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HOT BRANDING NEWS

TABLE OF CONTENTS

PROTECTING YOUR COMPANY'S BRANDS FROM DOMAIN NAME THEFT AND SCAMS	2
THE SUNRISE OF.TEL. ETC.	4
THE NEW TEXAS ANTI-PHISHING ACT	6
AROUND THE GLOBE	7
JAPAN	
KUWAIT	7
SOUTH AFRICA	
FEDERAL	8
Stimulus Act: Link to the Summary prepared by Haynes and Boone	8
Lily Ledbetter Fair Pay Act	8
Employee Free Choice Act	8
Revised I-9 Forms	10
Arbitration Enforceability Cases	10
STATES	11
California: New Statute re Nutritional Content	11
Florida: Restrictive Ordinance found Unconstitutional	11
Kansas: New Statute re Governing Law and Venue in Kansas	
Texas: Eminent Domain and Lost Future Royalties	12
Registration States: Disclosure Delivery Dates	13
KUDOS To Our Team on the Establishment of a Purchasing Co-op for IHOP and Applebee's Franchisees	13

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PROTECTING YOUR COMPANY'S BRANDS FROM DOMAIN NAME THEFT AND SCAMS

Why Should You Pay Close Attention Now to Domain Name Issues?

In short, the right domain name is prime "virtual" real estate that can leverage your brand, and for this reason, domain names, especially <.com> domain names, are highly valued in today's marketplace. For example, <sex.com> recently sold for $12 million, <diamond.com> purportedly commanded $7.5 million, and <vodka.com> was purchased in the $3 million range. Because of the value attributed to domain names, cybersquatting and other illegal and unfair uses of trademarks on the web remain a source of major concern.

Cybersquatting is nothing new, but certainly deserves the continued attention of brand owners. Cybersquatters are buyers of domain names that incorporate another's trademark, with a bad-faith attempt to profit from holding those domain names. According to several studies of some of the world's strongest brands by a leading trademark monitoring service, cybersquatting incidents continue to increase in number each year. This increase is due partly to the new trends in the domain name infringement arena discussed below.

Domain name tasting. A five-day grace period exists, during which a domain name registration may be rescinded, without the buyer incurring the usual registration fee. The listed purpose for this policy is to remedy typographical errors and the like that can occur during the registration process. However, some companies are using this grace period to taste the marketability of certain domain names, many which consist of misspellings of company and brand names. Those who taste domain names on a mass scale do so by buying hundreds, thousands, or even hundreds of thousands of domain names through the use of automated software programs, commonly directing those domain names to parked, pay-per-click websites. The registrants track the amount of traffic received at those sites, and cancel the lesser visited domain names with no fee or penalty. There may even be more domain names being tasted than registered at any given point.

Domain name kiting. Some domain name tasters register domain names, drop them within the five-day grace period, then reregister them, and continue this approach in perpetual cycles. This activity, referred to as domain name kiting, provides domain name owners with an economic benefit, as they receive money when visitors to their websites click on advertising links therein.

Even though many domain names being tasted are cancelled after five days, both the grand scale of tasting and the continual nature of kiting schemes make these websites difficult for Internet users and brand owners to ignore. Not only do these sites crowd the Internet, but they also may cause various harms to brand name owners, including customer confusion, loss of goodwill, and loss of revenues. Additionally, reviewing and researching such sites wastes trademark owners' resources.

Domain name spying. This development involves the practice of purchasing domains shortly after learning that an interested party checked their availability. Put another way, the companies that perform this activity monitor third parties' searches for domain names that may contain new trademarks, and then purchase domain names containing those phrases before the rightful owners can obtain them. Some companies appear to make spying their entire business model; thus, this practice might not be as rare as you might expect.

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Spam notices from Chinese entities. Notices are also commonly being distributed by email and mail to brand owners by several Chinese companies. These notices typically claim that other persons or companies will hijack your trademarks as a Chinese domain name (that is, with the .cn extension) or Internet keyword (also referred to in notices as an "Internet brand"), unless you immediately engage their companies to purchase these on behalf of your own company. In most cases, these are scams and the distributors of these notices are acting unethically.

What Can You Do to Protect Your Brands From Such Attacks on the Internet?
You may take several steps to both prevent and shut down cybersquatting.

Preventive steps include:

- **Registering key domain names.** You can never own all possible domain names that incorporate your company's brands. However, consider purchasing the obvious spellings and misspellings of your primary brands, with the extensions that are most commonly used and searched, namely .com, .net, and .org. If you conduct business outside of the U.S., or are likely to do so in the near future, then also consider registering domain names with the appropriate country code extensions, such as .eu (for Europe), .co.uk (for the United Kingdom), .cn (for China), or .ca (for Canada). Experienced trademark counsel can point you to a reputable company through which you can obtain Chinese domain names and keywords. The best offense is defensive registration.
- **Registering without hesitation.** To avoid domain name spying, register domain names of interest as soon as learning that they are available, and use only accredited registrars and other reputable companies to conduct searches.
- **Renewing your domain names.** Do not forget to renew the domain names you have acquired. Otherwise, someone else may grab them and demand money for their return, or post pornographic or other offensive content at those websites. You may be able to set up your domain names to renew automatically annually, or you can purchase them for years in advance so that you will not need to continue monitoring them. Otherwise, set calendar reminders with more than one company employee, if possible, so renewals are not inadvertently missed. Also, make sure that any departing employee hands over access to company domain names.
- **Monitoring the Internet.** Several services charge annual fees to monitor the Internet for possible infringement of your key brands. You may also monitor the web in-house, through the use of free websites that can point you to domain names incorporating your brand names, or through conducting searches of your brands via a search engine. Early detection of unauthorized use of your brand names may help to prevent any loss of Internet traffic from your company's website or other harm to your company's brands.
- **Bringing domain name and trademark notices to your counsel's attention.** If you receive any notice from an organization or company offering domain name or trademark assistance, we suggest you forward it to your counsel. While likely a scam, it is worth reviewing. If nothing else, it may lead your counsel to advise you of steps you should be taking – even if proceeding through a company other than the one that sent you the notice in question.

To obtain domain names that correspond to your client's trademarks but are already registered to third parties, several enforcement tactics could be considered and are often successful, including the following:

- **Sending a demand letter.**
- **Offering to purchase the domain.** If you proceed with making an offer to the registrant to buy the domain name at issue, we recommend that you conceal your identity in order to improve the likelihood that the registrant will agree to sell for a reasonable amount.

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- **Placing a backorder for the domain name.** You could also place a backorder on the domain name, whereby a company enables you to get in line to offer to purchase the domain name. Typically, backordering services only charge a fee (and a relatively small one, at that) when the backorder is successful.
- **Filing an administrative complaint.** A procedure governed by the Uniform Domain-Name Dispute-Resolution Policy (UDRP) allows for the filing of a complaint to request that a domain name be transferred to you. This procedure is available in many instances of cybersquatting, and depending on your goals, it can be a more cost-effective and efficient than proceeding with litigation.
- **Filing a lawsuit.** In some instances, though, money damages might be obtainable through litigation involving cybersquatting, and the facts at hand might warrant proceeding with a suit.

Conclusion

You are unlikely to prevent or stop all unfair and illegal activity on the Internet affecting your brands. Additionally, the vast size of the Internet and large scale of cybersquatting and other such activities can be overwhelming and intimidating. However, taking several of the steps listed above can be extremely useful in protecting your valuable brands.

Naturally, the most appropriate steps to will take vary depending on each scenario. Factors to consider include the importance of the domain name and brand to your business, your budget, the timeframe by which you desires to retrieve the domain name, the type of website content currently found at the domain name of interest, and the history and current behavior of the domain name registrant.

If you have questions about protecting your company's brand, contact Purvi Patel at (214) 651-5917, purvi.patel@haynesboone.com, or David Bell at (214) 651-5248, david.bell@haynesboone.com.

THE SUNRISE OF .TEL . . . MAY BE JUST THE THING TO HELP YOU SELL; DON'T BE LEFT ONLY IN THE .COM AGE

No matter what you sell, you want your customers to find you – the new .tel domain could help you do just that. The goal of the .tel domain is to enable users to store and update their contact information and make it available to approved contacts in a revolutionary way. The new Internet domain began its Sunrise Period for registered trademark owners on December 3, 2008.

So, what is .tel exactly?

The .tel domain deviates from commonly known domains (.com, .org, .net, .gov, etc.) because it circumvents the need for a registrant to create an actual website. Rather, a registrant stores its contact information directly on the domain name server and when an approved user types in the address for its .tel site, the registrant's contact data, including its phone numbers, email addresses, corporate website URLs, professional networking links, and address information, is displayed. Think of it as a customized .tel(ephone directory). A sample .tel web site is at http://www.hotels.tel.

What's is the anticipated benefit of this new format?

A search using the .tel name will load in a fraction of the time of a standard web page and since it is not tied to a website, the information can be retrieved from a variety of devices, including mobile or smart phones. So, if a user performs a .tel search using a smart phone, the search may return links to

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telephone numbers for your customers to call you by simply clicking on the link and not have to find you through a standard web page.

How do I set-up my .tel domain?

Registered trademark owners and authorized licensees can take advantage of a Sunrise registration period from December 3, 2008 through February 2, 2009, by completing an application with any ICANN accredited registrar for registration of a .tel domain name for three years. The estimated costs fall in the $500 range for the three year term and the selection method is on a first-come, first-served basis.
After the Sunrise period, there will be a Landrush period from February 3, 2009 through March 23, 2009 open to everyone at a premium price for any domain that is not registered during the Sunrise period. Then, there will be a general availability opening on March 24, 2009 open to everyone for any domain that is not registered during the Sunrise period or the Landrush period. Given that the general public will be able to start registering these .tel domains on February 3, 2009, businesses should consider registering their <Registered Trademark>.tel domain during the Sunrise period.

You can find more information about .tel at the website http://www.telnic.org or by contacting David Bell at david.bell@haynesboone.com

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THE NEW TEXAS ANTI-PHISHING ACT

Phishing is the practice of using deceptive websites and email to obtain sensitive personal information. According to The Global Phishing Survey, published in November 2008 by the APWG Internet Policy Committee, 47,324 phishing attacks occurred during the first half of 2008. APWG maintains a comprehensive archive of phishing and e-mail fraud activity. Phishing has grown past mere e-mail—such as the fake notices we have all received that your bank needs to update its records when you don't even do business with that bank. Internet users now need to be wary of phishers who download Trojan horses onto computers. This malware then allows the phishers to collect data when a user clicks on an URL and enters information into a legitimate web site and to use the stolen information for illegal purposes.

Texas Business and Commerce Code Chapter 325, effective April 1, 2009, represents an attempt by the Texas Legislature to curb this growing problem. The Act, officially known as the Anti-Phishing Act, prohibits the fraudulent use or possession of identifying information obtained via misleading websites, domain names, or e-mails.

Chapter 325 applies to persons who act with the intent to engage in conduct involving the fraudulent possession or use of another person's identifying information. The Act defines identifying information by cross-referencing section 32.51 of the Penal Code. This definition covers all information that alone or in conjunction with other information identifies a person. This information includes, but is not limited to, social security numbers, dates of birth, government identification numbers, unique biometric data, unique electronic information, and personal identification numbers.

Section 325.004 prohibits the creation or use of a web page or domain name for fraudulent purposes. The Act prohibits:

1. the creation of a web page or domain name and the representation of such as a legitimate online business without the business owner's permission; and
2. use the fraudulent web page, link, domain name, or other web page to request, solicit, or induce another to provide identifying information for a purpose the provider believes is legitimate.

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Similarly, section 325.005 prohibits phishing via e-mail. A person may not send or cause to be sent electronic mail to an address held by a Texas resident that:

1. is falsely represented as being from a legitimate business;
2. refers or links the recipient to a website represented to be associated with a legitimate online business; and
3. either directly or indirectly induces, requests, or solicits the recipient to provide identifying information for a purpose that he believes is legitimate.

The Act provides a cause of action against a person who engages in the prohibited conduct. Three entities may bring a civil action under section 325.006:

1. a person who provides internet access to the public and is damaged by the prohibited acts;
2. a trademark or website owner who is damaged by the prohibited acts; and
3. the Texas attorney general.

A plaintiff who brings an action under this statute may recover the greater of actual damages or $100,000 for each violation of the same nature. The Act defines acts of the same nature as those consisting of the same course of conduct regardless of the frequency of the conduct. If the prohibited conduct occurs often enough to constitute a pattern or practice a court may treble an award of actual damages. Additionally, a prevailing plaintiff is entitled to its reasonable attorney's fees and court costs. Injunctive relief is also available.

The Act contains a safe-harbor provision for internet service providers. Section 325.003 states that the Act does not apply to a provider of telecommunication or internet service when the provider engages in the good faith transmission, routing, or temporary storing or caching of identifying information.

The Anti-Phishing Act represents the Texas Legislature's recognition of the seriousness of fraudulent internet use. Large statutory damages and a statutory award of attorney's fees and costs to a successful plaintiff create an incentive for internet access providers and trademark holders to pursue phishers via state court litigation.

In response to increasing phishing activity, the U.S. Legislature has proposed several bills in the past, none of which have passed. The most recent bill, which failed to pass during last year's Congress, was the "Anti-Phishing Consumer Protection Act of 2008". There are already anti-fraud laws on the books which cover illegal phishing. In addition, the federal government and almost all of the states in the United States have enacted explicit criminal legislation related to identity theft which law enforcement can also apply to phishing. Only eleven states and the District of Columbia not have such laws. Some states, however, have been more aggressive than the federal government and have adopted statutes that specifically apply to phishing, including, in addition to Texas, California, New Mexico, New York, Pennsylvania, Vermont, Virginia and Washington. While most anti-phishing legislation is criminal in nature, California's law, like the new Texas Anti-Phishing Act, is a civil statute, and provides for recovery of the greater of actual damages or up to $500,000 per violation. At present, the future of the federal anti-phishing legislation, and whether Congress will reconsider its enactment, remains unclear.

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AROUND THE GLOBE

JAPAN

A January 2008 case against a Japanese company in which McDonald's has a minority interest held that managers of company-owned restaurants were not supervisors, and thus should have been paid overtime. The court held that the managers had "no discretion in their hours worked or scheduling of their time, and little discretion in formulating sales plans and budgets." Even though managers made significantly higher wages, they were held not to be "significantly different from regular employees." The plaintiff was awarded back overtime wages and other compensation. A Japanese law firm recently reported that some Japanese were converting company-owned stores to franchised stores to escape the overtime salary requirements.

KUWAIT

In January 2008, Kuwait adopted a new tax regime; in July 2008, the Ministry of Finance (MOF) issued regulations implementing the new tax regime. The revisions materially reduced the tax rate for foreign companies with Kuwaiti income from up to 55% to a flat rate of 15%. Income subject to the flat rate includes, among others, contracts performed fully or partially in Kuwait and the sale, lease, or other exploitation of any trade mark, patent, or copyright, net of permitted deductions. The revisions require that foreign companies operating in Kuwait and joint venturers and shareholders with Kuwaiti income (1) notify the Department of Income Tax (DIT) within 30 days of the signing of a contract or any change in an existing contract affecting tax income, (2) secure a "tax card"; (3) maintain books and records in a prescribed manner; and (4) submit a tax declaration on or before the 15th day of the 4th month after the tax year ends. Agencies in Kuwait may not assist or relate with a foreign company that does not have a tax card. In March, the Ministry of Finance issued the form of the new tax card. To complete the application, a company operating or trading in Kuwait will have to provide several documents, including articles of incorporation and amendments thereto, authority of the person signing for the company, a letter of authority for appointment of an accounting firm, Kuwaiti registration information, copies of agreement with the foreign company's sponsor in Kuwait and copies of new contracts that have not already been reported to DIT. A foreign company doing business in Kuwait may have already provided some of these documents, but must also provide these documents again to the DIT to secure the tax card. For more information, call Rob Lauer, (512) 867-8505, rob.lauer@haynesboone.com.

SOUTH AFRICA

The Department of Trade and Industry (DTI) has been considering a revamping of its consumer protection laws since 2004. The Franchise Association of South Africa (FASA) believes that South Africa will finally adopt an extensive consumer protection act within the next few months. The proposed Consumer Protection Act, 2008 (CPA) covers all types of consumer protection, such as pyramid schemes and lotteries, but of interest to franchisors, includes specific provisions relating to the offer, sale and relationships of franchises.

The CPA:

- mandates equality, privacy, information and disclosure, honest dealing and fair agreements, fair value, good quality and safety and supplier accountability;
- prohibits tying (called "bundling" in the CPA) unless the franchisor can show that the convenience of the bundling outweighs the limitation of the franchisee's right to choice, or will result in economic benefit for franchisees;
- grants franchisees the right of choice of suppliers, which will limit a franchisor's designation of suppliers unless the franchisor can show that the restrictions are "reasonably related" to the goods and services offered by the franchised business;
- prohibits making false, misleading or deceptive representations and coercion, undue influence, pressure or harassment, unfair tactics or any other similar conduct; and

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- grants franchisees a right to terminate by notice for 10 days after signing the franchise agreement.

In cases enforcing rights under the CPA, a court may consider the relative capacity, education, experience, sophistication and bargaining position of the parties. The CPA will apply to agreements signed 18 months after the president of S. Africa signs the bill and is not retroactive in application. Regulations to issue will likely reflect the disclosures to prospective franchisees reflected in FASA's guidelines. We will provide more information when South Africa promulgates the bill and issues regulations.

FEDERAL

Link to the Haynes and Boone Summary of the Stimulus Bill http://www.haynesboone.com/stimulus-bill/

WHAT A DIFFERENCE AN ELECTION DAY MAKES!

Lily Ledbetter Fair Pay Act. The Democratic Legislature approved, and on January 29, 2009, the Democratic President Obama signed, the Lily Ledbetter Fair Pay Act, a new wage discrimination bill that will lengthen the time in which a person suffering wage discrimination may file a claim. The statute of limitations to file a claim now runs 180 days from each paycheck received by a person suffering discrimination. The new act was passed in reaction to a 2007 Supreme Court denying relief and holding that the plaintiff had to have filed her claim within 180 days of the decision to pay her less, even if she had not discovered the discrimination in pay until years later. A bill proposed in 2007 died in the Senate after former Republican President Bush threatened to veto it. Franchisors and franchisees should be aware that the act is effective as of May 28, 2007 with respect to all claims pending on or after that date. For more on the Lily Ledbetter Fair pay Act, follow this link to read the firm's client alert: President Obama Signs Lily Ledbetter Fair Pay Act

Employee Free Choice Act. On March 10, the Employee Free Choice Act ("EFCA" and also referred to as "card check") was re-introduced in Congress. The so-called Employee Free Choice Act proposes to amend the National Labor Relations Act. The amendment arguably would strengthen labor unions by making it easier to join a union, requiring mediation and binding arbitration in negotiations between an employer and the union (with no right to appeal and effective for 2 years), and increasing penalties for employer violations.

The Committee for A Level Playing Field, comprised of Starbucks, Costco and Whole Foods, proposed a compromise to the bill that would allow management to continue using secret ballot elections, but would also allow unions access to employees during nonworking hours at a neutral location and mandate a fixed time for elections so companies wouldn't be able to delay a vote. Reaction from both unions and business was negative.

Small businesses believe that passage of this act would lead to increased wages and benefits that they can ill afford and loss of "nimbleness". Currently, the proposed act does not contain any provision which would exempt small businesses with fewer than a defined number of employees, however, some support for an exemption for small businesses may exist from labor unions. Democrats support this bill; Republicans do not. However, recently, Republican Sen. Arlen Specter and Democrat Sen. Dianne Feinstin, two senators who formerly supported the bill, have announced they would withhold support of the EFCA. One blogger believed that any vote on this proposal would likely be delayed until April, when the disputed election in Minnesota between Al Franken, Democrat, and Norm Coleman, Republican, has been finally decided. That event rests upon a decision in Coleman's lawsuit contesting the counting of some 400 write-in ballots. President Obama has already said he would sign this bill when it came to his desk, but more and more it appears that the bill he will be asked to sign will make the EFCA more palatable to business. See the firm's article in Bloomberg's Law Report, Labor & Employment, reprinted with permission. Article in Bloomberg's Law Report.

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In addition to affecting franchisors with employees in their company-owned outlets, the proposed EFCA could expose a franchisor to potential claims for violations of the act by a franchisee. Most cases under several other federal statutes in which the plaintiff claimed that the franchisor was liable for the acts or omissions of its franchisee have held that the rights of the franchisor under the franchise agreement do not amount to the level of control that would permit a court to hold a franchisor liable. All of these cases are decided on the individual facts.

Cases under federal statutes may claim franchisor liability under two different theories: that the franchisor and franchisee are one entity, and that the franchisee is the agent of the franchisor because of extensive controls.

Examples of cases in which claims were made under federal statutes in which the franchisor was held not liable include *Alberter v. McDonald's Corporation*, a 1999 Nevada US District Court case claiming under Title VII, (the franchisor was not one entity with the franchisee and thus was not liable for sexual harassment of a franchisee's employee); *Wilson v. Wendy's International, Inc.*, a 1998 US District Court in Mississippi (franchisor not liable because it did not hire, fire, promote, retain, discipline, or discharge franchisee employees, and did not supervise the day-to-day activities of such employees or determine conditions of employment or issue operating instructions); *Neff v. American Dairy Queen Corp.*, a 1995 Fifth Circuit case (franchisor was not liable for its franchisee's violation of the Americans with Disability Act, notwithstanding that it retained supervisory authority over structural modifications to the store and control over certain non-structural aspects of the franchisee's operations); and more recently, *Beuff Enterprises Florida, Inc., v. Villa Pizza, LLC*, a 2008 New Jersey US District Court case (franchisor was not the "employer" in a claim of discrimination in violation of the ADA when it removed a franchisee's principal from training for severe psoriasis an individual investor/guarantor who assisted in operation of a pizza restaurant franchise). The latest case reported in January 2009, *Bobby O. Matthews, et al. v. International House of Pancakes, Inc., et al.*, a Louisiana US District Court, again held that IHOP was neither the employer (franchisor did not direct the work schedules and/or the work performance of the two workers and did not pay them for their work or provide them with benefits) under the Civil Rights Act of 1964, nor one entity with the franchisee (franchisor and the franchisee never shared employees, officers, directors, equipment, or space, the two entities maintained separate books, records, and accounts, the franchisor did not direct the activities of the two plaintiffs, and the franchisee was solely responsible for the day-to-day operations of the restaurant).

The facts of the case led to a different conclusion in *National Labor Relations Board v. Fugazy Continental Corp.* T. In this 1987 New York Court of Appeals case stating claims under the NLRA, the extensive controls exercised by Fugazy boomeranged to expose the franchisor to liability. The Court confirmed the lower court's ruling that the franchisees of limousine franchises were employees of the franchisor under the NLRA because the franchisor had a pattern of exercising extensive controls over the most significant aspects of the franchisees' businesses. When the franchisees began to organize to strike, the franchisor took retaliatory actions by terminating those franchisees and refusing to pay them monies due to them for work performed prior to the strike. The franchisor was held liable and forced to offer reinstatement and to make whole former franchisees who did not wish reinstatement. Although the franchise agreement stated that the franchisees were independent contractors, the Court concluded that the franchisees were not independent contractors based on the franchise's two-year term, the conduct of the parties in that the franchisees were permitted minimal discretion regarding the operation of their businesses and that it was almost impossible for a franchisee to sell its business. In addition, the franchisor had a unilateral and virtually unlimited right to cancel a franchise without refunding the franchise fee.

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Revised I-9 Forms. The US Citizen and Immigration Services was to have implemented revised rules for Form I-9 on February 2, 2009. However, USCIS has extended the implementation to April 3. Employers must secure a Form I-9 from each of their employees to verify eligibility for employment. The new Form I-9 will require different documentation than the current form. After April 3, an employer will no longer be able to accept expired identification documents to verify employment authorization on the Form I-9. This rule also adds a new document to the list of acceptable documents that evidence both identity and employment authorization. You may review the revised Form I-9 at www.regulations.gov/immigrationforms and scroll to Employment Eligibility Verification on the list of forms. For further information or questions, contact Leigh Ganchan, (713) 547-2018, leigh.ganchan@haynesboone.com.

Will *In re American Express Merchants Litigation* Affect Class Action Waivers in Franchise Arbitration Provisions?. Generally, courts have been very supportive of dispute resolution through arbitration. This case represents a difference in attitude of the courts when provisions in an arbitration provision appear unfair to a party to the contract. The Second Circuit invalidated a waiver of class action in an arbitration provision in a suit alleging antitrust violations. The Second Circuit decision rested on the plaintiffs' claims that the expense of hiring experts to prove up damages would be prohibitive; therefore, the class action waiver would keep the plaintiffs from enforcing their rights -- a violation of public policy under the antitrust laws. This case is just one of several cases considering waivers of class actions in arbitration provisions over the last several years, almost all involving contracts the breach of which would result in small claims. For that reason, this case will not likely affect class action waivers in arbitration provisions in franchise agreements for the time being, unless the amount in controversy rests on an antitrust claim and the individual damages would be small—for example in a janitorial franchise or some business opportunities.

However, a First Circuit decision may be a forecast of issues that will be raised in future cases contesting arbitration provisions. In *Awuah v. Coverall North America, Inc.*, January 2009, the First Circuit Court remanded the question whether an arbitration provision in a franchise agreement was illusory. Six franchisees filed suit against the franchisor on their own behalf and on behalf of "all similarly situated individuals," alleging claims of breach of contract, deceptive trade practices, and violations of state wage and labor laws. In response to the franchisor's motion to stay proceedings with respect to three of the franchisees on the ground that they were bound by the arbitration clause in their agreements, the franchisees asked the court to declare the arbitration clause was unenforceable because it was unconscionable. The alleged unconscionable provisions included "the agreement's cost-sharing provisions, prohibition of punitive and exemplary damages, bar on class action arbitration, "no-modification clause," a requirement that the losing party pay the prevailing party's attorney costs, a prohibition on a claimant using the results of another arbitration proceeding in his own proceeding, and a provision allowing Coverall alone to initiate suit in court in certain circumstances" (from footnote 2 of the case) (some of the issues raised in California cases). The district court had held that a court could make that determination. Similar to *In re American Express Merchants Litigation* case described above, the franchisees asserted that the amounts likely to be recovered by each individual franchisee could be modest and that the cost of arbitration itself would be overwhelming and submitted evidence to that effect. The First Circuit narrowed consideration to whether the arbitration provision prevented a litigant from having access to the arbitrator to resolve claims, including unconscionability defenses.

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STATES

CALIFORNIA

A new California law effective as of January 1, 2009, amends the General Uniform Retail Food Facilities Law to require each food facility that meets specified criteria (including franchised outlets with at least 19 other franchised outlets with the same name in the state) to provide certain nutritional information. The required information includes, for each standard menu item, the total number of calories, grams of saturated fat, grams of trans fat, and milligrams of sodium. See our previous Hot Branding article entitled "Which Has More Calories: A Big Mac® or a Chocolate Shake", July 2008. IFA has urged other states not to follow the lead of California on nutritional disclosure. However, members of a West Virginia legislative interim committee on health issues are expected to endorse a draft bill that would require restaurant chains with 15 or more outlets in West Virginia to post calories for each menu item, in the belief that posting calories is more effective than listing nutritional content.

FLORIDA

Contrast the California law described above, which is clearly constitutional because it protects the public, with an ordinance of the city of Islamorada, Florida, which, in two separate cases, the Eleventh Circuit US Court of Appeals found violated the Dormant Commerce Clause of the US Constitution. We are hopeful that these two cases will discourage other cities from adopting similar ordinances that restrict national and franchised chains from developing outlets in their communities.

Islamorada attempted to preserve "small town community character" by restricting the development of non-local restaurants through enacting a zoning ordinance. The ordinance prohibited "formula restaurants" and limited the size of "formula retail" establishments. The definition of a "formula restaurant" was

> "a]n eating place that is one of a chain or group of three (3) or more existing establishments and which satisfies at least two of the following three descriptions: (1) has the same or similar name, tradename, or trademark as others in the chain or group; (2) offers any of the following characteristics in a style which is distinctive to and standardized among the chain or group: i. exterior design or architecture; ii. uniforms, except that a personal identification or simply logo will not render the clothing a uniform; or iii. has a standardized menu; or (3) is a fast food restaurant."

The ordinance limited the size of "formula retail" establishments to 50 street level frontage feet and not more than 2000 square feet of space. The ordinance defined "formula retail" as: "[a] type of retail sales activity of retail sales establishment...that is required by contractual or other arrangement to maintain any of the following: standardized array of services or merchandise, trademark, logo, service mark, symbol, decor, architecture, layout, uniform, or similar standardized feature."

In *Cachia v. Islamorada*, Cachia had signed a letter of intent with a corporation to convert his retail store to a Starbucks. The corporation advised him that the ordinance would prevent a Starbucks and terminated the letter of intent. Cachia filed suit asking for injunctive relief and damages. The district court dismissed, finding that the ordinance did not violate the Dormant Commerce Clause. The Dormant Commerce Clause prohibits "regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." Upon appeal, the Eleventh Circuit Court found that "the regulation serves as an explicit barrier to the presence of national chain restaurants, thus preventing the entry of such businesses into competition with independent local restaurants." Because the ordinance had the practical effect of discriminating against interstate commerce, the court used an "elevated scrutiny test", and remanded the case for further

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consideration to determine "1) whether the ordinance's stated interests constitute a legitimate local purpose; 2) whether the prohibition of formula restaurants adequately serves such purpose; or 3) whether Islamorada could demonstrate the unavailability of nondiscriminatory alternatives, such as zoning ordinances or building codes, to fulfill the same needs."

In *Island Silver & Spice, Inc. v. Islamorada*, the ordinance kept a store owner from selling its location for the development of a Walgreen's store. The Court granted injunctive relief, damages and held the ordinance invalid.

KANSAS

A new Kansas law became effective on January 1, 2009, which by its terms would apply to all franchise agreements with residents of Kansas. It requires that all contracts with Kansas residents be governed by Kansas governing law with venue in Kansas. The new law targeted practices in the construction industry, however, the broad definition of "dealership" clearly includes franchises, although that may not have been the intent of the sponsors of the bill which became law. The bill includes what may be unlawful restrictions on arbitration and at least one section is retroactive. IFA is investigating whether it was the intention of the sponsors of the bill that it apply to all franchise agreements. We wait to see if these matters will be remedied.

TEXAS

Eminent Domain and the 2009 Texas Legislature. Franchisors and franchisees who operate businesses from real estate they own should be interested in the eminent domain issues now facing the Texas Legislature. Sparked by challenges like the US Supreme Court's landmark Kelo decision (which upheld the taking of private property by eminent domain for a community redevelopment program) and public outcry against projects like the now-defunct Trans-Texas Corridor, the 2009 Texas Legislature will consider two proposed constitutional amendments and five statutory changes regarding eminent domain, each seeking to limit the state's power to take private property for public use. The adoption of either of these laws will result in significant changes to the condemnation process in Texas. Haynes and Boone has a full alert on this issue. Visit the Publications section of our web site List of Publications.

Lost Future Royalties. In *Progressive Child Care Systems v. Kids 'R' Kids, Int'l.*, a case of first impression, interpreting Georgia law, the Texas Court of Appeals affirmed a jury verdict of $1,384,008 in lost past-due and future royalties against a Texas franchisee. The franchisee had breached the agreement, which led to the franchisor's termination of the franchise agreement. Without any precedent upon which to rely under Georgia or Texas law, the Court reviewed the cases in other states, including *Postal Instant Press v. Sealy*, a California case, and *Am. Speedy Printing Ctrs., Inc. v. AM Mktg, Inc.*, a Sixth Circuit case out of Wisconsin. Progressive Child Care Systems, a franchisor of child care businesses, was entitled under Georgia law to recovery of lost past-due and future royalties that it would have received from Kids "R" Kids, a franchisee, but for the franchisee's breach that led to the termination of the parties' franchise agreements.

In reaching its decision, the Court refused to follow the *Sealy* case. In *Sealy*, the Court decided that the proximate cause of the loss of future royalties was not the franchisee's defaults, but arose from the franchisor's very act of terminating the franchise agreement. In the *Progressive Child Care Systems* case, the Court held that the franchisee's breach caused the termination and loss of future royalties, relying on breach of contract law theory, rather than a proximate cause theory. The Courts in both cases were probably influenced by the type of default by the franchisee. In the *Sealy* case, the franchisee defaulted on its financial obligations, whereas in the subject case, the franchisees had breached a material obligation by operating its business under a different trade name, as well as refusing to pay royalties. The *Progressive Child Care Systems* Court expressly noted that "the Sealy court did not preclude the award of future royalties if the

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franchisor terminated the agreement, if it was the franchisee's conduct that proximately caused the damages, and the award was not excessive, oppressive, or disproportionate." The Court found that the jury's award was not excessive.

VIRGINIA

Effective December 1, 2009, restaurants and bars in Virginia must restrict smoking to separate rooms that have their own ventilation. The measure exempts private clubs and open-air outdoor areas of bars. Governor Tim Kaine signed the bill on March 10.

REGISTRATION STATES

When Virginia passes proposed legislation to harmonize its franchise regulations with the revised Federal Trade Commission Franchise Rule, it will join ten other registration/disclosure states who have changed their franchise laws or their regulations. Michigan, New York, Rhode Island and Washington have not yet passed legislation to make their franchise laws or regulations consistent with the revised FTC Franchise Rule. The franchise laws of these four states already contemplate that the form of the disclosure document will be the format adapted by the NASAA, however the time for delivery of the disclosure document differs. In Michigan, New York, Rhode Island and Washington, the 10-day rule still applies and in New York and Rhode Island, the first personal meeting rule still applies.

KUDOS

First Purchasing Co-Op in Casual Dining/Family Dining Segment. Joyce Mazero headed up a team of 17 Haynes and Boone lawyers to represent IHOP Corp. and Applebees, Inc. in the closing and resulting creation of Centralized Supply Chain Services, LLC (CSCS), the IHOP/Applebee's joint purchasing co-operative. CSCS will have a combined purchasing power of $1.6 billion, will service 3400 company and franchised restaurants and is projected to save 3% to 5% in cost savings over the next several years. CSCS is now the sole approved buyer of products for the combined chains. This is a first among co-ops 1) because of the significant saved and purchasing dollars involved; 2) the two combined chains, owned by DineEquity, Inc., is the largest full service restaurant chain in the country, and 3) CSCS is the first foodservice co-op in the casual dining/family dining segment. The team has been working on this project since late July 2008. This complex transaction had to consider a multitude of franchisee interests, the need to protect the existing franchise systems, the complexity of Dine Equity's securitized structure, the negotiation environment and the related securities, antitrust, intellectual property, distribution, and tax issues.

Rob Lauer. Haynes and Boone is proud to announce that Rob Lauer, with whom many of you have worked, was named a partner of the firm.

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