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CONSPIRACY THEORIES: ESTABLISHING THIRD PARTY LIABILITY IN FRANCHISE LITIGATION

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INTRODUCTION

The vast majority of litigation in the franchise context occurs between the franchisor and franchisee. At times, however, the deterioration of a franchise relationship involves third parties requiring the plaintiff franchisor to employ unique strategies to protect its franchise system in the absence of a contract. This paper explores the various forms of third-party liability typically arising in franchise litigation including tortious interference, enforcing restrictive covenants against nonsignatories, misappropriation of trade secrets and contributory trademark infringement. The paper concludes with a discussion of procedural considerations and strategies in the context of litigation against third parties.

I. Tortious Interference

One area where third party actions arise in franchising is with tortious interference claims—often centered on the third party's mischief with an existing franchise relationship. In one example, a motor oil supplier lured away quick-lube franchisees by defaming the franchisor and offering to supply the franchisees directly.[1] In another, franchisor Weichert Real Estate Associates, Inc. sued a competing brokerage, Sandion, when it moved forward with the purchase of the former Weichert franchisee's offices while the Weichert franchise agreements were still in place.[2] A franchisee sued its franchisor's competitor, where the franchisor and the competitor were owned by the same company, alleging that its franchisor's competitor was trying to run it out of business.[3] Franchisees have brought tortious interference claims against competing franchisees that seek to operate in the objecting franchisee's exclusive territory.[4] A prospective franchisee was even able to state a claim against the principal of its would-be franchisor for his role in breaching a preliminary purchase agreement with the plaintiff and instead granting an exclusive territory to a different franchisee.[5] In this section, we will explore elements of and defenses to a tortious interference claim, as well as what franchisors can do to prevent such claims in their systems.

A. Elements of Tortious Interference

Nearly every jurisdiction in the United States recognizes the tort of tortious interference with contract or business expectations, although how the courts have construed the tort varies from state to state. In general, a claim for tortious interference with a contractual relationship or business expectancy has four elements: (1) the existence of a valid contractual relationship or business expectancy; (2) that defendants

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[1] *Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153, 1167 (3d Cir. 1993) (New Jersey law).

[2] *Weichert Real Estate Affiliates, Inc. v. Dean Kelby Realty, LLC*, No. 2:08-2652-PMD-BM, 2010 WL 3419268 (D.S.C. Aug. 3, 2010), *report and recommendation adopted*, No. 2:08-CV-2652-RMG, 2010 WL 3432810 (D.S.C. Aug. 30, 2010).

[3] *Dunlap v. Cottman Transmissions Sys.*, LLC, No. 2:11CV272, 2016 WL 7013514 (E.D. Va. Oct. 17, 2016), *aff'd*, 689 F. App'x 188 (4th Cir. 2017).

[4] *Hawk Enterprises, Inc. v. Cash Am. Int'l, Inc.*, 282 P.3d 786 (Okla. Civ. App. 2012); *Sensormatic Sec. Corp. v. Sensormatic Elecs. Corp.*, 249 F. Supp. 2d 703 (D. Md. 2003).

[5] *Herald Hotel Assocs. v. Ramada Franchise Sys., Inc.*, 191 A.D.2d 288 (N.Y.S. 1993).

had knowledge of; (3) an intentional and unjustifiable interference inducing or causing a breach or termination of the relationship or expectancy; and (4) resultant damage.[6] Some courts have taken the "unjustifiable interference" element and broken it out into two elements: (a) an intentional interference inducing or causing a breach or termination of the relationship or expectancy; and (b) that defendants interfered for an improper purpose or used improper means.[7] Similarly, the *Restatement (Second) of Torts* speaks of actionable interference as "improper," not as "unjustifiable."[8] New Jersey law is unique in that it also requires a plaintiff to prove that, but for the interference, the plaintiff "would have received the anticipated economic benefits."[9]

The only jurisdiction in the United States that does not recognize the tort of tortious interference with business expectations is Louisiana. In fact, Louisiana only recognizes a limited cause of action for tortious interference with contract, that a corporate officer has a duty to "refrain from intentional and unjustified interference with the contractual relationship between his employer and a third person."[10] Louisiana's Court of Appeals has somewhat ventured to expand the claim, holding that "'before an action for tortious interference with a contract will be permitted, the plaintiff must identify a duty existing between it and the alleged tortfeasor, the violation of which would give rise to delictual liability.'"[11]

B. Valid Contractual Relationship

To state a claim for interference with contract, the contract must be valid and enforceable.[12] For example, the Texas Court of Appeals has found that there was no existing franchise agreement to support a tortious interference claim where the franchisor was not bound to continue the franchise agreements after the franchisee had declared bankruptcy.[13] In a franchisor's suit to enjoin a competitor from acquiring several of its locations from the former franchisee's creditor-in-possession, the Ohio Court of Appeals found it outcome determinative that the plaintiff had a contractual relationship with the

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[6] *See, e.g., Tri-Star Lighting Corp. v. Goldstein,* 151 A.D.3d 1102, 1105 (N.Y. App. Div. 2017)); *Hahn v. Diaz-Barba, 125 Cal. Rptr. 3d 242, 258 (2011)*; *Smith v. Klein*, 492 N.E.2d 852 (Ohio Ct. App. 1985); *Ethan Allen, Inc. v. Georgetown Manor, Inc.*, 647 So.2d 812, 814 (Fla.1994); *Hansen v. Barrett*, 186 F. Supp. 527, 529 (D. Minn. 1960); *Hannigan v. Sears, Roebuck & Co*., 410 F.2d 285, 291 (7th Cir. 1969) (Illinois law); *Prudential Real Estate Affiliates, Inc. v. Long & Foster Real Estate, Inc.*, No. 99-1357, 2000 WL 248170 (4th Cir. Mar. 6, 2000) (Maryland law); *Kallok v. Medtronic, Inc*., 573 N.W.2d 356, 362 (Minn. 1998) (*quoting Kjesbo v. Ricks*, 517 N.W.2d 585, 588 (Minn. 1994)); *Jarosch v. Am. Family Mut. Ins. Co*., 837 F. Supp. 2d 980, 1004 (E.D. Wis. 2011).

[7] *Leingang v. Pierce Cty. Med. Bureau, Inc.,* 930 P.2d 288, 300 (Wash. 1997) (citations omitted); *Trau-Med of Am., Inc. v. Allstate Ins. Co.*, 71 S.W.3d 691, 701 (Tenn. 2002); *Mitchell Mach., Inc. v. Ford New Holland, Inc.*, 918 F.2d 1366, 1371 (8th Cir. 1990) (South Dakota law); *Nw. Nat. Gas Co. v. Chase Gardens, Inc*., 982 P.2d 1117, 1123 (Or. 1999).

[8] Restatement (Second) of Torts §§ 766-773 (1979).

[9] *Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153, 1168 (3d Cir. 1993) (internal quotation marks and source omitted).

[10] *9 to 5 Fashions v. Spurney*, 538 So.2d 228, 234 (La.1989).

[11] *Musa v. Musa*, 267 So. 3d 1190, 1195–96 (La. Ct. App. 2019) (quotation source omitted).

[12] *Nifty Foods Corp. v. Great Atl. & Pac. Tea Co.*, 614 F.2d 832, 837 (2d Cir. 1980) (New York law).

[13] *BP Auto., L.P. v. RML Waxahachie Dodge, L.L.C*., 448 S.W.3d 562, 570–71 (Tex. App. 2014).

creditor because the creditor had assumed the former franchisee's contractual obligations to the plaintiff.[14]

The analysis changes when parties are not attacking interference with an actual contract but a potential economic relationship. Prospective economic advantage is "something less than a contractual right [but] something more than a mere hope."[15] By definition it is inherently more speculative and certainly harder to prove. To establish a claim for interference with a prospective contractual relationship, a plaintiff must demonstrate "an objectively reasonable probability that a contract will come into existence."[16] A plaintiff can do this by proving "an anticipated business relationship with an identifiable class of third parties."[17] There is no tortious interference with a company's past customers if there is no identifiable agreement or something beyond mere hope that past customers may choose to buy from the plaintiff's business again.[18] Similarly, there is no claim for interference with a relationship with the community at large.[19]

There is also no liability for interference "by appropriate means" with an illegal agreement or a contract with purpose of effect in violation of established public policy."[20] Yet, states apply this principle in different ways. Under Illinois law, for example, a plaintiff can base a claim for tortious interference with prospective economic advantage on a contract that would have been merely voidable (as opposed to void from inception), such as by fraud in the inducement.[21] Under Florida law, a tortious interference claim will lie even if "predicated on an unenforceable agreement, if the jury finds that an understanding between the parties would have been completed had the defendant not interfered."[22]

Although the elements of a claim for tortious interference are straightforward enough, how courts treat the claim depends on the existence, length, and validity of the economic relationships such that that the approaches to the claim are as varied as there are states.

C. Knowledge of the Relationship

This element seems self-explanatory, but actual awareness or knowledge is not strictly necessary to establish a claim for tortious interference.[23] A third party is usually deemed to have knowledge of the contract if he has knowledge of the facts giving rise to

[14] *Escape Ent., Ltd. v. Gosh Ent., Inc*., Nos. 04AP–834, 04AP–857, 2005 WL 1252504 (Ohio Ct. App. May 26, 2005).
[15] *GNC Franchising LLC v. Khan*, Nos. 05-1341, 06-00283, 2008 WL 612749, at *11 (W.D. Pa. Mar. 3, 2008) (internal quotation marks and source omitted).
[16] *GNC Franchising LLC*, 2008 WL 612749, at *11 (internal quotation marks and source omitted).
[17] *Lucas v. Monroe Cty.*, 203 F.3d 964, 979 (6th Cir. 2000) (Michigan law).
[18] *Ethan Allen, Inc. v. Georgetown Manor, Inc*., 647 So. 2d 812, 815 (Fla. 1994).
[19] *Id*.
[20] Restatement (Second) of Torts § 774 (1979).
[21] *Malatesta v. Leichter*, 542 N.E.2d 768, 777–78 (Ill. App. 1989).
[22] *Ethan Allen, Inc.*, 647 So. 2d at 814 *(quoting Landry v. Hornstein*, 462 So.2d 844, 846 (Fla.Dist.Ct.App.1985)).
[23] *Prudential Real Estate Affiliates, Inc. v. Long & Foster Real Estate, Inc.*, No. 99-1357, 2000 WL 248170, at *5 (4th Cir. Mar. 6, 2000) (Maryland law).

the contractual duty, regardless of whether he appreciates their legal significance, believes there is no contract, or believes that the contract means something other than what it is later held to mean.[24]

Knowledge is also imputed "where a person believes that it is probable that something is a fact, but deliberately shuts his or her eyes or avoids making reasonable inquiry with a conscious purpose to avoid learning the truth."[25] Accordingly, the Fourth Circuit Court of Appeals has held that a third party knew or should have known the terms of the franchise agreement it interfered with because it was a "major player" in the real estate business, the contractual provision at issue was common in the industry, it knew of the contract's existence, it never asked the franchisee for a copy of the franchise agreement despite ample opportunity to do so, and it never asked if the franchisee had actually resolved his obligations to the franchisor.[26] But the Sixth Circuit Court of Appeals has held that a plaintiff failed to establish tortious interference where the third party had no specific knowledge of a non-standard contractual provision, reasoning that negligence in investigating contract details or inquiry into what the defendant "knew or should have known" impermissibly brings negligence into the analysis of an intentional tort.[27]

D. Breach

Generally, anything short of an actual breach of contract will not support a claim for tortious interference.[28] Accordingly, the inducing party's "adverse impact" or mere "hindrance of contract" is insufficient to satisfy this element.[29] Nevertheless, some jurisdictions hold that an "outright repudiation" of the contract at issue is not necessary, and a tortious interference claim can be based on the equivalent of a breach by economically coercing the parties into modifying their original agreement,[30] rendering a plaintiff's obligations more onerous[31], or preventing a plaintiff from realizing the full benefit of his contract with a third party[32]. Likewise, tortious interference claims may be

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[24] *Prudential Real Estate Affiliates, Inc.*, 2000 WL 248170, at *5 (Maryland law) (*citing Stannard v. McCool*, 84 A.2d 862, 867 (Md.1951)); *Citibank USA, Nat'l Ass'n v. Ragsdale*, No. 4:06-CV-71-FL, 2007 WL 9718327, at *5 (E.D.N.C. Dec. 18, 2007) (North Carolina law).

[25] *Prudential Real Estate Affiliates, Inc.*, 2000 WL 248170, at *5 (*quoting St. George Antiochian Orthodox Christian Church v. Aggarwal*, 603 A.2d 484, 490 (Md.1992)); *Acclaim Sys., Inc. v. Infosys, Ltd.*, 679 F. App'x 207, 212 (3d Cir. 2017) (Pennsylvania law); *Nat'l R.R. Passenger Corp. v. Veolia Transp. Servs., Inc.*, 791 F. Supp. 2d 33, 58 (D.D.C. 2011).

[26] *Prudential Real Estate Affiliates, Inc.,* 2000 WL 248170, at *4-5 (4th Cir. 2000).

[27] *Crown Equip. Corp. v. Toyota Material Handling, U.S.A., Inc.*, 202 F. App'x 108, 112-113 (6th Cir. 2006) (Ohio law).

[28] *Pizza Management, Inc. v. Pizza Hut, Inc.*, No. 86-1664-C, 1989 WL 46253, at *15 (D. Kan. April 14, 1989); *Beard Research, Inc. v. Kates*, 8 A.3d 573, 607 (Del. Ch 2010), *aff'd sub nom*, 11 A.3d 749 (Del. 2010); *Superior Edge, Inc. v. Monsanto Co.*, 964 F. Supp. 2d 1017, 1043 (D. Minn. 2013).

[29] *George A. Fuller Co., a Div. of Northrop Corp. v. Chicago Coll. of Osteopathic Med.*, 719 F.2d 1326, 1330–31 (7th Cir. 1983) (Illinois law).

[30] *Hannigan v. Sears, Roebuck & Co.*, 410 F.2d 285, 291 (7th Cir. 1969) (Illinois law); *Slater Numismatics, LLC v. Driving Force, LLC*, 310 P.3d 185, 193 (Colo. Ct. App. 2012); *Walt Peabody Advert. Serv., Inc. v. Pecora*, 393 F. Supp. 328, 332 (W.D. Ky. 1974); Restatement (Second) of Torts § 766 (1979).

[31] *Pac. Gas & Elec. Co. v. Bear Stearns & Co.*, 50 Cal. 3d 1118, 1127, 1129 (1990).

[32] *Meyer v. State by & through Oregon Lottery*, 426 P.3d 89, 103 (Or. App. 2018).

actionable even where the contract is terminated according to its own terms, such as a contract terminable at will.[33]

E. Unjustified Interference/Improper Means/Improper Purpose

This element of the claim is heavily litigated and is often the place where the parties spend the most time fighting. Whether interference is unjustified or improper "is a fact-intensive inquiry that requires an examination of the defendant's conduct, its motive, and the interests it sought to advance."[34] Other factors bearing on whether interference is unjustified or improper include the nature of the interest that was interfered with, balancing public policy interests of freedom of action and contractual expectation, the proximity or remoteness of the actor's conduct to the interference, and the relation of the parties.[35] Interference can be improper through its motive or its means.[36]

An effective way to defend a tortious interference claim is to show that the defendant was privileged to interfere or that the interference was simply fair competition. This is a common theme invoked in the case law: "Judge, we are simply two competitors and the fact that we took away their relationship is nothing more than brass-knuckled competition." The policy justification for the privilege is that "one has a right to be secure in his contracts to pursue his business or employment free from the interference of others except where such others act in pursuance of a superior or equal right."[37]

To this end, competition is justified, proper, or privileged if the defendant acted to protect its own financial or economic interests, the methods were not improper, and the motive was not malicious.[38] For example, being a creditor of one of the contractual parties is an economic interest justifying interference with a third party contract.[39] Conversely, there is no privilege if the defendant did not have a prior economic interest to safeguard, only had an unrealized prospective business advantage, or engaged in conduct that was improper or independently unlawful.[40]

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[33] *Pac. Gas & Elec. Co. v. Bear Stearns & Co*., 50 Cal. 3d 1118, 1126-1127 (1990); Restatement (Second) of Torts § 766, cmt. g (1979).
[34] *Duty Free Americas, Inc. v. Estee Lauder Companies, Inc.*, 797 F.3d 1248, 1280 (11th Cir. 2015) (Florida law) (internal quotation marks and source omitted); Restatement (Second) of Torts § 767 (1979).
[35] Restatement (Second) of Torts § 767 (1979).
[36] *Knight v. Snap-On Tools Corp*., 3 F.3d 1398, 1401 (10th Cir. 1993) (New Mexico law); *Leingang v. Pierce Cty. Med. Bureau, Inc*., 930 P.2d 288, 300 (Wash. 1997); *Nw. Nat. Gas Co. v. Chase Gardens, Inc.*, 982 P.2d 1117, 1123 (Or. 1999).
[37] *Noble Sys. Corp. v. Alorica Cent., LLC*, 543 F.3d 978, 983 (8th Cir. 2008) (internal quotation marks and source omitted) (Minnesota law).
[38] *Duty Free Americas, Inc. v. Estee Lauder Companies, Inc.*, 797 F.3d 1248, 1280-1282 (11th Cir. 2015) (Florida law) (internal citations omitted); Restatement (Second) of Torts § 768 (1979); *see also St. Jude Medical, S.C., Inc. v. Biosense Webster, Inc.,* 994 F. Supp. 2d 1033, 1049 (D. Minn. 2014).
[39] *Wilmington Tr. Co. v. Burger King Corp*., 34 A.D.3d 401, 402 (N.Y. App. Div. 2006)
[40] *Heavener, Ogier Services, Inc. v. R. W. Florida Region, Inc.*, 418 So.2d 1074, 1076-1077 (Fla. Dist. Ct. App. 1982); *Northeast Airlines, Inc. v. World Airways*, Inc., 262 F. Supp. 316 (D. Mass. 1966); *Fred Siegel Co. v. Artee & Hadden*, 707 N.E.2d 853 (Ohio 1999).

Be wary though: the Restatement (Second) of Torts § 768 specifically limits use of the privilege or defense with prospective contractual relations and contracts terminable at will.[41] So, a franchisor may not have a claim against a competitor that recruits its franchisees if the contracts were terminable at will. Likewise, a franchisee may not have a tortious interference claim against a competing franchisee that poaches its employees if the employment contract is terminable at will.[42] This said, many jurisdictions do not follow the Restatement and permit tortious interference claims for contracts terminable at will,[43] reasoning that it is the contractual relationship, not the terms of the contract, that is protected against external interference.[44] In franchising, most agreements are for a term of years and a franchisee's right to terminate early is either non-existent or contractually specified. A competitor's conduct that serves as the moving force of a franchisee's breach mid-term should be closely examined in this context.

Generally, the circumstances in which a third party has a "right" to interfere with an existing contract are narrowly drawn. In most jurisdictions, however, intentional interference alone does not support liability—the interference must be wrongful by some measure beyond the fact of the interference itself.[45] For example, under Maryland and Florida law, purposely inducing breach of contract, even for competitive purposes, is itself improper.[46] The means of interference may be wrongful or improper based on statute, regulation, recognized rule of common law, or established standard of a trade or profession.[47] Certain industries have rules and ways of doing business; when analyzing a competitor's interference, consider those customs and standards as a means to establish the improper means used. Under New Mexico law, interfering conduct is improper only where it is "innately wrongful or predatory in character" such as violence, threats, intimidation, deceit or misrepresentation, bribery, frivolous litigation, or defamation.[48] Under Maine law, a plaintiff must prove interference by fraud or intimidation.[49] Yet in some jurisdictions the means of interference need not be criminal or illegal to be unjustified, and a plaintiff may recover for tortious interference with contract "even if the defendant was engaged in lawful behavior."[50] For example, interference in violation of a fiduciary duty to the plaintiff is improper.[51]

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[41] Restatement (Second) of Torts § 768 (1979).
[42] *Re/Max Int'l, Inc. v. Realty One, Inc.*, 924 F. Supp. 1474, 1508 (N.D. Ohio 1996), *aff'd in part, rev'd in part*, 173 F.3d 995 (6th Cir. 1999).
[43] *Preston v. Wisconsin Health Fund*, 397 F.3d 539, 543 (7th Cir. 2005) (*citing, inter alia, Mendelson v. Blatz Brewing Co*., 101 N.W.2d 805, 807 (Wis. 1960)).
[44] *PG&E* v. *Bear Stearns,* 50 Cal. 3d 1118, 1127 (1990).
[45] *Nw. Nat. Gas Co. v. Chase Gardens, Inc.*, 982 P.2d 1117, 1124 (Or. 1999).
[46] *Prudential Real Estate Affiliates, Inc.*, 2000 WL 248170, at *5 (*citing Macklin v. Robert Logan Assocs.*, 639 A.2d 112, 119 (Md. 1994)); *Matrix Grp. Ltd., Inc. v. Rawlings Sporting Goods Co*., 477 F.3d 583, 592 (8th Cir. 2007) (Florida law).
[47] *Nw. Nat. Gas Co. v. Chase Gardens, Inc.*, 982 P.2d 1117, 1124 (Or. 1999).
[48] *Knight v. Snap-On Tools Corp*., 3 F.3d 1398, 1402 (10th Cir. 1993) (New Mexico law).
[49] *Currie v. Indus. Sec., Inc*., 915 A.2d 400, 408 (Me. 2007).
[50] *Carvel Corp. v. Noonan*, 818 N.E.2d 1100, 1103 (N.Y. 2004) (internal quotation marks and source omitted); *PG&E* v. *Bear Stearns,* 50 Cal. 3d 1118, 1127 (1990).
[51] *Bluesky Greenland Envtl. Sols., LLC v. 21st Century Planet Fund, LLC*, 985 F. Supp. 2d 1356, 1368 (S.D. Fla. 2013).

This said, the fact that a third party enters into an agreement with a franchisee who has breached a franchise agreement is not, in and of itself, improper.[52] "A franchisor may give a franchisee disinterested, truthful advice regarding the legality of the franchisee's current franchise agreement and any right the franchisee may have thereunder to properly terminate the agreement."[53] Anything beyond that potentially exposes the inducing party to the risk that its actions are improper or unjustified. Franchisors seeking to pull a particular franchisee away from a system should be sure to ask for and review that franchisee's agreement before taking any significant steps in that direction.

Interference can also be improper based on the actor's purpose or motive. Under Minnesota law, "[i]nterference is unjustifiable when it is done for the indirect purpose of injuring the plaintiff or benefiting the defendant."[54] So, "while bad faith may not be an element of the tort of tortious interference, it is often persuasive evidence on whether the defendant's conduct was proper and justified or improper and not justified."[55] Under Utah law, however, an improper purpose is insufficient by itself to support liability tortious interference; a plaintiff must also show improper means.[56]

Which party carries the burden of proof on the privilege or justification depends on the jurisdiction. Under Ohio law, it is the plaintiff's burden to prove "lack of privilege" or "improper interference,"[57] while in Minnesota, the burden belongs to the defendant[58]. Under Texas law, the burden of proving the privilege is on the defendant if the claim is for tortious interference with contract, but on the plaintiff if the claim is for tortious interference with prospective business relations.[59] All of this illustrates the varying ways courts in this country wrestle with this particular tort. Practitioners are reminded to study carefully how their state looks at the tort; they should further consider whether there are multiple jurisdictions to choose from when pursuing such a claim and what effect each jurisdiction's choice of law rules have on which substantive tortious interference law will be applied.

F. Effect of Franchisee Inviting Interference – Inducement and Cause

The question of which party initiated contact—the franchisee/franchisor or tortfeasor third party—is relevant to the third element of inducement.[60] If the franchisee/franchisor reached out to the third party first, can it really be said that any interference by the third party—regardless of whether it was for an improper purpose or by an improper means—induced the breach of the franchise agreement? Courts often

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[52] Gaylen L. Knack, *Tortious Interference Claims: Applying Principles of Tort Liability in the Franchise Context*, 9 Franchise L.J. 1, 17–18 (1990) (*citing Purcell v. Joyner*, 200 S.E.2d 363, 366 (Ga. 1973)).
[53] G. Knack, *supra* n. 52 at 18 (*citing* Restatement (Second) of Torts § 772 (1979)).
[54] *St. Jude Medical, S.C., Inc. v. Biosense Webster, Inc.,* 994 F. Supp. 2d 1033, 1048-49 (D. Minn. 2014) (emphasis added).
[55] *Nordling v. N. States Power Co.*, 478 N.W.2d 498, 506 (Minn. 1991).
[56] *Eldridge v. Johndrow*, 345 P.3d 553, 565 (Utah 2015).
[57] *Super Sulky, Inc. v. U.S. Trotting Ass'n*, 174 F.3d 733, 742 (6th Cir. 1999).
[58] *Sysdyne Corp. v. Rousslang*, 860 N.W.2d 347, 351 (Minn. 2015).
[59] *Wal-Mart Stores, Inc. v. Sturges*, 52 S.W.3d 711, 725 (Tex. 2001).
[60] *See Prudential Real Estate Affiliates, Inc.,* 2000 WL 248170, at *6.

refer to this as the interfering party being the "moving force" behind the breach; but put another way, this is simply "but for" causation.[61] The issue (like many of the elements in tortious interference) is a highly factual inquiry decided on a case-by-case basis.[62] What seems to be dispositive is whether the contract would have continued absent the third party interference.[63] In other words, did the third party's interference procure "the termination of a contract which otherwise would have continued in effect"?[64] If the contract would have been breached anyway, there is no interference.[65] Likewise, if the franchisee/franchisor extended an offer to the third party, and the third party's only act of interference was to simply accept the offer from the franchisee/franchisor, "the requisite quality of inducement" is missing and there is no interference.[66]

Therefore, it is not enough to show simply that a defendant interfered; there must be evidence that the defendant's conduct was the "moving force" behind the breach or that the breach would not have occurred <u>but for</u> the defendant's interference. For example, the Missouri Court of Appeals has found that a defendant's interference was not the moving force because the plaintiff's nonperformance rendered a lessee predisposed to breach the financing arrangement and the lessee testified that it was his decision to apply to defendant for financing.[67] Similarly, the Arizona Court of Appeals has found that a defendant did not induce the landlord to breach its lease with a previous tenant where the landlord first contacted the defendant in an attempt to engage defendant as a tenant and landlord visited defendant eight to ten times to discuss how advantageous it would be for defendant to relocate and become a tenant.[68] Washington courts similarly have declined to find inducement where the contracting party repudiated the agreement before the defendant was ever involved,[69] and where the defendant merely accepted an offer of the contracting party[70].

But financial distress and deciding to sell a business, by itself, does not establish that a breaching franchisee repudiated the contract before entering discussions with the defendant.[71] For example, the Wisconsin Court of Appeals affirmed summary judgment dismissing a distributor's tortious interference claim because the supplier had decided to terminate its contract with plaintiff before awarding it to another distributor, the plaintiff

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[61] *Corinthian Corp. v. White & Bollard, Inc.*, 442 P.2d 950, 957-958 (Wash. 1968); *Burkheimer v. Thrifty Inv. Co.*, 533 P.2d 449, 451 (Wash. App. 1975); *Island Air, Inc. v. LaBar*, 566 P.2d 972, 981 (Wash. App. 1977).
[62] *See* Restatement (Second) of Torts § 766, cmt. m (1979)
[63] *See Hahn v. Diaz-Barba*, 125 Cal. Rptr. 3d 242, 258 (2011).
[64] *See Island Air, Inc. v. LaBar*, 566 P.2d 972, 979 (1977) (internal quotation marks and source omitted).
[65] *See Burkheimer*, 533 P.2d at 452.
[66] *See Corinthian Corp.*, 74 Wn. 2d at 62.
[67] *Tri-Continental Leasing Co. v. Neidhart,* 540 S.W.2d 210, 217-218 (Mo. App. 1976).
[68] *Middleton v. Wallichs Music & Entm't Co.*, 536 P.2d 1072, 1075–76 (Ariz. Ct. App. 1975).
[69] *Lanning v. Poulsbo Rural Tel. Ass'n*, 8 Wash. App. 402, 406, 507 P.2d 1218 (1973)
[70] *Corinthian Corp. v. White & Bollard, Inc.*, 74 Wash. 2d 50, 61–62, 442 P.2d 950 (1968).
[71] *See Prudential Real Estate Affiliates, Inc.*, 2000 WL 248170, at *7 ("the terms of the deal between Long & Foster and Porter demonstrate that, despite the poor performance of the business, it nonetheless had some real value.").

and supplier had an acrimonious relationship, and the third party distributor's conduct had no bearing on the supplier's decision to terminate its contract with the plaintiff.[72]

Significantly though, even if a contracting party was inclined to breach, as evidenced by initiating contact with a defendant, that party may still be induced to breach if the defendant solicits beyond normal advertising or negotiates beyond mere acceptance of an offer.[73] For example, in *Heavener, Ogier Services, Inc. v. R. W. Florida Region, Inc.*, the Florida District Court of Appeals affirmed the issuance of a temporary injunction preventing two national real estate franchisors from soliciting each other's franchisees because such solicitation was encouraging the franchisees to breach their existing franchise agreements.[74] The lower court's injunction precluded either franchisor from initiating contact with the other's franchisees that were in existing franchise relationships, and if a competitor's franchisee contacted a franchisor, all the franchisor could do was offer to meet with the interested franchisee after its present contract had expired.[75]

In New York, a federal district court held that a plaintiff had failed to present sufficient evidence of the tort but noted that even if contact with the defendant had been initiated by the contracting party, the defendant could nevertheless have been a cause of the breach if defendant had assured the contracting party that it would represent her.[76] Thus, even where other underlying facts did not result in a claim that could prevail past summary judgment, courts recognize that an interfering party's conduct—if it serves as the "moving force" for a breach—can be enough to give rise to liability. For this reason, a federal district court in Philadelphia held in a non-franchise case that a defendant induced the breaching party to trade Dow Futures in violation of his restrictive covenants by entering into a joint venture with the breaching party, funding that joint venture with $2,000,000, and partially indemnifying the breaching party for costs arising from breaking its contracts with the plaintiff.[77] This is a classic example of being the "moving force" behind the breach.

In *Prudential Real Estate Affiliates*, there was a factual dispute as to whether the defendant or the breaching franchisee initiated contact.[78] The District Court nevertheless concluded that the plaintiff had presented sufficient evidence on summary judgment that the defendant, a competing franchisor, had induced the breach of its dele-orchard

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[72] *Edison Liquor Corp. v. United Distillers & Vintners N. Am., Inc.*, No. 00-2518, 2001 WL 1590762, (Wis. Ct. App. Dec. 12, 2001).
[73] *See* Restatement (Second) of Torts § 766 (1979), cmts. m-n; *see also Restatement (Second) of Torts* § 767 (1979), cmt. C; *Middleton*, 536 P.2d at 1075–76 (Ariz. Ct. App. 1975); *S. Union Co. v. Sw. Gas Corp.*, 180 F. Supp. 2d 1021, 1054–55 (D. Ariz. 2002).
[74] 418 So.2d 1074 (Fla. Dist. Ct. App. 1982).
[75] *Id*. at 1078.
[76] *Michele Pommier Models, Inc. v. Men Women NY Model Mgmt., Inc.*, 14 F. Supp. 2d 331, 336 (S.D.N.Y. 1998), *aff'd*, 173 F.3d 845 (2d Cir. 1999).
[77] *Fishkin v. Susquehanna Partners, G.P.*, 563 F. Supp. 2d 547, 588 (E.D. Pa. 2008), *aff'd in part*, 340 F. App'x 110 (3d Cir. 2009).
[78] 2000 WL 248170 at *6.

lessees.[79] Trial testimony showed that Ken and Vickie Meldrum, the orchard lessees, were satisfied with the plaintiff's management performance.[80] The plaintiff had also advanced considerable costs to Meldrums to prepare the orchard, without pay, in the hopes that that year's crop return would make up the balance.[81] The defendant was the only foreseeable means for the Meldrums to breach their contract days before harvest because it could immediately pack, market, and sell the Meldrum's fruit.[82] Furthermore, the defendant advanced significant sums of money to the Meldrums and the defendant had a "hunting list" for farmers with certain varieties of apples they needed for their buyers.[83]

Examining similar cases across different jurisdictions, a reliable predicator of liability has been condensed by at least one commentator this way: "Inducers with notice of the existence of a particular enforceable contract, who induced its breach by offering Promisor better terms and then obtained Promisor's performance for themselves, have consistently been held liable."[84] This section is long on factually specific examples for a reason: if a third party chooses to be the "moving force" behind a breach by offering incentives to a contracting party to leave one relationship in favor of the third party's competitive contract, liability will assuredly follow.

G. Relief

i. Damages

The final element of a claim for tortious interference is that pecuniary loss must have resulted from the interference of failure to perform the contract.[85] Even if all of the other elements are proven, the claim will be dismissed if a plaintiff cannot show that the defendant's actions caused any loss.[86] Damages recoverable for a successful tortious interference claim include: (1) the pecuniary loss of the benefits of the contract or the prospective relation; (2) consequential losses for which the interference is a legal cause; and (3) emotional distress or actual harm to reputation, if they are reasonably expected to result from the interference.[87] Be mindful that certain jurisdictions permit far broader damages for tortious interference. In jurisdictions like Wyoming, Wisconsin, and Arkansas, for example, courts allow plaintiffs to be compensated for <u>all harm</u> proximately caused by the breach, not just harm limited to these categories.[88]

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[79] No. 28974–5–III, 2011 WL 2536344, at *3-4 (Wash. Ct. App. 1034 June 28, 2011).
[80] *Id*.
[81] *Id.*
[82] *Id*.
[83] *Id*.
[84] Lillian R. BeVier, <u>Reconsidering Inducement</u>, 76 Va. L. Rev. 877, 884–85 (1990).
[85] Restatement (Second) of Torts § 766 (1979); *Prudential Real Estate Affiliates, Inc. v. Long & Foster Real Estate, Inc*., 208 F.3d 210, 2000 WL 248170, at *3 (4th Cir. March 6, 2000)
[86] *Springfield Investments, LLC v. Glob. Investments, LLC*, No. E201401703COAR3CV, 2015 WL 5064090, at *16 (Tenn. Ct. App. Aug. 27, 2015).
[87] Restatement (Second) of Torts § 774A (1979); see also .
[88] *Colorado Interstate Gas Co. v. Natural Gas Pipeline Co*., 661 F. Supp. 1448, 1478 (D. Wyo. 1987) (*quoting Martin v. Wing*, 667 P.2d 1159, 1163 (Wyo. 1983)); *Conway v. Pheifer*, No. 82-1348, 1983 WL

That said, any plaintiff will be hard-pressed to obtain damages causally disconnected from the underlying act of liability. For this reason, courts in Colorado have assessed the measure of damages for tortious interference with contract as the loss caused by the breach.[89] Citing to Comment e of the Restatement (Second) of Torts § 774A, which provides that any payments by the breaching party must be credited to the third party that induced the breach, the Colorado Supreme Court held that where a tortious interference plaintiff retains the contract's liquidated damages, there may be no further recovery against the inducing third party.[90] While an offset certainly may be appropriate due to straightforward application of rules governing causation, this appears highly draconian in that it does not necessarily fully account for a plaintiff's damages caused by the tortious interference.

ii. Injunction

Many jurisdictions have affirmed the availability of preliminary and permanent, injunctive relief in addition to monetary damages for tortious interference cases,[91] even if, under certain case facts, injunctive relief was not warranted.[92] Simply put, injunctive relief is "a common and non-controversial remedy for tortious interference."[93] Florida recognizes temporary injunctions as a form of relief for tortious interference cases, but the level of proof required to establish entitlement to a temporary injunction is not clear and irreparable harm is sometimes assumed.[94] Entitlement to injunctive relief is not automatic, though. The Ninth Circuit Court of Appeals vacated a preliminary injunction placed by a district court pending appeal of jury verdict for plaintiff, finding that the injunction was not meant to support the plaintiff's successful claims, including for tortious interference, and that the singular harms supporting the plaintiff's claims were adequately remedied by monetary damages.[95] Decisions like that, of course, balance the realities of how courts historically look at injunctive relief: if there is a remedy at law, then equitable relief will not necessarily be available.

iii. Affirmative Defense: Advice of Counsel

Interference may also be privileged if the defendant reasonably relied on the advice of counsel.[96] While advice of counsel has been held to be a complete defense in

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161527 at *6 (Wis. Ct. App., July 19, 1983); *Waste Mgmt. of Arkansas, Inc. v. Roll Off Serv., Inc.*, 199 S.W.3d 91, 99 (2004); *Baptist Health v. Murphy*, 365 Ark. 115, 121, 226 S.W.3d 800, 806 (2006).

[89] *Mem'l Gardens, Inc. v. Olympian Sales & Mgmt. Consultants, Inc.*, 690 P.2d 207, 212 (Colo. 1984).

[90] *Id.*

[91] *See Kallok v. Medtronic, Inc.*, 573 N.W.2d 356, 361 (Minn. 1998); *Dinges v. Tollenaar*, No. 00-2105, 2002 WL 1840874, at *3 (Iowa Ct. App. Aug. 14, 2002); *Frequent Flyer Depot, Inc. v. Am. Airlines, Inc.*, 281 S.W.3d 215 (Tex. App. 2009); *Score Bd., Inc. v. Upper Deck Co.*, 959 F. Supp. 234 (D.N.J. 1997).

[92] *Belden Corp. v. InterNorth, Inc.*, 413 N.E.2d 98 (Ill. App. 1980); *Ram Prod. Co. v. Chauncey*, 967 F. Supp. 1071 (N.D. Ind. 1997) (applying Michigan law).

[93] *Organovo Holdings, Inc. v. Dimitrov*, 162 A.3d 102, 122 (Del. Ch. 2017).

[94] *Heavener, Ogier Services, Inc.*, 418 So.2d 1074, 1075-1076 (Fla. Dist. Ct. App. 1982).

[95] *OTR Wheel Eng'g, Inc. v. W. Worldwide Servs., Inc.*, 743 F. App'x 771, 776 (9th Cir. 2018) (Washington law); *see also Organovo Holdings, Inc.*, 162 A.3d at 114.

[96] *Sysdyne Corp. v. Rousslang*, 860 N.W.2d 347, 352 (Minn. 2015) (*citing Kallok,* 573 N.W.2d at 362).

Connecticut,[97] other states treat it solely as a factor that negates the intentionality element of the tort[98]. The "advice of counsel" is not a panacea though, and there are a couple provisos to successful presentation of the defense. First, the defendant must candidly provide its attorney with all relevant information; relying on "infirm consultation with counsel and the resulting advice" is not justified.[99] Second, the defendant must have actually relied and acted on its attorney's advice.[100] The South Dakota Supreme Court, affirming judgment for plaintiff on a jury verdict, rejected a defendant's reliance on the "advice of counsel" defense because evidence was presented at trial that the defendant had acted contrary to his counsel's advice.[101] Accordingly, "[t]ortious interference is not justified when a plaintiff demonstrates that the defendant had knowledge of facts which, if followed by reasonable inquiry, would have led to a complete disclosure of the contractual relations and rights of the parties."[102] The authors believe the better rule to be that "advice of counsel" is a factor in assessing liability rather than a complete defense to a claim for tortious interference; otherwise, all would-be interferers would simply need to retain counsel, get an opinion, and interfere.

H. An Ounce of Prevention Is Worth a Pound of Cure: Protecting the Franchisor Client from Tortious Interference

Kevin Shelley and David W. Oppenheim provide excellent advice for helping your franchisor clients avoid tortious interference claims by competing systems by properly training franchise sales staff:

> The franchise salespersons should make clear, optimally in a writing countersigned by the franchisee, that the franchisor cannot enter a franchise agreement with the prospective franchisee that will become effective any sooner than the date following the day that the existing franchise agreement expires or otherwise terminates (unless there is a post-term covenant not to compete, which would extend even further into the future the effective date of the new franchise agreement). Also, any conversations concerning the prospective franchisee's entry into a new franchise agreement should be expressly conditioned upon the prospect's representation (again, in writing) that the current franchise agreement is about to expire and/or terminate and that the salesperson did not encourage termination or nonrenewal of the prospect's existing franchise agreement. The salesperson should also have the target confirm in writing that no derogatory statements were made about the existing franchisor, and that a franchise will only be offered after disclosure of an appropriate offering circular and receipt of satisfactory written documentation that the prospect's

[97] *Zeller v. Consolini*, No. CV 920060356, 1997 WL 374944, at *4 (Conn. Super. Ct. June 26, 1997).
[98] *Sirazi v. Gen. Mediterranean Holding, SA*, No. 12 C 653, 2015 WL 2265907, at *1 (N.D. Ill. May 12, 2015); *Ins. Assocs. Corp. v. Hansen*, 782 P.2d 1230, 1234, n.2 (1989).
[99] *Sysdyne Corp.*, 860 N.W.2d at 352 (*quoting Kallok,* 573 N.W.2d at 362.
[100] *Selle v. Tozser*, 786 N.W.2d 748, 753-754 (S.D. 2010).
[101] *Id.*
[102] *Kallok*, 573 N.W.2d at 362 (internal quotation marks and source omitted).

current franchise agreement has expired or otherwise terminated and that the prospect is not bound by any post-term covenant not to compete.[103]

Tortious interference is an evolving tort that is highly fact-specific. There is a body of case law that one can find to support a claim and the myriad defenses to it that exist. Parties must be mindful that some courts look at these claims as simply two competitors fighting over turf and will let slide conduct that could be actionable in another jurisdiction. Franchisors seeking to lull prospective franchisees to their systems should have established rules for such engagement and spend time training their development teams to ensure they do not cross over the line.

II. Enforcing Noncompetes Against Nonsignatories

Another area of the franchise relationship where disputes with third parties frequently arise is in the enforcement of covenants not to compete. Noncompetes are ubiquitous in franchise agreements and serve as a critical bulwark against the siphoning and exploitation of franchisors' confidential information, trade secrets, and goodwill—both during the term of the franchise relationship and after that relationship concludes. But they are contractual in nature and, ordinarily, contractual provisions can only be enforced against parties to the underlying contract. On the other hand, the overall effectiveness of a franchise agreement's noncompete often turns on its enforceability against nonsignatories to the franchise agreement.

For example, a former franchisee rebrands and operates a competing business through a new corporate entity; an undisclosed owner of a franchise opens a competing business; a franchise owner's family member—who may have worked for the franchise—starts a competing business; or a franchisee sells its business to (or the business is otherwise acquired by) a third party pursuant to an illusory transaction.[104] The competing business of the new corporate entity, the undisclosed owner, the family member, and the sham purchaser are unlikely to be parties to a noncompete with the franchisor, yet they are often no less the beneficiary of the confidential information and goodwill that the noncompete seeks to protect. In these instances, the ability to enforce a noncompete against nonsignatories is critical to the franchisor for the protection of its brand and system.

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[103] Kevin M. Shelley, David W. Oppenheim, When Conflicting Principles Collide: The Uncharted Boundary Between Fair Competition and Tortious Conduct, 22 Franchise L.J. 184, 188–89 (2003).

[104] *Relo Franchise Servs., Inc. v. Gilman*, No. 1:18CV578, 2018 WL 7288084 (S.D. Ohio Oct. 5, 2018) (franchisee's principals started competing business through new corporate entity), *R & R adopted*, 2019 WL 324215; *Cajun Global LLC v. Swati Enters., Inc.*, 283 F.3d 1325 (N.D. Ga. Dec. 13, 2017) (undisclosed owner started competing business); *Maids Int'l, Inc. v. Maids on Call, LLC*, No. 8:17CV208, 2017 WL 4277146 (D. Neb. Sept. 25, 2017) (franchisees' daughters started competing business after having worked for franchise); *Tanfran, Inc. v. Aron Alan, LLC*, No. 1:06CV830, 2007 WL 1796235 (W.D. Mich. June 20, 2007) (following franchise agreements' termination, trust in the name of the franchisee's owner's mother foreclosed on the franchised businesses' assets, pursuant to loan agreement between the franchisee and the trust, and started competing businesses).

To address this concern, a body of case law has developed to allow for the enforcement of noncompetes against third parties to the franchise relationship, notwithstanding the fundamental principle of contract law that "[a] contract cannot bind a nonparty."[105] In that regard, generally speaking, courts will enforce noncompetes against a nonsignatory where: (1) the signatory effectively controls the nonsignatory, such as in the case of alter ego corporation[106]; (2) there is evidence of a "conspiratorial act of aiding and abetting" the former franchisee's breach of the noncompete[107]; or (3) the nonsignatory has so benefited from the agreement underlying the noncompete, that equitable principles such as assumption and estoppel dictate they also be bound by the obligations contained in the underlying agreement[108]. Frequently, more than one of these elements is implicated in cases in which a court has held that a nonsignatory is bound by a franchise agreement's noncompete.

This section will explore: (1) the basic legal principles governing the enforceability of noncompetes against nonsignatories; (2) examples from recent case law in which a court has enforced a franchise agreement noncompete against a nonsignatory; and (3) practice pointers and critical considerations for enforcing noncompetes against nonsignatories.

A. Standard for Enforcing Noncompetes Against Nonsignatories

In any action to enforce a noncompete against a third party, before you can reach the third party, care must be taken to ensure that the underlying noncompete is valid and enforceable and has in fact been violated. The enforceability of a noncompete in a franchise agreement is usually a question of state common law.[109] Most states will enforce a noncompete in a franchise agreement as long as it is narrowly tailored to protect the franchisor's legitimate business interests, and reasonable in geographic scope, duration, and the scope of conduct prohibited.[110] Courts routinely hold that a franchisor's protectable business interests include trade secrets, confidential information, customer lists, and goodwill.[111] Assessments of the reasonableness of the geographic scope,

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[105] 17A Am. Jur. 2d Contracts § 400 (Feb. 2020 Update).

[106] *Winmark Corp. v. Brenboy Sports, Inc.*, 32 F. Supp. 3d 1206, 1221 (S.D. Fla. 2014) (adopting Report and Recommendation); *Cajun Global*, 283 F.3d at 1330.

[107] Michael R. Gray & Jason M. Murray, *Covenants Not to Compete and Nonsignatories: Enjoining Unfair Conspiracies*, Franchise L.J. Vol. 25 No. 3, at 107 (Winter 2006); *see also McCart v. H&R Block, Inc.*, 470 N.E.2d 756, 762 (Ind. Ct. App. 1984).

[108] *Cajun Global LLC*, 283 F.3d at 1330; *AAMCO Transmissions, Inc. v. Romano*, 42 F. Supp. 3d 700, 710 (E.D. Pa. 2014).

[109] Peter J. Klarfeld & Mark S. VanderBroek, *Law on Covenants Against Competition Shifts Towards Greater Enforceability by Franchisors*, Franchise L.J. Vol. 31 No. 2, at 76 (Fall 2011).

[110] *Id.*, at 77. *But see* CAL. CORP. CODE § 16600 (generally voiding most post-termination covenants not to compete).

[111] *See, e.g., U.S. Lawns, Inc. v. Landscape Concepts of CT, LLC*, No. 6:16CV929, 2016 WL 9526340, at *4 (M.D. Fla. Oct. 31, 2016); Maids *Int'l,* 2017 WL 4277146, at *7 (considering Connecticut and Massachusetts law); *ReBath LLC v. New England Bath Inc.*, No. 16CV1700, 2016 WL 8670165, at *3 (D. Ariz. July 15, 2016); *Outdoor Lighting Perspectives Franchising, Inc. v. Home Amenities, Inc.*, No. 3:11CV567, 2012 WL 137808, at *2 (W.D.N.C. Jan. 18, 2012); *Certified Restoration Dry Cleaning Network, LLC v. Tenke Corp.*, 511 F.3d 535, 548 (6th Cir. 2007) (applying Michigan law); *My Favorite Muffin, Too, Inc. v. Wu*, No. 00CV7820, 2002 WL 826483, at *4 (N.D. Ill. Apr. 30, 2002) Meineke *Discount Muffler v. Jaynes*, 999 F.2d 120, 123 n.5 (5th Cir. 1993) (applying Texas law).

duration, and scope of prohibited conduct are fact-specific, though most jurisdictions have a body of case law that generally addresses reasonable parameters of the latter two considerations. A full discussion of the enforceability of noncompetes is beyond the scope of this paper, but we encourage the reader to review *Covenants Against Competition in Franchise Agreements*, which provides a comprehensive overview of the topic.[112]

Assuming the underlying noncompete is enforceable and that it is in fact being violated, a nonsignatory may also be bound by the provision and subject to injunctive relief pursuant to Federal Rule of Civil Procedure 65(d) and its state analogs. Rule 65(d)(2) states that an order granting injunctive relief may bind the "officers, agents, servants, employees, . . . attorneys[,] and other persons . . . in active concert or participation with" the party to be enjoined.[113] Thus, to the extent that it can be established that a nonsignatory is acting in concert or participation with a signatory to the noncompete to commit a breach of the provision, Rule 65 provides for injunctive relief against the nonsignatory. Applying this statutory principle to case law, a nonsignatory will generally be bound by a noncompete if they have aided and abetted the provision's signatory in violating the provision or have so benefited from the agreement underlying the noncompete, and the business interests that the noncompete seeks to protect, that equity demands the nonsignatory also be bound by the noncompete.

It is fairly universally held that a court "can enjoin non-parties to [a] non-compete agreement, such as a family member of the signator or an alter ego corporation, where the nonparty is either under the signator's control or otherwise being used to aid or abet the signator in violating the non-compete clause."[114] Indeed, quoting a 1958 opinion by the Supreme Court of Florida, the Court of Appeals of Indiana, in an oft-cited opinion for the proposition that a nonsignatory may be bound by a franchise agreement's noncompete, *McCart v. H&R Block, Inc.*, noted that "the rule that a stranger to a covenant may be enjoined from aiding and assisting the covenanter in violating his covenant is supported by an overwhelming weight of authority."[115] The *McCart* court concluded that a husband could be bound by the noncompete in his wife's franchise agreement because he "knowingly participated and aided [his wife] in the violation of her contract with Block" and "[t]heir cooperative conduct amounted to mere subterfuge designed to avoid [the wife's] obligation under the contract."[116]

Other theories of equity may also apply to bind a nonsignatory to a noncompete. For instance, a court in the United States District Court for the Northern District of Georgia noted (quoting in part the Eleventh Circuit and the United States Supreme Court):

> [W]hile it is true that non-signatories are generally not bound by contracts, 'traditional principles of state law may allow a contract to be enforced by or

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[112] Michael R. Gray and Natalma M. McKnew, Covenants Against Competition in Franchise Agreements, (Third Ed. ABA Forum on Franchising 2012).
[113] Fed. R. Civ. P. 65(d)(2).
[114] *Winmark*, 32 F. Supp. 3d at 1221 (citation omitted).
[115] *McCart v. H&R Block, Inc.*, 470 N.E.2d 756, 760 (Ind. Ct. App. 1984) (citing *W. Shore Rest. Corp. v. Turk*, 101 S. 2d 123 (Fla. 1958)).
[116] *Id.*, at 762.

against nonparties to the contract through assumption, piercing the corporate veil, alter ego, incorporation by reference, third party beneficiary theories, waiver and estoppel.'[117]

Similarly, a court in the United States District Court for the Eastern District of Pennsylvania noted that "[i]t is well-established that a non-covenantor who benefits from the covenantor's relationship with a competing business must abide by the same restrictive covenant agreed to by the covenantor."[118]

B. Examples of the Enforcement of Franchise Noncompetes Against Nonsignatories

There is a body of recent case law addressing franchisor attempts to enforce a franchise agreement's noncompete against nonsignatories. The section is subdivided into common fact patterns in which the issue of the enforceability of a franchise agreement's noncompete against nonsignatories arises.

1. New label, same great taste: franchisee or its principals create a new company to operate a competing business

Perhaps the most straightforward example of a circumstance in which courts will enforce a franchise agreement's noncompete against a nonsignatory occurs when the franchisee's principals—who are also typically bound by the noncompete and themselves worked for the franchise—simply incorporate a new entity to operate a competing business. Under those circumstances, courts do not hesitate to enforce the noncompete against the new entity, because it is under the control of those bound by the noncompete and being used to circumvent the noncompete.[119]

For example, in *Relo Franchise Services, Inc. v. Gilman*, after building the most successful franchise in the system (a commercial real estate project management business), Connor and Charlene Gilman, the owners and operators of the corporate franchisee, established a new corporation, terminated their franchise agreement, and continued to operate their business under a new name.[120] Among other things, the new business employed all of the former employees of the franchise, characterized its change to industry contacts as a "rebranding," had solicited or intended to solicit contacts made during the term of the franchise agreement, and continued projects that had commenced during the term of the franchise agreement.

The district court had little problem finding that the Gilmans' new company was also bound by the noncompete contained in the franchise agreement, which on its face

[117] *Cajun Global LLC*, 283 F. Supp. 3d at 1330 (quoting in part *Lawson v. Life of the S. Ins. Co.*, 648 F.3d 1166 (11th Cir. 2011) (quoting in part *Arthur Andersen LLP v. Carlisle*, 556 U.S. 624, 631 (2009))).
[118] *Tantopia Franchising Co., LLC v. W. Coast Tans of PA, LLC*, 918 F. Supp. 2d 407, 416-17 (E.D. Pa. 2013).
[119] *See, e.g., Relo*, 2018 WL 7288084, at *6; *U.S. Lawns,* 2016 WL 9526340, at *7.
[120] *Relo Franchise Services, Inc. v. Gilman,* No. 1:18CV578, 2018 WL 7288084 (S.D. Ohio Oct. 5, 2018).

bound the Gilmans and the corporate franchisee, given its relationship to the Gilmans and the terminated franchise. The court also rejected the Gilmans' challenges to the enforceability of the underlying noncompete, including an argument that the scope of restricted conduct (*i.e.,* "services which have been offered by the franchised business") was overbroad. Accordingly, the court enjoined the Gilmans and their new business from engaging in conduct that violated the noncompete.

Similarly, in *U.S. Lawns, Inc. v. Landscape Concepts of CT, LLC*, owners of a landscape maintenance franchised business began operating a separate business that also offered landscape services shortly before their franchise agreement came to an end (the franchise agreement expired and when the parties were unable to negotiate an extension, the owners notified the franchisor of the agreement's termination).[121] Following the termination of their franchise agreement, the franchise owners' new business offered landscaping services in the same area as their former franchise, to the same customers.

The court found that the competing business was bound by the noncompete that its owners had agreed to in the franchise agreement. In doing so, the court considered analogous law from the enforcement noncompetes in employment agreements, observing that "Florida courts have not hesitated to enforce non-compete agreements against both the employee who signed the agreement as well as against the corporation through which the ex-employee conducted business even where the employee was the only signatory to the non-compete agreement."[122] The new business was enjoined from violating the franchise agreement's noncompete pursuant to Federal Rule of Civil Procedure 65(d)(2) because it was subject to the signators' control, and "[a]ny other result would render a non-compete clause or a non-solicitation clause to be unenforceable by use of the simple expedient of performing all solicitations in the name of a corporate nonsignatory or through use of an agent to aid and assist the ex-employee in violating the agreement."[123]

In short, courts will generally not hesitate to enforce a valid noncompete in a franchise agreement against a nonsignatory corporation where that corporation is a mere continuation of the formerly franchised business and is being used by a franchisee or its principals to circumvent the noncompete.

2. *All in the family: family member of franchisee's principal starts a competing business*

The connection between the former franchisee and its owners and a competing business is not always as clear as it is in the examples above. Another common fact pattern that often confronts franchisors seeking to enforce a noncompete against nonsignatories is when a family member of the franchisee's principal starts a competing

[121] *U.S. Lawns, Inc. v. Landscape Concepts of CT, LLC*, No. 6:16CV929, 2016 WL 9526340, at *3 (M.D. Fla. Oct. 31, 2016).
[122] *Id.*, at *7 (quoting *N. Am. Prods. Corp. v. Moore*, 196 F. Supp. 2d 1217, 1229 (M.D. Fla. 2002)).
[123] *Id.*

business with apparent connections to the franchise. In this context, there is often less evidence that the former franchisee or its principal "control" the new business. Still, courts will typically find that the nonsignatory family member and their competing business are bound by the franchise agreement where there is evidence that the nonsignatories and the signatories have conspired to violate noncompete.[124]

Take, for instance, *Maids International, Inc. v. Maids on Call, LLC*.[125] Timothy and Maryanne Scussel owned and operated four "The Maids" franchises, through the company Maids on Call, LLC, which were in the business of providing household maintenance and cleaning services. The Scussels' daughters Sara Rock and Stacey Garon were employed by the franchised businesses and involved in their operation. In April 2017, the franchisor, The Maids International, Inc., terminated the Scussels' franchise agreements for, among other things, the failure to pay royalties on unreported business. In or around September 2017, the Scussels' daughters started a new residential cleaning company operating under the name Two Sisters Cleaning Service.

The Maids International moved to enjoin Two Sisters, Sara Rock, and Stacey Garon from operating their competing business, pursuant to Federal Rule of Civil Procedure 65(d)(2), under the theory that the Scussels, Maids on Call, the Scussels' daughters, and Two Sisters conspired to circumvent the noncompete and nonsolicitation provisions contained in the franchise agreements for the Scussels' The Maids franchises. Though the sisters and Two Sisters had not signed a noncompete with The Maids International, the court observed that they could be bound by the noncompete and enjoined under Rule 65 if they were in privity or acting in concert with the Scussels.

The court determined that the Scussels, their daughters, and Two Sisters had acted in concert, were in privity, and, therefore bound by a preliminary injunction based on the following facts: (1) Two Sisters performed the same services and operated from the same locations as the Scussels' former The Maids franchises, using the physical assets of the former franchises (some of which were still in Timothy Scussel's name); (2) "The Maids" logo was still being displayed at one of the Two Sisters locations; (3) the Two Sisters Facebook page used the same email address used by the Scussels' former franchises; (4) at least two vehicles used by Two Sisters were registered to the Scussels' former franchised business; (5) Timothy Scussel was identified as the "Registrant," "Admin.," and "Tech." for the Two Sisters website and his personal email address was listed as the address associated with the website; (6) Timothy Scussel had driven for Two Sisters on at least two occasions; Maryann Scussel appeared to have submitted Two Sisters's state business registration; and most importantly to the court, (7) shortly after Two Sisters began operating Timothy Scussel sent a letter to the customers of the Scussels' The Maids franchises announcing his retirement and stating that his daughters were "ready to take over." The court viewed the retirement letter as describing how Two Sisters would be a continuation of the Scussels' The Maids businesses. The court also

[124] *See, e.g., Maids Int'l*, 2017 WL 4277146, at *5; *Tanfran*, 2007 WL 1796235, at *8; *McCart*, 470 N.E.2d at 762.
[125] *Maids Int'l, Inc. v. Maids on Call, LLC*, No. 8:17CV208, 2017 WL 4277146 (D. Neb. Sept. 25, 2017).

noted that Two Sisters served many of the same customers as the Scussels' former franchises.

A slightly more convoluted example of a franchise agreement's noncompete being enforced against a nonsignatory family member (or a family member's trust in this case) can be found in *Tanfran, Inc. v. Aron Alan, LLC*.[126] Aron Schrotenboer was the sole member of Aron Alan, LLC, the franchisee of several Mirage Tanning Centers. When the franchise began experiencing financial difficulties, Schrotenboer received a $1 million loan from his mother—through a trust in her name—for Aron Alan. The loan was secured by Aron Alan's Mirage Tanning franchises. But after Aron Alan continued to be unable to keep up with its financial obligations, Tranfran, the franchisor, terminated Aron Alan's franchises agreements. At the same time, Aron Alan was significantly behind on its repayment of the loan from the trust. Thus, the trust foreclosed on the franchised businesses and established a new a business using the surrendered assets (Miracle Tanning, LLC) to continue operating tanning businesses under the name "Miracle."

Tranfran moved to enjoin the trust and Miracle from operating their competing business in violation of the noncompetes contained in Aron Alan's franchise agreements. Opposing Tanfran's motion, the trust and Miracle argued that neither was a party to the noncompetes, there was no evidence that they were acting in concert with Aron Alan (its principal, Aron Schrotenboer, died before the franchise agreements were terminated), and all they had done was exercise the trust's rights under its loan agreement and make a prudent business decision to continue operating tanning businesses with the loan collateral.

The court rejected the trust's and Miracle's arguments, finding that the following evidence demonstrated that they conspired with Aron Alan to avoid the noncompetes: (1) the timing of the trust's decision to repossess Aron Alan's assets upon Tanfran's termination of the franchise agreement evidenced an effort to avoid the effects of the termination; (2) Miracle continued to use the former franchises' telephone numbers to direct business to Miracle; (3) the trust and Miracle continued to use Tanfran's operations manual and proprietary software; and (4) the trust's repossession of Aron Alan's assets prevented Tanfran from exercising its contractual right to purchase Aron Alan's business assets upon termination. The court found that the foregoing facts suggested that Aron Alan's business was passed to the trust and Miracle "uninterrupted," such that "to allow the [t]rust and Miracle to continue the tanning business would be tantamount to permitting Aron Alan to violate the non-competition agreements."[127]

In short, in cases like *The Maids International* and *Tanfran*, there may not be significant evidence that the former franchisee or its principals <u>control</u> the competing business of a family member; still, courts will find that the nonsignatory family member is also bound by the noncompete where the new business appears to be a mere continuation of the franchised business. The new business is more likely to be a mere continuation where, among other things, there is evidence of the absence of an arms-

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[126] *Tanfran, Inc. v. Aron Alan, LLC*, No. 1:06CV830, 2007 WL 1796235 (W.D. Mich. June 20, 2007).
[127] *Id.*

length transaction[128]; that the new business solicits the customers of the former franchise or otherwise redirects them to the new business[129]; or that the new business continues to use confidential information or proprietary materials provided by the franchisor to the former franchisee[130]. Circumstances like these evidence a concerted effort between the former franchisee, its principal, and the new competing business to retain the benefits of the franchise relationship, including customer goodwill, while avoiding the agreement's obligations. Courts will generally enforce a noncompete against a nonsignatory to prevent this kind of exploitation.

3. *The old switcheroo: an undisclosed owner starts a competing business*

Another common scenario in which courts will enforce a franchise agreement's noncompete against a nonsignatory is when an undisclosed owner of a franchise begins operating a competing business at the conclusion of the franchise relationship. In that scenario, it may be difficult to demonstrate that the former (disclosed) franchisee and its (disclosed) principal control the new business, or even conspired with the new business to avoid the noncompete. Still, courts will generally find that equitable principles dictate the undisclosed owner be bound by the noncompete, having otherwise benefited from the franchise relationship.[131]

Take, for instance, *Cajun Global LLC v. Swati Enterprises, Inc.*[132] Two months after the franchisee's principal signed a franchise agreement to operate a Church's Chicken restaurant, he sold the franchise without the franchisor's knowledge. For ten years, the buyer, Rahman, operated the franchise as if he were the franchisee, paying royalties and marketing fees, using the Church's Chicken trademarks, receiving operational and training support from the franchisor, and obtaining a copy of the franchisor's confidential operational manual. At all times, the franchisor remained ignorant of the sale and believed Rahman to be the manager of the franchise. Upon the expiration of the franchise agreement, Rahman rebranded the franchise as "Orange Fried Chicken," and continued operating a quick-service restaurant offering fried chicken, using a logo, trademarks, and décor "confusingly similar" to that used by Church's.

When the franchisor moved to enjoin Rahman from violating the noncompete in the franchise agreement, he argued he did not sign the agreement and, therefore, was not bound by the noncompete. The court disagreed. First, it observed that Rahman could be enjoined under Federal Rule of Civil Procedure 65(d) as an "owner, employee, and someone 'in active concert and participation'" with the franchisee and its principal.[133]

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[128] *See, e.g., Maids Int'l*, 2017 WL 4277146, at *5; *Merry Maids, L.P. v. WWJD Enters, Inc.*, No. 8:06CV36, 2006 WL 1720487, at *12 (D. Neb. June 20, 2006).
[129] *See, e.g., Maids Int'l*, 2017 WL 4277146, at *4; *Tanfran*, 2007 WL 1796235, at *8; *McCart*, 470 N.E.2d at 759.
[130] *See, e.g.*, *Tanfran*, 2007 WL 1796235, at *4.
[131] *See, e.g., Cajun Global LLC*, 283 F. Supp. 3d at 1330; *Little Caesar Enterprises, Inc. v. Little Caesar's Va, Inc.*, No. 2:09CV112, Bus. Franchise Guide (CCH) ¶ 14,199 (Aug. 27, 2009).
[132] *Cajun Global LLC v. Swati Enters., Inc.*, 283 F. Supp. 3d 1325 (N.D. Ga. 2017).
[133] *Id.*, at 1329-30.

Second the court observed that "while it is true that nonsignatories are generally not bound by contracts, traditional principles of state law may allow a contract to be enforced by or against nonparties to the contract through assumption, piercing the corporate veil, alter ego, incorporation by reference, third party beneficiary theories, waiver and estoppel."[134] Rahman, it held, could be bound by the contract under the theories of assumption and equitable estoppel "to prevent [him] from performing under and reaping the benefits of the Franchise Agreement for ten years, and then repudiating the post-expiration obligations on the basis that he did not sign the Franchise Agreement."[135]

Little Caesar Enterprises, Inc. v. Little Caesar's Va., Inc. presents similar facts.[136] There, the corporate franchisee included an undisclosed owner that the franchisor, Little Caesar, had previously rejected as a franchisee. The undisclosed owner acted as the franchise's primary operator, and had access to Little Caesar's proprietary and confidential information. At all times Little Caesar believed him to be the restaurant's manager. When Little Caesar became aware of the undisclosed owner's true involvement with the franchise, it terminated the franchise agreement. The undisclosed owner, who had ousted the disclosed owner, then rebranded the restaurant as "Family Pizza Plus" and, for a time, advertised as available for purchase certain Little Caesars products, displayed Little Caesars signage, and used Little Caesar's ingredients. Moreover, the restaurant continued to use the telephone number associated with the former Little Caesars franchise and elements of the Little Caesars trade dress.

When Little Caesar moved to enjoin the undisclosed buyer from operating Family Pizza Plus in violation of the noncompete, he argued that he did not sign the franchise agreement containing the noncompete and that the franchisee and its disclosed owner were not involved in the creation or operation of the new restaurant. Rejecting those arguments, the court held that "[e]quity cannot permit [the undisclosed buyer] to profit from his own misdeeds, especially at the expense of Little Caesar, which appears to have acted in this matter at all times in good faith."[137]

4. Can't win 'em all

Sometimes the relationship between a competing business and a former franchisee and its principals is just too tenuous to justify enforcing a noncompete against a nonsignatory. That was the case in *Winmark Corp. v. Brenboy Sports, Inc.*, despite some evidence of concerted action between the franchisee and the buyer.[138] There, the franchisee of a Play It Again Sports store sold its assets to Jorge Bocca after its franchise agreement was terminated. The purchase price was $55,000, plus some percentage of the new business's future sales. Bocca continued operating a similar sporting goods store under the name "Play or Trade Sport" from the same location as the former franchise.

[134] *Id.*, at 1330 (quotation marks and citation omitted).
[135] *Id.* (citation omitted).
[136] *Little Caesar Enterprises, Inc. v. Little Caesar's Va., Inc.*, No. 2:09CV112, Bus. Franchise Guide (CCH) ¶ 14,199 (Aug. 27, 2009).
[137] *Id.*, at 17.
[138] *Winmark Corp. v. Brenboy Sports, Inc.*, 32 F. Supp. 3d 1206 (S.D. Fla. 2014).

Evidence in the case showed, among other things, that the son of the owner of the formerly franchised business continued to serve as co-manager for Bocca and Play or Trade Sport, and that Play or Trade appeared to continue to use the franchisor's proprietary point of sale and inventory software.

The court enjoined the former franchisee from maintaining any interest in the competing business, including from receiving any further proceeds from the sale of business to the extent they were derived from the business's sales. However, it refused to enjoin Bocca and Pay or Trade Sport, observing that the franchisor had not established that Bocca and his competing business were "an alter ego for [the former franchisee] to secretly operate Play or Trade Sport, or that the[] non-parties are under [the former franchisee's] control."[139] The facts that the franchisor presented no evidence that it intended to refranchise the area in which Play or Trade Sport operated and that the next closest Play it Again Sports store was approximately 23 miles away, likely also factored into the court's holding. Importantly, the court also noted that even if the franchisor had established that Bocca and his competing business could be bound by the noncompete, the court could not enjoin them because they had not been named as defendants, they had no opportunity to defend themselves, and there was no evidence that they even had notice of the franchisor's intention to enjoin them from operating their business.

Winmark goes to show that there are boundaries to courts' willingness to override the fundamental principle of contract law, that he who has not signed is not bound, to bind nonsignatories to franchise agreement noncompetes. Where a nonsignatory acquires the assets of a formerly franchised business through an arms-length transaction, absent evidence that the former franchisee controls the new business, or of conspiratorial conduct between the former franchisee and the new business, convincing a court to enforce a noncompete in an agreement to which the new business is not a party will be exceptionally challenging.

C. Practice Pointers

The cases discussed above and other cases concerning the enforcement of franchise agreement noncompetes against nonsignatories highlight a few important tips for practitioners. Key among them are jurisdictional and related strategic considerations. Given the significance of those considerations and the common thread that runs through them in the larger context of establishing third party liability in the franchise context, they are given their own Section (Section VI), below. The considerations discussed in this section apply more narrowly to the context of enforcing noncompetes against nonsignatories.

1. Name those against whom the noncompete will (or attempted to) be enforced as parties to the litigation.

Federal Rule of Civil Procedure 65 states that an injunction order binds "the parties," their "officers, agents, servants, employees, and attorneys," and "other persons

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[139] *Id.*, at 1222.

who are in active concert or participation with" only if they "receive actual notice" of the injunction "by personal service or otherwise."[140] In the context of enforcing a franchise agreement noncompete against a nonsignatory, a litigant may be lulled into reading Rule 65 require only that a nonsignatory allegedly acting in concert with a signatory to breach the noncompete be given notice of an injunction order, *after its issuance*, to be bound by that order. That reading may not always be incorrect. In *U.S. Lawns*, the court rejected the defendants' argument that their competing business could not be bound by—and enjoined from violating—a noncompete that it did not sign because it had not been named as a party, and held that the business could also be enjoined under Rule 65(d)(2).[141]

However, as *Winmark* teaches, the most prudent approach is to name as a party any person or business against whom an injunction is sought and make clear the intention to obtain an injunction against them. There, the court noted that even if the franchisor had demonstrated that the nonsignatory' s competing business should be bound by the noncompete, the court could not enjoin it because it had not been named as a party.[142] In *Tanfran*, the nonsignatories to the franchise agreement were parties to the litigation, but made much of the argument that they could not be enjoined because the franchisor belatedly identified them as subjects of the franchisor's preliminary injunction motion.[143] The court took some care to determine the nonsignatories had adequate notice of the franchisor's intentions and an opportunity to defend themselves.

2. Consider making it contractual.

A prospective approach that franchisors may consider to confront the challenges presented by seeking to enforce a noncompete against a nonsignatory is limiting the circumstances under which such enforcement is necessary by increasing the number of key players that are <u>contractually</u> bound by a noncompete. Franchise agreement noncompetes and related guarantees will frequently bind, by signature, the franchisee, the franchisee's principals if it is a business, and the franchisee's or its principal's spouse. But franchisors may also consider imposing contractual requirements on franchisees to secure a noncompete agreement mirroring or substantially similar to that contained in the franchise agreement from key employees and high-level managers likely to have access to the franchisor's protectable information, as well as a requirement that any such agreement name the franchisor as a third-party beneficiary of the same.

However, this approach should only be considered for high-level employees with specialized job functions that give them access to truly protectable and confidential information such as trade secrets and customer lists. It should also be noted that noncompetes in the context of employment agreements are likely to receive greater

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[140] Fed. R. Civ. P. 65(d)(2).
[141] *See, e.g., U.S. Lawns*, 2016 WL 9526340, at *7. It is worth noting that the competing business's principals had been named as parties and therefore had an opportunity to defend themselves and the nonparty business.
[142] *Winmark Corp.*, 32 F. Supp. 3d at 1222-23.
[143] *Tanfran*, 2007 WL 1796235, at *3-4.

scrutiny and may not be enforceable.[144] Indeed, noncompetes in employment agreements are a recent target of enacted and proposed federal and state legislation aimed at rooting out alleged anticompetitive behavior.[145] Still, where advisable and enforceable, noncompetes between franchisees and high-level employees, which name the franchisor as a third party beneficiary, can assist franchisors in ensuring they are able to protect their valuable, confidential information and goodwill from misuse and abuse.

III. Misappropriation of Trade Secrets

Another instance in which third parties are often involved is when a franchisor's trade secrets are misappropriated. For example, a franchisee wrongfully using a franchisor's trade secrets to operate a competitive business may be operating that competitive business under a new third party entity. Franchisee employees, spouses, and other third parties closely related to the franchisee also have the opportunity to gain access to trade secrets which may later be misused. These third parties may be directly liable under the Uniform Trade Secrets Act ("UTSA"),[146] adopted in all states except New York,[147] and the federal Defend Trade Secrets Act, 18 U.S.C. § 1836, <u>et seq.</u> ("DTSA").

A. Definition of a Trade Secret

A "trade secret" is defined under the UTSA as:

> information, including a formula, pattern, compilation, program, device, method, technique, or process, that:
>
> (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and

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[144] *See, e.g. Medi-Loss Franchising USA, LLC v. Las Colinas Medi Weightloss Clinics, LLC*, No. 8:13CV990, 2013 WL 12122070 (M.D. Fla. Sept. 4, 2013) (observing noncompete in employment agreement of high-level employee of franchisee, which named franchisor as third-party beneficiary, would likely bind employee in enforcement action by franchisor <u>if</u> the underlying agreement was in fact enforceable under state law).

[145] *See, e.g.,* Workforce Mobility Act of 2019, S. 2614, 116th Cong. (2019); WASH. REV. CODE § 49.62.020 (effective Jan. 1, 2020).

[146] National Conference of Commissioners on Uniform State Law, UniformTrade Secrets Act with 1985 Amendments (Feb. 11, 1986),http://www.uniformlaws.org/shared/docs/trade%20secrets/utsa_final_85.pdf (last visited Feb. 12, 2020).

[147] *See* National Conference of Commissioners on Uniform State Laws, Acts: Trade Secrets Act, https://www.uniformlaws.org/committees/community-home?CommunityKey=3a2538fbe030-4e2d-a9e2-90373dc05792 (last visited Feb. 12, 2020). New York does not have any statute governing trade secret law therefore all claims for trade secret misappropriation are governed by common law. *See, e.g., Ashland Mgmt., Inc. v. Janien,* 82 N.Y.2d 395, 407, 624 N.E.2d 1007, 1013 (1993).

(ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.[148]

Franchisors use a variety of methods to protect their trade secrets. The key is to avoid being over-inclusive in the definition. Not every piece of confidential business information is a trade secret; whereas, every trade secret is part of a company's arsenal of confidential information. Confidentiality covenants, covenants not to compete, and comprehensive definitions of "confidential information," which fully capture and protect those aspects of the franchisor's system that "derive independent economic value" from "not being readily ascertainable" are critical. Careful drafting of these confidentiality obligations will likely encompass all parties associated with the franchisee who may have access to the information, including employees, owners and family members. These carefully drafted confidentiality provisions will often give franchisors claims against their franchisees for wrongful disclosure of the confidential information and franchisors will also have claims against third parties under the UTSA and DTSA.[149]

B. Misappropriation of Trade Secrets Under the Uniform Trade Secrets Act.

Franchisors faced with the theft and misuse of their trade secrets have a variety of remedies under UTSA, including injunctive relief for any actual or threatened misappropriation, monetary damages, and double damages and attorneys' fees where the misappropriation was willful and malicious.[150]

The UTSA defines "misappropriation" as:

(i) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or

(ii) disclosure or use of a trade secret of another without express or implied consent by a person who:

(A) used improper means to acquire knowledge of the trade secret; or

(B) at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was:

[148] UTSA § 1(4).
[149] *See, e.g., HCA Franchise Corp. v. Alsich*, No. 3:16-cv-476, 2016 WL 10706285 (N.D. Ind. 2016) (finding franchisor likely to succeed on the merits of its UTSA and DTSA claims for franchisee's unauthorized transfer of franchisor's confidential information in breach of the terms of the franchise agreement).
[150] *Id.,* §§ 2(a), 3.

(I) derived from or through a person who had utilized improper means to acquire it;

(II) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or

(III) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or

(C) before a material change of position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.[151]

The term "improper means," includes "theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means[.]"[152] In the franchise context, these "improper means" most often include the breach of the duty to keep the franchisor's proprietary information confidential as required by the franchise agreement.[153]

C. The Federal Defend Trade Secrets Act

DTSA established new federal protections for trade secrets when it became effective in 2016. More specifically, DTSA provides a private right of action for misappropriation of a trade secret related to a product or service used in, or intended for use in, interstate or foreign commerce.[154] Importantly, franchisors and other trade secret owners can now pursue their claims of misappropriation directly in federal court without any other basis for federal jurisdiction. The DTSA does not preempt state trade secret laws so franchisors will want to consider the most beneficial forum to bring their claim. DTSA also gives franchisors and others faced with the theft of their trade secrets a new tool to act quickly to prevent the dissemination of their trade secrets by giving federal courts the power to order seizure of property on an ex parte basis.[155] For example, in *Vice Capital, LLC v. CBD World, LLC*, a franchisor successfully seized a prospective franchisee's computers, computer hard drives, memory devices and smart phones determined to contain the franchisor's confidential information after the franchisor discovered the prospective franchisee, who operated using the franchisor's marks and system for a short period of time before declining to execute a franchise agreement, had

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[151] *Id.*, § 1(2).
[152] *Id.*, § 1(1).
[153] *See, e.g., HCA Franchise Corp*, 2016 WL 10706285, *7 (N.D. Ind. 2016); *see also JTH Tax, Inc. v. Freedom Tax, Inc.*, 3:19-cv-00085-RGJ, 2019 WL 2062519, *11 (W.D. Ky. 2019) (quoting similar definition of "improper means" under DTSA, 18 U.S.C. § 1839(6)(A), and finding nonsignatory officer of franchisee liable for misappropriation).
[154] 18 U.S.C. § 1836(b)(1).
[155] *Id.*, § 1836 (b)(2).

exported the franchisor's customer lists.[156] In addition to the seizure of property, DTSA affords aggrieved parties the ability to obtain injunctive relief,[157] monetary damages and, similar to UTSA, double damages and attorneys' fees for any willful and malicious misappropriation.[158]

IV. Contributory Trademark Infringement

Trademarks are one of the most valuable assets to any franchise system and a franchisor's protection of its trademarks from infringement is essential. It is not uncommon to see franchisors commence legal actions against former franchisees who have either continued to use the marks after termination or expiration of their franchise agreements or who have failed to de-identify their locations. A franchisor's efforts to obtain compliance may be frustrated when the franchisee has abandoned the location or is insolvent. Fortunately, franchisors faced with such situations may pursue an alternative (or additional) remedy against a third party, the landlord, under the theory of contributory trademark infringement.[159] This section will explore this remedy and also discuss the potential for a franchisor's third party liability for the infringing acts of a franchisee.

A. Elements of a Claim for Contributory Trademark Infringement

A claim for contributory trademark infringement derives from the Lanham Act, 15 U.S.C. § 1051, *et seq.* The theory was established by the United States Supreme Court in *Inwood Lab., Inc. v. Ives Labs, Inc.* which concluded that:

> Even if a manufacturer does not directly control others in the chain of distribution, it can be held responsible for their infringing activities under certain circumstances. Thus, if a manufacturer or distributor intentionally induces another to infringe a trademark, or if it continues to supply its product to one whom it knows or has reason to know is engaging in trademark infringement, the manufacturer or distributor is contributorily responsible for any harm done as a result of the deceit.[160]

To establish a claim for contributory trademark infringement, the claimant must prove four elements: (a) the defendant had sufficient control over the instrumentality used to infringe; (b) the defendant possessed the requisite knowledge of trademark infringement activity; (c) the defendant continued to supply its service despite said

[156] CIV-18-566-D, 2018 WL 8786293 (W.D. Okla. 2018).
[157] Notably, "[t]he DTSA 'merely authorize[s] and do[es] not mandate injunctive relief and thus do[es] not allow a presumption of irreparable harm." *JTH Tax, Inc.*, 2019 WL 2062519, at *13 (citing 18 U.S.C. § 1836(b)(3)(A), (B)).
[158] *Id.*, § 1836 (b)(3).
[159] *See* Bryan Huntington, *Contributory Liability — An Underutilized Trademark Remedy for Franchisors*, 23 The Franchise Lawyer 9 (Winter 2020).
[160] 456 U.S. 844, 854 (1982).

knowledge; and (d) the defendant failed to take remedial steps to stop the infringing activity.[161]

1. Using A Contributory Trademark Infringement Claim to Compel Deidentification.

Landlords who continue to display a franchisor's trademarks after termination of the franchise may face liability for contributory trademark infringement because courts are increasingly finding a duty for landlords to "avoid providing space to counterfeiters who the owner knows or has reason to know are selling counterfeit goods."[162] This cause of action "affords franchisors powerful leverage" to protect their trademarks after termination.[163]

The Eleventh Circuit Court of Appeals recently addressed the theory of landlord contributory liability in *Luxottica Grp., S.P.A. v. Airport Mini Mall* and determined that a landlord could be contributorily liable under the Lanham Act even without actual knowledge of infringement by its tenants if the landlord "suspects wrongdoing and deliberately fails to investigate."[164] Plaintiff Luxottica is the owner of the trademarks for Ray-Ban and Oakley products. Luxottica commenced a lawsuit against a defendant landlord who operated an indoor flea market leasing space to vendors selling counterfeit merchandise. The flea market was often subject to raids by law enforcement relating to the sale of infringing merchandise. A jury found the defendant landlord liable for contributory trademark infringement and, in its motion for judgment notwithstanding the verdict, the landlord argued its lack of actual knowledge of specific acts of infringement by its tenants absolved it of liability. The district court, in upholding the jury's verdict, held that the defendant's knowledge of specific acts of infringement were not required for a finding of contributory liability and that the duration, frequency and visibility of law enforcement raids established, at a minimum, the landlord's constructive knowledge of the infringing activity. The district court further determined that there was sufficient evidence for a reasonable jury to find that the landlord had the ability to take steps to stop counterfeit sales, had reason to suspect infringement by the tenants, may have actually known of the counterfeit sales, and deliberately failed to investigate.

Franchisors can apply the precedent developed by *Inwood Labs, Inc.*, *Luxottica*, and other authority to compel landlords to deidentify a former franchised location. As mentioned above, this is a particularly useful remedy when the franchisee has abandoned the premises or is insolvent. Courts are increasingly willing to apply the theory of contributory trademark infringement to cases where the landlord turned a blind eye toward

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[161] *Omega SA v. 375 Canal, LLC,* No. 12-civ-6979, 2016 WL 7439359, *2 (S.D.N.Y. Dec. 22, 2016).

[162] *Louis Vuitton Malletier v. Eisenhauer Road Flea Market, Inc.*, No. SA-11-CA-124-H, 2011 WL 13237799, *4 (W.D. Tex. Dec. 19, 2011) (emphasis removed).

[163] *Huntington*, *supra* n. 163.

[164] 932 F.3d 1303, 1312-13 (11th Cir. 2019) (quoting *Hard Rock Café Licensing Corp. v. Concession Servs., Inc.*, 955 F.2d 1143, 1149 (7th Cir. 1992)(landlord of flea market liable for tenant's sale of infringing products where landlord is "willfully blind" to the infringing acts); *see also Polo Ralph Lauren Corp. v. Chinatown Gift Shop*, 855 F. Supp. 648, 650 (S.D.N.Y. 1994) (same); *Habeeba's Dance of the Arts, Ltd. v. Knoblauch*, 430 F. Supp. 2d 709, 714-15 (S.D. Ohio 2006) (same).

its tenant's wrongful use of another's trademarks and this remedy should be considered where deidentification is not more easily attainable by other means.

Franchisors have also used contributory liability to compel deidentification and seek related Lanham Act damages against nonsignatory entities related to the franchisee. For example, in *Ramada Franchise Systems, Inc. v. Boychuk*, the franchisor prevailed on a contributory liability claim against the individual franchisee's management company who participated as a "moving, active conscious force" in infringing on the franchisor's trademarks by assisting with the operations of a hotel after the franchisee's termination.[165] Similarly, in *Tropical Smoothie Franchise Development Corp. v. Hawaiian Breeze, Inc.*, the franchisor defeated a motion to dismiss its contributory liability claim asserted against a former franchisee and a newly-formed related entity who commenced operations at the former franchisee's location using confusingly similar trade dress.[166] And, in *Mister Softee, Inc. v. Amanollahi*, the federal court enjoined a terminated franchisee and those acting in concert with him from further trademark infringement under a theory of contributory liability where the franchisee transferred his franchises to four other people without the franchisor's consent.[167]

2. Franchisor Third Party Liability for Franchisee Infringement

Franchisors may also face liability for contributory trademark infringement if they participate in or acquiesce to infringement by franchisees. For example, in *Mini Maid Services Co. v. Maid Brigade Systems, Inc.*, the Eleventh Circuit held that a franchisor cannot be liable for a single franchisee's trademark infringement solely because the franchisor failed to exercise reasonable diligence.[168] The court determined, however, that liability may attach if the franchisor actually knew about or intended to participate in the infringing activities.[169] Thus, if a franchisor intentionally induced its franchisees to infringe on another's trademark, knowingly participated in a scheme of trademark infringement carried out by its franchisees or acted in bad faith by refusing to exercise its contractual power to halt the infringing activities, the franchisor may be liable for contributing to the infringement.[170]

V. Civil Conspiracy

As described above, franchisors have a variety of tools to protect themselves from third party interference with the franchise relationship or franchise system. In addition to the various types of claims described above, franchisors may also choose to pursue

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[165] 283 F. Supp. 2d 777, 788 (N.D.N.Y. 2003) (quoting *Bambu Sales, Inc. v. Sultana Crackers, Inc.*, 683 F. Supp. 899, 913 (E.D.N.Y. 1988).
[166] No. 804CV0054417TGW, 2005 WL 1500886, *4 (M.D. Fla. June 23, 2005) (citing *Inwood Labs.,* 456 U.S. at 853).
[167] No. 2:14-CV-01687 (KM)(MCA), 2014 WL 3110000, *6-8 (D.N.J. July 1, 2014) (discussing *Inwood Labs*, 456 U.S. at 853-54).
[168] 967 F.2d 1516, 1521 (11th Cir. 1992) (declining to find franchisor liable for its franchisee's infringement of another franchisor's trademark).
[169] *Id.* at 1521-22.
[170] *Id.*

claims against these third parties for civil conspiracy, defined generally as the combination of two or more people "to do an unlawful act or to do an otherwise lawful act by unlawful means when some overt act is taken in furtherance of the conspiracy and some actual legal harm accrues to the plaintiff."[171] The intent to injure and a lack of justification are essential parts of a civil conspiracy cause of action.[172] Importantly, not all states recognize civil conspiracy claims as independent causes of action so the franchisor will want to be aware of the applicable state law when raising such claims.[173] In most scenarios, the franchisor will connect the conspiracy to one of the underlying torts described above, for example conspiracy to breach or interfere with the restrictive covenants in the franchise agreement or conspiracy to breach or interfere with the obligations of confidentiality in the franchise agreement.[174]

VI. Procedural and Strategic Considerations Related to Third Party Liability

Under the same theories used to bind nonsignatories to restrictive covenants discussed above in Section II, a franchisor may be able to bind a nonsignatory conspirator to the dispute resolution terms contained within the franchise agreement, such as an agreement to arbitrate, a forum selection clause, or a jury trial waiver.[175] Estoppel and incorporation by reference are two of the most common theories used to bind nonsignatories to the procedural provisions of franchise agreements and are discussed in greater detail below.[176]

Franchisors should not rush to enforce their dispute resolution obligations against third parties without first undertaking a careful analysis of the risks and benefits of applying those terms to third parties. For example, the choice of forum may have significant impact on a franchisor's ability to obtain relief against a third party. While the

[171] *See, e.g., Barmasters Bartending Sch., Inc. v. Authentic Bartending Sch., Inc.,* 931 F. Supp. 377, 386 (E.D. Pa. 1996).
[172] *Id.*
[173] *Quinn v. Thomas H. Lee Co.,* 61 F. Supp. 2d 13, 20 (S.D.N.Y. 1999); *Servpro Indus., Inc. v. Schmidt*, 905 F. Supp. 470, 474 (N.D. Ill. 1995) ("[A]n underlying wrong must exist for an action for conspiracy to exist."); *In re Bono Holdings, Inc.,* Nos. 08–70259 BM, 08–70278, 2009 WL 8556806 (Bankr. W.D. Pa. Sept. 22, 2009) ("Civil conspiracy is not independently actionable, but instead depends on the performance of an underlying tortious act. . . . [A] cause of action for civil conspiracy is 'wholly subordinate to the underlying tort's existence.'" (citing *Boyanowski v. Capital Area Intermediate Unit,* 215 F.3d. 396, 407 (3d Cir)).
[174] *See, e.g., Servpro Indus., Inc.*, 905 F. Supp. At 474-75 (area developer alleged tortious interference with contract as underlying tort against franchisor and franchisee).
[175] *See* supra § II. The theories include incorporation by reference, assumption, agency, alter ego and estoppel. *See also* Emily Cano, Darci Cohen and Diane Green-Kelly, *Unsigned Obligations: When are Nonsignatories Bound?* ABA 37th Annual Forum on Franchising W-2 (2014) (citing *Thomson-CSF, S.A. v. Am. Arbitration Ass'n,* 64 F.3d 773, 776 (2d Cir. 1995)); *Cajun Global LLC*, 283 F. Supp. 3d at 1330.
[176] E. Cano*, supra* n. 179 (citing *Arthur Andersen LLP v. Carlisle*, 556 U.S. 624, 631 (2009); *Crawford Prof'l Drugs, Inc. v. CVS Caremark Corp*., 748 F.3d 249, 257 (5th Cir. 2014); *Zurich Am. Ins. Co. v. Watts Indus., Inc*., 417 F.3d 682, 687 (7th Cir. 2005); *Denney v. BDO Seidman, L.L.P*., 412 F.3d 58, 71 (2d Cir. 2005); *Trippe Mfg. Co. v. Niles Audio Corp*., 401 F.3d 529, 532 (3d Cir. 2005); *Javitch v. First Union Securities, Inc*., 315 F.3d 619, 628-29 (6th Cir. 2003); *Employers Ins. of Wausau v. Bright Metal Specialties*, 251 F.3d 1316, 1322 (11th Cir. 2001); *Int'l Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH*, 206 F.3d 411, 416-17 (4th Cir. 2000)).

franchisor may have success binding a nonsignatory to the franchise agreement's forum selection clause, it may be prudent, particularly when seeking injunctive relief, to file in the forum where the third party defendant is located to expedite relief, limit challenges to the chosen forum, and eliminate the need to domesticate a foreign injunction. If the franchisor is seeking to bind a nonsignatory to the covenant not to compete, the franchisor should conduct a careful analysis of the laws on covenants not to compete in the proposed forum since that forum's laws, which may disfavor restrictive covenants because they are restraints on trade, may trump the franchisor's choice of law provision.

If the franchisor prefers to commence legal action in the forum designated in the franchise agreement, the franchisor may bind certain nonsignatories who are "inextricably intertwined" with the signatories to the contract or who should otherwise be estopped from denying the obligations of the franchise agreement after reaping its benefits.[177]

A. Estoppel

The doctrine of estoppel is an equitable doctrine that prohibits a nonsignatory from avoiding the obligations of a contract when the nonsignatory has simultaneously accepted the benefits and "it is widely accepted that nonsignatory third-parties who are closely related to [a] contractual relationship are bound by forum selection clauses contained in the contracts underlying the relevant contractual relationship."[178] Thus, in cases where the nonsignatory was closely involved in the former franchised business, they are likely to be bound by the franchise agreement's forum selection clause and subject to any related waiver of objections to personal jurisdiction or other procedural matters.

Estoppel often works to bind a franchisee's individual owners, spouses, or affiliated entities to the terms of the franchise agreement. For instance, in *Cajun Global LLC v. Swati Enterprises, Inc.*, the court found that an undisclosed owner's ten-year involvement with the franchise demonstrated that he was "so closely related to th[e] dispute that it was foreseeable that he would be bound by the Franchise Agreement's personal jurisdiction and forum selection clause."[179] Similarly, in *AAMCO Transmissions, Inc. v. Romano*, the court found that a franchisee's wife could be bound by the forum selection clause in her husband's franchise agreement given their "spousal relationship," and her husband's continued involvement in the competing business.[180] Specifically, the court held that the wife was bound by the franchise agreement's forum selection clause because "the allegations that [the husband] continues to be involved in the new transmission center that she owns suggests that she is a third-party beneficiary of the knowledge and experience that [the husband] gained in the course of his franchisee relationship with AAMCO."[181]

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[177] *See, e.g., Elite Advantage, LLC v. Trivest Fund, IV, L.P.*, No. 15-22146-CIV, 2015 WL 4982997, at *8 (S.D. Fla. Aug. 21, 2015).
[178] *AAMCO*, 42 F. Supp. 3d at 708 (second alternation in original); *see also Romano*, 42 F. Supp. 3d at 708.
[179] *Cajun Global*, *LLC* 283 F. Supp. 3d at 1331.
[180] *AAMCO*, 42 F. Supp. 3d at 709.
[181] *Id.*

These principals also apply in the context of jury waivers. In *Novus Franchising, Inc. v. Superior Entrance Systems, Inc.*, a nonsignatory affiliate entity was estopped from avoiding a franchise agreement's jury waiver provisions where the nonsignatory acted as the "de facto franchisee from the outset of the [franchise] relationship" who "performed in every respect as if it were a party to the franchise agreement . . . and benefit[ed] from its terms."[182]

In the arbitration context, "a party may be estopped from asserting that the lack of his signature on a written contract precludes enforcement of the contract's arbitration clause when he has consistently maintained that the other provisions of the same contract should be enforced to benefit him."[183] In order to compel a nonsignatory to arbitrate under an estoppel theory, one must show the nonsignatory received a direct benefit from the agreement itself.[184]

B. Incorporation by Reference

The doctrine of incorporation by reference is another useful tool to bind a nonsignatory to the dispute resolution terms of a franchise agreement, including agreements to arbitrate.[185] This doctrine may be used if the nonsignatory signed a separate agreement that incorporates the franchise agreement by reference. The successful application of the doctrine requires a two-step process.[186] First, the court must determine whether the agreement contains words evidencing an intent to incorporate another document, in the franchise context the franchise agreement.[187] Next, the court must determine whether the contractual terms sought to be applied in the incorporated document are broad enough to encompass the nonsignatory and the current controversy.[188] Courts may even incorporate an arbitration agreement by reference if the incorporation language does not specifically refer to the arbitration provision. For example, if a secondary contract incorporates the "general terms and conditions" of the other contract containing the agreement to arbitrate, a nonsignatory to the primary contract may be bound by its terms.[189] In short, be thorough and clear in your efforts to incorporate terms from other agreements.

There are multiple mechanisms under which practitioners may bind third parties to the dispute resolution and other procedural provisions in the franchise agreement in order

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182 No. 12-cv-204-wmc, 2012 WL 3542451 (W.D. Wis. Aug. 16, 2012).

183 *Int'l Paper Co.,* 206 F.3d at 418; *see also, e.g., Cajun Global LLC*, 283 F. Supp. 2d at 1330 (binding nonsignatory to franchise agreement's arbitration provision because "a party cannot have it both ways; it cannot rely on the contract when it works to its advantage and then repute it when it works to its disadvantage.")(citation omitted).

184 *Everett v. Paul Davis Restoration, Inc.*, 771 F.3d 380, 384 (7th Cir. 2014) (citing *Zurich Am. Ins. Co. v. Watts Indus.,* 417 F.3d 682, 687 (7th Cir.2005) (noting that order to trigger the doctrine the benefit received by the nonsignatory must flow directly from the agreement.)

185 *World Rental & Sales, LLC v. Volvo Const. Equip. Rents, Inc.*, 517 F.3d 1240, 1245 (11th Cir. 2008).

186 *Upstate Shredding, LLC v. Carloss Wall Supply Co.*, 84 F. Supp. 2d 357, 365-66 (N.D.N.Y. 2000) (binding nonsignatory to agreement to arbitrate).

187 *Id.*

188 *Id.*

189 *World Rental & Sales, LLC*, 517 F.3d at 1245.

to expedite relief against both the franchisee and third party. These tactics, however, require careful analysis and careful pleading to minimize a successful challenge to the franchisor's chosen forum. [190] Courts may be reluctant to hail a third party defendant into a foreign court without a detailed explanation of why the exercise of personal jurisdiction is appropriate. Compelling a nonsignatory to arbitrate will also require a clear showing of estoppel or the type of "inextricable intertwinement" described above. Moreover, it may be more beneficial for a franchisor to pursue relief in the third parties' home forum without seeking to apply contractual dispute resolution terms, particularly when expedited relief and enforcement is needed.

VII. Conclusion

The franchising model often results in disputes between franchisors and franchisees. But legal problems in franchising do not stop there. Third party issues are often prevalent in franchising because the economic relationship extends into the market where other forces interplay with that relationship. When confronting an existing franchise relationship, parties are forewarned to consider the impact of engaging with that relationship before taking any action to better their own economic hand.

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[190] *See, e.g., Get in Shape Franchise, Inc. v. TFL Fishers, LLC*, 167 F. Supp. 3d 173 (D. Mass. 2016) (determining the court could not exercise personal jurisdiction over competitive business operated by the franchisee's principal's sister on the basis that the business had no connection to the franchisor).