NEW ENGLAND FRANCHISE ASSOCIATION

January Dinner Meeting
January 15, 2008

Legal and Legislative UPDATE

LEGISLATIVE

- **Gift Certificate Legislation**
    - **Massachusetts.** Under MA law, gift certificates and merchant credit slips must be redeemed for at least seven years from the date they are issued. The issuance date and the expiration date must be clearly indicated on the face of the certificate or, if it is an electronic card, on the sales receipt, on a website, or by toll-free phone number. If the expiration date is not noted, the certificate will be redeemable forever. Once a gift certificate has been redeemed for at least 90% of its value, the consumer may elect to receive the remaining value in cash.
    - **New Hampshire.** Gift certificates with a face value of $100 or less cannot contain expiration dates. Those with a face value in excess of $100 expire when escheated to the state as abandoned property. Any dormancy, latency, administrative or other fees or service charges that reduce the total redeemable amount of the gift certificate are not allowed. (Does not apply to season passes.)
    - **Rhode Island.** Monthly or annual service or maintenance fees on gift certificates are not allowed. Time limitations for redeeming a gift certificate and expiration dates on gift certificates are not allowed. Language suggesting that an expiration date may apply to the gift certificate is not allowed. Unused portions of redeemed gift certificates must be given back to the consumer by reissuing a gift certificate for the unused amount or by giving such amount to the consumer in cash if less than $1.00 is owed. (Does not apply to gift certificates that are distributed to a consumer pursuant to an awards, loyalty or promotional program where no money or value is given in exchange by the consumer, but any limitations must be disclosed in writing at the time of issue. Does not apply to prepaid wireless telephone service or cards.)

- **Franchise Issues.** A few franchise-specific issues have arisen with respect to gift certificates. One franchisor was sued for allegedly failing to disclose that participation in its gift card program was mandatory and would require franchisee to pay expenses related to the program. Another franchisor was sued for allegedly improperly keeping proceeds derived from its franchisees' sale of franchisor's gift cards and for failing to report the use of those funds.
- **Unclaimed Property Laws.** Those who offer gift certificates should also be aware of state unclaimed property (or escheat) laws. These laws may require those who hold abandoned property, including some gift cards, to keep certain records, file certain reports, or turn such property over to the state. Those who do not comply with these laws may be subject to rather large penalties.

- **New Massachusetts Security Breach Notice Law** (October 31, 2007)
  - Massachusetts recently enacted legislation that enlists businesses to help combat the risks of identity theft and fraud. Massachusetts is the thirty-ninth state to pass a Security Breach Notice Law. This new law imposes obligations on *employers of Massachusetts residents* in cases of *unauthorized access* to *personal information* that *creates a substantial risk of identity theft or fraud*. If you employ residents of other states, those states may impose their own obligations.'
  - "Personal information" under the Breach Notice Law is defined as a resident's first and last name, or first initial and last name, in combination with one or more of the following: (a) social security number; (b) driver's license number; (c) financial account number, or credit or debit card number.
  - An employer has an obligation to report under the Breach Notice Law when (a) it knows or *has reason to know* of a breach of security; or (b) when it knows or *has reason to know* that personal information of a Massachusetts resident was acquired or used by an unauthorized person, or was used for an unauthorized purpose. Under these circumstances, the employer must provide notice as soon as practicable to (a) the attorney general; (b) the director of consumer affairs and business regulation; and (c) the resident.

The Breach Notice Law includes a description of the form and method of notice.

  - Under the new law, employers should consider whether their contracts with outside vendors (i.e. payroll companies) should be revised to address potential disclosure of employees' personal information. Under the Breach Notice Law, outside vendors that "maintain or store" personal information have independent responsibilities to notify employers (the "owners" of the personal information). Nevertheless, contracts with vendors can and should address liability issues if the vendor fails to comply.

- **Energy Independence and Security Act of 2007 (EISA)** (Signed into law on December 19, 2007 and takes effect on January 1, 2009)
  - This act amends the Petroleum Marketing Practices Act. Franchise agreements entered into after the effective date are required to allow franchisees to install renewable fuel tanks and pumps on premises not leased from franchisor, to convert existing tanks and pumps for renewable use, whether or not leased from franchisor, if so certified or warranted, to advertise that renewable fuels are available and their pricing, to sell renewable fuel on the premises, to replace one of the three major grades of motor fuel offered at the franchise location with renewable fuel, and to purchase renewable fuels from others if the franchisor does not offer them.

COURT DECISIONS

- **Massachusetts: LeMaitre v. Massachusetts Turnpike Authority** (MA App. Ct., November 5, 2007)
  - The court found that each version of employer's incentive program was a new binding offer that formed a contract when employee accepted by complying with the terms of the program. Therefore, employee was

entitled to cash in his unused sick days at the higher proportions afforded by previous, corresponding versions of employer's incentive program.

- Employee worked for employer from 1975 through his retirement in 2002. Employer's incentive plan allowed employees, upon retirement, to receive a lump sum cash payment in the amount of a percentage of the unused sick days accrued during their employment. Beginning in 1979, this cash-redeemable percentage was 50% and was decreased to 20% in 1996. In addition, a percentage value of an employee's accrued, unused sick days would be applied to employees post-retirement health insurance premiums. In 1975, the incentive plan provided that 25% of a retiree's unused sick days would be available to reduce his premiums. Around 1978, a new version of the plan increased that percentage to 50%, and yet another version again decreased the percentage to 20% in 1996, when the medical benefit was eliminated going forward. Upon employee's retirement, employer compensated employee for 20% of his accrued, unused sick days, according to the 1996 plan, which was still in effect. Employer made no payments under the health insurance premium plan in effect until 1996.
- An at-will employee's employment contract may include the terms of a personnel manual. However, employer argued that employee's awareness of employer's right to unilaterally change the plan and of the actual changes meant that employee could not have relied on the terms of each plan. The court dismissed this argument, finding that just because an employer reserves the right to make unilateral changes to a personnel manual does not, in itself, prompt the conclusion that rights already earned under former plan versions will be changed by future versions. Therefore, employee's earning and accruing sick leave after each plan change was an acceptance that made the plan's offer binding, and therefore, he earned rights under each provision of the plan that could not be denied by the employer. The court noted that if employer did not want to make legally binding promises, it should have stated in the manual that

no promise was made by the employer therein, despite the contents of the manual. Here, employer simply used the word "supersedes" in the upper right-hand corner of the first page of each updated plan, which the court found insufficient.

- **Federal: Comedy Club, Inc. v. Improv West Associates, et al.** (U.S. Court of Appeals for the Ninth Circuit, September 7, 2007)
    - After franchisee breached their agreement with franchisor, arbitrator upheld broad non-compete agreement against franchisee, but court reversed arbitrator's decision.
    - The trademark license granted franchisee an exclusive nationwide trademark to use franchisor's trademarks. A few years later, franchisee breached its agreement with franchisor by failing to open the agreed upon number of comedy clubs and tried to protect its right to use the trademarks after franchisor sought a declaratory judgment against franchisee, which dispute was directed to an arbitrator.
    - The court relied on the language of *Dayton Time Lock Service, Inc. v. Silent Watchman Corp.*, which stated that "exclusive-dealing contracts are not necessarily invalid…[but] they are proscribed when it is probable that performance of the contact will foreclose competition in a substantial share of the affected line of commerce." Here, the non-compete applied to the contiguous U.S. until 2019, except for the current Improv clubs of franchisee. The court found that this met the *Dayton* test and partially voided the non-compete. Balancing the protection of franchisor's trademark and franchisee's right to run its business, the court gave franchisee permission to open non-Improv clubs wherever it does not currently operate an Improv club and denied franchisee permission to open any non-Improv clubs where it currently owns/operates Improv clubs.
- **Important Non-compete Cases/Issues**
    - If an employee signed a non-compete agreement at the time of hire, that non-compete agreement may be no longer enforceable under Massachusetts law (and some other states as well) if there has been a

"material change" in the employment relationship, such as when an employee is promoted, receives a raise, or takes on new responsibilities. The general rule is that any time an employee's employment relationship with the employer changes materially, a new noncompete agreement must be signed.

- Employers should evaluate whether an employee who is subject to a noncompete agreement has experienced a material change in his/her employment. If so, it may be advisable to request that the employee execute a new non-compete agreement.

INTELLECTUAL PROPERTY ISSUES

- **Pet Butler and Dog Butler** (Federal Trademark Issue)
  - Dog Butler and Pet Butler are each pet waste removal services. Dog Butler, founded in the early 1990s, operates in the Oregon and Washington area out of two units. Pet Butler, founded in the late 1990s, has about 80 "poop-scooper" franchisees.
  - In August 2005, Pet Butler filed a federal trademark application for "Pet Butler," which was rejected, as it was too similar to Dog Butler's trademark that was registered in 2003. Pet Butler's request for reconsideration was denied. Currently, further action on the application has been suspended.
  - Now, the many Pet Butler franchisees find themselves without federal trademark registration protection for their name. Worse, if Dog Butler pursues a cease and desist action an d can show that it has senior rights, the Pet Butlers will be looking for a new name and signage.
  - Potential franchisees should consider what kind of trademark protection they get with their investment. Franchisors should act early to protect their marks before they become heavily marketed and widely recognized .

CASE UPDATES

- **Ohio: Davco Acquisition Holding Inc. v. Wendy's International, Inc.**
  (Complaint filed in U.S. District Court; Southern District, Ohio; October 17, 2007)
    - Franchise agreement stated that franchisee would purchase all food and similar items from suppliers meeting franchisor's standards. Franchisee could request approval of alternate suppliers. Franchisor could, but was not required to, inspect and approve the suggested alternate suppliers. Franchisee sought permission from Franchisor to go to open-bid and noted that Pepsi was still being sold by some units. Wendy's denied the request. A few months later, Wendy's sent a letter saying Pepsi and Coke were not equivalent and refused to approve Pepsi. Wendy's refused to consider Pepsi – and did not do any of the supplier-review items listed in the Franchise Agreement as part of approving an alternative supplier.
    - Franchisee alleged that Wendy's and Coca-Cola had an undisclosed agreement whereby Coca-Cola contributed to Wendy's national advertising fund based on each gallon of fountain beverage syrup franchisees purchased. This allegedly led to an artificial inflation of franchisee's cost of fountain beverage syrup, which allegedly has been transferred (at least in part) by Coke to the advertising fund resulting in a contribution above the 3% Wendy's is allowed to target for the national advertising fund. The franchisee has asserted that Wendy's had a duty to disclose this relationship with Coke – which was not done properly in the UFOC.
    - Status: Wendy's has filed a motion to dismiss the complaint for failure to state a claim upon which relief can be granted. Wendy's argues, among other things, that because franchisee does not claim that Wendy's ignored its request to approve Pepsi products, Wendy's has complied with its promise in the franchise agreement, and therefore, franchisee has failed to allege a breach of contract. Wendy's also suggests that franchisee

conflates the language of the agreement to create an obligation that does not exist. Wendy's further states that the inflation of beverage syrup prices is merely speculative. Finally, Wendy's argues that the franchise agreement specifically states that franchisor is not obligated to make credits to the advertising fund on franchisee's behalf.

- The franchisee has responded that Wendy's mainly mischaracterizes franchisee's claims and the facts of the complaint. Franchisee argues, among other things, that while franchisor may have the right to deny franchisee's request, but that franchisor must still evaluate franchisee's request and must do so in light of franchisor's implied obligations of good faith and fair dealing. Finally, franchisee argues that while franchisor may not be required to credit the advertising fund on franchisee's behalf, this language in the agreement does not excuse franchisor's inflating the price of beverage syrups.

For more information, contact:

TARLOW BREED
HART & RODGERS, P.C.
Counsellors at Law

<u>Michael J. Radin and Katie A. Ahern</u>

Tarlow Breed, Hart & Rodgers, P.C.
101 Huntington Avenue, Suite 500
Prudential Center
Boston, MA 02199
617.218.2000
mradin@tbhr-law.com
kahern@tbhr-law.com