ABA Forum on Franchising

The Franchise Lawyer

American Bar Association • Forum on Franchising

Vol. 13 No. 3 | Summer 2010

Message from the Chair

While highly visible Forum activity is not the hallmark of the summer months, I can assure you that it is the season when most work actually gets done. We are busily planning for this year's Annual Meeting in October, a program not to be missed. ***Read more...***

Message from the Editor-in-Chief

As my term as Editor-In-Chief of *The Franchise Lawyer* comes to a close with this issue, I want to express my sincere thanks to a number of folks who have contributed mightily to making this a deeply rewarding experience. I am also gratified that the ABA Forum on Franchising continues to stand for scholarship, education and collegiality of the highest order. ***Read more...***

The ABA Forum on Franchising 2010 Annual Meeting

Don't miss the 2010 Annual Forum in San Diego. October 13-15, 2010! Choose from a wide variety of excellent workshops geared toward everyone, from beginning franchise lawyers to more seasoned franchise practitioners. Early Bird registration is now open! ***Read more...***

Annual Forum Community Service Event

This year's ABA Forum on Franchising Community Service Event, hosted by the Women's Caucus and the Corporate Counsel Division, will take place right on Ocean Beach, at the mouth of the San Diego River. Come join your friends and colleagues for a wetlands improvement project benefiting the San Diego River Park Foundation. ***Read more...***

Recognize Your Outstanding Colleagues in San Diego!

Ron Gardner, Forum Chair, seeks your nominations for the following awards which will be presented at the Annual Forum meeting in October: Lewis Rudnick Award, Chair's Award for Substantial Written Work or Presentation, Chair's Future Leader Award and Chair's Explorer Award. ***Read more...***

Nominating Committee Report from Ron Gardner, Forum Chair

Under the Leadership of Edward Wood Dunhan, Immediate Past Chair of the Forum, the Nominating Committee has made nominations for members of the Governing Committee for terms commencing in August 2011. Joseph J. Fittante of Larkin Hoffman Daly & Lindgren Ltd., Minneapolis, MN has been nominated to serve as the next Chair of the Forum. ***Read more...***

Ethical Risks in Misleading a Mediator

If you tell a mediator that your client's insurance coverage or the authority granted by your client's Board of Directors puts a specific limit on the settlement your client can offer or accept, the mediator might work to bring the other side within that ballpark. But what if what you told the mediator were not true? ***Read more...***

Leegin: All Bark, No Bite?

Three years ago, the U.S. Supreme Court abandoned the doctrine that established a rule of *per se* illegality for minimum resale price maintenance agreements in favor of the more lenient “rule of reason” test. The *Leegin* decision bookends an earlier opinion, *State Oil v. Khan*, where the Court declared that maximum resale price maintenance agreements should be reviewed under the rule of reason standard. ***Read more...***

Cleaning Franchisees Held to be Employees

On March 23, 2010, a US District Court in Massachusetts found individual franchisees of Coverall North America, Inc. to be employees under a unique independent contractor test in the Massachusetts wage and hour statute. The case is a serious rebuke to models such as those Coverall uses in its janitorial franchises. ***Read more...***

New Books from the Forum on Franchising

Annual Franchise and Distribution Law Developments 2009
Joel R. Buckberg and Jon P. Christiansen

International Franchise Sales Laws – 2009 Supplement
Andrew P. Loewinger and Michael K. Lindsey, Editors

Financial Performance Representations: The New and Updated Earnings Claims
Stuart Hershman and Joyce G. Mazero

Fundamentals of Franchising, Third Edition
Rupert M. Barkoff and Andrew C. Selden, Editors

Antitrust Handbook for Franchise and Distribution Practitioners
Co-published with the ABA Section of Antitrust Law

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and Licensing, via email at copyright@abanet.org or via fax to 312-988-6030.

The Franchise Lawyer

American Bar Association • Forum on Franchising

Vol. 13 No. 3 | Summer 2010

Message from the Chair

While highly visible Forum activity is not the hallmark of the summer months, I can assure you that it is the season when most work actually gets done. We are busily planning for this year's Annual Meeting in October, a program not to be missed. ***Read more...***

Message from the Editor-in-Chief

As my term as Editor-In-Chief of *The Franchise Lawyer* comes to a close with this issue, I want to express my sincere thanks to a number of folks who have contributed mightily to making this a deeply rewarding experience. I am also gratified that the ABA Forum on Franchising continues to stand for scholarship, education and collegiality of the highest order. ***Read more...***

The ABA Forum on Franchising 2010 Annual Meeting

Don't miss the 2010 Annual Forum in San Diego. October 13-15, 2010! Choose from a wide variety of excellent workshops geared toward everyone, from beginning franchise lawyers to more seasoned franchise practitioners. Early Bird registration is now open! ***Read more...***

Annual Forum Community Service Event

This year's ABA Forum on Franchising Community Service Event, hosted by the Women's Caucus and the Corporate Counsel Division, will take place right on Ocean Beach, at the mouth of the San Diego River. Come join your friends and colleagues for a wetlands improvement project benefiting the San Diego River Park Foundation. ***Read more...***

Recognize Your Outstanding Colleagues in San Diego!

Ron Gardner, Forum Chair, seeks your nominations for the following awards which will be presented at the Annual Forum meeting in October: Lewis Rudnick Award, Chair's Award for Substantial Written Work or Presentation, Chair's Future Leader Award and Chair's Explorer Award. ***Read more...***

Nominating Committee Report from Ron Gardner, Forum Chair

Under the Leadership of Edward Wood Dunhan, Immediate Past Chair of the Forum, the Nominating Committee has made nominations for members of the Governing Committee for terms commencing in August 2011. Joseph J. Fittante of Larkin Hoffman Daly & Lindgren Ltd., Minneapolis, MN has been nominated to serve as the next Chair of the Forum. ***Read more...***

Ethical Risks in Misleading a Mediator

If you tell a mediator that your client's insurance coverage or the authority granted by your client's Board of Directors puts a specific limit on the settlement your client can offer or accept, the mediator might work to bring the other side within that ballpark. But what if what you told the mediator were not true? ***Read more...***

Leegin: All Bark, No Bite?

Three years ago, the U.S. Supreme Court abandoned the doctrine that established a rule of *per se* illegality for minimum resale price maintenance agreements in favor of the more lenient "rule of reason" test. The *Leegin* decision bookends an earlier opinion, *State Oil v. Khan*, where the Court declared that maximum resale price maintenance agreements should be reviewed under the rule of reason standard. ***Read more...***

Cleaning Franchisees Held to be Employees

On March 23, 2010, a US District Court in Massachusetts found individual franchisees of Coverall North America, Inc. to be employees under a unique independent contractor test in the Massachusetts wage and hour statute. The case is a serious rebuke to models such as those Coverall uses in its janitorial franchises. ***Read more...***

New Books from the Forum on Franchising

Annual Franchise and Distribution Law Developments 2009
Joel R. Buckberg and Jon P. Christiansen

International Franchise Sales Laws – 2009 Supplement
Andrew P. Loewinger and Michael K. Lindsey, Editors

Financial Performance Representations: The New and Updated Earnings Claims
Stuart Hershman and Joyce G. Mazero

Fundamentals of Franchising, Third Edition
Rupert M. Barkoff and Andrew C. Selden, Editors

Antitrust Handbook for Franchise and Distribution Practitioners
Co-published with the ABA Section of Antitrust Law

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and Licensing, via email at copyright@abanet.org or via fax to 312-988-6030.

Forum on Franchising
AMERICAN BAR ASSOCIATION

The Franchise Lawyer

American Bar Association • Forum on Franchising

Vol. 13 No. 3 | Summer 2010

INSIDE THIS EDITION

THE FRANCHISE LAWYER

Editor-in-Chief
Eric H. Karp
Witmer, Karp, Warner & Ryan LLP
22 Batterymarch Street
Boston, MA 02109
617-423-7250
ekarp@wkwrlaw.com

Message from the Chair

By Ronald K. Gardner
Forum Chair

As I write this, it is a beautiful sunny Friday afternoon in mid-summer. I hope you are enjoying the opportunities that the summer brings to most of us to take a few days off to rest and relax, and to contemplate the rhythm of not only the seasons, but also of our lives and our practices.

While highly visible Forum activity is not the hallmark of the summer months, I can assure you that it is the season when, perhaps, the most work actually gets done. To begin with, as you probably know or have heard by now, we are busily planning for this year's Annual Meeting in October. I want to take just a few minutes to talk to you about why I believe this will likely be one of the best Forum events in recent memory.

First, this year's program is being chaired by the extraordinarily talented duo of Deb Coldwell of Haynes & Boone and Kathy Kotel of Carlson Restaurants Worldwide. Bringing Deb's highly-respected views as a litigator together with Kathy's unparalleled experience as an in-house lawyer at major franchisors has resulted in one of the most diverse and intellectually satisfying set of program offerings ever. Just one quick look at our brochure (which I hope you have received by now – and if you have not, you should find online at **http://new.abanet.org/Forums/franchising**), will give you a flavor for what I am talking about. Programs on cutting-edge issues such as the use and impact of social media on franchising and franchising in Latin America are juxtaposed against insightful new twists on old topics, including workshops specifically aimed at discussions of the most frequently-litigated substantive provisions in a franchise agreement, litigating injunctions, and best practices with respect to franchise compliance and/or starting a franchise system. These are just a few of the many, many offerings we will have for you this fall.

I also remain extraordinarily excited about this year's program because of the extremely high quality of the panelists that Deb and Kathy have put together. Of course, we are always the beneficiaries of the wisdom and experience that many very experienced practitioners give to those of us as Forum members every year. This year, in addition to our own "in-house" experience, we will also have the benefit of the insight of regulators, outside experts, and others. In short, the program is not to be missed.

Finally, who would not be excited by the prospect of spending a few days enjoying the (hopefully) warm sun of southern California along the beautiful Coronado shoreline? Having had the opportunity to visit there within the last year, I can tell you that the Hotel Del Coronado is everything you will expect it to be – and quite a bit more. Picturesque, historic, and filled with individuals eager and willing to make your stay comfortable and enjoyable, the Hotel Del deserves the reputation it has earned.

So, as our speakers continue to slave over their papers throughout the remaining two months of the summer, all in anticipation of helping you better understand your practice area, please do your part and register early to join us from October 13-15 at the Hotel Del Coronado. It is easy as well – you can register online at

Forum on Franchising
American Bar Association
321 N. Clark Street
Chicago, IL 60654

http://new.abanet.org/Forums/franchising.

Of course, preparing for this year's program is not the only thing that is going on within the Forum this summer. Elsewhere in this newsletter you will see the formal announcement of the conclusion of the work of this year's Nominating Committee. Please let me take this opportunity again to thank Edward Wood (Jack) Dunham, our Immediate Past Chair, who has done an outstanding job in chairing this year's Nominating Committee. Thanks also to Committee members Alex Brito, Susan Grueneberg, Stuart Hershman, and Mark Kirsch, without whose willingness to share with us the benefit of their time, insight and wisdom, the nominations process would not have been as smooth, and the results not as dependable.

As a result of the work of these fine people, I am thrilled, assuming confirmation through our elections in October, at the prospect of welcoming Kathy Kotel and Kerry Bundy back for a second term on our Governing Committee, as well as welcoming new Governing Committee members Jim Goniea, Diane Green-Kelly, Mike Lindsey, and Eric Karp. All of these people have been nominated for a term beginning on August 1, 2011.

Beyond these additional nominees, I am extraordinarily pleased to announce that the Nominating Committee has nominated Joe Fittante, of Larkin Hoffman, to succeed me as the Chair of the Forum on Franchising. Joe is an extremely talented lawyer, friend, and gifted leader. Over the years, Joe has chaired our YLD Division, has served as the Diversity Officer, and is currently serving as our Program Officer. His wisdom and insights into many issues are evident to all of us who have had the privilege of serving with him on the Governing Committee over the last several years. I am absolutely certain that the Forum will find itself in very, very good hands under Joe's leadership.

Of course, with new additions come departures. I want to take this opportunity to thank both Peter Klarfeld and Andy Scott for the invaluable contributions they made to the Forum while on the Governing Committee. While Andy has recently chosen to retire, Peter continues his extraordinary contributions to the Forum, finding himself in the midst of editing the highly-valuable *Covenants Against Competition in Franchise Agreements*.

Finally, work is continuing as we plan for yet another teleconference – the next one scheduled in the first week of September. Sponsored by the Corporate Counsel Division, this program on "alternate fee arrangements" is one that should be of interest to everyone who practices franchise law. We hope that you will continue to watch the ListServ, and your e-mail, for further announcements about this fascinating and highly relevant topic.

Sunshine beckons. I hope you enjoy the rest of your summer with a cool beverage, a good book, and some time to relax. In the meantime, please make sure your register for the meeting in October – I look forward to seeing you there!

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and Licensing, via email at copyright@abanet.org or via fax to 312-988-6030.

The Franchise Lawyer

American Bar Association • Forum on Franchising

Vol. 13 No. 3 | Summer 2010

INSIDE THIS EDITION

THE FRANCHISE LAWYER

Editor-in-Chief
Eric H. Karp
Witmer, Karp, Warner
& Ryan LLP
22 Batterymarch Street
Boston, MA 02109
617-423-7250
ekarp@wkwrlaw.com

Message from the Editor-in-Chief

By Eric H. Karp

As my term as Editor-In-Chief of *The Franchise Lawyer* comes to a close with this issue, I want to express my sincere thanks to a number of folks who have contributed mightily to making this a deeply rewarding experience.

First, to our Immediate Past Chair, Jack Dunham, for bravely entrusting this responsibility to me and to the current Chair, Ron Gardner, for his unflagging support, wisdom and leadership.

Second, to our current and former Associate Editors, Max Schott, Glenn Plattner, Kristy Zastrow, Jennifer Moore and Jason Murray, each of whom cheerfully and expertly did all that I asked of them, and more. With Max securely at the helm as my successor, I am supremely confident of the future of *The Franchise Lawyer.*

Third, to the indomitable Kelly Rodenberg for expertly and patiently shepherding us through the transition to our electronic format and for generally being as indispensable as anyone can be.

Fourth, to my colleagues in the Forum who willingly contributed outstanding and timely articles of interest to their fellow members. Thanks especially to those that contribute so constructively to the dialogue on the ListServ, a rich source of ideas and topics for *The Franchise Lawyer.*

During my tenure, we converted *The Franchise Lawyer* to an exclusively electronic format, then redesigned that format, and continually worked to achieve the widest distribution possible to members of the Forum. We have strived in each issue to consistently present balanced viewpoints. As I stated to each of the authors, if you primarily represent one side of the franchisor/franchisee aisle, make sure that readers from the other side will also learn something of value from your article.

I am deeply gratified that the ABA Forum on Franchising continues to stand for scholarship, education and collegiality of the highest order. Whether we represent franchisees, franchisors or both, this is one venue where we can and we do disagree without being disagreeable. Of that, we can all be proud.

Thank you for the opportunity to serve.

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and Licensing, via email at copyright@abanet.org or via fax to 312-988-6030.

Forum on Franchising
American Bar Association
321 N. Clark Street
Chicago, IL 60654

The Franchise Lawyer

American Bar Association • Forum on Franchising

Vol. 13 No. 3 | Summer 2010

INSIDE THIS EDITION

THE FRANCHISE LAWYER

Editor-in-Chief

Eric H. Karp
Witmer, Karp, Warner & Ryan LLP
22 Batterymarch Street

The ABA Forum on Franchising 2010 Annual Meeting REGISTRATION IS NOW OPEN!

JOIN YOUR COLLEAGUES IN SAN DIEGO!

- Attend one of the Wednesday intensives: *The Impact of Social Media on Franchising and the Franchise Practitioner in 2010* or *Fundamentals of Franchising®.*
- Choose from a wide variety of excellent workshops geared toward everyone from beginning franchise lawyers to more seasoned franchise practitioners.
- Compare your decisions with those of your peers using an audience voting system during our plenary: *Strategic and Tactical Decision-Making: What Do Your Peers Think Of Your Decisions?*
- Experience the Hotel Del Coronado and its rich traditions, take a stroll on the white sandy beaches of Southern California, and enjoy the shopping and amenities of Coronado Island and nearby San Diego!
- Network with in-house and outside franchise counsel and regulators.
- Join us Saturday morning (10/16) for our community service project, a coastal habitat clean-up event at the mouth of the San Diego River on Ocean Beach.

REGISTER ONLINE NOW AT

Boston, MA 02109
617-423-7250
ekarp@wkwrlaw.com

Forum on Franchising
American Bar Association
321 N. Clark Street
Chicago, IL 60654

www.new.abanet.org/forums/franchising

Early Bird Registration Ends July 31, 2010!

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and Licensing, via email at copyright@abanet.org or via fax to 312-988-6030.

The Franchise Lawyer

American Bar Association • Forum on Franchising

Vol. 13 No. 3 | Summer 2010

INSIDE THIS EDITION

THE FRANCHISE LAWYER

Editor-in-Chief
Eric H. Karp
Witmer, Karp, Warner & Ryan LLP
22 Batterymarch Street

2010 ABA Forum on Franchising Community Service Event Hosted by the Women's Caucus and Corporate Counsel Division

JOIN US!

This year's ABA Forum on Franchising Community Service Event will take place right on Ocean Beach, at the mouth of the San Diego River. Come join your friends and colleagues for a wetlands improvement project benefiting the San Diego River Park Foundation, in an area containing habitats for a number of endangered animals and plants.

Each year, the annual community service event is a collegial and interactive opportunity to do some good while having fun. This year, we've got the warm ocean breeze, gorgeous scenery and the vibe from an eclectic and quintessential San Diego beach. If you've never joined us before, consider making this the year you do.

Buses pick us up at the Hotel at 8:00 a.m. and return us at 1:00 p.m. Family members are welcome, and donations to the Foundation are gratefully accepted.

Forum on Franchising
American Bar Association
321 N. Clark Street
Chicago, IL 60654

No experience necessary – just bring a laid-back attitude, and maybe a pair of sunglasses!

Questions? Please contact Brian Balconi at Brian.Balconi@LCECORP.com, Dawn Newton at DNewton@fablaw.com or Heather Bias at HBias@pqus.com.

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and Licensing, via email at copyright@abanet.org or via fax to 312-988-6030.

The Franchise Lawyer

American Bar Association • Forum on Franchising

Vol. 13 No. 3 | Summer 2010

INSIDE THIS EDITION

THE FRANCHISE LAWYER

Editor-in-Chief
Eric H. Karp
Witmer, Karp, Warner & Ryan LLP
22 Batterymarch Street
Boston, MA 02109
617-423-7250
ekarp@wkwrlaw.com

Recognize Your Outstanding Colleagues in San Diego!

Lewis G. Rudnick Award

The Rudnick Award will honor members of the Forum who, over the course of distinguished careers as franchise lawyers, have made substantial contributions to the development of the Forum and to franchise law as a discipline -- by publishing scholarly articles; writing or editing texts; speaking at franchise law meetings; serving the Forum as an officer, committee chair or member, or journal editor; and/or recognized accomplishments as a practicing franchise lawyer – while comporting themselves in accordance with Lew Rudnick's high standards of professionalism, decency and collegiality. The Award was presented to John R.F. Baer in 2009.

Chair's Award for Substantial Written Work or Presentation

This Award will recognize a young and/or diverse lawyer who has published a scholarly article in The Franchise Law Journal or The Franchise Lawyer, or prepared a paper and presented a workshop at a Forum annual meeting. Factors considered will include complexity of subject matter, competency of delivery, feedback from audience or readers, feedback from editors or program directors, and the relative experience of the author/presenter.

Chair's Future Leader Award

This award will go to a young and/or diverse Forum member who has demonstrated a substantial commitment to the Forum by undertaking significant leadership efforts, such as mentoring other Forum members or law students interested in pursuing careers in franchise law; work on membership marketing or other outreach efforts; assistance with special projects undertaken by the Forum Governing Committee or a Forum Division; or assisting with the Forum's annual meeting.

Chair's Explorers Award

This award is designed for newcomers to the Forum – a relatively new Forum member, an ABA member interested in joining the Forum, or a law student currently enrolled in an ABA-accredited law school and a member of the ABA Law Student Division – who have demonstrated an interest in pursuing a career in franchise law. Nominees will be asked to identify any activities that demonstrate their commitment, including prior attendance at franchise related conferences, contributions to the Forum, goals for future involvement in the Forum and any recommendations for Forum governance.

Any Forum member who is or has been a Governing Committee member or *ad hoc* member (e.g., Division Director, YLD Representative, editor-in-chief of The Franchise Law Journal or The Franchise Lawyer) is ineligible to receive a Chair's Award.

Please send your nominations for all awards by September 1st to the Forum Chair, Ronald K. Gardner at

Associate Editors
Max Schott (2010)
Gray Plant Mooty
Minneapolis, MN

Glenn J. Plattner (2011)
Bryan Cave
Santa Monica, CA

Kristy L. Zastrow (2012)
Dady & Garder
Minneapolis, MN

Forum on Franchising
American Bar Association
321 N. Clark Street
Chicago, IL 60654

rkgardner@dadygardner.com. Ron and Jack Dunham will choose the recipients, subject to the approval of the Forum Governing Committee, and the awards will be presented at the 33rd Annual Forum on Franchising this October in San Diego.

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and Licensing, via email at copyright@abanet.org or via fax to 312-988-6030.

Forum on Franchising
AMERICAN BAR ASSOCIATION

The Franchise Lawyer

American Bar Association • Forum on Franchising

Vol. 13 No. 3 | Summer 2010

INSIDE THIS EDITION

THE FRANCHISE LAWYER

Editor-in-Chief
Eric H. Karp
Witmer, Karp, Warner
& Ryan LLP
22 Batterymarch Street
Boston, MA 02109
617-423-7250
ekarp@wkwrlaw.com

Nomination Report

By Ronald K. Gardner
Forum Chair

I am pleased to let you know that Edward Wood Dunham, Chair of the Nominating Committee, has reported the results of the Committee's deliberations.

The nominees are:

Chair Elect - (2 year term commencing 8/11)

Joseph J. Fittante, Larkin Hoffman Daly & Lindgren Ltd.

Governing Committee - (3 year terms, commencing 8/11)

Kerry L. Bundy, Faegre & Benson LLP

Kathryn M. Kotel, Carlson Restaurants Worldwide

Eric H. Karp, Witmer, Karp, Warner & Ryan LLP

James A. Goniea, American Driveline Systems, Inc.

Governing Committee - (2 year terms, commencing 8/11 -- one to finish the balance of Joe's term when he becomes Chair, the other to fill the new spot that had to be 2 years this time to get the long-term cycle right)

Michael K. Lindsey, Paul, Hastings, Janofsky & Walker LLP

Diane Green-Kelly, Reed Smith

Forum members will vote on these nominations during our annual business meeting on Friday, October 15, 2010 in San Diego, CA.

Forum on Franchising
American Bar Association
321 N. Clark Street
Chicago, IL 60654

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and Licensing, via email at copyright@abanet.org or via fax to 312-988-6030.

ABA Forum on Franchising

The Franchise Lawyer

American Bar Association • Forum on Franchising

Vol. 13 No. 3 | Summer 2010

INSIDE THIS EDITION

THE FRANCHISE LAWYER

Editor-in-Chief
Eric H. Karp
Witmer, Karp, Warner
& Ryan LLP
22 Batterymarch Street
Boston, MA 02109
617-423-7250
ekarp@wkwrlaw.com

Ethical Risks in Misleading a Mediator

By Peter J. Klarfeld
Gray Plant Mooty

If you tell a mediator that your client's insurance coverage or the authority granted by your client's Board of Directors puts a specific limit on the settlement your client can offer or accept, the mediator might work to bring the other side within that ballpark. But what if what you told the mediator were not true?

Toward the end of my portion of a program on mediating franchise disputes that was presented at the Forum on Franchising's Annual Meeting last October, I offered the following hypothetical on mediation ethics:

1. Your client is ordered by a court before which it is a defendant to participate in mediation, with one of the court's Magistrate Judges serving as the mediator.

2. In a premediation meeting to discuss strategy, the CEO of your client tells you that (a) the limit of the company's insurance for claims of this kind is $1 million, and (b) that is the highest the company will go to settle the matter.

3. The mediation goes forward and by late afternoon, you sense that the party on the other side has come around to wanting to settle the case.

4. The mediator meets with your side separately and says that the time is right for your side to make its best offer.

5. You say to the mediator: "Look, it's been a long day, and we'd like to get this over with. The limit of the company's insurance coverage is $500,000. You can tell them we'll go $250,000 over that, for a total of $750,000. But that's it. That's as high as my client will go to settle this matter."

6.The mediator presents that offer to the other side and returns to say: "We have a deal at $750,000."

7.Should you

(a) Alert the managing partner of your firm that you've just saved the client $250,000 and that this may be a good case for premium billing, or

(b) Worry about what you would do if you could no longer practice law?

Forum on Franchising
American Bar Association
321 N. Clark Street
Chicago, IL 60654

8. Would the answer be different if the mediator were not a judicial officer?

At the Forum program, the hypothetical served only as a consciousness-raising exercise because, owing to time constraints, the panel moved on to other issues before I could discuss the ethical rules that might help guide a lawyer's conduct in such a situation. I am happy to have the opportunity to discuss those rules briefly here. I also want to add a bit of a twist to raise a related, but distinct, set of issues.

The basic question raised by the hypothetical is to what extent a lawyer is ethically permitted to bluff, puff or even lie in the course of a mediation. Three of the American Bar Association's Model Rules of Professional Conduct are worth considering in that regard:

Rule 4.1 of the ABA Model Rules provides:

In the course of representing a client, a lawyer shall not knowingly:

> (a) make a false statement of material fact or law to a third person; or
>
> (b) fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

Rule 3.3 (a) provides:

> A lawyer shall not knowingly:
>
> (1) make a false statement of fact or law to a tribunal . . . .

Rule 8.4 provides:

> It is professional misconduct for a lawyer to:
>
> (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation.

On their face, these rules appear to pose serious problems for the lawyer in the hypothetical. However, the ABA has put a gloss on their application to mediation that brings their effect more in line with common negotiating practice. In 2006, the American Bar Association Standing Committee on Ethics and Professional Responsibility issued Formal Opinion 06-439 titled "Lawyer's Obligation of Truthfulness When Representing a Client in Negotiation: Application to Caucused Mediation." The opinion's opening summary states:

> Under Model Rule 4.1, in the context of a negotiation, including a caucused mediation, a lawyer representing a client may not make a false statement of material fact to a third person. However, statements regarding a party's negotiating goals or its willingness to compromise, as well as statements that can fairly be characterized as negotiation "puffing," ordinarily are not considered "false statements of material fact" within the meaning of the Model Rules.

Thus, the opinion indicates that there are two types of statements that despite being "less than entirely forthcoming" are nonetheless allowed in the course of mediation. The first is a declaration of "a party's negotiating goals or its willingness to compromise" -- for example, a statement such as: "My client will not accept less than (or pay more than) $750,000 to settle this matter." The second is a statement "that can fairly be characterized as negotiation 'puffing,'" which the opinion indicates would include exaggerating the strengths or minimizing the weaknesses of a client's position. For example, a lawyer might overstate his or her confidence that acceptable options are available if the negotiation fails, such as by stating that he or she is confident of prevailing on summary judgment despite actually believing that that prospect is remote. While the opinion does not attempt to rationalize these two exceptions (other than to say that they comport with generally accepted negotiating conventions), the characteristic they appear to share is that each posits an internal calculation, assessment or intention (upon which no adverse party should rely) rather than asserting the existence of an external "material fact."

Back to Top

Using these guidelines, a franchisor's counsel would be free in the hypothetical mediation to take the position that his or her client did not intend to settle for more (or less) than $750,000, even though the client had authorized a higher (or lower) settlement amount. However, when the lawyer adds that the client's maximum insurance coverage is $500,000, while knowing that the coverage is $1 million, it is likely that a violation of Model Rule 4.1(a) has occurred. The opinion points out that the same would be true of a lawyer's statement that the client's board of directors had authorized a settlement of no higher than $500,000 when the board had, in fact, authorized payment of a higher amount.

So much for Rule 4.1, but what about Rules 8.4 and 3.3? With respect to Rule 8.4, which does not by its terms limit its prohibition of misrepresentations to those of "material fact," the opinion concludes that, whatever its outer parameters, Rule 8.4 does not prohibit statements in mediations that are allowable under Rule 4.1.

However, Rule 3.3, which is titled "Candor Toward The Tribunal," may, in some circumstances, take away even the limited room to maneuver that Rule 4.1 affords. Like Rule 8.4, Rule 3.3 is not limited to statements of "material fact." Moreover, Formal Opinion 06-439 specifically concludes that Rule 3.3 applies in a court-sponsored mediation in which a judge acts as the mediator. In that setting, the duty of candor is elevated: counsel simply may not knowingly make a false statement of fact to a judge. Thus, if the mediator/judge asks counsel for his or her client's bottom-line settlement amount, counsel has only two ethical options under Rule 3.3: to decline to answer or to tell the truth.

In sum, the ABA Ethics Committee's opinion on the extent to which "truthfulness" is required in mediated negotiations provides some relief from the strict requirements of candor contained in the ABA's Model Rules of Professional Conduct, at least outside of a court-sponsored mediation. But two significant caveats are in order. First, the lines drawn in the opinion are far from clear, and it would serve you well to give the opinion a close reading before heading into the next mediation in which you are acting as counsel for a franchisor or franchisee. Second, it is important to remember that the ABA Model Rules and ABA Ethics Committee opinions do not, in the end, contain the ethical standards governing your conduct. Instead, the operative ethical rules are those of the states in which you are licensed and practice and those of the courts in which you appear. While those rules may be based on the ABA Model Rules, they may differ substantially, in both their express terms and in their interpretation, from what has been promulgated by the ABA.

Finally, let's add a twist to the hypothetical. Let's say it is not counsel for one of the parties who makes the false statement about the extent of insurance coverage, but the CEO of the franchisor or franchisee that the lawyer represents who gives the misinformation to the mediator. Model Rule 4.1(b), set out above, provides:

> a lawyer shall not knowingly . . . fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting in a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6,

and Rule 1.6 (b)(2) provides:

> (b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:
>
> > (2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services.

So, what are a lawyer's obligations if he or she is present and knows that the CEO's statement to the mediator was false? Can the lawyer consult with his or her client to decide how to proceed, and who is the client for that purpose, the CEO or the corporation's Board of Directors? Can the lawyer avoid the issue by withdrawing from the representation?

Think about it.

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and

 ISBN: 1938-3231

American Bar Association | 321 N Clark | Chicago, IL 60654 | 1-800-285-2221

The Franchise Lawyer

American Bar Association • Forum on Franchising

Vol. 13 No. 3 | Summer 2010

INSIDE THIS EDITION

THE FRANCHISE LAWYER

Editor-in-Chief
Eric H. Karp
Witmer, Karp, Warner
& Ryan LLP
22 Batterymarch Street
Boston, MA 02109
617-423-7250
ekarp@wkwrlaw.com

Leegin: All Bark, No Bite?

By Victor Vital and Elizabeth Wirmani
Baker Botts L.L.P.

Three years ago this summer, the U.S. Supreme Court abandoned the 100 year-old *Dr. Miles* doctrine that established a rule of *per se* illegality for minimum resale price maintenance (RPM) agreements in favor of the more lenient "rule of reason" test. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007). Under the rule of reason standard, courts are forced to consider the pro-competitive effects of vertical price restraints, only striking down such restrictions where the anti-competitive effects outweigh the competitive advantages. The *Leegin* decision—heralded by those favoring economic analysis of vertical price restraints—bookends an earlier opinion, *State Oil v. Khan*, where the Court declared that maximum RPM agreements should be reviewed under the rule of reason standard. *State Oil v. Khan*, 522 U.S. 3 (1997).

Many assumed, and perhaps even hoped, that the radical shift in law promulgated by *Leegin* would alter the landscape of antitrust jurisprudence. Nowhere was this more true than the franchise community. But to the surprise of many, and contrary to the effect of *Khan*, the high court's ruling has not been interpreted as a green light to engage in minimum RPM arrangements. Indeed, rather than embrace new policies and practices that employ the flexibility afforded by *Leegin*, many businesses (including franchise companies) have adopted a wait-and-see mentality. How is it that this opinion, once thought revolutionary in scope, has resulted in such a relatively small practical impact? The simple answer lies in the uncertain future of the rule of reason.

Leegin and the Franchise Community

The franchise community received *Leegin* with anticipation and expectation. At first glance, the more flexible rule of reason test provided an opportunity to control downstream pricing, which would address the persistent problem of free-riders as well as a franchise company's disadvantage competing in the market with competitors that own the entire chain of distribution. Many believed an increase in RPM agreements would stimulate interbrand competition by encouraging franchisees to provide services and promotional efforts on behalf of the franchisor's products, giving consumers greater choices. At the same time, others feared that franchisors would use RPM agreements to obtain monopoly profits or facilitate cartels at the supplier level. Some franchisees worried that *Leegin* marked an end to their independent development of pricing schemes reflective of local markets and customer needs. Still others worried that franchisors would use RPM agreements to force prices so high that they could not sustain business.

As the years have passed, franchisors and franchisees alike have waited for the proverbial ball to drop. But anecdotal evidence suggests that relatively few franchisors have embraced the freedoms allowed by *Leegin*. This result provides a stark contrast to the reaction following *Leegin*'s sister opinion, *Khan*. In the wake of the *Khan* decision, many franchisors raced to mandate maximum price restrictions. This was particularly true in the fast-food business where franchisees saw a flurry of maximum price setting, particularly with the advent of the "dollar menu." With *Leegin* however, we have not seen a similar revolution of the relationship between franchisees and franchisors with respect to price determinations, especially in industries that would be affected by the decision, including luxury markets.

Reasons Franchisors Refuse to Embrace *Leegin*

The easiest explanation offered for *Leegin*'s limited impact in the franchise community is that many franchisors are contractually bound by older franchise agreements expressly limiting their right to set minimum prices. But as each year passes, such reasoning contains less and less force. New agreements are executed; old agreements are renegotiated. And yet, the flood of minimum RPM agreements once expected to dominate the majority of franchise relationships have failed to materialize. We propose that franchisors' continued reluctance to implement RPM agreements lies primarily in the continued uncertainty surrounding the interpretation, enforcement, and utility of such agreements.

Lack of Judicial Guidance

One of the first questions franchisors and franchisees asked in the wake of *Leegin* was "how will the rule of reason be applied?" Three years later, that answer remains unclear. The Supreme Court left the question of how the rule of reason should be interpreted to the lower courts. The majority specifically suggested that lower courts should "establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market to provide more guidance to business." Despite this call to action, there have been relatively few opinions analyzing the application of the rule of reason under *Leegin*.

As a preliminary matter, the dearth of opinions likely results from potential litigants' reluctance to bring a case in the first instance. Antitrust cases are notoriously expensive. The time, cost, and risk associated with these cases increased when courts moved from the bright-line *per se* rule to the fact-intensive rule of reason. Success requires experienced attorneys and economic experts knowledgeable not only about the challenged RPM arrangement, but also the market as a whole and the pro-competitive and anti-competitive effects of the restriction. The rule of reason standard also increases the risks to a defendant by limiting the possibility of a successful motion to dismiss or summary judgment. Indeed, if a plaintiff forces a RPM agreement to court, chances are its legality will be decided by a jury. These factors militate in favor of settlement, and accordingly decrease the number of cases that ever make it before a judge.

Back to Top

Moreover, those cases that do make it in front of a judge are often disposed of on procedural grounds. This is especially true in light of the heightened pleading requirements in *Bell Atlantic v. Twombley*, which requires plaintiffs to allege facts that plausibly suggest that an RPM agreement exists and that it is unreasonable. *See Spahr v. Leegin Creative Leather Products, Inc.*, 2008 WL 3914461 (E.D. Tenn. 2008); *Jacobs v. Tempur-Pedric, Int'l, Inc.*, 2007 WL 437980 (N.D. Ga. Dec. 11, 2007) (rejecting Plaintiff's implausible market definition and granting dismissal under *Leegin* and *Twombly*). More problematic for franchisors, those few courts or governmental agencies that have substantively interpreted the rule of reason under *Leegin* imply that some RPM agreements may be "inherently suspect." *See, e.g.*, *In re Nine West*, FTC Docket No. C-3937, at 10, 12 (May 6, 2009), *available at* http://www.ftc.gov/os/caselist/9810386/080506.order.pdf; *Baybyage.com, Inc. v. Toys "R" Us, Inc.*, 558 F. Supp. 2d 1011 (E.D. Wis. 2007).

Faced with this dearth of judicial guidance on the application of the rule of reason, franchisors have been—and will continue to be—hesitant to test the waters by implementing a vertical price restraint that might be challenged in court, unless otherwise mandated by the company's business model.

Congress and the States on the Offensive

In addition to the lack of judicial guidance, franchisors must face the uncertain future enforcement of minimum RPM agreements in light of the aggressive campaign against the rule of reason in the federal and state governments. In the past few years, members of Congress have led an offensive attack against *Leegin*, seeking to legislatively overturn the Supreme Court's 2007 opinion. That effort seems to be picking up steam. On March 18, 2010, a Senate panel voted to approve a bill (S.R. 148) that would make it illegal for manufacturers to set a minimum resale price for their products. The House Judiciary Committee approved a similar bill (H.R. 3190) in January 2010. Recent appointments to the FTC and the DOJ have lobbied Congress for such legislative action, and presumably will continue to do so.

Likewise, the majority of state governments have advocated for a legislative solution to *Leegin*. In November 2009, forty-one state attorneys general sent Congress a letter urging the passage of *Leegin*-repealer legislation. The attorneys general urged that "Congress, not the Court, is better positioned to evaluate the detrimental impact of resale price fixing on consumers and the underlying public policy of the nation's antitrust laws." But in many cases, state governments are not waiting on Congress to legislate a *per se* rule. Several states, like California, already have state laws that may prohibit RPM agreements. Other states, in reaction to *Leegin*, are passing legislation restoring the *per se* rule under state law. For example, Maryland expressly rejected the *Leegin* decision by statute. In many states, attorneys general have expressed willingness to prosecute RPM agreements under their existing antitrust laws despite the fact that litigation in state forums will create inconsistent results as between federal courts and state courts.

Until Congress and state governments settle on a legislative reaction to *Leegin*, uncertainty will surround the potential enforcement of any RPM agreement and thus, discourage franchisors from entering into such agreements where they may otherwise be inclined. For this reason, the elections of 2010 and the subsequent make-up of Congress and state governments will prove to be particularly important to franchisors and franchisees alike.

Economic Uncertainty

A final uncertainty that plagues many franchisors is the potential usefulness of RPM agreements in a robust economic market. One year after the *Leegin* decision, the economy crashed. In this climate, few franchisors are inclined to require that franchisees charge their customers higher prices, especially in luxury markets. Accordingly, though *Leegin* was decided three years ago, franchisors do not have the benefit of experience with respect to vertical price setting. Once the economy improves, we can expect some franchisors to test the utility of minimum RPM agreements for the first time, and as the collective experience with these agreements grows, we will likely witness an increase in the overall impact of *Leegin* on the franchise community.

The Uncertain Future of *Leegin*

Amidst all the uncertainty, one thing is clear: the boundaries and future enforceability of minimum RPM agreements have yet to be determined under the rule of reason. Until the courts adequately define the application of the rule of reason and governments decide their legislative strategy, we can expect continued reluctance from franchisors. They will likely continue to accomplish minimum RPM in the same indirect ways they utilized before *Leegin*, including limiting free goods, minimum advertising policies (MAPS), and an exercise of the *Colgate* doctrine, which permits manufacturers to impose minimum RPM by announcing and enforcing policy to terminate any retailer that sells below the manufacturer-set price. In the end, *Leegin* is undoubtedly a revolutionary legal opinion. As for its practical impact in the franchise community, however, we must continue to wait and see.

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and Licensing, via email at copyright@abanet.org or via fax to 312-988-6030.

American Bar Association | 321 N Clark | Chicago, IL 60654 | 1-800-285-2221

ABA Forum on Franchising

The Franchise Lawyer

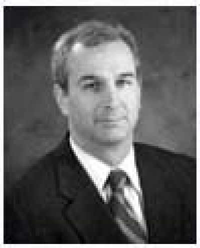
American Bar Association • Forum on Franchising

Vol. 13 No. 3 | Summer 2010

INSIDE THIS EDITION

THE FRANCHISE LAWYER

Editor-in-Chief
Eric H. Karp
Witmer, Karp, Warner
& Ryan LLP
22 Batterymarch Street
Boston, MA 02109
617-423-7250
ekarp@wkwrlaw.com



Cleaning Franchisees Held to be Employees in Massachusetts

By Michael J. Radin
Tarlow, Breed, Hart & Rodgers, P.C.

On March 23, 2010, a US District Court in Massachusetts found individual franchisees of Coverall North America, Inc. ("Coverall") to be employees under a unique independent contractor test in the Massachusetts wage and hour statute. *Awuah et al v. Coverall NA, Inc.*, Civil Action No. 07-10287-WGY (let's call it "Coverall II"). This decision follows an earlier Massachusetts Supreme Judicial court (our highest court) decision ("Coverall I") that went against Coverall under a different employment statute. The case is a serious rebuke to models such as those Coverall uses in its janitorial franchises. The case is very hard fought and continues with great intensity for the litigants, with some serious implications for franchising generally.

Massachusetts has its own Rules about Independent Contractor Status. We are familiar with the IRS 20-factor test (and the general state-level variants) for testing employee versus independent contractor status. The tests have their nuances depending on whether one is looking at tax rules, wage and hour rules, unemployment benefits, workers' compensation rules, health insurance and the like.

In 2004, Massachusetts changed its wage and hour law statute (Chapter 149 Section 148B or the "Wage Statute") just as the Big Dig (considered the largest, most complex, and technologically challenging highway project in US history) was hitting peak labor intensity. To protect against perceived abuses by the construction trades, the statute was amended in a subtle but seismic way.

The 2004 amendment to Chapter 149 Section 148B modified the second of three prongs that an employer had to prove for contractor status. The amended statute provides that an individual is *deemed to be an employee* unless the employer can prove all three of the following: (i) the individual is free from control (both under contract and in fact), (ii) the service is performed "outside the usual course of business" of the employer, *and* (iii) the individual is customarily engaged in an established trade or business. The burden is on the employer to prove all 3 prongs.

The prior version of the statute had an alternative test to satisfy the second prong. The second prong formerly read: "such service is either outside the usual course of business for which the service is performed or is performed outside of all places of business of the enterprise…" With the amendment, control or place of providing the service became irrelevant – the new test was solely whether the worker assisted in the employer's core business. By removing the alternative, the revised Wage Statute made it practically impossible for wage and hour purposes to use contractors in Massachusetts to provide any service that is part of the employer's usual course of business. This is unlike the rules in any other state, and is the trap into which Coverall fell not once but twice.

1. Coverall I. In Coverall N.A., Inc. v. Comm'r of Div. of Unemployment Assistance, 447 Mass. 852 (2006)

("Coverall I"), Coverall lost an administrative claim for unemployment compensation sought by an individual franchisee. That case involved a different Massachusetts statute that to this day retains a 3-prong test nearly identical to the prior version of the Wage Statute.

In Coverall I, the Massachusetts Supreme Judicial Court (having on its own initiative pulled the case from the appellate court) upheld a trial court decision upholding an administrative review board's decision. The review board had found that Coverall failed to prove one of the necessary 3-factors of the contractor test under the Massachusetts unemployment compensation statute (the so-called "ABC" test). The SJC determined that Coverall failed to prove to the Division of Unemployment Assistance the third-prong of the ABC test - that the franchisee operated an independent trade or business.

Coverall argued in Coverall I that the franchisee was in an independent business because it was capable of securing its own accounts (the "capability" test). In rejecting application of the capability test to the facts presented, the SJC looked at the nature of the business as compelling the worker to depend on a single employer for the continuation of the services. Specifically, the franchisee was required to allow Coverall (i) to negotiate the contracts and pricing directly with clients, (ii) to bill clients, and (iii) to provide a daily cleaning plan that the franchisee had to follow. Even if capable of securing other business, "it is undisputed that the growth of [the franchisee's] business inevitably expanded Coverall's clientele base, as each new 'client' became a Coverall client." A key fact noted by the Coverall I court was that the franchisee's unit failed upon discharge by Coverall from the franchisee's sole account. Thus, the Coverall I court found there to be substantial evidence to support the administrative decision that Coverall failed to prove that the franchisee's business was independent, and therefore the administrative decision would not be overturned by the court.

There are two noteworthy aspects of Coverall I. First, as is often the case, the court was reviewing an administrative decision. Courts are generally reluctant to reverse administrative decisions, and the burden to overturn is a heavy one. Second, the wording the SJC used is interesting. The court stated "[B]ecause the examiner's final conclusions incorporated these facts, we conclude that there was substantial evidence supporting the examiner's conclusion that Coverall failed to satisfy its burden of establishing that the claimant's business was independent of Coverall under the third prong of the ABC test." (This language reveals that courts sometimes confuse the independence tests in the second and third prongs of the ABC test and the Wage Statute.) In light of the 2004 changes to the Wage Statute and Coverall I, Coverall II was like a slow motion train wreck.

2. Coverall II. The Coverall II decision was issued in response to a motion for partial summary judgment on the issue of employee status. The facts of the case (which were not discussed in much detail) are as follows: several individual workers brought a claim alleging misclassification as independent contractors and the commission of an unfair or deceptive practice. This case was not the first attack by some of these franchisees. See *Awuah v. Coverall N. Am., Inc.*, 554 F.3d 7 (1st Cir. 2009) (franchisees attempted to avoid the arbitration clause in their franchise agreements on grounds that the arbitration clause was illusory – an effort that was also asserted in the Coverall II case in late June 2010).

The Coverall II is procedurally complex. The ruling related to a test case on the contractor issue with respect to the three plaintiffs. (There is an effort to certify a class on the issue of employee status in Massachusetts, and the judge has ruled that he would consider an opt-in class for Massachusetts misclassification claimants excluding those with arbitration agreements. The plaintiffs have petitioned the SJC on the issue of enforceability of the arbitration clauses.) The Court analyzed the Unit Agreements in some detail. The specific terms referenced by the court include (i) references that Coverall invested heavily to develop its system for establishing and operating a cleaning service business, (ii) the required training, (iii) the exclusive right of Coverall to perform billing and collection and to deduct its fees before remitting to the franchisee, and (iv) prior to May 2009, that franchisees were not allowed to be parties to the customer agreements unless the customer specifically requested a direct contract with the franchisee.

The Coverall II Court began its analysis under the Wage Statue by noting that Coverall had the burden of proving each prong, and that it had failed in Coverall I to prove those elements under the ABC Test. The Court then focused solely on the prong of the Wage Statute that it considered dispositive – the second prong (whether the worker is performing services that are outside the usual course of business of the employer). The Court cited a superior court case for the proposition that to satisfy the second prong, Coverall had to establish that the worker is performing services as part of an independent, separate and distinct business from that of the employer. This formulation reflects how the second and third tests can be blurred by the courts.

In arguing that it was in a separate business, Coverall asserted that it was in the *franchising business*, not the cleaning business. Coverall argued that it sells franchises and trains and supports the franchises, but does not clean any customers nor "employ" anyone who does. It asserted that "numerous courts" accepted that the functions and business of a franchisor are separate and distinct from that of its franchisees, and that their shared economic interest does not make the franchisor an employer. The court accepted the latter proposition, but with respect to the former assertion, the Court noted that cases cited by Coverall did not support its position. According to the Coverall II court, those cases did not discuss or explore whether a franchisor and its franchisees were in the same business.

Back to Top

The Court compared Coverall's position to earlier claims made by other Massachusetts employers (specifically, a car detailing company and a delivery business) who claimed that they did not have employees because their workers signed contracts calling themselves contractors. The courts in those cases found that the employers were in the same business as their workers, as that business was the only service provided to the customers of the employer, and the employer would have ceased to operate without the services of those workers. The court did not accept the employers position that they were not in the underlying service business because all they provided was administrative services for the provision of the underlying services.

Coverall cited *Kerl v. Dennis Rasmussen, Inc.*, 682 NW2d 328 (Wis. 2004) and a Massachusetts franchising treatise for the position that franchisors were in a distinct business because franchising was a product or service distribution system. The Court found this unpersuasive. The Coverall II Court stated that to accept Coverall's claim that the franchisor is not in the business of providing the services offered by its franchisees "sounds vaguely like a modified Ponzi scheme – a company that does not earn money from the sale of goods and services, but from taking in more money from unwitting franchisees to make payments to previous franchisees." While there was hyperbole in the Court's reference to a modified Ponzi scheme, the Court expressly said that it did not apply to Coverall.

According to the Coverall II decision, Coverall was not in a distinct business from its franchisees based on the following:

(a) Coverall invested significantly to develop the "System" used by its franchisees;
(b) Coverall trains, and provides uniforms and id badges
(c) Until May 2009, Coverall contracted directly with all customers and billed the customers directly (unfortunately the court did not address whether the post-May 2009 changes to the contracting approach would affect the analysis, thus missing important opportunity to provide some key guidance.);
(d) Coverall receives a percentage of the revenue from every cleaning service.

To the court, these facts "establish that Coverall sells cleaning services, the same services provided by these plaintiffs." Since the franchisees did not perform services outside the usual course of Coverall's business, Coverall failed to prove separate and distinct businesses and thus failed to meet its burden as to the second prong of the Wage Statute. Having found strict liability on Coverall, the case proceeded to permit the plaintiffs to show damages.

Interestingly, in May, the court dismissed the claims under the Wage Statute. Although a written explanation has not been entered, counsel in the case confirmed that the court dismissed those claims after the plaintiffs failed to satisfy a court order that they produce evidence of damages from the misclassification. However, the case continues on other fronts and, for the time being, the above written decision on the Wage Statute remains published.

3. What does it Mean in Massachusetts? For franchisors, this case deserves careful reading. It is important to remember that the case technically addresses a unique prong we have here. However, the ruling reveals how courts sometimes blur the independence tests under the second and third prongs of the Wage Statute and the ABC test. Despite this, there is hope that specific factors used in the Coverall system might keep this holding limited.

Until things are clarified, there are a few key lessons for franchisors. First, franchisors in Massachusetts should be very careful when using agreements that give them too much control over franchisee's operations. Franchisors need to be very cautious with respect to any activities they do that are core day to day operations of franchisees' businesses. For example, allowing the franchisee to negotiate and manage its contracts and pricing should help avoid the impact of this decision. Of course, not being involved directly with collections should reduce the risk. This ties in to the on-going concern about whether it is appropriate to craft the most pro-franchisor agreement that experienced counsel can conceive – control only what you need to but be wary of being deemed the employer (or otherwise becoming vicariously liable). Second, franchisors should be very careful when individuals operate the unit rather than entities – franchisees should be incorporated. The Coverall II court noted that individuals enter into the standard Coverall agreement, which includes methods and procedures for cleaning services that Coverall could change periodically – hence a line of direct control over the provisions of day to day services. Third, franchisor's (particularly those selling route-based systems) should franchise from a different entity than the one(s) that provides support services to or that owns any operating units. Any franchisor owning operating units is at real risk under Coverall II, and that structure should not be used in Massachusetts until the scope of Coverall II is clarified. Fourth, review your franchise agreements carefully. It should help to use language that differentiates the license from unit support services which can be a basis to distinguish activities of franchisor and franchisee. Unfortunately, given the lack of clear direction from the court, none of these can be relied on to eliminate the risk, but they should help.

For franchisees, this case presents significant opportunities and is a powerful precedent, particularly in the pending cases against other janitorial franchisors here. First, a failed franchisee can use the Wage Statute as a sword to seek damages, including possibly triple damages and attorneys fees for violations. In Massachusetts, the fact that a franchisee earned more than minimum wage may not be a defense. Second, the threat of a class action could be a more powerful tool. Third, failed franchisees facing claims from their own unpaid employees could use this decision in an effort to seek to shift some of the liability for wages (and perhaps other benefits due) to the franchisor – a push which is being attempted increasingly by failed franchisees as the hard economy drags on.

Many commentators have suggested that the strict Massachusetts Wage Statute has driven work to other states with more flexible contractor laws. There is movement to get the Massachusetts Wage Statute modified, which ultimately is the only way to correct much of the confusion. The IFA wrote an amicus brief in both of the Coverall cases noted above, and supports legislative relief. Unfortunately, amending the statute requires sailing through the choppiness of the state political process. Stay tuned as this play has a few more acts left in it.

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and Licensing, via email at copyright@abanet.org or via fax to 312-988-6030.

American Bar Association | 321 N Clark | Chicago, IL 60654 | 1-800-285-2221

The Franchise Lawyer

American Bar Association • Forum on Franchising

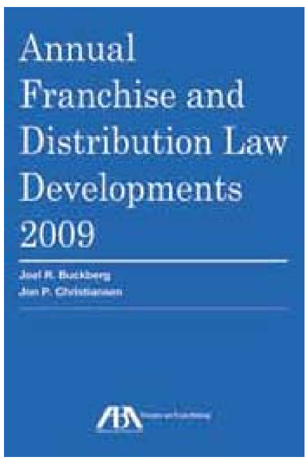
Vol. 13 No. 3 | Summer 2010

INSIDE THIS EDITION

THE FRANCHISE LAWYER

Editor-in-Chief
Eric H. Karp
Witmer, Karp, Warner & Ryan LLP
22 Batterymarch Street
Boston, MA 02109
617-423-7250

Books from the Forum on Franchising



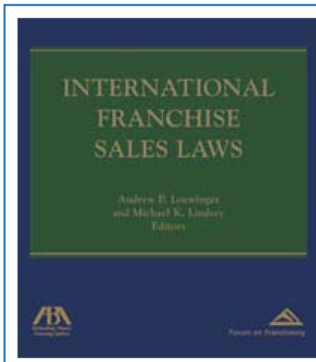
Product Code: 5620129
Forum Member Price: $85.00
Regular Price: $100

Annual Franchise and Distribution Law Developments 2009

Joel R. Buckberg and Jon P. Christiansen

Written by two seasoned professionals, this book includes extensively researched case law from August 2008 to August 2009. Compiled into an easy-to-use reference, this book will cut timely research out of your day by putting the latest review and analysis on franchise and distribution law at your fingertips.

For more information or to place an order, click **here**.



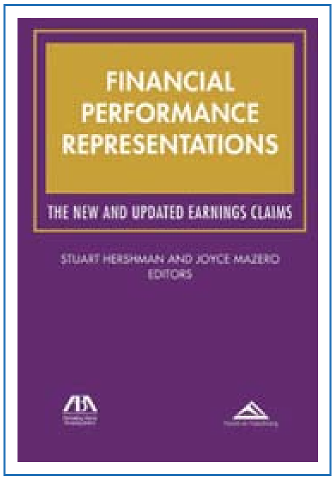
Product Code: 5620119S
Forum Member Price: $40.00
Regular Price: $60.00

International Franchise Sales Laws 2009 Supplement

Andrew P. Loewinger and Michael K. Lindsey, Editors

International Franchise Sales Laws addresses disclosure requirements in the countries of Australia, Brazil, Canada, China, France, Indonesia, Italy, Japan, Malaysia, Mexico, Romania, South Korea, Spain and Taiwan. This supplement features updates to sections on Australia, Canada and China. For each jurisdiction, two authors licensed to practice in the jurisdiction address the jurisdiction's disclosure requirements in a uniform format. Each country chapter is organized to provide a comprehensive discussion of each of the applicable laws and also a practical and easy-to-use reference for counsel to comply with those laws. 2009, 102 pages, loose-leaf

For more information or to place an order, click **here**.



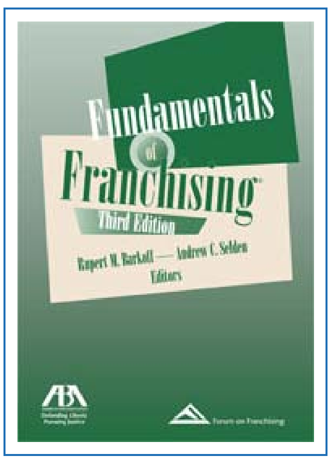
Product Code: 5620128
Forum Member Price: $110.00
Regular Price: $135.00

Financial Performance Representations: The New and Updated Earnings Claims

Stuart Hershman and Joyce G. Mazero

This new book sheds light on all aspects of the earnings claim area, including defining what an "earnings claim" really is, the origins of its regulation under the franchise disclosure laws, how a franchisor should prepare an earnings claim, how a franchisee should use an earnings claim, how a franchisee may attack lawful and unlawful earnings claims, how a franchisor may defend against such attacks, and how the government franchise enforcement authorities, particularly the FTC, investigate and prosecute unlawful earnings claim activity.

For more information or to place an order, click **here**.



Product Code: 5620126
Forum Member Price: $110.00
Regular Price: $135.00

Fundamentals of Franchising, Third Edition

Rupert M. Barkoff and Andrew C. Selden, Editors

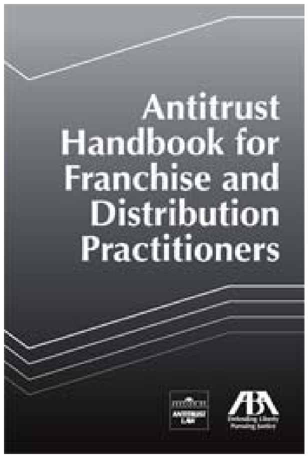
The new edition of *Fundamentals of Franchising* is charged with useful definitions, practical tips, and expert advice from experienced practitioners. Written specifically to help lawyers and non-lawyers brush up on franchise law, this practical guide examines franchise law from a wide-range of experiences and viewpoints. Each chapter is written by two experienced practitioners and provides you with a well-rounded overview of franchise law and alerts you to issues that may require further research or expertise. 2008, 410 pages, 7 x 10, paper

For more information or to place an order, visit **here**.

Antitrust Handbook for Franchise and Distribution Practitioners

Co-published with the ABA Section of Antitrust Law

Organized by issue—pricing and advertising, customer and territorial restrictions, exclusive dealing, purchasing constraints, and joint franchisee action—to enhance its usefulness to practitioners, this book will prove an invaluable aid to practitioners advising clients on antitrust issues involved in franchising, whether they are selling through a business format or product distribution franchise.



For more information or to place an order, click **here**.

Product Code: 5030510
Forum Member Price: $139.00
Regular Price: $169.00

Back to Top

The Franchise Lawyer is published by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, IL 60654-7598. Requests for permission to reprint should be sent to the attention of Manager, Copyrights and Licensing, via email at copyright@abanet.org or via fax to 312-988-6030.

American Bar Association | 321 N Clark | Chicago, IL 60654 | 1-800-285-2221