The GPMemorandum

TO: **OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS**

FROM: **GRAY PLANT MOOTY'S FRANCHISE AND DISTRIBUTION PRACTICE GROUP**

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Below are summaries of recent case decisions of interest to franchisors.

TRADEMARKS

WASHINGTON FEDERAL COURT DENIES MOTION TO HOLD DEFENDANTS IN CONTEMPT OF CONSENT JUDGMENT FOR TRADEMARK INFRINGEMENT

A federal judge in Seattle has denied a franchisor's motion for a contempt order to enforce a consent judgment obtained against an accused trademark infringer and his company. *Two Men & A Truck/Int'l, Inc. v. T&S Transp., Inc.*, 2014 U.S. Dist. LEXIS 4759 (W.D. Wash. Jan. 13, 2014). In this case, Two Men and a Truck had sued the defendants for trademark infringement based on their use of various iterations of the plaintiff's trademark, TWO MEN AND A TRUCK, in connection with moving services identical to those offered by the franchise system. In a consent judgment resolving the dispute, the defendants had agreed to a permanent injunction restraining them from using the mark, "or any colorable imitation thereof including without limitation 'Two Men & a Truck,' '2 Men and a Truck' and '2 Men & a Truck,' "whether alone or in combination with other terms such as 'Special,' in any manner whatsoever."

Two Men and a Truck subsequently became aware that the defendants were promoting their business with phrases such as "Two Men & A Moving Truck," "Two Men and a Van," and "Two Movers and a Truck." The court held that the consent judgment was not specific enough to warrant a finding (under the clear and convincing evidence standard) that the defendants had violated it. Although the term "colorable imitation" has a specific meaning in trademark law, the court found the term could be considered vague by the *pro se* defendants. Further, although not

exhaustive, the consent judgment's list of proscribed permutations of the phrase "Two Men and a Truck" could have led the defendants to believe that only words and symbols that amounted to those very phrases violated the judgment, and that the phrases they were using were not prohibited. In its only concession to Two Men and a Truck, the court did note that despite the ruling that the defendants had not violated the consent judgment, the defendants "remain subject to consequences if they are infringing Plaintiff's trademarks or otherwise violating the law."

The decision is a cautionary tale for lawyers concerning the care that needs to be taken in drafting consent judgments. In this case, Two Men and a Truck found itself before an unsympathetic judge who narrowly interpreted the restrictions imposed on the defendants and also found ambiguity in the language of the consent judgment. The fact that the defendants were not represented by counsel also influenced the judge to rule in their favor.

ARBITRATION

COURT FINDS FRANCHISEE WHO ORALLY ASSUMED A FRANCHISE AGREEMENT IS NOT BOUND BY THE AGREEMENT'S ARBITRATION CLAUSE

In *Doctor's Associates, Inc. v. Edison Subs, LLC*, 2014 U.S. Dist. LEXIS 371(D. Conn. Jan. 3, 2014), the United States District Court for the District of Connecticut denied Subway's motion to compel arbitration of claims arising out of a franchise agreement that Edison assumed pursuant to an oral assignment agreement. Edison, the defendant, did not receive or review the written franchise agreement before assuming it. After being involuntarily ejected from the franchised business premises after two years of operation, Edison filed a complaint in state court alleging breach of contract and fraud in the inducement, among other claims. Subway filed a motion to enjoin the franchisee from proceeding in state court and to compel arbitration pursuant to the written franchise agreement Edison had assumed, but never signed.

The court observed that a signatory to an agreement may compel a nonsignatory to arbitrate using one of five theories: (1) incorporation by reference, (2) assumption, (3) agency, (4) veil piercing/alter ego, and (5) estoppel. In this case, estoppel was the only relevant concept. Under the estoppel theory, a nonsignatory that knowingly exploits an agreement with an arbitration clause may be estopped from avoiding arbitration. The court found that because Edison did not receive a copy of the written franchise agreement before it entered into the oral assignment, it did not knowingly exploit the benefits of the franchise contract. Instead, the benefits Edison received were from the alleged oral franchise agreement. As a result, Edison was not bound by the written agreement's arbitration clause and could not be estopped from filing an action in state court. Subway's motion to compel arbitration and enjoin the franchisee from proceeding in state court was denied.

DISTRICT COURT GRANTS FRANCHISOR'S MOTION FOR STAY WHILE SEVENTH CIRCUIT CONSIDERS APPLICATION OF FEDERAL ARBITRATION ACT TO "NON-BINDING" ARBITRATION CLAUSE

A federal court in Indiana has granted a franchisor's motion to stay proceedings in three related lawsuits pending appeal to the Seventh Circuit. *Druco Rests., Inc. v. Steak n Shake Enters.*, 2014 U.S. Dist. LEXIS 8198 (S.D. Ind. Jan. 23, 2014). Three franchisees had filed separate lawsuits against Steak n Shake ("SNS") alleging breach of contract, fraud, and violations under their respective state franchise laws. After SNS sought to stay all three actions and compel arbitration, the trial court concluded the respective agreements contained only "nonbinding" arbitration provisions and, for that reason, were not controlled by the mandatory stay provisions of the Federal Arbitration Act.

SNS appealed the court's decision to the Seventh Circuit and requested that the trial court stay proceedings until the appeal could be decided. The court granted the stay, noting that the franchisees had not shown any good reason for the trial court to proceed with the underlying actions while the Seventh Circuit considered the fundamental issue of whether the trial court had jurisdiction over the claims in the first place. The court further noted that because the nonbinding nature of the franchise agreements' arbitration provision was an issue of first impression, the reasoning against asserting simultaneous jurisdiction with the court of appeals was all the more compelling.

STATE FRANCHISE LAWS

LICENSEE WHOSE BUSINESS PLAN DENIED FRANCHISEE STATUS ESTOPPED FROM CLAIMING IT WAS A FRANCHISEE

In *U-Bake Rochester, LLC v. Utecht*, 2014 U.S. Dist. LEXIS 7106 (D. Minn. Jan. 21, 2014), the United States District Court for the District of Minnesota recently held that a plaintiff's prior acknowledgement that it was not a franchisee barred the plaintiff from later asserting claims under Minnesota and Wisconsin state franchise statutes. U-Bake Rochester ("UBR") executed a trademark license agreement with Utecht Bakeries that allowed UBR to use the U-BAKE trademark in connection with a retail store located in Rochester, Minnesota. After revenues plummeted in its second year of operation, UBR sued Utecht. On Utecht's motion for summary judgment, the court dismissed, among other counts, UBR's claims for violation of the registration and disclosure requirements under the Minnesota and Wisconsin franchise statutes.

The court held that even assuming that the relationship between UBR and Utecht fell within the definition of a franchise under the Minnesota and Wisconsin statutes, UBR's prior conduct equitably estopped it from claiming violations of those statutes. UBR's

counsel had contributed to the drafting of the license agreement and expressed his knowledge of the type of business arrangement that constitutes a franchise. His knowledge, the court held, is imputed to UBR. The license agreement expressly said that the parties were not in a franchise relationship. Moreover, the business plan UBR submitted to a third party for a loan acknowledged that UBR was not a franchise and even touted the benefits of a nonfranchise relationship. On those facts, the court found it would be inequitable to allow UBR to now assert claims under the franchise statutes.

FRANCHISE SALES

NEW JERSEY FEDERAL COURT DISMISSES FRANCHISE SALES FRAUD CLAIMS WITHOUT PREJUDICE

In *Robinson v. Wingate Inns Int'l*, Bus. Franchise Guide (CCH) ¶ 15,197 (D.N.J. Dec. 20, 2013), the court held that the owner of two hotel franchises failed to state actionable franchise sales fraud claims against franchisors Wingate and Wyndham. Robinson, the franchisee, entered into separate franchise agreements with each franchisor, and both businesses subsequently failed as a result of Robinson's failure to obtain financing. When Robinson filed suit, the franchisors moved to dismiss his claims that they had violated the FTC Rule, committed fraud in the inducement, and violated the New Jersey Consumer Fraud Act (NJCFA).

The court dismissed the plaintiff's claim under the FTC Rule because the Federal Trade Commission Act does not grant a private right of action. The court then dismissed Robinson's fraud claim against Wingate as barred by the statute of limitations and his fraud claim against Wyndham for failure to allege a material misrepresentation of fact. Finally, the court dismissed Robinson's claim under the NJCFA, holding that "a franchise is a business, not a consumer good or Service contemplated by the act." Although the court stated that it was aware of an intermediate New Jersey state court decision that had held that the NJCFA did apply to the sale of a franchise, it nonetheless held that it was bound to follow prior Third Circuit authority to the contrary. The court dismissed the claims at issue without prejudice.

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