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Is British Columbia Next in Line?

Canada's Third Most Populous Province Considers Franchise Legislation

By Dominic Mochrie

Proposed franchise legislation featured prominently in "An Agenda for Justice," a report recently released by the British Columbia Branch of the Canadian Bar Association ("CBA"). The document, released on Feb. 5, 2013, in advance of the upcoming provincial election, presents a series of judicial and legislative reforms and recommendations aimed at improving access to justice for all British Columbians.

This was not the first such suggestion. In the fall of 2012, the British Columbia Law Institute ("BCLI"), a law reform research organization, announced the commencement of a project to examine whether there is a need for franchise legislation in British Columbia and, if so, what provisions any such legislation should have in order to provide legal protection for franchisees operating in British Columbia. The project was finalized, and the *Consultation Paper on a Franchise Act for British Columbia* (the "Consultation Paper") was made public on April 2, 2013.

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You Say You Want an Evolution? Private Equity Finds Its Franchising Groove

By David W. Koch

Last fall, conference organizer The Capital Roundtable held its second full-day program on "Private Equity Investing in Franchise Companies" at the University Club in New York City. A roomful of small-market and middle-market private equity companies, investment bankers, lenders and brand executives gathered to explore the latest thinking on investing in franchise concepts. The event underscored private equity's current fascination with the franchising business model. But it also revealed that a mutual education process between private equity and franchising has been taking place.

Just one year earlier, a similar group with many of the same attendees had livened The Capital Roundtable's initial program on franchising. How did the discussion change from one year to the next, and how does it continue to evolve?

Inevitably, private equity professionals and franchising professionals — fund managers, brand owners, operators, and their lawyers, accountants and consultants — have influenced each other as they have worked together more often. The intensity of private equity transactions is, after all, a bonding experience. Professionals from different disciplines live in close mental quarters for weeks at a time, exposed to each other's talents and blind spots. Like a team of mountain climbers, they learn to trust and rely on each other — except that the mountain is made of data, not rock.

Roughly two years ago, a private equity firm retained this author to conduct the "franchising" part of the due diligence on a target company with more than 2,000 franchises. It was the private equity firm's first foray into franchising, and we conducted the due diligence in traditional fashion. We sent a detailed request list, formed a team to divvy up review of the responses, dove deep into the target company's past and present franchise documents and registration records, and closely examined a representative sample of the files of individual

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Private Equity

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franchisees in the system. Then we wrote a detailed report to the private equity firm about our findings. The report included a background section on U.S. and Canadian franchise sales laws and franchise relationship laws and the consequences of noncompliance. We listed some concerns, mostly minor, about the target company's standard contracts and disclosure documents. Based on the sampling of franchisee files, we assessed the integrity of the company's disclosure and contracting processes — getting the right things signed by the right people at the right time. We provided details about identifying "franchise sellers" and registering brokers.

Eighteen months later, the private equity firm retained us for a new transaction. The due diligence request to the target was not much different — if you ask for the world upfront, you can always pare down the list by negotiation — but the actual review was dramatically different. No real team was utilized for the project; it was just a principal reviewer with targeted help on discrete tasks. No full-blown report was issued upon completion of the review, either. Instead, we prepared a series of short memos and e-mails addressing specific issues for which the client requested analysis.

What was different after 18 months? True, the second transaction involved a smaller investment to acquire a minority interest in the franchise brand. The private equity firm, not surprisingly, started off by scaling back its anticipated due diligence budget to the size of the transaction. That proportionality fell aside, however, as the transaction proceeded.

Ultimately, it was not the size and nature of the transaction that most affected the franchise due diligence the second time around. What really changed in those 18 months was the private equity firm's knowledge about franchising, and the franchise law firm's knowledge about private equity. And judging from the Capital Roundtable programs a year apart, this education was by no means unique to one attorney-client relationship.

Important Lessons

These are just a few of the important lessons that buyers, sellers and their professional advisers seem to have drawn in the last few years:

1) *Don't get lost in the trees.* When new to franchising, private equity firms tend to worry excessively about franchise law compliance (yes, you read that correctly). If they know anything about franchising, they know that franchise sales are highly regulated. Regulatory compliance (FDD disclosures and state filings) also happens to be the easiest subject for franchise counsel to review in due diligence. There are lots of paper records, and paralegals can do much of the work. You just find all of the state approval letters and line up the dates of the FDD receipts and contract signatures, right?

This combination of client concern and ease of review produces exactly what one would expect: a due diligence report weighted toward technical errors in franchise sales. But technical errors rarely threaten serious damage to the value of the transaction, unless they are so voluminous as to indicate a consistent disregard for compliance (which this author has yet to see). So the traditional due diligence effort in the registration/disclosure compliance area is usually disproportionate to the value of the information obtained. Fund managers have figured this out, and they have learned not to worry so much about a tainted franchise sale here and there. Meanwhile, franchise counsel have learned to temper their sample sizes and truncate the franchise compliance review if no serious problems are seen in the first wave.

2) *Know your land mines.* Private equity investors are interested in issues that can detract significantly from the value of the target company's operations — enough to

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Franchising

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Private Equity

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affect the indemnities demanded from the seller, or perhaps even to affect the purchase price of the deal, or in an extreme case, to blow up the deal entirely. These may be business issues that are not within the province of franchise counsel, such as a flawed unit-level business model. Conversely, they may be legal issues about which franchise professionals are uniquely qualified.

Franchise counsel who have been sensitized to private equity thinking will focus on issues with potential widespread effect in the franchise system. These days, the longest, costliest and most disruptive legal battles typically spring from purchasing requirements and restrictions, management of advertising funds and territory battles (including parallel distribution channels). It can be difficult, however, to conduct due diligence on these concerns. When asked to identify an issue on which he would have wanted better due diligence by his fund, a 2011 Capital Roundtable panelist cited "the amount of ill will created by captive supply arrangements." Active litigation or threats will make issues obvious, but otherwise the franchise due diligence team might have to dig below the surface (in advisory council or marketing committee minutes, for example).

Franchise advisers must continue to educate their private equity clients about new liability risks that might not have occurred to them yet. Based on recent experience, due diligence should consider, for example, whether the target franchise company could have exposure to "employer" liability for its franchisees or their staff, or liability for security breaches and disclosure of customers' personal data by franchisees. In one recent deal, we called for a close look at the franchisor's confidential operations manual because the table of contents hinted at a high degree of control over franchisees' employment practices.

3) *Private equity companies are not vultures.* The old stereotype of private equity funds looking to invest as little cash as possible, load up target companies with debt, strip out costs and flip the company for a profit at the first opportunity is no longer valid in franchising — if it ever was. On the contrary, private equity companies have held their portfolio franchise concepts for extended periods, and not just because of the Great Recession. With striking speed, fund managers have learned what franchise professionals have always known — that franchising is all about the relationships. For example, one panelist at the 2012 Capital Roundtable cited "the mentoring aspect of franchising" as one of the reasons that his company likes to invest in the sector. Another panelist recommended looking at the "age" of franchisees—*i.e.*, how long they've been in the system — as an indicator of the health of the franchise system.

Other 2012 participants specifically countered the idea of drastic, buyer-driven changes in the franchise system. One panelist observed that post-closing changes could easily "turn a healthy system into discontent," while another pointed out that his fund was "not looking for businesses that we have to come in and change." These comments had a different flavor from some of those made at the 2011 program, where, for example, a panelist named "convincing franchisees to invest in a re-brand" as an obstacle to growth of a portfolio company.

Of course, other forces may also be at work. *Bloomberg Businessweek* recently ran an article titled "Private Equity Shakeout" (February 25-March 3, 2013), which reported that there are now 4,500 buyout shops with $3 trillion in assets. According to the article, these firms have put to work only 28% of the "unprecedented" $702 billion that they raised from 2006 to 2008. Fund performance "has sagged," and, in turn, the weaker performance hinders the ability to raise new capital for new funds, setting the stage for a "purge" of private equity players in coming years.

While the *Businessweek* article was by no means specific to the small-market and middle-market private equity companies that dominate activity in franchising, the article may help explain a less strictly financial approach toward target franchise companies and their franchisees. Simply put, the competition for deals is intense, so there is an incentive to appear less intimidating to potential sellers.

The more likely explanation of the emphasis on franchise relationships, however, is the intense education in franchising that private equity companies have received in the last several years. From buying, selling and managing franchise brands, PE firms have learned that returns on investment are a function of the overall health of the franchise system, which in turn depends on the quality of the franchise relationships. Through the same process, the PE firms have taught franchise system owners and their advisers how to enhance the value of their brands.

British Columbia

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Overview of the Consultation Paper

The BCLI clearly states its recommendation that British Columbia adopt franchise legislation. It observes that the need arises from the popularity of franchising as a business model and its use by a wide variety of vendors in both the business and retail sector. Expressing similar concerns as the CBA, the BCLI notes that a franchisee is often required to make significant investment and commitment in the franchise business, but it is typically the franchisor who has the disproportionate balance of power, information that the franchisee does not have access to, and can impose on the franchisee its non-negotiable standard-form franchise agreements.

The Consultation Paper examines the existing franchise legislation in Canada, the Uniform Law Conference's Uniform Franchises Act, franchise legislation from the United States and Australia, and the

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UNIDROIT model of franchise legislation. The paper then sets out specific recommendations for what should be included in BC's franchise statute.

Specific Recommendations

The first and most significant concern for franchisors is whether the legislation in BC will follow the Uniform Franchises Act. This template legislation was developed by the Uniform Law Conference of Canada ("ULCC") in 2005 to help encourage uniform franchise legislation across Canada. The ULCC's franchise law project was started at a time when only Alberta and Ontario had legislation in force to directly regulate franchising. The template legislation is based in part on Ontario's and Alberta's franchise legislation and includes key provisions dealing with disclosure, the duty of fair dealing, rescission rights, damages for misrepresentation and dispute resolution. Prince Edward Island, New Brunswick and Manitoba enacted franchise legislation, substantially modeled on the uniform act, in 2005, 2007 and 2012, respectively.

What will doubtlessly come as some relief for franchisors is the BCLI's recommendation that BC's legislation follow the Uniform Franchises Act. The BCLI recognizes that imposing requirements that are unusual, unique or inconsistent with those of other provinces will create barriers to entry in British Columbia. Harmonized legislation "minimizes the regulatory burden for franchisors," the Consultation Paper states.

However, none of the provinces that adopted the Uniform Franchises Act to date adopted it wholesale; each province has made some changes. Manitoba's recently enacted franchise legislation is the biggest outlier, and its provisions deviate from the model act in certain respects, mainly in relation to the delivery of a disclosure document. Accordingly, it is perhaps unsurprising that the Consultation Paper also provides for some deviations from the template legislation. Highlights include:

- *No mandatory mediation provision.* The BCLI takes the position that mandatory mediation may actually contribute to the power imbalance between franchisors and franchisees due to potential delay or obstruction of dispute resolution and exertion of economic pressure on a less well-positioned party. In addition, the BCLI takes into consideration the fact that mandatory mediation procedures generally reach success when both parties wish to continue their commercial relationship. Should this be the case for a franchisor and a franchisee, the parties would be motivated to undertake voluntary mediation, regardless of any statutory obligation to do so. Conversely, in the event that the continuing relationship is not a mutual concern, mandatory mediation would merely create an extra financial burden, as well as an extra step on the way to court for the parties.
- *A "substantially complete" standard for disclosure documents.* The BCLI recommends that disclosure documents be considered valid if they are in substantial compliance with legislation and regulations, thereby ensuring that a minor defect in the documents does not lead to major non-compliance consequences such as rescission of the franchise agreement.
- *Additional disclosures.* The BCLI suggests some additional mandatory disclosure requirements, including: 1) that a franchisor be required to state whether an exclusive territory will be granted under the franchise being offered to the franchisee, and 2) if the franchisor reserves the right to sell goods and services directly in competition with its franchisees.
- *Electronic delivery.* The BCLI recommends that delivery of disclosure documents by way of electronic means, such as DVD or e-mail, be expressly permitted.
- *Consolidating statutory and non-statutory claims.* The BCLI notes that the language in the Uniform Franchises Act to specify the application of local law related only to claims "enforceable under the Act." The BCLI theorizes that this could result in the division of a single action into one action for claims enforceable under the legislation being brought in the franchisee's jurisdiction, and another action for all other claims (*i.e.*, claims not enforceable under the Act) being brought in the franchisor's preferred jurisdiction. Accordingly, the BCLI recommends that the jurisdictional provision should be broader than claims "enforceable under the Act," and should extend to encompass any claim "arising from a franchise agreement." Accordingly, this means that the franchisee should be able to deal with all claims — statutory or not — in British Columbia.
- *Arbitration and jurisdiction.* The BCLI also notes the lack of clarity with respect to whether the jurisdiction clause should apply to arbitration proceedings and suggests that the legislation should make it clear that it does.
- *Misrepresentation of financial projections.* The BCLI takes the position that a franchisee's statutory right to sue for misrepresentation should extend to misleading statements regarding financial projections supplied by the franchisor to entice a franchisee to sign a franchise agreement. However, the BCLI also suggests an exclusion from liability if the projections contain cautionary language that states that the forward-looking projections are based on assumptions about the future and that actual results may vary. As a practical matter, given the ease

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COURT WATCH

By Chris Bussert

Arbitrator Bias Established

It is relatively rare for an arbitration award to be vacated and even more rare for an award to be vacated as a result of arbitrator bias. Recently, however, the Sixth Circuit in *Thomas Kincade Co. v. White, et al.*, 2013 WL 1296238 (6th Cir. April 2, 2013) vacated an arbitration award as a result of the actions of the "neutral" arbitrator on a three-person arbitration panel.

Thomas Kincade Company ("Kincade") and David and Nancy White (the "Whites") entered into several agreements pursuant to which the Whites became "Signature Dealers" of Kincade's artwork. The parties' agreements included an arbitration provision. In 2002, the parties commenced an arbitration in which Kincade claimed that the Whites failed to pay for artwork it provided, and the Whites counterclaimed that they had been fraudulently induced into becoming Signature Dealers.

In accordance with arbitration rules, each party was entitled to appoint one arbitrator, and then the two arbitrators chosen by the parties would choose the panel's neutral arbitrator, who would chair the panel and decide the issues in the arbitration. Mark Kowalsky was chosen as the neutral arbitrator. Nearly five years and 50 hearing days into the arbitration, Kowalsky announced to Kincade that the Whites and the Whites' advocate on the arbitration panel had each hired Kowalsky's firm for substantial engagements. Many irregularities followed, each of which favored the Whites. On May 9, 2008, the arbitration panel in a 2-1 decision (with the arbitrator chosen by Kincade dissenting) issued an "Interim Award" in which the Whites were awarded $567,300 in damages on their claims, and Kincade was denied recovery on its breach of contract claims. The Interim Award further provided that all claims that had not been expressly granted were denied.

Despite the foregoing, Kowalsky later ordered the parties to submit applications for fees and costs. Kincade objected, arguing that such an award would improperly modify the Interim Award. On Feb. 26, 2009, a Final Award was issued which, among other things, granted the Whites $487,000 in attorneys' fees. All told, the Whites' final award exceeded $1.4 million.

Kincade filed an action in the U.S. District Court for the Eastern District of Michigan seeking to vacate the Final Award. The district court vacated the Final Award because of Kowalsky's evident partiality. The Whites then appealed to the Sixth Circuit.

At the outset, the Sixth Circuit observed that "evident partiality or corruption" was an appropriate ground for vacating an arbitration award. To establish evident partiality, the challenging party must establish that "a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration." *Andersons, Inc. v. Horton Farms, Inc.*, 166 F.3d 308, 328 (6th Cir. 1998). "This standard requires a greater showing than an appearance of bias, but less than actual bias," and to meet it, a party "must establish specific facts that indicate improper motives on the part of the Arbitrator." *Id.* at 329.

In this case, the Sixth Circuit found that Kincade had established "a convergence of undisputed facts that, considered together, show a motive for Kowalsky to favor the Whites and multiple, concrete actions in which he appeared actually to favor them." As to motive, the court was less than impressed with the disclosure, nearly five years into the arbitration and after nearly 50 hearing days, of Kowalsky's law firm being hired by the arbitrator chosen by the Whites and by the Whites for separate engagements that appeared to be substantial. Kowalsky's actions going forward only added fuel to the fire. These actions included: 1) allowing the Whites to rely on documents they had deliberately failed to produce to Kincade when requested four years earlier; 2) denying Kincade any relief on a straightforward breach of contract claim that was virtually uncontested; 3) failing to offer any response to the serious objections that Kincade had raised in the decisions he had rendered as an arbitrator; and 4) awarding the Whites nearly $500,000 in attorneys' fees, despite the plain terms of the Interim Award that provided the Whites' request for fees had been denied. These actions, when combined with the dealings of the Whites' arbitrator and the Whites with Kowalsky's firm, were, in the view of the Sixth Circuit, more than sufficient to show his evident partiality and resulted in its affirming the vacating of the Final Award.

Pizza Restaurant Franchisor's Trade Dress Found to Be Unprotectable

Many businesses strive to protect the ornamental elements of the interior and/or exteriors of their business premises from copying by competitors through claims of "trade dress." As a recent decision from the U.S. District Court for the Eastern District of Michigan establishes, such claims can be difficult to prove absent evidence establishing the protectability of the claimed trade dress and of confusion in the marketplace. *Happy's Pizza Franchise LLC v. Papa's Pizza, Inc.*, No. 10-15174, 2013 WL 308728 (E.D. Mich. Jan. 25, 2013).

Happy's Pizza Franchise, LLC ("Happy's") instituted an action against Papa's Pizza Restaurants ("Papa's") primarily based on a claim that Papa's had copied the design of Happy's restaurants and allegedly used Happy's expansive menu. Happy's claimed that it had adopted "Unique Décor Protocols"

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Court Watch

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that distinguished the design of its restaurant from other restaurants and that had allegedly been copied by Papa's. These protocols included the following: 1) granite countertops and tabletops; 2) ceramic-tiled walls and faux-venetian plaster-finished walls; 3) extensive neon lighting; 4) ceramic floors; 5) large back-lit menu with faux-venetian plaster walls; 6) large, black, industrial-styled rugs; 7) back-lit pictures of menu items; 8) stainless steel shelving units behind the service counter; and 9) stacks of pre-folded pizza boxes and large coin-operated candy and bubble gum dispensers.

Happy's moved for partial summary judgment on its claims of trade dress infringement.

In order for Happy's to succeed on its claim, the court observed that it must prove that:

1. the trade dress in question was distinctive in the marketplace, thereby indicating the source of the good it dresses;
2. the trade dress is primarily non-functional; and
3. the trade dress of the competing good is confusingly similar.

As to the first factor, the court noted that Happy's offered only one theory of distinctiveness, *i.e.*, that its trade dress was inherently distinctive based on its arbitrary use of each element constituting the Unique Décor Protocols. The court held that this showing was insufficient to establish distinctiveness, particularly in view of the fact that each of the individual items comprising the Unique Décor Protocols was generic. The court added that although the decision by Happy's to use these generic elements may be arbitrary, this fact alone did not create protectable trade dress.

The court also found that Happy's claimed trade dress was primarily functional. Although Happy's asserted its expansive menu, black industrial-style rugs, granite countertops, back-lit images and menu, ceramic-tiled walls and floors, stainless steel shelving, and stacked pizza boxes were non-functional because the "total package" was allegedly unique to Happy's restaurants, Happy's failed to establish that these elements were not commonly used in the industry and that there were other alternatives for Papa's to use in conducting its business.

Finally, the court found evidence provided by Happy's of alleged customer confusion to be lacking. Happy's relied solely on an affidavit of a manager of a Happy's restaurant, which stated that "customers have frequently expressed confusion over the phone and in person to me … between Happy's and Papa's Pizza Restaurant." The court found this to be insufficient because no customer statements or particularity regarding the confusion was provided. Moreover, the manager's affidavit failed to tie any of the confusion customers may have been experiencing to the alleged similarity in the décor between Happy's and Papa's.

Because Happy's failed to provide sufficient evidence to establish the essential elements of a trade dress claim, its motion for partial summary judgment was denied.

Franchisee Successfully Pleads a Fraud Claim

As law students, we were taught at the very beginning of our legal education that fraud claims were different from all other claims. For whatever reason, courts have historically been reluctant to allow fraud claims to proceed to judgment, perhaps because claims of fraud impugn defendants' character, just by the mere filing of such claims. Thus, courts have created barriers to fraud claims moving quickly through the judicial system. Under modern pleading rules, courts will permit claims other than fraud claims to proceed with bare-bones allegations of facts. In contrast, fraud claims must be pled with particularity — that is, a more detailed presentment of the facts supporting the claim must be included in the complaint.

A recent decision from the U.S. District Court for the District of Maryland, *Raymond v. Hanley*, Bus. Franchise Guide (CCH) ¶ 18,018 (D. Md. Feb. 25, 2013), is a good example of a different principle: Courts will bend over backward to allow a fraud claim to proceed when the case has been properly pleaded to the court. In *Hanley*, the court denied the defendants' motion to dismiss for failure to state a claim on which relief could be granted, following a recent trend in case law to allow fraud claims to proceed at least past the motion to dismiss, and also found that the waivers were void under Maryland law. (*See Randall v. Lady of America Franchise Corp.*, 532 F.Supp.2d 1071 (D. Minn. 2007) and *Long John Silver's, Inc. v. Nickleson*, __ F.Supp.2d __, 2013 WL 557258 (W.D. Ky. Feb. 12, 2013). The case is somewhat complicated, but in essence, the defendants argued that the plaintiff's alleged misrepresentations were, in fact, opinions or estimates, not statements of fact, and these could not be the basis for a fraud claim. The defendants also pointed to various waivers in the plaintiff's franchise agreement as grounds for denying the plaintiff the right to proceed with his fraud claim. The defendants argued that the plaintiff's reliance on representations made outside of the franchise disclosure document and franchise agreement, in light of the plaintiff's express waiver of reliance on this extrinsic information, was unreasonable.

The court, however, found that the plaintiff's claims of misrepresentation and omissions of facts necessary to make statements by the defendants not misleading were plausible under the circumstances. While the plaintiff in *Hanley* was, for the most part, allowed to proceed on his claims, *Hanley* must be viewed with suspicion. The published decision related to a motion to dismiss, and, as is so often the case, once discovery has been conducted, the strength of the fraud claim may vaporize.

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News Briefs

Washington State Goes Electronic for Franchise Filings

In mid-March, the Securities Division of the Washington State Department of Financial Institutions went live with an online E-File system for new applications, renewals, amendments and reapplications for franchises in the state of Washington. It can be accessed at http://dfi.wa.gov/sd/franchise.htm.

According to a staff member, early activity on E-File was brisk, with 195 filings coming in through April 19.

CA Franchise Relationship Bill Passes Senate Committee

California SB 610, which would significantly expand rights and protections for franchisees, passed the Senate Judiciary Committee by a vote of 5-2 on April 17. With the vote, the bill has been moved to consideration by the full Senate, where a vote might be taken soon.

While passage in the Senate Judiciary Committee is a success for proponents of the bill, it is a long way from becoming law. Not only would the bill have to pass the California Senate, but it would also have to move through the California Assembly. And that latter development seems unlikely, given that in the same week, the Assembly delayed until next year its consideration of HB 1141, which addresses some of the same franchise relationship issues.

Under SB 610, franchisors would be held to a duty of acting in good faith and fair dealing with franchisees, and franchisees would gain the right to sue for damages when franchisors act unfairly with respect to the sale, renewal, transfer or termination of a franchise. Triple damages and attorneys' fees also could be awarded. In addition, SB 610 would ease franchisees' ability to form independent associations.

Prior to the vote, numerous franchisee representatives testified before the Judiciary Committee in favor of the bill. Peter Lagarias, principal of the Lagarias Law Offices in San Rafael, CA, reflected on its potential impact for franchisees. "Many franchisees invest their life savings in their franchises, sometimes taking loans on their homes, and often look to their franchises for their livelihoods," Lagarias told *FBLA* after his testimony. "They deserve a level playing field especially on terminations and renewals."

Lagarias added that he considers SB 610 to be "an important first step" in strengthening the California Franchise Relations Act, but that AB 1141 "has additional needed changes."

Also testifying in favor of the bill were Ali Mazarei and Amin Salkhi, both of whom are owners of convenience store franchises and on the board of directors of the Service Station Franchise Association, Inc.; Keith Miller, a Subway franchisee and board member of the Coalition of Franchisee Associations; and owners of Quiznos franchises and McDonald's franchises.

The International Franchise Association ("IFA") opposes SB 610 and sent a representative to testify. IFA believes that the good faith requirement would increase litigation and interfere with franchisor-franchisee contracts, Dean Heyl, IFA's Director, State Government Relations, Public Policy & Tax Counsel, told the committee. Also, IFA has argued that making cancellation or non-renewal of franchise contracts more difficult could potentially harm the franchise brand, other franchisees and even consumers, if franchisors are unable to remove bad actors from their ranks.

State Roundup: Numerous Franchise Bills Proposed Across Nation

State legislators are considering more than a score of bills with direct impact on the franchising industry, and they include legislation about non-compete agreements, taxes and status of employment.

One bill that had franchisors concerned was Minnesota H.F. No. 506. This bill would void almost all non-compete agreements that prohibit parties from "exercising a lawful profession, trade, or business." Although aimed primarily at employment non-competes, the language of the bill was broad enough to encompass franchising. In April, the Labor, Workplace and Regulated Industries Committee decided not to vote on the bill until additional study is conducted this summer.

A bill in Illinois, SB 2169, would require franchisors to file an annual return stating the gross sales of each franchisee operating in the state, as well as each franchisees' name, address, the certificate of registration number and federal identification number. The concept, proponents say, is to get a more accurate reading on sales within the state and to thus ensure that taxes are fully assessed. No action has yet been taken on the bill. New York is the only state with this type of sales reporting requirement, though Massachusetts is also considering similar legislation.

In Washington state, HB 1440 would reclassify some types of contractors as employees, potentially affecting many franchises. The law could edge into issues seen in other states, such as Massachusetts, about whether certain types of franchisees are contractors or employees. Already, two substitute versions of the bill have been introduced, indicating the significance that affected parties are placing on the issue.

Burger King Sues Former Franchisees

Burger King has sued the former owners of seven franchise restaurants in Missouri, Joseph R. Gunther and Vicki Gunther, for breaching their franchise agreement in 2012 by failing to make royalty and advertising payments. After notifications for

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Obituary

Ira Marcus, a founding member of **Marcus & Boxerman** in Chicago, who practiced law for 40 years, recently passed away after a long illness. He was an experienced transactional and franchise law attorney who represented numerous franchisors, franchisees and related associations. Regularly contacted as a resource by franchise industry publications, Marcus was a member of the Illinois Attorney General's Franchise Advisory Board and was listed by the Leading Lawyers Network as a "Top Business Lawyer in Illinois."

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franchise violations, Burger King terminated the franchises in January 2013, but the lawsuits allege that the former franchisees continued to use Burger King's trademarks. Burger King is seeking back royalties, punitive damages, and attorneys' fees. The restaurants are located in Columbia, Jefferson City, Moberly and O'Fallon, MO, and the lawsuit has been filed in the Southern District of Florida.

The Gunthers could not be reached by *FBLA*. Burger King representatives would not comment to *FBLA* about the litigation.

Instant Tax Service Franchisee Permanently Enjoined from Tax Return Prep

The principals of a Las Vegas franchisee of Instant Tax Service consented in February to a civil injunction that bars them from preparing tax returns for others. Benyam Tewolde and Yordanos Kidanits consented without admitting the allegations against them, and the order was signed by a judge in the U.S. District Court for the District of Nevada, said the U.S. Department of Justice.

The Justice Department charged that Tewolde, Kidanits and some of the staff members at their franchised offices prepared false tax-return forms with fabricated businesses and income, falsely claimed education credits and dependents, sold deceptive loan products, prepared bogus W-2 forms and committed other violations.

The Justice Department added that four more lawsuits are pending against Instant Tax Service, its founder Fesum Ogbazion, and its franchisees. Tewolde and Kidanits could not be reached for comment. A trial on Justice's request to permanently shut down the franchisor is scheduled for May 2013.

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with which a franchisor could comply with this exclusion, it seems that this may not result in much real protection for franchisees. Further, the BCLI does not comment on why the existing right of action for misrepresentation is inadequate to deal with this issue.

- *Wrap-around disclosure requirements.* The Consultation Paper recommends that the use of "wrap-around" documents be permissible in British Columbia; that is, allowing disclosure documents prepared in one jurisdiction to comply with that of other jurisdictions as long as they include additional information needed to comply with their own legislation and regulations.
- *Waivers and releases.* The BCLI makes some recommendations to clarify certain confusing issues that have arisen in other jurisdictions, referring particularly to the case law about the non-waiver sections of Ontario's franchise legislation, and when a franchisor can rely on a release by a franchisee. The BCLI recommends that the franchise legislation should have an express provision stating that the statutory bar to waiving or releasing a right under the legislation does not prevent a waiver or release that would take place as part of a post-dispute settlement.
- *Rescission and damages claims.* The BCLI also states that the legislation should clearly provide that the exercise of the statutory right of rescission should not bar the franchisee from also pursuing a statutory right of damages, as long as double recovery does not occur.

The Path from Here

The BCLI is soliciting comments on the Consultation Paper through Sept. 30, 2013. It will then produce a report with final recommendations and draft legislation. Interested stakeholders, including franchisors, are encouraged to participate in this broad consultation.

If British Columbia becomes the sixth province to enact franchise legislation, the scale will have finally tipped so that the majority of Canadian provinces directly regulate franchising. This may be a signal to the remaining provinces that there is a legislation gap, and it is the appropriate time to consider harmonization of franchise laws across all provinces.

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