees refused to carry the product without such retaliation resulting.

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