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Spring 2015

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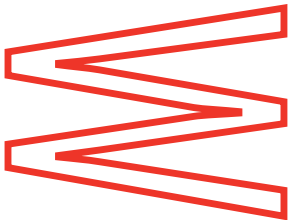
The Next Hot Trend in Economic Development: Craft Beer

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The Brewers Association, a trade association representing small and independent American craft brewers, recently released 2014 data on the United States craft beer industry. For the first time ever, at 11 percent, the craft segment reached double-digit volume share of the marketplace.

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Class Action Attempt to Void Jimmy John's Non-Competes Goes Stale

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Sandwich chain Jimmy John's has been in the news lately because of non-compete agreements that employees of its franchisees sign. This is not necessarily good news for Jimmy John's, but it does underscore some interesting issues.

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Greetings From Hospitalitas

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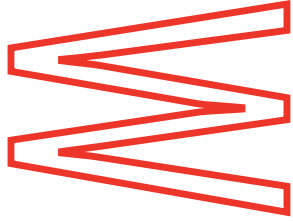
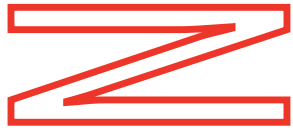
Use of Customer Survey Data Upheld in Hotel Franchise Terminations

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In most cases, courts and state legislatures have made it more difficult for franchisors to terminate franchise agreements. However, one federal court in New York recently upheld the use of negative guest satisfaction surveys as a basis for termination.

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The Next Hot Trend in Economic Development: Craft Beer, *continued*



Based upon this data, craft brewers produced 22.2 million barrels of beer, experienced an 18 percent rise in volume, and witnessed a 22 percent increase in retail dollar value, estimated at \$19.6 billion, or 19.3 percent of market share.

In addition, as of the writing of this article, there are 3,464 breweries in the United States and 3,418 of those fit within the definition of craft. This represents a net 19 percent increase year over year from 2013. More importantly, craft breweries now employ 115,469 individuals, up 4.3 percent from 2013.

In a press release issued by the Brewers Association, Bart Watson, the organization’s chief economist, said, “With the total beer market up only 0.5% in 2014, craft brewers are key in keeping the overall industry innovative and growing. This steady growth shows that craft brewing is part of a profound shift in American beer culture, a shift that will help craft brewers achieve their ambitious goal of 20% market share by 2020.”

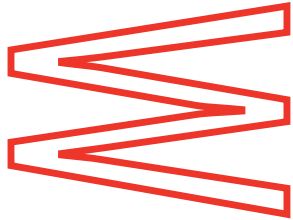
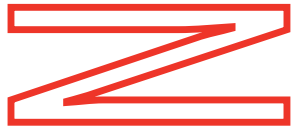
Watson also went on to say, “Small and independent brewers are deepening their connection to local beer lovers while continuing to create excitement and attract even more appreciators.”

While this production- and consumer-related data is indicative of greater market adoption by consumers, it is also, in part, attributable to the fundamental and meaningful evolution of state regulatory schemes, namely state beer distributor franchise laws, that have hindered growth in the craft segment for many years. In general, these “beer franchise” laws are much more invasive of the commercial relationship than general franchise disclosure relationship laws, and dictate the relationship between the beer manufacturer and the beer distributor, preserving what most people refer to as the “three-tier system.”

Historically, state beer franchise laws have been highly protectionist of the distribution tier and in most circumstances prevent the brewery from selling product to anyone other than the distributor. Some of the more dated bodies of beer franchise law inhibit the growth of the craft beer segment even further, but we will save that discussion for a future article. From the perspective of the breweries, one of the most impactful exceptions to the three-tier system and beer franchise laws is the allowance of limited on-site sales, either through a taproom or sales for off-site consumption.

This reform has played a critical role in the development of the craft beer segment as it creates tremendous opportunities for consumers to experience the product in a unique manner. Some craft beer ecosystems have been further enhanced by other regulatory changes, while other areas of the United States lag woefully behind, including the Southeast. In many parts of the country, craft beer has moved from a conversation that once centered exclusively around regulatory competitiveness to one that is now deeply rooted in economic development and tourism.

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The Next Hot Trend in Economic Development: Craft Beer, *continued*



The growth of the craft beer segment is also starting to be embraced by state and local economic development organizations. Craft breweries are a unique economic development value proposition because this industry creates an intersection point for manufacturing and tourism, something that cannot be said for very many, if any, other industries.

A few years ago, craft brewers Sierra Nevada, New Belgium and Oskar Blues began looking for East Coast expansion opportunities. Roanoke, Virginia, made a serious run at Sierra Nevada by putting together an economic development package valued at around \$13 million in incentives. Likewise, Philadelphia, Pennsylvania, made a similar run at New Belgium.

Roanoke and Philadelphia both lost these craft brewery expansion opportunities as Sierra Nevada and New Belgium decided to locate in Asheville, North Carolina, following the lead of Oskar Blues. By landing all three of these craft brewery expansion projects, Asheville firmly staked its claim as a viable and sustainable craft brewery cluster, leading to significant financial investment in manufacturing assets and attracting countless tourists to the area.

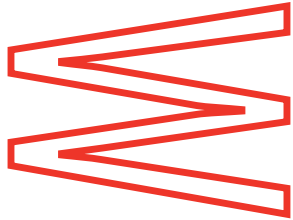
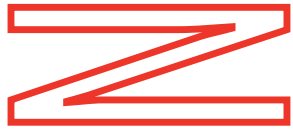
Not long after these companies invested meaningful capital in the Asheville economy and started hiring new employees, other states and cities began to take notice. From Arizona to Virginia, from parts of California to South Carolina, and a number of other states in between, state legislatures began modernizing beer laws in a way that encourages further development of existing craft brewery ecosystems as well as attracting expansion projects.

In 2014, Stone Brewing Company, a San Diego, California-based craft brewery, issued a request for proposals for a \$75 million, nearly 300-job East Coast expansion project. The site selection process spanned 20 states and took nearly a year to complete. In the end, Richmond, Virginia, prevailed and will eventually be the home for the craft brewery's East Coast operations.

Not wanting to lose another craft brewery expansion project like they had in Roanoke with Sierra Nevada, Virginia's state and economic development organizations had sought to accomplish two objectives in trying to lure Stone Brewing Company to Richmond: (1) make fundamental changes to beer franchise, distribution and three-tier laws in order to make the craft beer segment more competitive relative to other states, and (2) put together a financial incentive package that would assist Stone Brewing Company in the development of its East Coast project. The authorization of taprooms was the most critical component of this effort.

Virginia accomplished both of these objectives and ultimately landed Stone Brewing Company. When all is said and done, the company will invest \$74 million in Richmond and create 288 jobs in the first three years. The company expects to generate \$100 million in revenue by the end of year four and eventually reach \$100 million in annual revenue at the Richmond location.

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The Next Hot Trend in Economic Development: Craft Beer, *continued*



In order to incentivize this development, the City of Richmond is issuing \$23 million in bonds for the manufacturing facility and \$8 million in bonds for the restaurant and beer garden, and providing \$2 million in city grant funds. To further this effort, the State of Virginia is contributing \$5 million from the Governor’s Opportunity Fund and an additional \$250,000 from the Governor’s Agriculture and Forestry Industries Development Fund. The Stone Brewing

Company facility is expected to come online in 2016.

In October 2014, representatives from Green Flash Brewing Company, another San Diego craft brewery, joined state and local officials at a groundbreaking and ribbon cutting in Virginia Beach. By spring 2016, the town will be home to a 100,000-barrel-a-year Green Flash production facility, a 4,000-square-foot tasting room, and a one acre beer garden. The project constitutes a \$20 million investment and will create at least 40 new jobs for the area.

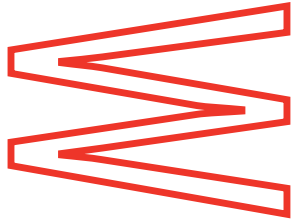
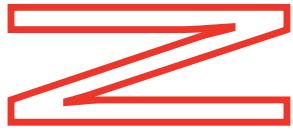
Most recently, there have been rumors swirling that Ballast Point Brewing Company, yet another San Diego-based craft brewery, is considering an expansion project in Richmond. Speculation is beginning to brew (pun intended), whether the interest is due exclusively to the economic development incentives Stone Brewing Company received for its project or whether it is due to the market demand and the existing ecosystem. It is likely both.

So why are states like North Carolina and Virginia drafting policy to incentivize investment in craft breweries? There are three critical reasons for this, two of which have already been mentioned: this is a manufacturing industry and there is a tourism component to it. The third reason that states and regions are starting to focus on the craft beer industry is the perception that these businesses help create attractive places to live and work.

First, and most fundamentally, craft breweries are manufacturers, a highly-coveted target of economic developers. The development, construction and operation of a craft brewery generally involves significant financial outlays and creates meaningful jobs, two of the most critical objectives for economic developers. With the explosive production growth in the craft beer industry and rising demand, more opportunities exist to export these products outside the borders of a state, bringing in new dollars to local communities, another critical objective of economic development.

Second, tourism surrounding craft beer is intensifying in the United States. Places like Asheville, North Carolina, and Bend, Oregon, have developed niche tourism opportunities around craft beer clusters. This sort of tourism activity has a positive ripple effect with local hotels, restaurants and retailers as people explore highly unique and local craft beer experiences.

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The Next Hot Trend in Economic Development: Craft Beer, *continued*

The community enhancement component is the final leg of this economic development stool. Craft breweries often locate in higher density areas, adaptively reusing once blighted buildings and becoming chief “place-making” agents of local communities. As people move into denser core cities and communities, there is a premium on “place,” which is the intersection of live, work, play and quality of life experiences. Craft breweries play an instrumental role in “place-making” efforts.

We will likely see more economic development activity related to the craft beer industry. States will further amend dated regulatory laws to create more ideal business environments for existing craft breweries while also incentivizing expansion projects. We will see the craft beer segment continue to grow as the demand for highly localized, flavorful and innovative beers increases with each passing year.

Will the craft beer bubble burst? Sure, but probably not any time soon. So support of your local breweries is an opportunity to advocate for this creative economy industry.

For an intoxicating perspective on the craft beer and craft spirit industry, visit our blog, “[Judiciously Crafted](#).” Tune in for brief posts and articles aimed at helping craft brewers build their brand and tell their story through their craft products.

Class Action Attempt to Void Jimmy John’s Non-Competes Goes Stale, *continued*

On April 8, 2015, a United States District Court in Illinois issued an opinion and order which held that two employee plaintiffs did not have standing to pursue their claims for declaratory relief to determine the legal interests, validity and enforceability of the Confidentiality and Non-Competition Agreements. Plaintiffs Emily Brunner and Caitlin Turowski brought suit against several franchisee defendants for violations of the Fair Labor Standards Act and the Illinois Minimum Wage Law. Additionally, the employees’ Second Amended Complaint sought a declaratory judgment and injunctive relief seeking to invalidate the Confidentiality and Non-Competition Agreements.

According to the court’s opinion, Jimmy John’s is a gourmet sandwich company with more than 2,000 standardized sandwich shops located throughout the United States (in 44 states and the District of Columbia). Jimmy John’s was founded in 1983 by James John Liautaud, who is an Illinois resident and the current CEO of Jimmy John’s. After founding the company, Liautaud began franchising Jimmy John’s Sandwich Shops to franchisees. Essentially, there were three categories of defendants: 1) Liautaud, 2) the Jimmy John’s franchisor entities, and 3) the franchisee/operator defendants. Each employee of Jimmy John’s or a franchisee is required to sign various agreements, including Confidentiality and Non-Competition Agreements, as a condition of their employment. The Confidentiality and Non-Competition Agreements lay out various restrictions concerning where former employees can work, what job functions they can perform and when a former employee must disclose their intent to work at a competing food service establishment. Specifically, the Non-Competition Agreement prohibits former employees from working at food service venues which derive 10 percent or more of their revenue from the sale of sandwiches, submarines or wraps. This prohibition is applicable to all food service venues within a prescribed radius of the employees’ former Jimmy John’s Sandwich Shop.

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Class Action Attempt to Void Jimmy John's Non-Competes Goes Stale,

continued



Plaintiff Emily Brunner is still employed as an assistant store manager (ASM) at a franchised Jimmy John's Sandwich Shop in Downers Grove, Illinois, which is owned and operated by the JS Fort Group. These defendants own and operate 28 different Jimmy John's Sandwich Shops in Illinois.

Plaintiff Caitlin Turowski formerly worked as a delivery driver and an ASM at a franchised Jimmy John's Sandwich Shop in Gurnee, Illinois. The Gurnee, Illinois, franchise is owned and operated by the Severson Defendants, who own and operate 12 different Jimmy John's Sandwich Shops throughout Illinois.

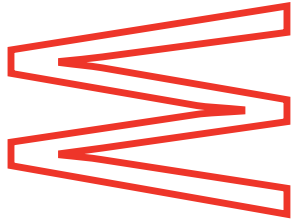
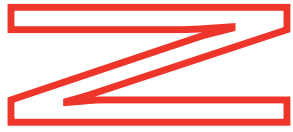
Count VII of the Plaintiffs' Second Amended Complaint sought to invalidate confidentiality and non-compete agreements that Jimmy John's, LLC requires its employees, including low-level sandwich makers and delivery drivers, to sign. The defendants argued that the plaintiffs lacked standing to pursue injunctive and declaratory relief. The court noted that a federal court may only declare the rights and other legal relations when there is an actual controversy.

Brunner (who still works at a franchised Jimmy John's Sandwich Shop) alleged that she "does not understand the scope of her obligations under the confidentiality provisions of the Confidentiality and Non-Competition Agreement...and is reasonably apprehensive that her prior and ongoing/current disclosures of certain information could constitute breach..." The court noted that not only did Brunner fail to specify if she applied, was interviewed or was offered a position, she was also unsure if any of the sought-after food service establishments are covered under the terms of the Non-Competition Agreement. Brunner's fear apparently stemmed from her knowledge of a past lawsuit in which Liautaud sued his cousin to enforce the Confidentiality and Non-Competition Agreements.

Turowski formerly worked at a franchised Jimmy John's Sandwich Shop. After she left Jimmy John's Sandwich Shops, she was employed by BBQ'd Productions in Third Lake, Illinois, a restaurant located within the prohibited three-mile radius of the Libertyville Jimmy John's Sandwich Shop. Turowski was uncertain whether BBQ'd Productions is a "competitor" under the terms of the Non-Competition Agreement.

The court held that Brunner and Turowski failed to allege any facts, beyond a "litany of possibilities," demonstrating any concrete, sufficient injury giving them standing to pursue injunctive relief. The court further held that the complaint did not state valid reasons for the plaintiffs possessing a reasonable fear of litigation. Interestingly, the court noted that Jimmy John's and the franchisee defendants submitted affidavits attesting to their intention not to enforce the Confidentiality and Non-Competition Agreements against the plaintiffs "in the future." The court granted the defendants' motion to dismiss Count VII, which sought declaratory relief on the non-compete agreements. The court dismissed many of the claims, but did allow the plaintiffs' claims for violation of the FLSA to proceed against the franchisee defendants.

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Class Action Attempt to Void Jimmy John's Non-Competes Goes Stale, *continued*

So, Jimmy John's managed to avoid an opinion on the merits that these agreements were invalid. By prevailing on the standing issue, Jimmy John's lived to fight this issue of enforceability of the non-compete agreements another day. But the case does raise a few questions, including what the result might have been if the employee had gone to work for a competitor that violated the letter of the non-compete agreement.

Generally, a restrictive covenant is reasonable only if it is no greater than is required for the protection of a legitimate business interest of the employer, does not impose undue hardship on the employee and is not injurious to the public. In a case like this, the employer might have a hard time articulating a legitimate business interest. On the one hand, a three-mile geographic radius is very small and almost unheard of today. Surely an employee could find a new job five or ten miles away, if he or she wanted to. On other hand, what is the point of having a three-mile radius restriction at all? These restrictions are typically directed at the market reality that retailers face: when an employer invests time and energy in training, it hates to lose an employee to a competitor for a small increase in wages or benefits. Cutting attrition is a reasonable objective.

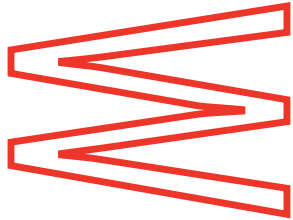
This case serves as a reminder to remember essential questions all employers should consider regarding their policies for covenants not to compete and confidentiality agreements. Each employer should determine whether a covenant not to compete is necessary in the first place, and whether such an agreement is really necessary for all its employees or just certain employees. Would the employer be comfortable arguing for the enforcement of the non-compete agreement in court? Would the employer's attorneys feel comfortable seeking enforcement of or defending the agreement in court? Does the employer have legitimate trade secrets it is trying to protect? If so, does the employer adequately communicate with its employees about what information is confidential? It is worthwhile for employers to periodically review policies and procedures for non-compete agreements and confidentiality agreements.

In addition to the news reports and legal articles on the subject of Jimmy John's non-compete agreements, certain Congressmen have urged the Department of Labor and the Federal Trade Commission to investigate Jimmy John's practice. Thus, while Jimmy John's may have dodged a bullet on the non-compete agreements in this case, we may hear more about this topic and this system in the future.

Use of Customer Survey Data Upheld in Hotel Franchise Terminations, *continued*

In *HLT Existing Franchise Holding, LLC v. Worcester Hospitality Group, LLC* (U.S. Ct. App., 2nd Cir., Case No. 14-593-cv, April 9, 2015), the U. S. Court of Appeals for the Second Circuit upheld a franchisor's decision to terminate a franchise based primarily upon negative results of guest satisfaction surveys.

The terminated Hampton Inn franchisee, seeking damages and injunctive relief based on the franchisor's termination decision, argued that the guest satisfaction surveys were inadmissible hearsay statements and should not have been considered by the court in assessing whether the franchisor acted properly in



Use of Customer Survey Data Upheld in Hotel Franchise Terminations, *continued*

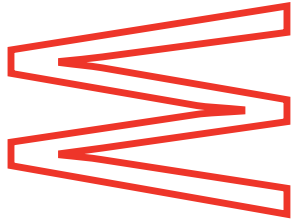


terminating the franchise. “Hearsay” is defined as any out-of-court statement offered into evidence to prove the truth of the matters asserted in the statement. (Fed. R. Evid. 801(c)). The guest satisfaction surveys were clearly out-of-court statements. However, the court reasoned that the surveys were not offered to prove the truth of the matters asserted in the survey reports, but rather “were admitted solely for the purpose of showing their effect on [the franchisor’s] decision to terminate the franchising agreement.” The court relied on a line of cases holding that a statement offered to show its effect on the listener is not hearsay. The survey data tended to show that the franchisor did not act arbitrarily, irrationally or in violation of its implied obligation of good faith and fair dealing. The court found it proper to consider the survey data for that purpose.

Failing in its primary argument, the franchisee pursued a different line of attack by pointing out that the survey data was not even collected by the franchisor. The survey data was actually collected by Medallia, Inc., a large third-party survey administrator, and transmitted to the franchisor. Since it came from a third party, the franchisee reasoned it should not have been considered by the court. The court found that Medallia regularly compiled guest survey scores at the time the guests submitted those survey responses. Medallia’s reports recorded guest impressions in the course of regularly conducted business activity. Additionally, the franchisee did not dispute the trustworthiness of Medallia’s records. Thus, the court found that the survey results were properly considered.

Finally, the franchisee claimed that the liquidated damages provision in the franchise agreement should not be enforced. The court noted that a contractual provision fixing damages in the event of future breach will be enforced if the preset amount bears a reasonable proportion to the probable loss and the actual loss is difficult or impossible to estimate with any precision. The burden rests with the party seeking to avoid the payment of damages. Expressing a reluctance to “interfere with the parties’ agreements,” the court upheld the liquidated damages provision.

Twenty-one states currently have some version of franchise relationship statutes. Seventeen of those statutes require the franchisor to show good cause in order to justify franchise termination or non-renewal of the franchise. Additionally, most states’ laws require any contracting party to meet an obligation of “good faith and fair dealing.” As this case demonstrates, guest satisfaction surveys can provide a powerful tool to help franchisors meet that legal hurdle. Franchisors should ensure that such surveys are compiled and recorded in a manner that ensures they will be admissible in court, particularly at the summary judgment stage where they may make the difference between efficient disposition and protracted litigation.



Franchisees Flatline in Case Against Doctors Express

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On April 1, 2015, the U.S. Court of Appeals for the Third Circuit thoroughly shot down claims brought by franchisees of Doctors Express Franchising. Those claims asserted that Doctors Express misrepresented initial start-up costs and capital requirements in its Franchise Disclosure Document, made “deleterious system-wide changes” such as changes in required vendors and company leadership, and refused to provide a formal, audited accounting of its advertising and marketing fund.

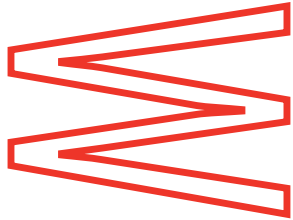
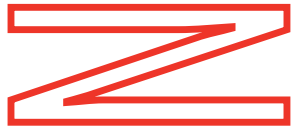
The plaintiff franchisees, Laura Fabbro, Surendra Pai and their associated entities, alleged that these actions violated the Maryland Franchise Registration and Disclosure Law, the New Jersey Franchise Practices Act and state common law theories of breach of contract, breach of the implied covenant of good faith and fair dealing, fraud and negligent misrepresentation.

The Third Circuit began by affirming the district court’s dismissal of the breach of contract claim for the most basic reason: the plaintiff franchisees did not point to a single provision of the Franchise Agreement that was breached. Rather, the provision challenged was merely an estimate of costs, from an affiliate in Maryland, that came with the caveat that “a franchisee’s costs will depend on a number of factors including local economic and market conditions.” The court found that the plaintiff franchisees did not plausibly articulate why understating initial start-up costs, capital investments or working capital constituted a breach of contract. Because the plaintiffs’ breach of contract claim failed, so too did their claim for breach of the implied covenant of good faith and fair dealing.

Next, the court affirmed dismissal of the plaintiff franchisees’ fraud and negligent misrepresentation claims primarily because they were based on predictions or promises regarding future events. Both Maryland and New Jersey law bar such claims in the absence of proof of intent to deceive on the part of the party making the predictions. The plaintiff franchisees did not plausibly allege any such intent on the part of Doctors Express, nor did they allege that Doctors Express knew the predictions were inaccurate at the time they were made. Thus, the court found that under both Maryland and New Jersey law, the plaintiffs failed to state a claim as a matter of law.

The plaintiff franchisee’s most novel argument was that Doctors Express “constructively terminated” their franchise by making “material changes to their business model that have harmed, rather than helped, franchisees.” They also alleged that Doctors Express’s “incompetence, combined with stubborn management and strict requirements,” rendered the plaintiffs’ investment “inoperable.” The Third Circuit soundly rejected these arguments, holding that because there was no breach of contract, no misrepresentations and no allegations evincing a “manifest intent of the defendant to cease doing business with plaintiffs,” there could be no constructive termination. To the contrary, the plaintiff franchisees had demonstrated the implausibility of their argument by asserting they were still “in good standing” with Doctors Express – showing that nothing had actually been terminated.

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Franchisees Flatline in Case Against Doctors Express, *continued*

Finally, the Third Circuit affirmed the dismissal of the plaintiff franchisee’s remaining claims under the Maryland Franchise Registration and Disclosure Law, based on the statute of limitations, finding that, as evidenced on the face of the pleadings, the claims were not brought within the requisite three-year limitations period.

This case is a good example of a franchisor that appears to have done nothing wrong in making judgement calls on disclosure. Doctors Express, in providing cost and working capital information about a Maryland affiliate in its Franchise Disclosure Document, provided an adequate caveat warning prospective franchisees that costs depend on a multitude of factors. Doctors Express also steered clear of any breaches of its Franchise Agreement when making changes to the system, as evidenced by the fact that Fabbro and Pai were unable to point to any provision that was actually breached, despite being given multiple chances. This discussion supports the good faith, discretionary use of truthful data in FDDs, recognizing that franchisors need that latitude without “fly speck” second-guessing from franchisees. This court recognized that such discretion, in what is akin to a “business judgment” rule, should not be retracted by a court seeking perfect, customized disclosure and system management.

NLRB’s Quickie Election Rule Takes Effect

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In previous articles, we have explained how the National Labor Relations Board (NLRB) has taken the position that franchisors and franchisees are joint employers of the employees, setting the stage for large-scale union organization. (Click [here](#) or [here](#) for examples.) These cases involve labor organizing by the Service Employees International Union (SEIU) in franchised businesses like quick-service restaurants. The relatively small numbers of employees for each franchisee has prevented the organizing of these businesses. The SEIU wants the NLRB to introduce multi-employer collective bargaining across franchise systems and to promote the application of the financial resources of franchise systems to provide higher pay and benefits for these workers.

Recent actions of restaurant workers demanding a higher minimal wage also are considered to be an indicator of union support and of the potential for union organizing in that industry. For example, the “Fight for \$15” strikes returned in cities across America on April 15, one day after the NLRB’s new “quickie election” rules went into effect. Fight for \$15 is one of several groups across the country involved in efforts to force quick-serve restaurants to increase the wages they pay to \$15 per hour.

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NLRB's Quickie Election Rule Takes Effect, *continued*



A recent NLRB rule referred to as “quickie election” increases the ability for unions to organize quickly and calls on employers in all industries, including hospitality, to be proactive and respond appropriately. The NLRB released its Final Rules on quickie elections in December, and they are now in effect. These rules come down heavily in favor of unions. This Final Rule from the NLRB makes it easier for unions to organize because of a much shorter timeframe

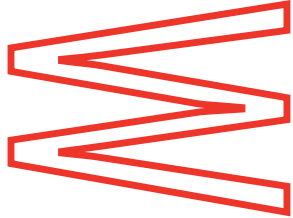
between the union’s filing a petition for an election and the time the company has to campaign. These changes mean that many elections can be held in as few as 13 days from the time the petition for an election is filed, as opposed to about 40 days under the old rules. Other significant changes include mandatory pre-election postings; the limiting of pre-election hearings; a mandate that employers provide employees’ personal information, including cell phone numbers via an “Excelsior list;” and the expediting of post-election objections.

The rule also streamlines union elections in part by allowing certain documents to be filed electronically instead of by mail. In addition, it generally delays legal challenges from employers – such as whether certain workers are eligible to vote – until after workers have cast their ballots.

The underlying purpose of the Final Rule is to limit employers’ ability to combat a union organizing effort after a petition for an election is filed with the NLRB. An employer will now have very limited time between the filing of the petition for election and the actual vote to educate its employees so that they can make an informed decision about representation. Consequently, the chances of an employer being vulnerable to organization efforts have significantly increased. In order to be able to effectively counter a union campaign, employers now have to be more proactive than ever and prepare for potential union efforts in advance of those efforts.

Some actions an employer can take to start preparing a labor relations education and response plan include:

- Do not wait until a union shows up before deciding to talk to employees about workplace matters, including a company’s non-union preference and the reasons for that preference.
- Remind employees about the value of what the company already provides and share obstacles to providing additional benefits in the face of rising costs, such as for health care.
- Institute good human resources practices, build a strong culture and be prepared to respond immediately if problems occur.
- Provide union awareness training to managers and supervisors including how unions operate, signs of union organizing, the employer’s position on unionization and what they can and cannot say in response to organizing or potential organizing.
- Consider a union vulnerability assessment to see what underlining issues might spark a union organizing attempt.



Georgia Supreme Court to Franchisees: Read Your Contracts!

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A book came out several years ago entitled “Everything I Really Need to Know, I Learned in Kindergarten.” There is a lot of truth in that statement. Keep your hands to yourself. Eat your vegetables. Respect your elders. Read your contracts before you sign them.

Okay, maybe that last one is a little beyond kindergarten, but it is no less axiomatic. That point was driven home by the Georgia Supreme Court in its opinion released April 20, 2015, in *Legacy Academy, Inc. v. Mamilove, LLC*, Case No. S14G1891.

In July 2001, sisters Michele and Lorraine Reymond approached the defendant, franchisor Legacy Academy, Inc., about the purchase of a daycare franchise to be located in suburban Atlanta. The sisters testified that Legacy provided them an earnings claim purporting to state the historical earnings of existing Legacy Academy franchises. This “earnings claim” reflected that in the first two years after purchasing a franchise, the franchisee could expect to receive net income of \$260,000 and \$440,000, respectively.

The Reymond sisters formed Mamilove, LLC to operate their franchise. A location was selected in consultation with the franchisor. In September 2001, the sisters were provided an offering circular and franchise agreement, which was signed the day it was presented. Neither sister read the offering circular or the agreement before signing on. Ten years later, the franchisee filed suit alleging that Legacy fraudulently induced the franchisee to sign the agreement by providing false information about historical earnings of Legacy franchises. The franchisee plaintiffs sought to rescind the agreement as well as recover money damages and statutory penalties.

The case was tried before a jury. At the close of the plaintiffs’ proof, the franchisor defendant moved the trial court to direct a verdict in its favor. This motion was denied and the jury returned a verdict for the franchisee awarding in excess of \$1 million in damages.

Legacy appealed, asserting – among other issues – that the trial court was in error in denying the directed verdict. The Georgia Court of Appeals affirmed the trial court (328 Ga. App. 775, 761 S.E.2d 880 (2014)), and the Georgia Supreme Court accepted the appeal. The Georgia Supreme Court reversed the Court of Appeals and held in favor of the franchisor.

The Georgia Supreme Court noted that in order to seek rescission of a contract for fraudulent inducement, the franchisee had to prove that Legacy, through misrepresentations, induced the Reymond sisters to sign the franchise agreement and that the Reymond sisters justifiably relied upon the misrepresentation, being “reasonably diligent in the use of the facilities at their command.” This “reasonable diligence” requirement proved fatal for the franchisee.

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Georgia Supreme Court to Franchisees: Read Your Contracts!, *continued*



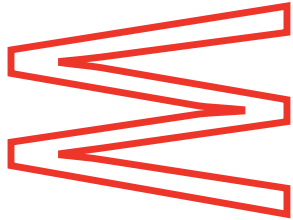
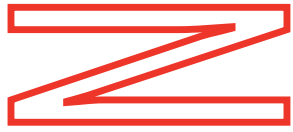
It was undisputed that neither sister read the offering circular or the franchise agreement before signing. The court noted that one sister had a master’s degree in business administration and the other worked for WebMD. Had they bothered to read the franchise agreement, they would have seen disclaimers stating that Legacy was making no representations regarding potential volume, profit or success of the franchise. In the agreement, the franchisee

disclaimed any reliance on any such representations. The court cited well-settled law that a party who has the capacity and opportunity to read a written contract cannot later assert fraud in the procurement of his signature based upon extra contractual representations that differ from the terms of the written contract. The court held that because the representations allegedly relied upon were expressly disclaimed in the written agreement, the earlier earnings claims could not have been reasonably relied upon as a matter of law.

The Raymond sisters argued that they were not given a real opportunity to read the agreement. They asserted that Legacy required them to sign the agreement the day it was presented or Legacy would make their desired location available to another potential franchisee. The court found that proof legally insufficient to establish that the Raymonds were prevented from reading the agreement by fraud. The mere fact that Legacy was in a hurry does not prove that the franchisee was prevented from reading the contract.

The court also noted that the franchise agreement contained a provision that “this agreement constitutes the entire agreement between the parties,” and that it supersedes and terminates any prior agreements between the parties. The court held that this provision, frequently called a “merger clause,” prohibited any claims based upon pre-contractual representations.

In this case, the complaining franchisee representatives failed to read the contract by which they would be bound. Had the sisters done so, they would have learned that the earnings projections they found so enticing were expressly disclaimed by the franchisor. Such disclaimers are common in franchise agreements or ancillary documents signed at a franchise agreement closing. Thus, the sisters could not have reasonably relied on the earlier projections. The lesson for franchisees, particularly in Georgia, is clear: Read your agreements carefully before signing. That said, no franchisor should rely on this decision as the basis for assurance that violations of disclosure timing and other requirements will have no consequences. Had the franchisee acted sooner, the appellate court may have been more sympathetic.



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Joel is a shareholder in the Firm’s Nashville office, where he counsels business clients, particularly those in hospitality, franchising and distribution, on strategic planning, transactions, financing, mergers and acquisitions, regulatory compliance and operations. He served for four years as administrator for the International Franchise Association’s Franchise Compliance Training Program and is currently a legal advisor and trainer for IFA’s Fran-Guard compliance and business culture training program.

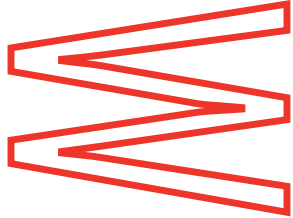
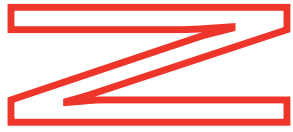
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