

COURTS HONOR CONTRACTUAL CHOICE OF LAW AND FORUM PROVISIONS AND REJECT PUBLIC POLICY INVALIDATION: CURVES LITIGATION

By Deborah Coldwell and Iris Gibson

The ability of franchisors and franchisees to freely choose their forum and law remains a contested issue. In a group of cases involving current and former Curves' franchisees in six courts throughout the United States, Haynes and Boone franchise litigation attorneys have once again obtained favorable rulings that strengthen a franchisor's ability to insist that the forum and law stipulated in their franchise agreements be honored. A New York federal court transferred a case to Texas based on forum selection clauses and a Texas federal court dismissed out of state consumer protection and franchise act claims based on choice of law provisions. In doing so, the New York and Texas courts rejected the franchisees' arguments that public policy invalidated these contractual provisions.

New York—Choice of Forum

On December 22, 2006, a group of New York franchisees sued Curves in New York federal district court. Curves sought dismissal or alternatively transfer of the case to the Texas federal district court specified in the forum selection clauses contained in each franchise agreement.

On September 29, 2008, the Southern District of New York issued its Order granting transfer to the Western District of Texas. The District Court first determined that the anti-waiver provision of the New York Franchise Sales Act did not render the forum selection clauses unenforceable, as argued by plaintiffs. Having established that forum selection clauses are presumptively enforceable, the court determined that a parties' contractually expressed preference for a forum is entitled "substantial consideration" and the party opposing a valid clause must "demonstrate exceptional facts explaining why he should be relieved from his contractual duty." In light of the forum

selection clauses and the convenience and fairness transfer factors, the Court determined that plaintiffs could not demonstrate exceptional facts that would justify setting aside the forum selection clause. Therefore, the New York franchisees' claims were transferred to the Western District of Texas, the forum where the related case discussed below is already pending. The New York franchisees join Florida and New Jersey franchisees, whose actions were previously transferred to Texas based on the forum selection clauses.

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Texas—Choice of Law

This consolidated action in the Western District of Texas consists of one-hundred and fifty-one current and former franchisees from twenty-four states, Canada, and Puerto Rico. In their kitchen sink complaint, the franchisee plaintiffs assert twenty-six non-Texas statutory claims based on the franchise acts and consumer protection laws in the states where the franchisees are located. In its motion to dismiss, Curves sought dismissal of the out of state claims based on the choice of law clauses contained in each franchise agreement, which require application of

Texas law to the dispute. Plaintiffs insisted that the application of Texas law was against the public policy embodied in the statutes of the other states.

On September 30, 2008, the magistrate issued a Report and Recommendation dismissing all of the out of state claims based on the choice of law clauses contained in each franchise agreement. Applying the “most significant relationship test” to determine the validity of the choice of law clauses at issue, the Court determined that the law of Texas, Curves’ corporate

Location and the law specified in each franchise agreement, applies and that the out of state statutory claims must therefore be dismissed. In applying the “most significant relationship test” set forth in the Restatement of Conflicts, the Court focused on “certainty, predictability and uniformity of result” in completing its analysis. The Court reasoned that to require each dispute to be settled under the law of the franchisee location may create different results stemming from the same contract and that uniformity of result of contracts would best be protected by applying the law of Texas, which is the single state which has a substantial relationship to every contract in this case. Plaintiffs again argued that anti-waiver provisions found in the laws of eleven states that contain franchises owned and/or previously owned by plaintiffs void the Texas choice of law provisions. The Court determined that the anti-waiver clauses of the other states were irrelevant and that Texas law applied to all of plaintiffs’ causes of action.

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AROUND THE GLOBE**Australia: Alberta, Canada**

Cases involving technical violations of franchise laws, such as failure to register, in Alberta, and several US franchise registration states, have also limited remedies to those provided in the statute, usually damages or rescission or enforcement actions. Normally, such violations would not void or rescind the franchise agreement. Two recent cases in two different countries reflect two different holdings regarding technical violations.

In *Master Education Services Pty Limited v Ketchell* [2008], on August 27, 2008, the High Court in Australia held that a technical breach of the Franchising Code of Conduct, which did not damage the franchisee, did not automatically void a franchise agreement which was otherwise in good standing. Clause 11(a) of the Code required the franchisor to receive the prospective franchisee’s written statement that it had received, read and had a reasonable opportunity to understand the franchisor’s disclosure document and the Code before the franchisor signed the franchise agreement or received non-refundable money. The trial court held that the franchise

agreement was not void and the franchisee was only entitled to damages. On appeal, the New South Wales Supreme Court of Appeal held that the agreement was void. The High Court did not agree and held the agreement enforceable.

In contrast, an Alberta Court of Appeals case, *Hi Hotel Limited Partnership v Holiday Hospitality Franchising Inc.*, the court upheld the Queen's Bench court's declaration of an effective rescission by a Holiday Inn franchisee because the franchisor had not provided a signed and dated certificate and had not signed and dated the disclosure document, as required under the Alberta Franchises Act. The Court of Appeals analogized the franchise disclosure statute to securities disclosure statute, which also require signatures and dates. The franchisor's counterclaim for damages was dismissed because the agreement had been rescinded.

Indonesia

Indonesia issued its Franchise Operations Regulations, Minister of Trade Decree No. 31/M-DAG/PER/8/2008 (Decree 31) on August 21, 2008. This decree describes the rules implementing Government Regulation No. 42 of 2007 (Regulation 42). Decree 31 provides standard forms required to comply with the requirements set out in Regulation No. 42.

Like the previous regulations, Indonesian law must govern the agreement, and the prospectus and agreement must either be in Indonesian or an Indonesian translation must be attached to the filing. The regulations describe what information must be included in the prospectus, which is similar to what must be included in a US disclosure document, including a balance sheet for the last two years, total outlets and a list of its existing franchisees. The regulations also describe what information must be included in the agreement. A franchisor must deliver a written and signed prospectus and agreement to a prospective franchisee not less than two weeks before signing the agreement.

The franchisor and the franchisee must each have a Franchise Registration Certificate (STPW) from the Ministry of Industry and Trade (Ministry). The certificates are valid for five years, and may be extended for another five years. As part of its obligations, the franchisor must report on its

franchising activities to the Director General of Domestic Trade annually no later than March 31 of the following year.

If a franchisor terminates a franchise before it expires, the franchisor may then enter into another franchise agreement for the same "region", which is not defined, but is assumed to be the territory of the terminated agreement, provided that all issues arising from the terminated agreement among the parties have been settled in writing within six months after the termination date, often referred to as a "Clean Break Agreement." Best practice is to secure a Clean Break Agreement at the time the franchise is signed in order to circumvent trying to get one when the franchise relationship may be hostile.

Regulation 42 provided for transition provisions for franchisors who were already registered in Indonesia. Regulation 42 required franchisors with pre-existing registration to re-register by July 23, 2008, however until Decree 31 issued, there were no procedures to do so.

If you are considering franchising in Indonesia, please contact Rob Lauer, in the Austin office, rob.lauer@haynesboone.com, (512) 867-8505.

UNITED STATES

Tying Case: *Bansavich v. McLane Co., Inc.* (D. Conn. Oct. 2008)

In *Bansavich*, the District Court granted a motion to dismiss, relying on the reasoning of *Queen City Pizza v. Domino's Pizza*. In what seems like ancient history now—1997—the *Queen City Pizza* court held that Domino's purchasing restrictions did not constitute unlawful tying in violation of the antitrust laws, because the restrictions were disclosed in the offering

circular and in the franchise agreement before the franchisee voluntarily entered into the contract. *Queen City Pizza* has been followed by other courts.

Bansavich was a Mobil "On the Run" convenience store franchisee. Mobil required franchisees participating in the "Exclusive Product Program" to

purchase certain products--the Exclusive Products--from approved suppliers. McLane Corp. was the only approved supplier in Connecticut, where Bansavich's business was located. Bansavich bought the Exclusive Products from McLane. Then McLane informed Bansavich that it would not sell those products to her unless she also agreed to purchase its tobacco products. Bansavich claimed that McLane had impermissibly tied the sale of the Exclusive Products to that of its tobacco products, in violation of section 1 of the Sherman Act.

The District Court granted the motion to dismiss because Bansavich failed to plead a plausible relevant market. The alleged market was defined by what Bansavich was required to purchase. Her proposed market impermissibly excluded potential substitutes,

such as non-Mobil-branded coffee, soda, pastries and promotional products that would be reasonably interchangeable by consumers and provided no plausible explanation as to why the market should be limited in a particular way, except for the fact that she was contractually required to buy such items from McLane. The Court further observed that Bansavich couldn't take advantage of a Ninth Circuit rule allowing a plaintiff to narrow the relevant market the way Bansavich did. That case, *NewCal Industries, Inc. v. Ikon Office Solution*, held that an antitrust claim could be viable where a defendant exploited a contractually-created market power to gain market power in a different market, where such power had not

been contractually mandated. That rule only applies where the second market is wholly derivative of the first (think copiers and copier service), and not to independent markets like coffee cups and cigarettes.

SBA Lending

Small businesses that have tried to borrow money in the last three months know that it is simply not possible because of the financial market crisis. SBA lending has decreased by 58% since about a year ago. Two primary reasons underlie the lack of availability of SBA guaranteed Section 7(a) loans to small businesses. First, SBA loans have become unprofitable for lenders, and, second, banks could no longer find buyers for packages of SBA loans.

Hopefully, SBA loans to small business will be more attractive to banks because the SBA has addressed those two issues. Effective immediately, as announced in the Federal Register on November 13, 2008. The SBA will now permit banks to charge interest based on LIBOR (London Interbank Offered Rate) instead of the prime rate. In normal times, the prime rate was higher than LIBOR, the rate at which banks were able to borrow funds, enabling banks to profit from SBA prime loan loans; in recent times, LIBOR has been equal to or exceeded the prime rate. This change (along with a change in the method permitted for pooling loans into packages for resale) should make SBA loans more attractive to purchasers in the secondary markets. On Nov. 25, right before we distribute this Hot Branding issue, the Wall Street Journal prime rate is 4% and LIBOR is 2.20%, after 3 days of increase, an indication that credit is still not flowing between banks. *We would like to hear about your experience in pursuing an SBA-guaranteed loan.*

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DISABILITY LAW EXPANSION

By Felicity A. Fowler and Laura E. O'Donnell

What Would You Do?

Employee Sally Symptomfree asks your company to accommodate her epilepsy by providing her with regular breaks. Sally has been on medication for her epilepsy for 2-years and has had no epileptic seizures or other symptoms during that time. Without the medication, however, Sally would have seizures and other symptoms that would affect her ability to concentrate, drive a car and perform other daily functions. You are charged with determining the legally appropriate response to Sally's request. What would you do?

In the past, your analysis of Sally's request would be relatively easy. You could confidently advise your company that, legally, Sally was not "disabled" under the governing Americans with Disabilities Act (the "ADA") and, therefore, no reasonable accommodation was required because Sally's medication controlled her epilepsy.

The ADA Amendments Act (the "ADAAA"), which was signed into law by President George W. Bush on September 25, 2008, and becomes effective on January 1, 2009, changes the legal considerations for responding to Sally's request and for handling other issues related to employee disabilities and accommodation requests.

The Pre-Amendment Disability Landscape

President George H.W. Bush signed the Americans With Disabilities Act (the "ADA") into law in July 1990. The ADA prohibits discrimination against an individual with a "disability," which is defined to include (A) a physical or mental impairment that substantially limits one or more of the major life activities of such individual; (B) a record of such an impairment; or (C) being regarded as having such an impairment. 42 U.S.C. §12102(2). The ADA also requires employers to provide reasonable accommodations to employees

with disabilities, unless the employer can meet the difficult standards of showing that the accommodation would impose an undue burden on the company's operation. 29 C.F.R. 1630.9(a).

After the ADA's passage, most courts narrowly interpreted the ADA's "disability" definition to exclude many impairments. In *Sutton v. United Air Lines, Inc.*, 527 U.S. 471 (1999), for example, the United States Supreme Court considered whether two applicants who were denied employment based on their eyesight were "disabled." The applicants' uncorrected visual acuity was 20/200 or worse but, with glasses or contacts, their vision was 20/20. *Id.* at 475. The Supreme Court held that whether an individual is disabled must take into account measures that mitigate or correct the individual's impairment. *Id.* at 482. If an employee or applicant can not show that she is substantially limited in a major life activity with the corrective measure (in this case, glasses or contacts), the individual is not disabled. *Id.* at 482-83.

Therefore, the Court concluded that the applicants in *Sutton* were *not* disabled because, with glasses or contacts, the vision problems were completely corrected. *Id.* at 493-94. The *Sutton* holding, however, had a much broader effect; the decision meant that employees, such as Sally, with serious, albeit controlled, impairments were not protected from discrimination or entitled to reasonable accommodations under the ADA.

In *Toyota Motor Mfg., Ky, Inc. v. Williams*, 534 U.S. 184 (2002), the Supreme Court likewise narrowed the group of individuals covered by the ADA. In *Toyota Motor Mfg.*, an employee with carpal tunnel syndrome claimed that her employer failed to provide her with reasonable accommodations. In rejecting Williams's claim, the Supreme Court held that the terms

“substantial” and “major” in the text of the ADA “need to be interpreted strictly to create a demanding

standard for qualifying as disabled.” *Id.* at 197. The Supreme Court found that a “substantially limiting” impairment is one that “prevents or severely restricts an individual from performing major life activities.” *Id.* at 198 (emphasis added). The Court concluded further that the ADA’s reference to “major life activities” should be limited to “those activities that are of central importance to daily life” for most people. *Id.* at 201 (emphasis added). Thus, under the *Toyota Motor Mfg.* decision, even if Sally’s epilepsy was not corrected by medication, it might still not be a covered disability if Sally could not show that the epilepsy caused “severe” restrictions on activities of “central importance” to her daily life.

The ADAAA Will Increase the Number of Employees Who are Protected From Disability Discrimination and Entitled to Accommodations

The passage of the ADAAA explicitly rejects the holdings in *Sutton* and *Toyota Motor Mfg.* Once effective, the ADAAA will broaden the group of employees who are covered by the ADA and will increase employer responsibilities. It is, therefore, imperative that employers pay attention to the legal changes and alter their responses to questions such as the ones posed by Sally.

- *Broad Construction of What Constitutes of “Disability”*

The ADAAA provides that the ADA’s definition of “disability” (“a physical or mental impairment that substantially limits one or more of the major life activities of such individual”) shall be construed broadly. See ADAAA § 4(a), 3(a)(4)(A).

Consistent with this rule of construction, the ADAAA specifically rejects the *Toyota Motor Mfg.* holding that a “substantially limiting” impairment is one that

“prevents or severely restricts an individual from performing major life activities” and tasks the Equal Employment Opportunity Commission (“EEOC”) with defining what sort of impairment would substantially limit a major life activity. See ADAAA § 6(a)(2). Employers should expect that the EEOC will provide a broad definition.

The ADAAA also enlarges the ADA definition of major life activity. The ADAAA overrules the Supreme Court’s holding in *Toyota Motor Mfg.* that major life activities should be limited to “those activities that are of central importance to daily life” for most people. Instead, the ADAAA definition of “major life activities” includes both activities that have previously been recognized as major life activities, such as walking, as well as activities that have not been specifically recognized in the past, such as reading, bending, and communicating. See ADAAA § 4(a), 3(2). The ADAAA also includes major bodily functions such as “functions of the immune system, normal cell growth, digestive, bowel, bladder, neurological, brain, respiratory, circulatory, endocrine, and reproductive functions” as major life activities. See *id.* This widened list of major life activities will increase the number of employees who can claim an ADA-covered disability. For example, employees who assert they are disabled because of various learning, reading or concentrating impairments will now be much more likely to have a covered “disability” under the ADA.

The ADAAA also expands disability coverage by providing that an individual may be disabled even if the individual’s impairment or condition does not currently substantially limit a major life activity. Now, an impairment that is episodic or in remission (for example, cancer) will be considered a disability if, when active, it would substantially limit a major life activity. See ADAAA § 4(a), 3(4)(D).

- *Mitigating Measures Not Applicable*

Another significant change in the ADAAA is the rejection of the *Sutton* holding that the disability status

of an individual is to be ascertained before accounting for mitigating or corrective measures other than “ordinary eyeglasses or contact lenses.” See ADAAA § 4(a), 3(4)(E). Thus, an employee may now be disabled even if the effects of the employee’s impairment are corrected by medication, prosthetics, hearing aids, medical equipment, learned behavioral or adaptive neurological modifications, assistive technology, or accommodations. This change is specifically intended to reach employees like Sally who can control or correct their impairments with medication.

It should also be noted that, although the ADAAA provides that individuals who need normal eyeglasses are not disabled, the ADAAA prohibits employers from using selection criteria or employment tests based on an applicant’s or employee’s uncorrected vision unless the test is job related for the particular position and consistent with business necessity.

Employers should not overlook the significance of these changes. In responding to employee disability claims and requests for accommodations, employers should keep in mind that what is deemed a disability is broader than in the past and, consistent with the ADAAA’s stated intent to provide broad coverage, begin their analysis with the assumption that many impairments will be deemed “disabilities” under the law, even if these impairments were not covered in the past.

- *Individuals Regarded As Impaired Broadened*

Another noteworthy change in the ADAAA is the expansion of the number of individuals who can claim they are “regarded as” disabled. In the past, to establish that an employee was “regarded as” having a disability, the employee had to show that the employer not only regarded him as having an impairment but that the employer believed that the impairment substantially limited a major life activity. The ADAAA eliminates the substantial limitation requirement, stating that an individual has been discriminated against unlawfully on the basis of a

disability if the individual is “regarded as having” an impairment regardless of whether “the impairment limits or is perceived to limit a major life activity.” See ADAAA § 4(a), 3(3)(A). Unless the impairment is transitory (lasting less than six months) or minor, an employer that merely believed an employee to be impaired (regardless of whether the impairment itself was truly substantial or the employer believed the employee was substantially impaired) regards that employee as “disabled” for the purposes of the ADAAA. See ADAAA § 4(a), 3(3)(B).

What Do The Disability Changes Mean for Employers?

As in the past, employers risk discrimination claims whenever they take adverse action against a disabled employee. The ADAAA increases this risk because it increases the number of individuals with disabilities. Given the significant broadening of the disability definition, employers should review their disability discrimination and reasonable accommodation policies and practices to ensure that these policies and practices are in compliance with the ADA’s expanded scope. Employers should likewise train managers on how to recognize and handle an accommodation request, what to say and not to say in this situation and how to appropriately discipline employees to avoid claims of disability discrimination.

With respect to Sally, her epilepsy is most likely a covered disability under the ADAAA. Sally is, therefore, entitled to a reasonable accommodation that will allow her to perform the essential functions of the job. If Sally’s request for breaks would allow her to perform the essential functions of the job, it is probably a reasonable accommodation. If there are concerns with this requested accommodation, however, you have the right to engage Sally in an interactive discussion of accommodations that will enable her to perform the essential functions of her job. But, especially given the new disability landscape, the bottom line is that you will likely need to provide Sally with a reasonable accommodation of her disability.

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WARNING! WARNING! IDENTITY THEFT RED FLAG RULES

by Gayle Cannon

In back issues of "Hot Branding," we have mentioned the Fair and Accurate Credit Transaction Act (FACTA). FACTA provides consumers with increased protection from identity theft. This is the act that restricted you from disclosing credit card numbers except for the last 5 digits, in addition to other provisions. Congress also required the FTC and other credit regulators to adopt rules to implement FACTA. The FTC issued its rules in November, 2007 - called the Red Flag Rules - that require covered entities to create specific rules and procedures for handling credit information. Although originally scheduled to become effective on November

1, 2008, the FTC has delayed the date by which companies must comply to May 1, 2009. Many subject entities that were not even aware of the initial rulemaking process discovered very late in the process that they were subject to the scope of the rules because they were engaged in activities that would cause them to fall under FACTA's definition of creditor or financial institution.

Some franchisors may be subject to the Red Flag Rules. These rules were initially described as intended to apply only to financial institutions, collection agencies, landlords, auto dealers and others who are in the business of extending credit to their customers. However, because of the very broad definitions in the Red Flag Rules, the rules also will apply to any franchisor or franchisee who issues credit cards and to franchisors who defer payments of franchisees or who offer financing to their franchisees, apparently also including deferments of royalties and repayment at a later time. The rule does not apply however to

franchisees that have 'branded' credit cards with their logo if they are not involved in the credit application or decision process.

Based on the comments to the rules when they were proposed, it appears that the FTC did not envision that these rules would impact franchisors when they were proposed and adopted. The International Franchise Association is in discussions with the FTC to discuss clarification. If the FTC does not exclude application of the Red Flag Rules to franchisors (and franchisees who issue credit cards), you should know what they are and what you will need to do to comply with them.

The Red Flag Rules require financial institutions and creditors to develop and implement written identity theft prevention programs. A covered entity must provide for the identification, detection, and response to patterns, practices, or specific activities (the red flags) that could indicate identity theft. Some franchisors and franchisees may fit the definition of a creditor under the rule. A "creditor" is any entity that

regularly extends, renews, or continues credit; any entity that regularly arranges for the extension, renewal, or continuation of credit; or any assignee of an original creditor who is involved in the decision to extend, renew, or continue credit. Any creditor who offers or maintains a "covered account" must comply. A "covered account" includes "any ...account...for which there is a reasonably foreseeable risk to customers...from identity theft...."

To comply with the Red Flag Rules, a covered franchisor or franchisee must take the following steps:

- Design and implement a written identity theft prevention program to detect, prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account.
- Adopt "reasonable policies and procedures" to identify relevant red flags, to detect and respond appropriately to red flags, to and to update the program periodically. The red flags policy should be drafted to apply to the company's program. The Red Flag Rule lists 26 examples of red flags.
- You can find the examples listed at <http://ftc.gov/os/fedreg/2007/november/071109/redflags.pdf>, p 63767-8. The Red Flag Rules are flexible, in that a company may fit its program and rules and policies to its credit programs. A covered entity may also look at its past history of identity theft, if any.

- The Board of Directors (or, presumably, other governing body) of the covered entity must approve the Red Flag program and the policies and procedures.
- Either the Board, a board committee (or equivalent body) or a member of senior management must oversee the Red Flag program and the policies and procedures.

As with the FTC Franchise Rule, a plaintiff has no private right of action for a company's non-compliance, however state consumer protection laws may give plaintiffs a private right of action and state attorneys general would have enforcement rights. And of course, the FTC would have enforcement rights against a non-complying company. The Red Flag Rules permit civil money penalties for each violation. A franchised chain may also suffer negative publicity if a customer's identity is stolen and suffers damages from that theft.

For additional information and counsel on adopting a Red Flag Program, contact Robert Levy, a partner in the Houston office; Robert.Levy@haynesboone.com, (713) 547-2032.

IMMIGRATION ENFORCEMENT STEPPED UP: "FAST FOOD FELONIES"

By Leigh N. Ganchan

Dubbed "Fast Food Felonies" in the press, increasingly owners and managers of franchise food establishments across the country are finding themselves in federal courts responding to charges of federal felony immigration offenses. Numerous Immigration and Customs Enforcement (ICE) raids and investigations are putting employers on edge as they try to comply with a broken immigration system. ICE probes can be prompted by everything from anonymous tips, identity theft reports, to private employment discrimination suits.

Mack Associates Inc., owner of 11 Reno-area McDonald's restaurants faced this situation recently. Two top executives and the corporation itself pleaded guilty in federal court in July to federal felony immigration offenses for encouraging illegal aliens to reside in the United States. The charges stem from an ICE investigation that began in March 2007 after the agency received a tip about a possible incidence of identity theft from the sheriff's office. The corporation will pay a \$1 million fine - \$500,000 for each count, the maximum allowed - and be placed on probation.

Citing the “lure of employment” as one of the most significant factors fueling illegal immigration, ICE is demonstrating a propensity to raid chain entities. ICE executed federal search warrants at eight Casa Fiesta restaurants, a chain of Mexican restaurants, throughout northern Ohio this year. This worksite enforcement operation was the culmination of more than a yearlong investigation. In Hawaii, ICE agents took eight workers into custody at the Cheeseburger Island Style and Cheeseburger in Paradise restaurants as well as 14 aliens who were employed by the Bubba Gump Shrimp Company. ICE continues to develop this case.

In public statements ICE leaders are very clear about their resolve to pursue “those who willfully violate our nation’s hiring laws, regardless of their place on the corporate ladder.” ICE admits that these investigations are complex and can take months, or even years, to build. They have confirmed, however, that they will “invest whatever time it takes to ensure that those who flout the law are brought to justice.” Prosecutions are mounting in fiscal year 2008. ICE has made 937 criminal arrests in connection with worksite enforcement investigations. Of those, 99 involve owners, managers, supervisors or human resources employees who face charges ranging from harboring to knowingly hiring illegal aliens. In addition to the criminal arrests, ICE has made more than 3,500 administrative arrests for immigration violations during worksite investigations.

Employers concerned about this spike in immigration-related prosecutions have taken deep interest in a statement from the U.S. Attorney prosecuting Houston’s own Shipley Do-Nut Flour and Supply Company, a corporation that supplies baking materials and logistical support to retail stores and to 200 franchises across the southern U.S. The U.S.

Attorney noted that “starting soon after the ICE raid, [Shipleys] upgraded its immigration compliance program and hired a consultant to comply with employment regulations . . . Federal prosecution of the company would have been more severe without this change.”

Update on “No Match” Letters

In a related development, on October 23, Michael Chertoff, Homeland Security Secretary, asked a US District Court judge in San Francisco to lift the injunction preventing the government from sending out no-match letters to thousands of employers. The notices in conjunction with a DHS Final Rule would make it necessary for employers to resolve the discrepancies within a 90 day period or terminate the employee whose information is facially inconsistent with the SSA database. This could impact a massive number of US citizens and other authorized workers for whom the SSA database simply has inaccurate data - in fact the Inspector General for the SSA has confirmed that about 70% of the erroneous records relate to US citizens. Critics note that the Administration made few changes to the final regulation upon which the judge could rely to lift the stay and has not taken any steps to “fix the database,” according to the UCLA’s Immigrants Rights Project. The U.S. Chamber of Commerce said that it is reviewing litigation options.

We urge all franchisors and franchisees to be proactive in their immigration compliance efforts. The enforcement efforts by ICE and Homeland Security will not likely decrease in the near future.

For more information regarding I-9 compliance planning, contact Leigh N. Ganchan, head of Business Immigration Group, in the Houston office, leigh.ganchan@haynesboone.com, (713) 547-2018.

STATE UPDATE

New Jersey

New Jersey's Franchise Practices Act currently applies only to licensing arrangements where the licensee has a place of business, such as soda delivery truck owners and wholesale distributor franchisees. After hearings, the New Jersey Assembly Committee on Commerce and Economic Development passed the proposed bill A2491, submitted by Senator Joseph Cryan back in March. The bill will come before the New Jersey Assembly in 2009. The proposed bill also adds language to the purposes clause of the Act, in which it states that it is in the public interest to "protect franchisees from unreasonable termination by franchisors that may result from a disparity of bargaining power between national and regional franchisors and small franchisees." The Act applies only to those franchisees where the franchisor has gross sales of products or services to a franchisee in excess of \$35,000 in the prior year; and more than 20% of the franchisee's sales are intended to be or derived from the franchise, indicating a reliance by the franchisee on the franchisor's sale of products and services. Sen. Cryan proposed no changes to that part of the Act. IFA testified at the hearing that it believed

this change would lead to increased litigation and not be beneficial to the economy of New Jersey.

Rhode Island

The amendment to the Rhode Island Fair Dealership Act on which we reported in the July 2008 Hot Branding issue, became effective on July 4, 2008.

Texas

Two Fifth Circuit cases recently decided could affect franchise litigation in Texas. *Morrison v. Amway Corp.* is a warning to franchisors how not to use the unilateral right to amend their manuals generally retained in the franchise agreement. *In Re: Volkswagen* may make it easier for defendants

(franchisors or franchisees) to change venue in multi-district cases.

Morrison v. Amway Corp., Unilateral Right to Amend an Agreement Makes Arbitration Clause Unenforceable.

The Facts

In a dispute that lasted over 10 years, the Fifth US Circuit Court of Appeals held that the retention of a unilateral right to amend an agreement rendered an arbitration clause illusory and unenforceable, based on Texas law. Amway distributors in Texas filed the case against Amway in 1998. The Fifth Circuit Court of Appeals held that "only an illusory and unenforceable agreement to arbitrate" resulted when Amway distributors agreed to abide by dispute resolution procedures set forth in rules of conduct in which Amway had reserved the right to unilaterally amend simply by publishing notices of amendment. Nothing in the rules of conduct prevented Amway from amending the arbitration program to eliminate arbitration entirely or restrict its applicability to certain claims or disputes. Therefore, once notice of such an amendment was published, mandatory arbitration would no longer be available even as to disputes

which had arisen, and of which Amway had notice, prior to the publication.

In June 1997, Amway first had notice that the plaintiff distributors were complaining about how profits on the sales of Business Support Materials were determined. In September 1997, Amway informed its distributors that it was amending its Rules of Conduct, to which all distributors agreed when they signed their annual agreements. The distributors later alleged that Amway made this change only after it was clear that Amway and the distributors were heading to litigation. Then followed a long series of court maneuverings by both parties.

In January 1998, the plaintiff distributors filed in Texas state court, alleging a slew of claims ranging from violations of the Texas antitrust statute, the Texas Deceptive Trade Practice Act and the Texas Business Opportunities Act to implied breach of implied contract, to name a few, and prayed for compensatory damages in excess of \$10 million. The case was moved to federal district court, where the court granted

Amway's motion to stay pending arbitration. A parallel case filed by other distributors in state court was also stayed.

In May 2001, after the distributors in the federal case were not permitted to appeal the stay order, the distributors requested arbitration. In the arbitration, the distributors first alleged that there was no valid agreement to arbitration, and if there were such an agreement, it did not apply because the dispute arose prior to the date on which Amway revised its Rules of Conduct to require arbitration. Amway filed a counterclaim. After discovery and hearings, in January 2005, the arbitrator granted both parties' claims, without analysis or explanation. The distributors moved to vacate the award, alleging the bias of the arbitrator and the unenforceability of the arbitration agreement. In March 2005, Amway moved to confirm the award and enter judgment on it. The distributors moved for rehearing after the District Court denied their motion for a rehearing. The distributors then filed their notice of appeal to the Fifth Circuit Court of Appeals.

The only issue that the Court ultimately decided was whether the district court erred in its 1998 order staying their suit pending arbitration.

The Distributors' Argument

The distributors argued that applying the arbitration agreement to disputes arising before 1998 rendered the arbitration agreement illusory, lacking in consideration and unenforceable. Their premise was based on Amway's retention of the right to unilaterally repeal or amend the Rules of Conduct, which right did not exempt the arbitration provision.

The Court's Decision

After comparing the facts to other Texas cases, the Fifth Circuit Court of Appeals agreed and reversed and remanded the case back to the District Court. The Court's decision on this one issue made consideration of the other claims on appeal unnecessary. One of those claims was that the JAMS arbitrator was biased because she had been trained by Amway and the Amway Distributors Association and had conducted mediation training for some Amway employees—facts that the arbitrator had disclosed to the distributors. None of the parties raised any questions or objections, even after they were asked to do so by JAMS and the arbitrator.

The Lesson

At least in Texas, franchisors should not make amendments to manuals, policies and procedures retroactive to apply to events which occurred prior to the date of a notice of effectiveness of the change. The Fifth Circuit did not discuss any facts which might justify making amendments retroactive. Such changes may not impair the written contract, and should not apply to material rights upon which franchisees may have relied when they entered into the franchise agreement.

In the *Amway* case, the decision was limited in its application because Amway required its distributors to renew their agreements every year, and by the following year Amway had inserted an arbitration provision in their distributorship agreement. As franchise agreements are rarely renewed annually, best practice by franchisors who wish to add an arbitration provision when none exists in the franchise agreement is to secure the franchisee's written agreement of amendment to the franchise agreement. We note that some franchisors have opted against including arbitration provisions in their agreements in the last few years.

The Fifth Circuit may also have been influenced by the timing of the addition of the arbitration requirement—

Amway may have had an ulterior motive because of the distributors disputes.

In Re: Volkswagen: Refusal to Transfer Venue was Clear Abuse of Discretion.

The Holding

In a surprising decision, the Fifth US Circuit Court of Appeals sitting en banc, in a 10-judge majority opinion issued on October 10, 2008, held that the trial judge's refusal to transfer a products liability case from Marshall to Dallas was a clear abuse of discretion. One federal law permitted the plaintiffs to sue a corporation in any district in the state. Another federal law said that that privilege must take into consideration inconvenience to the other party. In the majority opinion, Judge E. Grady Jolly wrote, "The underlying premise of Section 1404(a) is that courts should prevent plaintiffs from abusing their privilege under Section 1391 by subjecting defendants to venues that are inconvenient under the terms of Section 1404(a)."

The Facts

The case involved an automobile accident in which a child died and a plaintiff was severely injured. The

accident occurred in Dallas, the plaintiffs lived in a city adjacent to Dallas, and all documents and physical evidence related to the accident were in Dallas, as were most witnesses and police and medical personnel who responded to it. The only connection with Marshall was the plaintiff's choice to file there and that

the deceased child formerly lived there. Presumably their decision to file in the Marshall Division of the Eastern District was based on its reputation as being plaintiff-friendly and reluctant to transfer venue.

The Dissent

Seven judges joined in a dissent. Among other reasons, the dissenting opinion pointed out that mandamus was not appropriate for permitting appeals

from a court's discretion to fix venue. The opinion pointed out, with reference to convenience, that Volkswagen would have to bring its expert witnesses from Germany, and that venue in Marshall was not inconvenient when a four lane highway ran between Dallas and Marshall, and that electronic discovery made it irrelevant where venue was set.

Relating to this issue, also see the lead article on **Choice of Law and Choice of Forum Clauses in Franchise Agreements**, the lead article above.

KUDOS

Another Win for a Client

Nina Cortell and Jeremy Kernodle in the Dallas Litigation Practice successfully reversed an \$8.5 million judgment against our client Blockbuster Inc. (see *Blockbuster Inc. v. C-Span Entertainment, Inc.*, No. 05-06-00849-CV (Tex. App.-Dallas Aug. 12, 2008)). Blockbuster franchisees were not entitled to judgment on any of their claims or to attorney's fees because the claims against Blockbuster were released

upon execution of a consent to transfer. For additional information on this lawsuit, contact Nina Cortell, nina.cortell@haynesboone.com, (214) 651-5579.

Appointments

In a salute to Deb's contributions to the Forum Committee on Franchising over many years, Deb Coldwell was elected to a 3-year term on the

Governing Committee of the ABA Forum Committee on Franchising, beginning in 2009. Deb begins her term as she ends her 3-year term as Editor-in-Chief of The Franchise Law Journal, published by the Forum Committee on Franchising.

Rob Lauer was appointed to a 2-year term on the International Division of the ABA Forum on Franchising.

Joyce Mazero was appointed to serve on the Hospitality Management Board of Governors of the University of North Texas. Joyce is the only attorney on the Board of Governors, comprised of experienced executives in the foodservice and supply and manufacturing industries.

Articles and Presentations

Monograph, **Financial Performance Representations: The New and Updated Earnings Claims**, Joyce Mazero and Stuart Hershman, co-editors, published

by the ABA Forum Committee on Franchising, October 2008.

Article, "Pieces of the M&A Puzzle: Key Transaction Challenges for the Franchise Lawyer," Joyce G. Mazero, Jan S. Gilbert, Robert A. Lauer, ABA Franchise Law Journal, Fall 2008

Presentation and Article: "Litigating Disclosure Claims," Deb Coldwell, presented at the ABA Forum on Franchising meeting, Austin, October 2008.

Series of 3 Articles on Leadership, Joyce Mazero, *Franchise Times*, September, October and November, 2008

Joyce Mazero spoke on the Foreign Corrupt Practices Act at the Global Risk Panel, Fall Institute of Women Corporate Directors, held October 28, 2008 and sponsored by KPMG and Haynes and Boone LLP

Article, "Is Refranchising Right for You?" Rob Lauer, ABA Franchise Lawyer, Summer 2008

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