



2024 > LEGAL
SYMPOSIUM

MAY 5-7 > WASHINGTON, DC



How to protect the Franchise System in a World Without Enforceable Non-Competition Covenants

- Recent Updates
 - Federal and State Rule-Making
 - Recent Case Law
- Trade Secrets
- Non-Solicitation
- Trade Dress
- Other Avenues

Rule-Making Updates – FTC Final Rule

Total Ban in Employment Context

(a) *Unfair methods of competition*—(1) *Workers other than senior executives*. With respect to a worker other than a senior executive, it is an unfair method of competition for a person:

- (i) To enter into or attempt to enter into a non-compete clause;
- (ii) To enforce or attempt to enforce a non-compete clause; or
- (iii) To represent that the worker is subject to a non-compete clause.

(2) *Senior executives*. With respect to a senior executive, it is an unfair method of competition for a person:

- (i) To enter into or attempt to enter into a non-compete clause;
- (ii) To enforce or attempt to enforce a non-compete clause entered into after the effective date; or
- (iii) To represent that the senior executive is subject to a non-compete clause, where the non-compete clause was entered into after the effective date.

Rule-Making Updates – FTC Final Rule

Definition of Non-Compete

Non-compete clause means:

(1) A term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from:

(i) seeking or accepting work in the United States with a different person where such work would begin after the conclusion of the employment that includes the term or condition; or

(ii) operating a business in the United States after the conclusion of the employment that includes the term or condition.

(2) For the purposes of this part 910, term or condition of employment includes, but is not limited to, a contractual term or workplace policy, whether written or oral.

Rule-Making Updates – FTC Final Rule

Definition of Worker

Worker means a natural person who works or who previously worked, whether paid or unpaid, without regard to the worker's title or the worker's status under any other State or Federal laws, including, but not limited to, whether the worker is an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor who provides a service to a person. The term worker includes a natural person who works for a franchisee or franchisor, but does not include a franchisee in the context of a franchisee-franchisor relationship.

Rule-Making Updates – FTC Final Rule

Going forward for all employees; retroactive for employees that are not “senior executives” (both policy-making position and min \$151,164 in annual comp)

Policy-making authority means final authority to make policy decisions that control significant aspects of a business entity or common enterprise and does not include authority limited to advising or exerting influence over such policy decisions or having final authority to make policy decisions for only a subsidiary of or affiliate of a common enterprise.

Policy-making position means a business entity’s president, chief executive officer or the equivalent, any other officer of a business entity who has policy-making authority, or any other natural person who has policy-making authority for the business entity similar to an officer with policy-making authority. An officer of a subsidiary or affiliate of a business entity that is part of

Rule-Making Updates – FTC Final Rule

Exceptions:

- (i) Bona fide sale of business
- (ii) Existing cause of action
- (iii) Good faith
- (iv) International
- (v) In-Term

Rule-Making Updates – FTC Final Rule

- Eff. 120 days after publication (~ August 2024) (pending court challenges and injunctive relief)
- Notice to workers **before** effective date – no obligation to amend
- Does not supersede state law – unless state law permits prohibited provisions.

Rule-Making Updates – State

- California (eff. Jan 1, 2024)
 - Prohibits “seeking” to enter into violative contract
 - Applies to out of state workers
 - Notice to affected employees
- New York (Vetoed)
 - Governor seeks to limit to highly paid employees
 - Proposed ban in NYC (three options)

Rule-Making Updates – State

- Washington DC (eff. October 2022)
 - Ban applies to employees making less than \$150,000 annually
 - Applies going forward only
- Minnesota (eff. July 2023)
 - Ban applies to all workers – no salary threshold
 - Expressly does not apply to non-solicit and non-disclosure
 - Prohibits out-of-state forum or governing law

Rule-Making Updates – State

- Colorado (eff. March 2022 / August 2022)
 - Creates criminal liability if force or threats are involved
 - Limits total ban to employees under \$101,000
 - Prohibits out-of-state forum or governing law
- Illinois (eff. January 2022)
 - Limits total ban to employees under \$75,000
 - Creates 14 day waiting period
 - Prohibits without sufficient consideration (2+ years of employment)
- Legislation pending: Wisconsin and New Jersey

Case Law Updates

- **Unreasonable Scope:**

- ***Cookie Dough Bliss Franchising, LLC v. Feed Your Soul Minnesota, LLC***, No. CV 23-1552 (JWB/TNL), 2023 WL 4901292, at *4 (D. Minn. Aug. 1, 2023).
- ***Madison Auto Center, LLC v. Lallas***, No. 2022AP1376, 2023 WL 3880300 (Wis. Ct. App. June 8, 2023).

- **Blue Penciling:**

- ***HOA Franchising, LLC v. MS Foods, LLC***, No. 1:23-CV-04096-ELR, 2023 WL 9692401 (N.D. Ga. Dec. 20, 2023).
- ***GPI, LLC v. Patriot Goose Control Inc.***, No. CV2320953MASTJB, 2024 WL 1704731 (D.N.J. Apr. 18, 2024).

Case Law Updates

Postnet International Franchise Corporation v. Wu, 521 F. Supp. 3d 1087 (D. Colo. 2021).

JTH Tax, LLC v. Leggat, No. 2:22CV41 (RCY), 2022 WL 3970197, at *1 (E.D. Va. Aug. 31, 2022).

- Make required state-specific disclosures but avoid modifying express terms of the franchise agreement and maintain favorable choice of law and forum selection provisions. Consider whether federal law preempts any unfavorable state law.
- Differentiate franchisor/franchisee non-competition covenants from employment non-competition covenants as PROMOTING COMPETITION.

Servpro Industries v. Woloski, No. 3:17-CV-01433, 2019 WL 3552516 (M.D. Tenn. Aug. 5, 2019), *aff'd*, No. 21-5685, 2022 WL 633844 (6th Cir. Mar. 4, 2022).

- File first to secure venue outside of the unfavorable forum.
- Consider whether failure to adhere to state law has a voiding effect or should constitute a breach of contract instead.

Trade Secrets

- Strategic use of trade secret protection can mirror some protective features of non-compete covenants.
 - *Gimex Properties Corp., Inc. v. Reed*, 205 N.E.3d 1 (Ohio App. Dec. 29, 2022) (injunction enforcing franchise agreement non-compete and confidentiality clauses prohibiting competing or disclosing trade secrets upheld on appeal, citing substantial evidence that former franchisees possessed trade secrets that could potentially harm franchisor if used for or by a competitor).
- **Trade Secret** = Information that can be used in the operation of a business or other enterprise that is sufficiently valuable and secret to afford an economic advantage over others, including things like formulas, patterns, compilations, programs, devices, methods, techniques, or processes.
 - To qualify as a trade secret, the information must also not be generally known to the public, and the owner must take reasonable steps to maintain its secrecy.

Trade Secrets

- Considerations for Trade Secret as Non-Compete Alternative:
 - Clearly identify and document the trade secrets.
 - Implement robust “external” confidentiality obligations to maintain secrecy.
 - Implement robust “internal” confidentiality measures as well.
 - Be aware trade secret claims carry a high burden of proof and often preempt other claims arising from the same set of facts, such as fraud and unjust enrichment.
- Recent franchise/distribution trade secret cases:
 - *FIMIC, S.r.L. v. ADG Solutions, Inc.*, 1:19-CV-05636-SDG, 2022 WL 4715685 (N.D. Ga. Sept. 30, 2022) (summary judgment motion on trade secret claim denied, question of whether plaintiff took reasonable measures to protect trade secret is for jury).
 - *Got Docs, LLC v. Kingsbridge Holdings, LLC*, No. 19 C 6155, 2023 WL 2078450 (N.D. Ill. Feb. 17, 2023)(trade secret claim survived summary judgment, but other claims for conversion, unjust enrichment, and breach of fiduciary duty, were preempted by trade secret statutes).

Trade Secrets - Actions Franchisors Can Take to Improve Enforceability

- Pre-Litigation Strategies for Safeguarding Proprietary Information
 - Broad Definition of Trade Secrets
 - Physical and Electronic Security Measures
 - Protection in Public Materials
- Preventing Unnecessary Spread and Utilization
 - Limiting Disclosure in Training and Materials
 - Internal Protocols

Trade Secrets - Actions Franchisors Can Take to Improve Enforceability (Cont.)

- Enforceable Post-Termination Obligations
 - Ceasing Association with Franchisor's System
 - Transfer of Assets
 - Return of Materials
- Legal Remedies and Exit Procedures
 - Liquidated Damages Provision
 - Exit Procedures for Former Franchisees
 - Legal Actions
 - Resource Allocation

Non-Solicitation Covenants

- Often lumped together with non-competes
- Some bans are broad enough to ban non-solicits (CA)
- Others expressly carve-out (MN / FTC)
- Otherwise test is:
 - Duration – similar to non-compete (1-2 years)
 - Scope – quantity and nature of customers; degree of connection; ability to conduct other business; history of when client work was performed; etc.

Non-Solicitation Covenants - Actions Franchisors Can Take to Improve Enforceability

- Non-Solicitation Provisions
 - Definition of Customers
 - Prohibited Activities
 - Exceptions
 - Timing
- Extension to Other Contracts
 - Suppliers, Service Providers, and Clients
 - Exclusivity Contracts

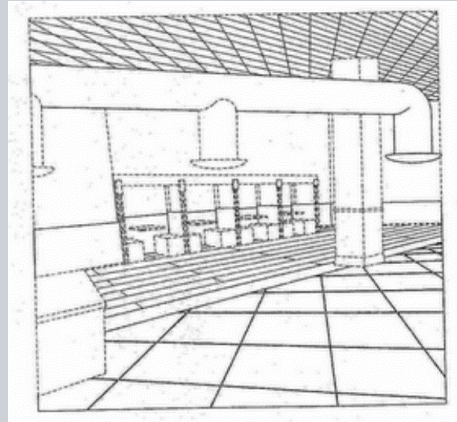
Non-Solicitation Covenants - Actions Franchisors Can Take to Improve Enforceability (Cont.)

- Consequences of Violation
 - Clear Enforcement Measures
 - Turnover of Customer Lists
- No-Poach or Anti-Poaching Clauses
 - Distinction from Non-Solicitation
 - Legislative Scrutiny (WA, NY & NJ)
 - State Legislation Examples
 - Impact on Franchising
 - Best Practice – Don't include and if necessary no wages or mobility

Trade Dress

Potbelly Sandwich Works, LLC

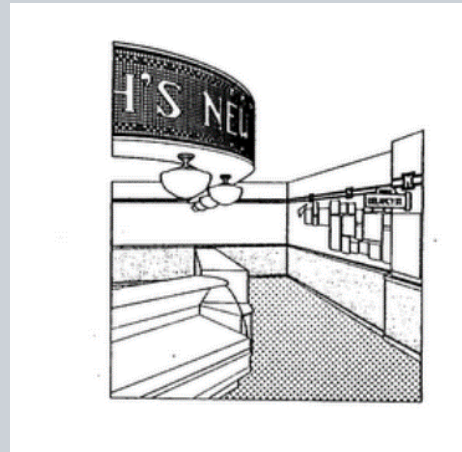
interior of a restaurant produced by a combination of a tin ceiling, open duct work, wainscoting and a floor having a wood section and a hard surface section. The solid lines show the positioning of the mark in connection with the restaurant and those features claimed by the applicant as its mark



Trade Dress

Noah's New York Bagel Company

interior of a retail store and restaurant evoking early 20th century New York through the combination of a tile motif reminiscent of a 1900s New York subway station and old-fashioned light fixtures, dark wood, and photographs and memorabilia of old New York



Other Avenues

Deceptive Trade Practices

Unfair trade practices that undermine the franchise system or violate principles of fair competition

- 1) Improper Use of Confidential Information
- 2) Infringement of Trademarks or Intellectual Property Rights
- 3) Misleading Advertising or Marketing Tactics
- 4) Undercutting Pricing Established by the Franchisor
- 5) Recruitment of Employees or Customers from Other Franchise Locations
- 6) Breach of Fiduciary Duty
- 7) Non-Compliance with Quality Standards

Other Avenues

Tortious Interference

- Challenge actions that harm a franchisor's existing or prospective business relationships
- BUT, must establish several elements: (i) defendant's knowledge and intent to interfere, (ii) causation, and (iii) damages.
 - *Brow Art Management, LLC v. Idol Eyes Franchise, LLC*, No. CV 23-11434, 2023 WL 4665357 (E.D. Mich. July 20, 2023) (plaintiff found not to have acquired non-compete covenants in asset purchase from predecessor in interest, but plaintiff had demonstrated likelihood of success on the merits of tortious interference claim).

Thank You!

Q&A

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