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# LITIGATION AGAINST COMPETITORS

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## I. Introduction: When and How Do Franchise Systems Compete

Competition in the franchise industry is fierce. Franchise systems compete for prospective franchisees, sales talent, media coverage, and intellectual property—not to mention consumers. This competition is a necessary component of a vibrant franchise market and promotes the efficiency of franchising as a distribution model. However, when competitors make unsubstantiated claims in advertisement, purchase competitors' keywords, or use underhanded tactics to lure away top performing franchisees and sales representatives, competition can lead to litigation. This paper will explore the practical considerations involved in deciding to sue a competitor, the legal claims that typically arise among competing franchise systems and the types of relief available to litigants. This paper will also provide pre-litigation best practices to prevent disputes with competitors along with sound advice to contemplate if litigation cannot be avoided.

Consider the following hypothetical. Frankie's Franks is a large franchisor, with 368 units of quick service food outlets specializing in gourmet hot dogs. Its best-selling product is a gourmet hot dog called "Famous Frankie's Footlong". Howie's Hot Dogs is Frankie's biggest competitor, with 240 units of similar quick service food outlets. Frankie's stores are located primarily in malls, while Howie's has cornered the highway rest area market. Howie's has decided to enter the mall market and has recruited Frankie's best sales team along with its biggest, multi-unit franchisee, Foot Long Dogs, Inc. Foot Long Dogs, Inc. has 23 locations in malls located primarily in the New York tri-state area. Both the Frankie's sales team and Foot Long Dogs, Inc. are subject to 6 month non-competes as part of their respective agreements with Frankie's.

Shortly after recruiting Foot Long Dogs, Inc., Howie's purchased the following keywords: Footlong, Famous Footlong, and Famous Frankie's footlong. Foot Long Dogs, Inc. also kept the Frankie's Franks secret recipe for the Famous Frankie's Footlong and provided it to Howie's, who then created its own specialty hot dog called, "Howie's Hot Dog Hero". Next, Howie's ran an advertising campaign with the claim that "7 out of 10 hot dog experts prefer Howie's Hot Dog Hero over Frankie's Famous Footlong." A separate Howie's advertisement made the inflated claim that 25 franchisees switched over from Frankie's. Howie's also allowed Foot Long Dogs, Inc. to open and begin operating in all locations immediately. Due to a delay with a signage company, some of the new locations are still flying the Frankie's Franks signs adjacent to a temporary banner that reads, "soon to be Howie's Hot Dogs."

Frankie's is enraged by the actions of both Howie's and its former franchisee, and it contacts its outside legal counsel to discuss its options. They want to sue Howie's, their former franchisee and the departing sales team. What types of claims can Franke's bring and what are its remedies?

## II. Major Types of Legal Claims in Competitor Litigation

A wide range of legal claims can be brought against a competitor. Among these potential causes of action, of course, are those to enforce post-termination covenants not to compete, which has been the subject of many franchise-law seminars and papers. The routine situation of a holdover franchisee who continues to operate independently at the formerly franchised location leads to a common form litigation between "competitors" - albeit one of the illegitimate variety. Here, we will focus instead more on the cases franchisors can bring against their competitors other than in the routine post-term franchisee dispute. Intellectual property rights are a major focal point of litigation against competitors. Actions to protect trademarks and trade dress, trade secrets, copyrighted materials, patents, and other intellectual property, all are common intellectual property fighting issues. So, too are claims involving "false advertising," "antitrust" violations such as monopolization or exclusive dealing, "unfair competition," or actions to remedy "interference with contracts," and other claims.

No attempt will be made here to provide a fulsome analysis of any type of action or of all potential causes of action. Rather, our goal is to provide a broad description of the major types of claims to expect and what it is that could make a competitor's conduct unlawful.

### A. Trademark Infringement

Trademarks are fundamental to franchising. After all, the brand's marks are what are licensed and for which a fee is paid to meet the definitional elements of a franchise. It should not be surprising that franchisors have sought to protect their trademarks against infringement by competitors.[1] Another fundamental precept is that, once a licensor loses control of a trademark, the resulting risk of irreparable harm in the form of consumer confusion will be great. Therefore, if another franchise system or some other entity begins to infringe on the marks of a franchisor, cases of this type can be filed on short notice to prevent harm in the marketplace.

There have not been many instances of trademark litigation between franchisors. The rare instance involves a system beginning to offer a menu item or other product under a name another already is using. The battle between the Steak N Shake and Burger King franchisors over use of the name "Steakburger" was a juicy example.[2]

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[1] The most common form of trademark litigation in franchising involves claims against former franchisees that refuse to stop using the marks. One of the authors refers to such cases as "take down your signs" actions. Like lawsuits to enforce covenants not to compete, trademark litigation against former franchisees usually arises very soon after termination of a franchise. We will leave the discussion of this type of case against a "competitor" at the store level for other articles and seminars. *See, e.g.,* Clay A. Tillack and Mark E. Ashton, "Who Takes What: The Parties' Rights to Franchise Materials at the Relationship's End," 28 *Franchise L.J.* 88, 90 (Fall 2008); *Burger King Corp. v. Mason*, 710 F.2d 1480, 1493 (11th Cir. 1983) (stating that "continued trademark use by one whose trademark license has been cancelled satisfies the likelihood of confusion test and constitutes trademark infringement"); *see also Pappan Enters. v. Hardee's Food Sys*., 143 F.3d 800, 807 (3rd Cir. 1998) (granting a franchisor's request for a preliminary injunction against a franchisee and finding that any harm to the franchisee was clearly outweighed by irreparable harm to the franchisor from continuing illegal use of its trademark); Christopher P. Bussert, "Trademark Counterfeiting: A New Danger that Lurks for Holdover Franchisees," *The Franchise Lawyer*, Vol. 15, No. 4 (Fall 2012).

[2] *The Steak N Shake Company, et al. v. The Burger King Corp.*, No. 4:04-cv-00525-CDP (E.D. Mo.) (filed May 5, 2004).

Another trademark case was *Firehouse v. Scurmount,*[3] in which the dispute related to use of the name "Firehouse." Yet another was *Phelan Holdings, LLC v. Wendy's Int'l, Inc.*, No. 2:11-cv-392-Ft.M-99DNF (M.D. Fla. July 3, 2012), a dispute over use of phrases "You Can't Fake Fresh" and "you can't fake real". Another was *Two Men and a Truck/International, Inc. v. Thomas*, Case No. 8:12CV340 (D. Neb. Nov. 7, 2012), in which the court enjoined a too-cute competitor who used the name "Two Men and Two Trucks".

In our hypothetical, Frankie's Franks could surely assert a "take down your signs" trademark claim against its former franchisee, Foot Long Dogs, Inc. However, it would have a less than compelling trademark claim against its competitor, Howie's Hot Dogs. While Howie's potentially utilized Frankie's secret recipe in its new signature Hot Dog, it did not utilize any of Frankie's trademarked names or phrases in advertising its new signature Hot Dog.

### B. Misappropriation of Trade Secrets

Trade secret misappropriation is another legal claim commonly brought in competitor litigation. The Uniform Trade Secrets Act defines a "trade secret" 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
>
> (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.[4]

Thus, to qualify as a true trade secret, economic value of the information alone is not sufficient, as the information also must be the object of reasonable efforts to maintain its secrecy.

*Frosty Bites, Inc. v. Dippin' Dots, Inc.*[5] exemplifies a fact pattern in which trade secret misappropriation claims can arise in franchising. Frosty Bites had been a former retail dealer of Dippin' Dots, Inc. ("DDI"), but had declined DDI's offer to become a franchisee and had instead opened a competing business. DDI filed suit, alleging Frosty Bites had misappropriated and was using DDI's trade secrets. The district court granted summary judgment to Frosty Bites, finding that DDI's failure to use reasonable

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[3] *Firehouse Restaurant Group v. Scurmont LLC*, No. 4:09-cv-00618-RBH, 2011 WL 4943889 (D.S.C. Oct. 17, 2011).

[4] Uniform Trade Secrets Act § 1(4) (1985). In 2016, a federal trade secrets law also was passed. Public Law No: 114-153. It provides a similar definition and a private right of action.

[5] 2003 U.S. Dist. LEXIS 8472 (N.D. Tex. May 19, 2003).

methods to maintain the secrecy of its purported trade secrets defeated its trade secret misappropriation claim.[6] On the other hand, in *Re/Max of America, Inc. v. Viehweg*[7], a federal district court in Missouri granted the franchisor a permanent injunction against a former salesman who stole documents and other information from the franchisor and attempted to use that misappropriated information to benefit the franchisor's competitors.

There are multiple strategies franchisors can undertake in order to avoid the need for trade secret litigation.[8] First, key employee and other agents of the franchisor and franchisee, as well as third parties exposed to a system's "secret sauce," should be required to sign confidentiality agreements. At the end of all relationships, the employee, franchisee, or other party should be required to turn over all copies of the operations manual or any other written materials that may contain confidential information.[9]

In our hypothetical, Frankie's has a viable trade secret misappropriation claim against its former franchisee based upon the theft by its former franchisee of the secret recipe for Frankie's Famous Footlong. However, the strength of this claim will depend upon the measures that Frankie's employed to maintain the security of the secret sauce, including whether Frankie's required its former franchisee to sign confidentiality agreements. Frankie's may also have a viable trade secret claim against its competitor for utilizing this information with knowledge that it is a protected trade secret of a competitor.

### C. Tortious Interference

Another common legal claim raised in disputes between franchise competitors is the doctrine of tortious interference, a type of claim often included in conjunction with other causes of action. The tort of "interference" can be formulated as either tortious interference with a contract or tortious interference with prospective business relations.

The highly-publicized case involving the Starwood and Hilton hotel chains provides an excellent example of how tortious interference claims can arise in franchising. Starwood accused Hilton of misdeeds such as corporate espionage, theft of trade secrets, and fraud.[10] But one of the most straight-forward allegations at the heart of the dispute was that Hilton knowingly and intentionally induced key employees at Starwood to breach promises they had made to their employer, thereby "tortiously

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[6] Id. at *15.

[7] 619 F. Supp. 621 (E.D. Mo. 1985).

[8] Mark S. VanderBroek and Christian B. Turner, "Protecting and Enforcing Franchise Trade Secrets," 25 *Franchise L. J.* 191 (Spring 2006)

[9] Id.

[10] Starwood Hotels & Resorts Worldwide, Inc. v. Hilton Hotels Corp., et al., No. 09 CIV. 3862 (S.D.N.Y) (filed April 16, 2009).

interfering with Starwood's contractual relations" with those employees. The underlying situation no doubt was particularly disturbing to Starwood because, as Starwood stated in the very first paragraph of its filed complaint, "Starwood and Hilton are direct, head-to-head competitors."[11] This case also demonstrates that normal competitive tensions can move to the courtroom almost immediately when one company hires employees from another, particularly if the employees were at a high level in their former company. The *Starwood v. Hilton* case very quickly proceeded from filing to the preliminary injunction stage, and ultimately to a settlement that included a permanent injunction by consent.[12]

There is a fine line between behavior that is part and parcel of normal business competition in our robust free enterprise system, and behavior that rises to the level of being tortious and unlawful.[13] Not all interference with a competitor is illegal, as competitors by nature continually "interfere" with each other legally, especially in trying to obtain customer business. According to the Restatement (Second) of Torts, *unlawful* "interference with contract" is defined as follows: "One who intentionally and improperly interferes with the performance of a contract … by inducing or otherwise causing the third person not to perform the contract, is subject to liability to the other for the pecuniary loss resulting to the other from the failure of the third person to perform the contract."[14] Note the requirement that the interference by the third party with the performance of the contract must be both intentional and improper.

In these circumstances, hiring parties are wise to find out in advance what contracts exist and to make sure those contracts are honored, and all employers should take care that their employment contracts protect against employees taking company secrets across the street to a competitor.

Tortious interference battles also can arise when a franchisor is accused of intentionally and improperly interfering with the contractual relationships between a competing franchisor and its franchisees. In *Heavener, Ogier Services v. R.W. Florida Region*,[15] for example, an appellate court in Florida affirmed the district court's 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.[16] The injunction precluded either franchisor from initiating contact with any franchisees of the other that were bound by existing

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[11] Id.

[12] *Id.*, Docket # 76, Consent Permanent Injunction (filed December 22, 2010).

[13] Kevin M. Shelley and David W. Oppenheim, "When Conflicting Principles Collide: The Uncharted Boundary Between Fair Competition and Tortious Conduct," 22 *Franchise L. J.* 184, 185 (Winter 2003).

[14] Restatement (Second) of Torts, § 766 (1979).

[15] 418 So. 2d 1074 (Fla. Dist. Ct. App. 1982).

[16] *Id.* at 1077.

contracts. All the franchisor could do if contacted by a franchisee of the other was to offer to meet with the interested franchisee after its present contract expired.[17] In *AFC Enterprises (doing business as Popeyes) v. Cajun Operating Company (doing business as Church's*[18]*)*, another battle erupted over the solicitation of franchisees. That case apparently settled with trial approaching after more than 30 depositions.[19]

The *AFC Enterprises* case, in addition to claims for interference with contracts, also included claims for tortious interference with prospective business relations. Such a claim is defined to occur as follows: "One who intentionally and improperly interferes with another's prospective contractual relation … is subject to liability to the other for the pecuniary harm resulting from loss of the benefits of the relation, whether the interference consists of (a) inducing or otherwise causing a third person not to enter into or continue the prospective relation or (b) preventing the other from acquiring or continuing the prospective relation."[20] Tortious interference with prospective business relationships can occur either through the inducement of the third party not to enter into the business relationship with the harmed party, or the prevention of the harmed party from entering into the relationship with the third party.

Our hypothetical surely contains facts supporting a claim by Frankie's against Howie's for tortious interference with contractual relations. Howie's recruited Frankie's best sales team and one of its largest, multi-unit franchisees, both of which were under contract with Frankie's. This recruitment arguably induced both groups to breach the terms of their respective contract, including the non-compete provision.

### D. False Advertising

The ads a company publishes may be a major competitive activity. Sometimes, a competing franchisor views another system's ad as "false," and litigation results under the federal Lanham Act or state laws. In *Jackson Hewitt v. H & R Block*, a lawsuit challenged comparative advertising under the Lanham Act and New Jersey Consumer Fraud Act.[21] This case settled on the eve of trial, but not before extensive procedural wrangling.[22] The unusual case of *Phoenix of Broward v. McDonald's* involved false

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[17] Id.

[18] *AFC Enterprises, Inc., dba Popeyes Chicken & Biscuits v. Cajun Operating Co. et al.*, Civil Action No. 2007EV001961E (Fulton Count, Georgia) (filed 2007).

[19] *Pope, et al*., "AFC Enterprises Resolves Suit Against Former Franchisees" (law firm news release available at www.pmkm.com/jay-f-hirsh/afc-enterprises-resolves-suit-against-former-franchisees-2).

[20] Restatement (Second) of Torts, § 766B (1979).

[21] Case No. 1:11-cv-00641-AKH (S.D.N.Y.) (filed May 26, 2011).

[22] See Civil Docket Case No. 1:11-cv-00641-AKH (S.D.N.Y.) (stipulation of dismissal signed by the court February 24, 2012, after more than 200 docket entries). See also *Doctor's Assocs., Inc. v. QIP Holders LLC*, 2010 WL 669870 (D. Conn. Feb. 19, 2010) (where franchisor of Subway franchise system brought false-advertising claims based on a series of commercials run by franchisor of Quiznos franchise system, which claimed that Quiznos sandwiches had double the amount of meat of Subway sandwiches, and

advertising claims attempted to be lodged as a class action by Burger King franchisees against McDonald's Corporation related to its Monopoly-themed advertising and promotion.[23] *Pizza Hut v. Papa John's* was another case in which one franchisor challenged another's comparative advertisements.[24] *Avis v. Hertz* also included allegations that the defendant had misrepresented the relative size of the two competitors' respective fleets of rental vehicles.[25]

Section 43 (a) of the Lanham Act provides a cause of action against "[a]ny person who, on or in connection with any goods or services . . . uses in commerce any word, term, name, symbol, or device, or any combination of origin, false or misleading description of fact, or false or misleading representation of fact, which . . . in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities."[26] That language provides plenty of fodder for competitors to assert claims. While not all of the lawsuits referenced above ultimately have been well-received by the courts,[27] many such claims are asserted.

Our hypothetical presents two advertising campaigns that may be the subject of litigation. The first, that "7 out of 10 hot dog experts prefer Howie's Hot Dog Hero over Frankie's Famous Footlong", would be subject to an analysis of whether and how Howie's obtained the information to support such a statement. Ultimately, if the statement is not based on a properly conducted survey of undisputed experts in the field, it may be subject to a proper claim under the Lanham Act. The second advertisement, which made the inflated claim that 25 franchisees switched over from Frankie's. This analysis would be far less scientific and Frankie's would be able to utilize accessible, empirical data to demonstrate that this advertisement is false.

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Quiznos moved for summary judgment arguing that the evidence showed that the claims in its advertisements were not false or misleading, the court declined to grant summary judgment citing numerous disputes of material fact as to the truth or falsity of Quiznos' claims).

[23] 489 F.3d 1156 (11th Cir. 2007).

[24] 80 F. Supp. 2d 600 (N.D. Tex. 2000).

[25] Avis Rent A Car System, Inc. v. Hertz Corp., 782 F.2d 381 (2d Cir. 1986).

[26] 15 U.S.C. §1125 (a)(1)(B).

[27] For example, the Avis v. Hertz claim was rejected on appeal by the United States Court of Appeals for the Second Circuit. Avis Rent A Car System, Inc. v. Hertz Corp., 782 F.2d 381 (2d Cir. 1986). So too did the Fifth Circuit ultimately reject the claim on appeal in Pizza Hut v. Papa John's. Pizza Hut, Inc. v. Papa John's Int'l, Inc., 227 F.3d 489 (5th Cir. 2000), cert. denied, 532 U.S. 920 (2001). A federal district court's dismissal of the Burger King franchisee's case against McDonald's also failed, as the case was dismissed on standing grounds, which was affirmed on appeal. *Phoenix of Broward v. McDonald's*, 489 F.3d at 1160.

### E. Antitrust

Antitrust claims may be raised in competitor litigation as well, although these types of claims often are both extremely complex and difficult to prove. One representative case, *Coalition For A Level Playing Field v. Autozone*,[28] involved a claim by a "mom and pop" retailer against a large chain of stores. The allegation was that the chain obtained a competitive advantage by violating antitrust law. This lawsuit was dismissed by the district court, which later denied the plaintiff's request to amend its allegations, and the dispute soon settled while an appeal was pending.[29]

### F. Other Possible Claims

Many other types of claims also can be brought against competitors. Other causes of action may include unfair competition (somewhat by definition)[30], along with claims under state Deceptive Trade Practices statutes or Consumer Fraud Acts.[31] Unjust enrichment, defamation, libel, slander, conversion, civil theft, and even fraud or misrepresentation also may find their way into the complaints filed in some franchise cases.

## III. Overview of Available Relief

The types of relief available in cases against competitors are just as varied as the causes of action discussed above.

### A. Injunctive Relief

Often competitor cases begin with a flurry of activity when it is discovered that "the bad guys" are in the process of "stealing" something, such as trade secrets or even franchisees. State and federal courts have procedures for expedited proceedings to halt the alleged unlawful conduct through a temporary or preliminary injunction. The purpose of such measures generally is to "preserve the status quo" until the court can rule on the merits of the dispute after discovery, motions, and trial, if the case goes that far.

[28] Case No. 1:04-cv-08540-RJH (S.D.N.Y. 2010).

[29] *Coalition For A Level Playing Field, L.L.C., et al. v. Autozone, Inc., et al.*, Case No. 1:04-cv-08450-RJH, Slip Op. at 21 (S.D.N.Y. Sept. 28, 2011); *see also id.,* Civil Docket ##118,119.

[30] *See, e.g., Zynga, Inc. v. Patmore, et al*., Case No. CGC-12-525099 (S.D.N.Y.)(filed Oct. 13, 2012) (involving unfair competition claims and counterclaims between online social game companies).

[31] Although the subject is beyond the scope of this paper, it should be noted that standing may be a problem for some claims under consumer laws, as the competitor may not be protected under those statutes.

To obtain injunctive relief at the outset of the case, however, courts typically require the plaintiff to show both a "likelihood of success on merits" and some formulation of "harm" that will be done (irreparably) if the defendant is not stopped.[32]

Federal courts in particular routinely grant injunctive relief to enforce the rights of a trademark holder.[33] The Lanham Act itself provides for injunctive relief to stop infringement, and courts often find that harm is presumed and presumed to be irreparable when trademarks are infringed.[34]

At the end of a case, where appropriate, injunctions intended to maintain the status quo pending the conclusion of the litigation can be made permanent to protect one's intellectual in perpetuity, as well.

### B. **Royalties or Other Recovery of the Defendant's Profits from IP Infringement**

Intellectual property law picks up on the equitable theory of "unjust enrichment" in allowing trademark owners and others with intellectual property rights to recover from wrongdoers not just actual, compensatory damages, but to force disgorgement of the ill-gotten gains of infringement.[35]

### **C. Tort Damages**

In a case for interference with contracts or prospective advantage, a plaintiff can recover "compensatory damages" sufficient to cover losses proximately caused by the defendant's tortious conduct.[36]

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[32] *See, e.g., Kos Pharm., Inc. v. Andrx Corp.*, 369 F.3d 700, 708 (3d Cir. 2004).

[33] *See, e.g., Burger King Corp. v. Hall*, 770 F. Supp. 633, 637 (S.D. Fla. 1991) (finding that federal trademark infringement and unfair competition justify the issuance of a preliminary injunction); *Long John Silver's v. Washington Franchise*, 1980 U.S. Dist. LEXIS 16635, at *14 (E.D. Va. June 24, 1980) (issuing preliminary injunction against Washington Franchise, since they otherwise would be receiving a "free ride"); *Cottman Transmission Sys. v. Melody*, 851 F. Supp. 660, 671-72 (E.D. Pa. 1994) (enjoining the ex-franchisee from using the franchisor's name, logos, trademarks, telephone numbers, advertising materials, and proprietary manuals).

[34] *See* 15 U.S.C. § 1125(c)(1) (2010) ("The owner of a famous mark shall be entitled, subject to the principles of equity and upon such terms as the court deems reasonable, to an injunction against another person's commercial use in commerce of a mark or trade name, if such use begins after the mark has become famous and causes dilution of the distinctive quality of the mark, and to obtain such other relief as is provided in this subsection.").

[35] *See, e.g., Limelight Productions, Inc. v. Limelite Studios, Inc.,* 60 F.3d 767 (11th Cir.1995)("Courts in this Circuit have interpreted Lanham's damages provision to embody both actual damages under 15 U.S.C. 1117(a)(2) and presumed damages (or ill-gotten profits) under 15 U.S.C. 1117(a)(1)").

[36] *See, e.g., Sole Energy Co. v. Petrominerals Corp*., 128 Cal. App. 4th 212, 26 Cal. Rptr. 3d 798 (4th Dist. 2005). ("The measure of damages for intentional interference with contractual relations or

### D. Exemplary or Treble Damages

Punitive damages may be assessed under state-specific rules in tort cases. In addition, the Lanham Act, the Clayton Antitrust Act, and other statutes allow aggrieved plaintiffs to recover multiple damages when a defendants' conduct is shown to have been intentional (in the case of trademark infringement) or as an incentive for parties to act as "private attorneys general" to enforce the laws.[37]

### E. Prejudgment Interest

Interest can be awarded to ameliorate the time a plaintiff may have been damages to when it is awarded judgment.

### F. Other Relief

Many of the statutes discussed above also allow the prevailing plaintiff to recover other, specialized types of relief from the defendant. The legal expenses and costs the plaintiff incurred to pursue its case is one prominent example of such other relief.

## IV. Tactical Considerations in Competitor Litigation

There are a number of initial tactical decisions that must be made by a franchise system that has decided to sue its competitor. The first of these decisions is where to file suit. This includes deciding whether to file in state court or federal court, and then selecting among the appropriate venues for the suit, giving due consideration to ensuring that whatever venue you choose will have personal jurisdiction over the defendants that you name.

If federal jurisdiction exists, the franchise system should carefully consider the differences between state and federal court proceedings in light of the particular facts of the case to determine the best course. Federal courts are more experienced in handling trademark infringement and trade secret claims. In many jurisdictions, federal courts are also more efficient at case management and resolution efforts. Just by way of example, the Federal Rules of Civil Procedure require parties to make pre-discovery disclosures, require the disclosure of experts, and allow for the deposition of experts.[38] Many states do not have the same disclosure requirements and do not permit expert depositions. In addition, an out-of-town party may be less likely to get "hometowned" in federal court.

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prospective economic advantage is an amount that will reasonably compensate the plaintiff for all loss or harm caused by the defendant's conduct.")

[37] *See, e.g., U.S. Structures, Inc. v. J.P. Structures, Inc.,* 130 F.3d 1185, 1191 (6th Cir. 1997) (finding that **tr**eble damages were appropriate when the franchisees, after being terminated, continued to use the franchisor's trademark, including by participating in a profitable advertising campaign that featured the trademark.)

[38] Fed.R.Civ. P. 26 (a)(2).

A franchise system can also gain a tactical advantage by choosing an advantageous venue (or challenging the venue chosen by its competitor). The paramount consideration should be to choose a venue that will give you an advantage. This advantage would typically be found in franchise system's home state, where a bench or jury pool is familiar with your brand and its company. The franchise system may even employ a large number of people in the community. Moreover, a home state venue will lessen any budgetary impact and strain on company resources from a personnel perspective. However, there are instances when a different jurisdiction will provide a more favorable forum for your company's position. This can be gleamed from prior decisions in similar cases. This consideration must be weighed against any tactical advantage gained from being on your home court.

Another initial tactical decision is who to name in a suit. In our hypothetical, there are several potential defendants, including the competing franchisor, the former franchisee, its personal guarantors, if any, and the sales team that defected. Care should be taken to identify the proper corporate affiliate, parent or subsidiary that engaged in the wrongful conduct.

A party seeking to file suit must also consider whether it is appropriate to seek a preliminary injunction or temporary restraints. Most courts consider some combination of the following factors when deciding whether to issue a TRO or preliminary injunction: (1) whether there is a substantial likelihood of success on the merits; (2) whether the TRO or preliminary injunction is necessary to prevent irreparable injury; (3) whether the threatened injury outweighs the harm that the TRO or preliminary injunction would cause to the non-movant; and (4) whether the TRO or preliminary injunction would be adverse to the public interest.[39] Injunctive relief is often sought in the franchise industry where companies trade on the goodwill and reputation of their brand. Entire articles are devoted to evaluating preliminary injunctions in the context of a franchise dispute. For purposes of this paper, franchise systems should strongly consider seeking a preliminary injunction if the reputation and goodwill of its brand is being tarnished by a competitor. Even if the effort is unsuccessful, preliminary injunctions often require full evidentiary hearings which provide an early glimpse at your adversary's position. In our hypothetical, it is likely that the franchisor would seek preliminary injunctive relief the address the trade secret misappropriation, ongoing use of its trademarks, and likely the false advertising that is tarnishing its reputation and goodwill.

A cease and desist letter or warning letter is typically appropriate prior to seeking injunctive relief, unless the harm is so immediate and dire as to not permit sufficient time to send the letter. Otherwise, there are many advantages and few disadvantages in sending a warning letter. First, from a logical perspective, there is the possibility that a letter alone will resolve the dispute, saving the cost of preparing an application for injunctive relief. Second, a warning letter provides a blanket of reasonability that can be utilized in future pleadings and interactions with the Court. One disadvantage in

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[39] *See e.g., Parker v. State Bd. of Pardons and Paroles*, 275 F.3d 1032, 1034–1035 (11th Cir.2001); *see also Schiavo ex rel. Schindler v. Schiavo*, 403 F.3d 1223, 1225-26 (11th Cir. 2005)

sending a warning letter is the possibility that the other side decides to file first and obtains the advantages associated with doing so, including selection of venue.

Although not common, a party may seek a preliminary injunction later in the case as opposed to at its inception. A party may also seek permanent injunctive relief without first requesting either ex parte or preliminary relief. A permanent injunction may be sought as part of the full trial on the merits. By doing so, the party is not abandoning its claim for injunctive relief, it is simply acknowledging that it may not obtain the injunction without some level of discovery. In this regard, a party should consider asking the Court for expedited discovery, even if that discovery is limited to the aspects of the claim that are potentially causing irreparable harm.

If a franchise system determines that the complained of conduct cannot be prevented or undone and is compensable in monetary damages, it may dispense with any request for injunctive relief and file a Complaint asserting all potential causes of action against the various defendants (discussed above).

For the defendant/competitor served with a lawsuit, the initial determination should be whether to file a motion to dismiss on the pleadings. Without covering all of the various pre-answer motions, which is outside the scope of this paper, a competitor/defendant may be able to limit the claims asserted against it, or obtain early discovery into its adversary's claims.

Finally, it is crucial for the franchise system to preserve documents, electronically stored information and other tangible evidence as soon as it determines that litigation is reasonably foreseeable. It is nearly as crucial to serve a demand upon your adversary to do the same. The duty to preserve documents, electronically stored information, or tangible evidence based on the existence of pending, threatened, or reasonably foreseeable litigation arises under the common law, but can also arise from a contract, a statute or regulation.[40] A violation of this duty can result in adverse inference, sanctions, or in some jurisdictions, an independent cause of action for spoliation. In an emotionally charged litigation between competitors, there is a very real risk of one or both parties failing to properly preserve key documents and other evidence.

## V. Practical Concerns Heightened in Competitor Litigation

Lawsuits against competitors can be some of the most emotional, protracted litigation franchisors will ever face. The perceived *absolute need to win* is stronger when the opposing party in litigation also is your opposing party in business. In addition, other factors make litigation against competitors even trickier than other litigation. Those special factors include heightened confidentiality concerns, commercial considerations, and even lurking antitrust dangers about resolving a matter in ways that are deemed "too cooperative" with competitors.

[40] *Callahan v. Stanley Works*, 703 A.2d 1014, 1018 (N.J. Super. 1997); s*ee also Victor Stanley, Inc. v. Creative Pipe Inc.*, 269 F.R.D. 497, 521 (D. Md. 2010).

This section of the paper will address the latter pragmatic realities as well as the legal issues involved in lawsuits between one franchisor and another or any other form of litigation among competitors. The aim is to provide guidance and ideas in the event one either sees a need to sue a competitor, or if a competitor sues one's own company.

### A. Disclosure Requirements

One vexing consideration for franchisors is the extent to which they must disclose details of the lawsuit in their disclosure documents for franchise sales. The Federal Trade Commission and various states' rules require disclosure of pending and past litigation. For example, under federal law, Item 3 of a Franchise Disclosure Document must disclose any "administrative, criminal, or material civil action alleging a violation of a franchise, antitrust, or securities law, or alleging fraud, unfair or deceptive practices, or comparable allegations" presently pending against the franchisor or an affiliated entity.[41] The franchisor also must disclose any pending "civil actions, other than ordinary routine litigation incidental to the business, which are material in the context of the number of franchisees and the size, nature, or financial condition of the franchise system or its business operations."[42] These latter categories would appear to include certain types of cases involving competitors, such as antitrust or fraud claims brought by a competitor against a franchisor, or any other "material" cases. A determination of whether a civil action against a competitor is "material" will be made on a case-by-case basis, and depends on whether disclosure of that action would be likely to influence a prospective franchisee's investment decision.[43]

### B. Confidentiality

Another consideration in disputes with competitors is that a party to the litigation may request in discovery certain information that a company would hate to provide to its competitor. This can include customer information, pricing, copies of tax returns, strategic plans, margin data, and other very sensitive information. In attempt to ease such concerns, the Federal Rules of Civil Procedure permit the court to issue a protective order "requiring that a trade secret or other confidential research, development, or commercial information not be revealed or be revealed only in a specified way."[44] Protection of a party's trade secrets or other legitimately confidential business information is sufficient grounds to acquire a protective order, although the order is open to challenge from the opposing litigant or some other member of the public.[45]

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[41] 16 C.F.R. § 436.5(c)(1)(i)(A).

[42] 16 C.F.R. § 436.5(c)(1)(i)(A).

[43] *See* Federal Trade Commission's *Franchise Rule Compliance Guide* at 35-36.

[44] Fed. R. Civ. P. 26(c)(1)(G).

[45] *Citizens First Nat'l Bank v. Cincinnati Ins. Co.*, 178 F.3d 943, 946 (7th Cir. 1999).

A protective order, however, while theoretically helpful, is not always enough to ameliorate the problems inherent in turning over secrets to a competitor. In *Nutratech v. Syntech International*,[46] for example, a case between competitors, the litigants had stipulated that the materials in question should be subject to a court protective order. But the defendant argued that certain confidential business information such as overall sales figures and customer/supplier lists should be for attorney's eyes only and should not be shared with the plaintiff's president.[47] The plaintiff argued in response that its officers needed to have the information in order to properly prosecute the lawsuit.[48] The district court sided with the defendant, finding that disclosure of the confidential business information to the plaintiff's president would cause competitive harm to the defendant and ordered that the information be designated "attorney's eyes only."[49]

Because the need to protect confidential information and trade secrets is widely recognized in litigation between competitors, and because this issue generally affects both sides, having clear guidelines and strong sanctions built into a protective order is about all that can be done to reduce concerns about the use of discovery to gather competitive information that will be abused in the marketplace.

### C. Settling Without Violating Antitrust Law

Section 1 of the Sherman Act famously prohibits any "agreement" that is "in restraint of trade." This would include some agreements among competitors in settling litigation. Although it is not a franchise case, *Clorox Co. v. Sterling Winthrop Inc.*[50] provides an example of such a lawsuit. While these claims often are not successful, the mere fact that these cases are brought at all can be extremely costly and time-consuming for all involved. Therefore, franchisors should be mindful of the possibility of such claims being raised at some later date when they are negotiating settlement agreements with their competitors.

### D. Budgetary Impact of Competitor Litigation

Disputes between competitors often can be more expensive than any other form of lawsuit. One reason for greater cost is that opposing litigants who also compete with each other in the marketplace may fight in court harder and longer than they would against a non-competitor. Whereas a typical business litigation may be about who owes whom how much money in a case against a landlord, vendor, creditor, customer, franchisee, or some other category of current or former business associate, and the parties may have reasons to preserve the business relationship for their own current or

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[46] 242 F.R.D. 552 (C.D. Cal. 2007)

[47] *Id.* at 554.

[48] *Id.* at 554-55.

[49] *Id.* at 555-56.

[50] 932 F. Supp. 469 (E.D.N.Y. 1996).

future benefit, competitor litigation is different. Competitors, generally speaking, do not perceive a strong desire to protect their relationships with each other. It is more common that they hold irrational, negative beliefs about each other.

In competitor litigation, pleadings often can be drafted with more detailed accusations, discovery can be drafted to be even more prying than normal, or requests may be viewed with added resentment and vigor. Deposition notices in particular can be more numerous and less polite. “Bad PR” occurs, sometimes because one party or the other uses the press to advance its cause. There can be retaliation of various sorts.

All of the above can cost a fortune in attorney time, but it also distracts the litigants from their focus on the marketplace. In-house lawyers and business people spend time gathering documents, sitting for depositions, and attending court proceedings. Companies often treat litigation against competitors as battles they cannot afford *not* to fight, or at least they cannot lose. These lawsuits may take on a “bet-the-system” life of their own.[51] With so much perceived to be at stake, reduced attention is paid to cost.

### E. Witnesses and Evidence

One of the most unfortunate aspects of litigation against competitors is that third parties affiliated with one or both companies can become embroiled in the case. The reason for this is that when the essence of a claim is “you are misleading my customers” or “you are inducing my franchisees to breach their contracts with me,” the testimony of the customers or franchisees often is seen as crucial. An ironic and doubly difficult problem arises, however, in that while a company never wants to see its business partners burdened by having to participate in litigation, it is hard to prove a case through third parties anyway. Even customers and franchisees who are thought to be loyal or favorable to one side or the other often try to stay “neutral” in litigation, so their testimony ends up not being that effective for either side. This makes competitor claims both hard to prove and hard to defend.

Other witnesses in competitor litigation tend to be the individuals who made the business decisions and directed the actions at issue. That means the very top people in the litigants’ organizations may need to testify in court, which in turn means they will need to prepare for and give depositions, sign affidavits, have their documents searched, and generally be active in the litigation from start to finish.

Expert witnesses also are commonly used in competitor litigation. These can run the gamut from forensic computer specialists who can search computers for copied or missing data and metadata, to economists or accountants who can calculate or refute damages claims, to consumer survey specialists who can determine the “likelihood of confusion in the marketplace” in a trademark infringement case.

[51] Robert Zarco and Quentin Wittrock, “Bet-the-System Litigation: A ‘Hands On’ Interactive High Level Strategic Dialogue,” IFA 42nd Annual Legal Symposium (May 17-19, 2009).

### F. Exit Strategies

To prevent competitor litigation from becoming a quagmire, the party that starts the case should have an exit strategy firmly in mind from the beginning. An exit strategy may be to seek a preliminary injunction and then negotiate a resolution immediately after that initial motion process is completed, or it may be to "send a message" through the filing of the lawsuit and then work toward an early resolution. The problem with any strategy along these lines is that once the case is started, it can take on a life of its own due to the reaction of the party that is sued, which, of course, the initiating party cannot control.

## VI. Discovery and Tactics

In discovery, a litigant's goal is to gather as much relevant information as possible as efficiently as possible to support its claims and defenses. Given their competitive and time-sensitive natures, the pressure to achieve these goals is particularly acute in competition cases. The best way to achieve a litigant's goals under such circumstances is to carefully consider at the outset the proof necessary for each claim and defense and then to focus one's discovery efforts on the most likely sources of information and documents to support those claims and defenses. Toward that end, this section will focus on how to develop and execute upon an appropriate discovery plan.

### A. Discovery Related Motions

Unfair competition/covenant cases often require the filing of a number of early discovery motions. The most common motions are: (1) to preserve evidence; (2) for a protective order; and (3) to expedite discovery.

#### 1. *Motion to Preserve Evidence*

Counsel should consider filing a motion to preserve evidence at the outset of the case, especially if a franchisor has reason to believe that evidence, including any underlying proprietary information or other property at issue, may be destroyed. A motion to preserve asks the court to order that no relevant documents, computer data or other information in the possession or under the control of a defendant be destroyed, changed or altered during the period of time pending the litigation. Motions to preserve are particularly useful in cases involving theft or misuse of computer or other electronic data, which can easily be modified or deleted, both willfully and inadvertently. Of course, counsel must inquire and ensure that its client's own preservation house is in order before putting into play any concerns about any defendant's motives and behavior.

#### 2. Motion for Protective Order

Unfair competition/covenant cases almost always involve the entry of a protective order governing the treatment of documents and oral testimony produced during the course of discovery. The protective orders come about by agreement, motion and ever more frequently standing court scheduling/discovery order. A franchise company seeking relief for alleged unfair competition or theft or misuse of its proprietary information will undoubtedly be required to produce such information, as well as other confidential business information, including information about strategy, plans, operations, customers, financial condition and profitability. A protective order ensures and orders the procedures and rules for identifying, maintaining, challenging the designation of and using any documents, as well as any portions of deposition transcripts and court filings, that are deemed to be confidential.

#### 3. *Motion to Expedite*

Given the emergent nature of unfair competition/covenant cases, plaintiff litigants will often want to conduct as much discovery as possible on an expedited basis. Depending on how fast the plaintiff litigant wants the case to move, a motion to expedite can be coupled either with or filed shortly after the filing of the complaint and motion for a preliminary injunction. A motion to expedite provides an opportunity to orient the judge to both the urgency of the situation, as well as the pertinent facts. Copies of proposed the discovery to be propounded (including, any document requests, deposition notices and third-party subpoenas) should be attached to the motion. Attaching the actual discovery has the parallel benefits of forcing counsel to carefully consider and outline the types of proofs that will be required and consequently information that will be sought.

### B. Sources of Information and Documents

To support a plaintiff litigant's claim in an unfair competition/covenant case, documents and other information can be located from a variety of sources, including the plaintiff litigant itself. Other potential sources include: (1) any ex-franchisees, employees or vendors; (2) any new or competing franchisors or employers; and (3) any third-party who may have been involved, including investors, brokers and recruiters.

#### 1. The Opposition

A franchisor that has been wronged by a former franchisee, employee, vendor or competing franchisor should of course focus its principal discovery efforts upon the opposition. Among the categories of documents and information which should be sought from the opposition are the following: (1) any proprietary information or documents misappropriated from the plaintiff litigant; (2) any information or documents that demonstrate a conspiracy among defendants; (3) any documents or information showing direction/participation/agreement by any new or competing franchisor or employer; (4) any information or documents that demonstrate knowledge or intent by the new franchisor or employer, including its own confidentiality, franchise and employment agreements, covenants and manuals; (5) any information or documents showing the possession or use of any misappropriated information or documents.

### 2. The Plaintiff Litigant

A franchisor that has been wronged by a former franchisee, employee, vendor or competing franchisor is frequently focused like a laser on the opposition. For good reason. At the same time, the plaintiff litigant can be so focused on the opposition that it fails to focus on its own files, which may provide some of the best evidence on the following points: (1) the ex-franchisee, employee, vendor or competing franchisor was a party to various agreements or provisions in a single agreement not to take, misuse or disclose confidential information or other property, or solicit employees, customers, prospects or leads; (2) an ex-franchisee, employee or vendor received various as applicable franchisee, employment, training or other manuals that outlined the company's policies and expectations and signed acknowledgments of receipt for the manuals; (3) an appropriate level of trust and confidence was placed in the ex-franchisee, employee or vendor; (4) the ex-franchisee, employee or vendor engaged in wrongful or otherwise disloyal conduct prior to termination of the applicable relationship; and (5) a competing franchisor and perhaps related third-parties such as brokers and recruiters engaged in wrongful or otherwise actionable conduct.

### 3. Third Parties

The plaintiff litigant must also focus on any third-party who may not only have been involved, including investors, brokers and recruiters, but also third parties who may merely possess relevant information or documents. If the competitor used an unrelated employer's computer network or work station to engage in actionable conduct, the unrelated third party likely possesses responsive information. The plaintiff litigant should also seek discovery from any investors, brokers or recruiters involved in the complained of conduct.

## VII. Best Pre-Litigation Practices to Prevent Disputes with Competitors or to Prevail in Them

An owner of proprietary information or other property can lose its ability to protect such information or other property through a variety of failures, including most importantly: (1) failing to take sufficient steps to protect it from unnecessary dissemination and use; and (2) failing to enforce its rights once someone does misuse, misappropriate or disclose the information or other property. Accordingly, adopting best pre-litigation practices on the front-end not only helps to prevent disputes with competitors by discouraging and hopefully preventing the occurrence of actionable misbehavior, but also materially raises the chances of prevailing in them should they otherwise occur by enhancing the chances of protectable rights and interests being found to exist.[52]

[52] Note that you cannot enforce your rights against those who obtain the information through legitimate means. Legitimate means of acquiring information or other property include: (1) independent discovery or development; (2) reverse engineering (*e.g.*, taking apart an item to understand how it was made); and (3) obtaining the information or other property from the public domain.

Proprietary information or other property that has been confidentially disclosed or shared will not in most instances lose its status as a protectable asset. The key is to ensure that you use reasonable measures to keep the proprietary information or other property protectable. For example, revealing proprietary information or other property to a corporate employee who has signed a confidentiality agreement and needs the information in order to perform his job should not by itself result in the loss of the trade secret. Similarly, revealing proprietary information or other property through a franchise or licensing agreement where the agreement obligates the franchisee or licensee to maintain confidentiality should not by itself result in the loss of a protectable interest.

While the criteria for different types of proprietary information and other property vary, generally you have a protectable right or interest in proprietary information or property if the information or property is restricted, confidential and/or a secret and provides you with a competitive advantage. In contrast, information or other property that is generally known or has been disclosed to or discovered by the public does not enjoy the same protections. Some of the key factors in determining whether information or other property is protectable include: (1) if the information or other property is known outside of your business or system; (2) whether you have restricted access to the information or other property within your business or system; (3) whether you have taken reasonable measures to protect the information or other property; (4) whether the information or other property is valuable to you, your business and your system, as well as to your competitors; (5) whether you expended substantial effort or money in obtaining and developing the information or other property; and (6) whether it would be difficult for others to acquire or duplicate the information or other property.[53] Although the answers to all of the foregoing questions are important, the most significant factors in determining whether something is protectable is the extent to which the owner has restricted its access or use and thereafter taken steps to protect the information or other property.

While most laws require the owner of proprietary information or other property to take reasonable measures to protect their protectable status, there are many different ways to go about taking such measures. These measures can be placed into three broad categories: (1) written agreements; (2) structural safeguards and best practices; and (3) written notices.

### A. Written Agreements

As to the first category of reasonable measures, having written agreements in place with your officers, employees, franchisees, licensees, prospective franchisees and licensees, landlords, outside contractors and vendors, and all of their key respective employees, restricting their ability to misappropriate, use or disclose your proprietary information and other property or otherwise unfairly compete with you is fundamental. A written employment, franchise or brokerage agreement provides unequivocal proof that

[53] *See, e.g., Integrated Cash Mgmt. Servs. v. Digital Transactions, Inc.,* 920 F.2d 171, 173 (2d Cir.1990) (quoting *Eagle Comtronics, Inc. v. Pico, Inc.,*89 A.D.2d 803, 453 N.Y.S.2d 470, 472 (4th Dep't 1982)); *see also* Restatement of Torts § 757.

the employee, franchisee or broker at the outset of the relationship was aware of his/her duty to maintain the confidentiality of the franchisor's confidential information and other property. Such documentation is indispensable for a clear understanding of the counter-party's obligations both during the relationship and thereafter. Equally critical is properly identifying any information deemed to be confidential or proprietary during the parties relationship so there is no dispute as to whether the information is considered to be of a sensitive nature. This is especially so if the written agreement requires such a designation.

While non-managerial employees are not frequently asked to enter into such agreements at the beginning of their employment, they are still subject to common-law employment obligations to maintain the confidentiality of information they learn by virtue of their employment and to refrain from competing unfairly with their former employer.[54]

Examples of potentially available agreements in a franchise context include:

- **Non-Disclosure Agreements** (also known as "NDAs" and "Confidentiality Agreements"). Non-Disclosure Agreements are in essence a promise by a counter-party not to misappropriate, use or disclose proprietary information or other property. A Non-Disclosure Agreement puts the counter-party on notice of the confidentiality of the information and helps to prove the existence of its protectable status in the event of a lawsuit.

- **Non-Compete Agreements** (also known as "Restrictive Covenants" or "Covenants Not To Compete"). Non-Compete Agreements are in essence a promise by a counter-party not to engage in certain defined types of competitive behavior for a certain period of time and within a defined geography. Covenants Not to Compete are designed to prevent current and former franchisees or employees from using the franchisor's goodwill and proprietary and confidential information to compete against it. In-term covenants – those applicable to current franchisees and employees – are more universally enforceable. Post-term covenants – those applicable to former franchisees and employees – are generally enforceable, as long as they are reasonable in time, geographic scope and the activities proscribed. That said, employment covenants face stricter scrutiny than franchise covenants and employer terminations of employment relationships and, to a lesser but perhaps growing degree, franchisor terminations of franchise relationships can affect the enforceability of a Covenant Not to Compete.

- **Non-Solicitation Agreements**. A Non-Solicitation Agreement is a contract or clause within a broader contract in which a counter-party agrees not to solicit a company's clients, customers or employees for the benefit of the counter-party or another competitor after leaving a franchise, employment or vending relationship with the company. In a franchise context, customer and employment relationships, as well as prospect and developer-site lists, might be the proper subject of a Non-Solicitation

[54] *See* The Restatement (Second) of Agency § 396(b) ("After the termination of the confidential relationship, the agent, nonetheless, owes a duty not to disclose the principal's trade secrets, lists of names, or other confidential matters given to the agent.").

Agreement. Subject to varying state laws, Non-Solicitation Agreements are generally enforceable and can be presented at any stage of a relationship, including as part of a mutual termination or severance agreement.

- **Confidentiality Provisions and Use Restrictions in Franchise Brokerage, Re-Sale Lead Referral and Lease Agreements**. In a franchise system context, confidentiality provisions and use restrictions can be used to establish and protect valuable rights in both information and property in an array of contracts collateral to the operation of a franchise system. Those contracts include franchise sales and brokerage agreements entered into with third-party vendors, re-sale lead referral agreements entered into with franchisees wishing to leave the system and prospective franchisees seeking to either enter or expand within the system, and lease agreements and collateral lease documents with third-party landlords regarding franchise business premises.

- **Non-Disparagement Clauses**. A Non-Disparagement clause or provision (also known as "Protection of Reputation" clause) restricts individuals from taking any action that impacts negatively a company, its reputation, products, services, management or employees. Non-Disparagement clauses are found in virtually all franchise settlement agreements and a large measure of executive employment agreements and employment severance agreements. Some forms briefly describe the prescribed actions and other forms build an exhaustive list of prohibited actions.

- **Invention Assignment Agreements**. An Invention Assignment Agreement is a contract or provision in a broader contract that gives a party certain rights to inventions created or conceptualized by a counter-party during the course of either an employment or independent contractor relationship. Typically, this type of agreement or provision in a franchise context requires an employee or franchisee to disclose any inventions to the franchisor, to legally assign any ownership rights in the inventions to the franchisor, and to assist the franchisor in taking any further actions to protect and perfect its rights in the inventions.

- **Self-Help Clauses**. Self-Help Clauses provide for a party to have the right to take a series of corrective or preventative measures against a counter-party. Common examples have traditionally been found in a landlord-tenant context involving eviction and abandoned property, as well as in sale-lease contexts involving repossession. A majority of states have banned self-help by landlords against tenants. In states that give landlords the right of self-help, landlords may evict a tenant on their own only if they can do so in a peaceful manner. That said, the definition of a peaceful manner varies widely by state from not breaching the peace to having the tenant's consent. One other potential form of self-help in a franchise context is through provisions contained in software license agreement between a franchisor and its franchisees related to the providing of electronic system services and customer leads. Subject to applicable law and potential claims of *de facto* termination, franchisors acting as software providers or licensors may retain the right to disable a franchisee's software from a remote location upon the occurrence of certain default events.

## B. Structural Safeguards and Best Practices

The second broad category of reasonable measures involves adopting and implementing appropriate structural safeguards and best practices. For example, franchisors should:

- Store proprietary information, documents, data and items in segregated, secure areas;
- Use identification cards, passwords, logging and tracking software, and other surveillance methods to restrict access to location of and functionality with regard to protected documents, data and items;
- Disclose the information and items to employees, franchisees and vendors only on a need-to-know basis and only with contractual safeguards and duties in place;
- Limit franchisee and vendor employees' access to proprietary information to only on a need-to-know basis and only with contractual safeguards and duties in place;
- Prohibit and prevent the general public's access to proprietary information;
- Secure, track and limit access and functionality to information and items on computer networks;
- Use firewalls to restrict access to electronic sites where proprietary information can be found;
- Use digital methods to encrypt, track, and protect information sent over the internet and via email;
- Use unnamed or coded ingredients used in trade secret recipes or formulas; and
- Monitor and screen writings, articles, speeches, presentations and other publications by employees to prevent disclosure of confidential information.

## C. Written Notices

The third broad category of reasonable measures involves developing and adopting appropriate written notices that designate sensitive areas, networks, documents, data and other things as confidential and/or restricted. For example, franchisors should:

- Distribute to employees a formal, written statement or policy manual outlining the franchisor's confidentiality, non-disclosure and use policies and the obligations to adhere to the same;
- Inform franchisees and those vendors and employees who have access to confidential information about the specific information subject to protection, the applicable use restrictions and security measures, and the obligation to maintain the secrecy of the information;
- Mark all documents and computer files containing proprietary information with warning signs indicating that the information is confidential and subject to protection/restrictions; and

- Adopt and implement software, email, and internet policies that alert franchisees, vendors and employees to the confidentiality of certain information.

As long as they give you a competitive advantage over your competitors and you take reasonable measures to protect them as set forth above, proprietary information and other property theoretically may be valuable and protectable forever. In contrast, if through sloth or neglect you allow your proprietary information and other property to be unnecessarily disclosed to the public or fail to take adequate measures to protect them, proprietary information and other property are likely to lose their value and protectable status in relatively short order.

**D. Post-Relationship Procedures and Considerations.**

Post-relationship franchise and employment procedures and considerations are another important component in an overall strategy for protecting confidential information, as well as for discouraging and preventing unfair competition. Indeed, in a franchise context, the overwhelming majority of unfair competition and misappropriation of information, customers and goodwill occurs when franchise, employment and agency relationships between a franchisor and a franchisee, employee or vendor is terminated. Accordingly, the need to develop post-relationship procedures that manage the transition and contemplate prospective unfair competition, misuse and misappropriation is manifest.

Post-relationship procedures are often the last opportunity a franchisor has to orient its departing franchisee, vendor or employee of its obligations and to prevent unfair competition, misuse or misappropriation. Following clear post-relationship protocols and procedures may also be helpful to protecting and proving the existence of protectable information and other property. Finally, it is worth repeating that the law will enforce an obligation to protect confidential information and property only where a claimant has shown that it has taken reasonable precautions to protect the information and property. This is yet another reason to adopt and implement uniform post-relationship policies and procedures.

While a franchisor's post-relationship procedures should consider and complement the norms of its particular industry, the franchisor should ultimately develop, implement and adhere to its own post-relationship procedures. A well-constructed and uniformly applied franchisor procedure for franchisees is not likely to be the exact same as one constructed for employees or vendors. This section will briefly consider some of the possible elements of such procedures, including conducting exit interviews, considering the effects of termination decisions, gathering and protecting confidential information, counseling franchisees, customers and employees during the transition, and providing notice to new franchisors, employers or other actors when appropriate.

### 1. *Effect of Termination*

As discussed above, various contractual provisions, including covenants not to compete, are important tools used to prevent the loss of proprietary information and know-how, customers and goodwill following the termination of a relationship. In some states, covenants not to compete will not be enforced as a matter of law where an employer terminates or breaches an employment relationship. In other states and jurisdictions, a franchisor's decision to "voluntarily" terminate a franchisee can figure centrally into whether various provisions, including covenants not to compete, will be enforced and to what degree. Therefore, it is very important for franchisors to be knowledgeable about the applicable franchise and employment laws in its principal place of business and carefully consider and weigh how the termination of a relationship could be best positioned and how the termination would play out in a variety of different contexts.

### 2. Conducting Exit Interviews

Ideally, an exit interview advances three important goals. In particular, an exit interview gives the franchisor or, as the case may be more often, the franchisor as employer: (1) a final chance to remind the departing franchisee or employee of his or her obligations under any applicable agreements and the common law not to take, disclose, misuse or solicit; (2) a practical moment to request and secure the return of all corporate documents, lists and other documents and things in the person's possession; and (3) an opportunity to ask questions and explore reasons and motives for past behavior and future plans. During the exit interview, the departing franchisee or employee should be clearly reminded of his or her continuing obligations, including not to disclose confidential information or unfairly compete after the relationship.

Exit interviews have the potential to become adversarial and awkward. It is the franchisor's responsibility to keep them on track and to make sure the franchisor's core objectives get met. Because litigation is always a possibility, the guidance and presence of legal counsel at this stage may prove to be a worthwhile precaution.

### 3. Termination Notices/Termination Agreements

Conducting exit interviews with departing employees, let alone franchisees, is not always possible. Often times, the exit interview is replaced in whole or in part by formal termination notices and, where mutual agreement is possible, severance or termination agreements. In such writings, the franchisor should review the former franchisee's or employee's various agreements, especially express written agreements not to disclose trade secrets and confidential information, non-solicitation agreements and covenants not to compete. In situations where severance or termination agreements are being signed, the franchisor should take care to carve-the terms out of any release and typically attempts to have the franchisee or employee re-acknowledge and re-affirm the provisions from the prior document(s).

### *4.* Protecting Goodwill and Customers

Like other businesses, one of the single most valuable assets of a franchise business is often its "goodwill" under its marks, which can be measured by the positive relationship it has developed with its brand's customers. The franchisor's actual and prospective revenue streams and profits are often directly related to the business relationships it has developed and hopes to further develop and maintain with its actual and prospective customers. For this reason, it is crucial for the franchisor to protect its "customer" base. Of course, in a franchise system, a "customer" can be thought of as anyone from a retail customer to actual franchisees to qualified applicants to leads and even prospects.

There is no clear majority rule regarding the trade secret or confidential status of customer lists in the absence of an express agreement between the parties. Accordingly, the best way for a franchisor to protect its "customer" lists from disclosure by a franchisee, employee or vendor is by utilizing non-disclosure and non-solicitation provisions in its agreements. A protectable customer list and the existence of express non-disclosure and non-solicitation provisions in an applicable written agreement may significantly assist the franchisor in maintaining the confidentiality of the relevant "customer" base.

Another important method for protecting a franchisor's "customer" base is to effectively communicate with the "customers" during the transition phase following a relationship's termination, albeit a franchisee, employee, broker or other vendor relationship. Once an actual or potential "customer" enjoys a comfortable and good relationship with a franchisee, employee, broker or other vendor, it may be solicited and vulnerable to following the franchisee, employee, broker or other vendor to the competition unless aggressive efforts are made by the franchisor to protect and retain the actual or prospective customer.

To prevent the migration of actual or prospective "customers," the franchisor should contact them and advise them that while as applicable the franchisee, employee, broker or other vendor is no longer affiliated with the franchisor, the franchisor wants to retain them and will continue to provide them with the goods and services they desire and expect. The importance of written and personal touches to customer retention cannot be overstated. In order to avoid the possibility of a future civil action for tortious interference or defamation, the franchisor should refrain from mentioning the circumstances under which the franchisee, employee, broker or other vendor left the system, and should focus instead on assuring the customer that customer expectations and service needs will be met.

### 5. Providing Notice to New Franchisors and Employers

Providing notice to the new franchisor or employer of a former franchisee or employee is another post-employment technique to consider. The most common and effective method of providing notice to a former franchisee's or employee's new franchisor or employer is by means of a letter from the franchisor. As applicable, the new franchisor or employer should be advised that the franchisee or employee had access to confidential information and that he or she has a continuing contractual and/or common-law duty not to disclose or misuse such information. The letter should also reference any applicable covenants not to compete, non-solicitation and nondisclosure provisions.

The benefits of providing notice include preventing the new franchisor or employer from later claiming that any prohibited uses or disclosures, or solicitation of customers, was innocent or inadvertent. The potential detriments include potential allegations against the franchisor of defamation or tortious interference with actual or prospective contractual relationships. Accordingly, a franchisor should exercise caution when drafting such letters and make sure they are accurate, based on fact, do not overstate the franchisor's legal rights, and are not defamatory in nature.

## VIII. Conclusion

Franchise systems have competed for many years. The methods and manner in which competition occurs has grown exponentially with the rise of social media and the increasing reliance on the internet in general. In this environment, it is inevitable that competing franchise systems will end up in court. A franchise system must be armed with knowledge of both how to avoid this type of litigation and, if necessary, how to prevail in this type of litigation. This includes a thorough understanding of the various types of claims that arise between competitors and the relief available for each. Given the high stakes and emotion involved in competition litigation, a franchise system must also fully evaluate the practical concerns discussed in this paper. The franchise system that understands and appreciates the topics discussed in this paper will have an advantage over its competitors that extends beyond the products or goods that it offers.