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Changes to State Civil Rights Statutes

The Continued Increase of Employment Liability Risks

By David L. Cahn
and David G. Ross

Franchisors probably know that workplace discrimination is “against the law.” But, as business owners who could suffer the consequences of a real or imagined violation, they probably don’t know enough. What types of discrimination are prohibited? Who enforces these laws, and what are the consequences if you fail to comply? Does the size of your business play a factor in determining the level of risk? And do rights and obligations vary from state to state and locality to locality? A review of the state of Maryland’s recent changes to its Fair Employment Act provides an excellent illustration of these issues — and should give business owners such as franchisors and franchisees a greater understanding of how the system works.

A PRIMER ON CIVIL RIGHTS LAWS

The issue of employment discrimination is largely governed by federal, state, and (sometimes) local statutes. The most famous of these statutes are Title VII of the Civil Rights Act of 1964 (“Title VII”), 42 U.S.C. §2000e *et seq.*,

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Franchisee Chapter 11: A Primer for Franchisors

By Daniel M. Eliades and David S. Catuogno

With the American economy softening, franchisors are increasingly worried about the financial health of their franchisees. Oftentimes, troubled franchisees will seek refuge in the bankruptcy courts, hoping to reorganize their business affairs under Chapter 11 of the Bankruptcy Code (the “Code”).

Chapter 11 bankruptcy filings by existing franchisees present complex challenges for franchisors. Upon a filing, a franchisor confronts financial recovery of outstanding amounts due; quality concerns; preservation of system integrity and the protection of intellectual property; and the risks and rewards of a potential continued business relationship with a post-bankruptcy franchisee. Occasionally, a franchisor could even be subject to an attempt to assign the franchise agreement to a third party without regard for the franchisor’s approval. Certainly, these myriad issues present potential pitfalls for the unwary, but managed properly and efficiently, a Chapter 11 filing by a franchisee may provide opportunity for the vigilant franchisor.

IS THE FRANCHISE AGREEMENT PROPERTY OF THE BANKRUPTCY ESTATE?

Step one for a franchisor is to determine whether the franchise agreement is property of the bankruptcy estate. Such “property” is defined broadly under the Code and includes all legal or equitable interests of the debtor in property at the commencement of the case. Courts have consistently held that *existing* contract rights of a debtor, such as an interest in a franchise agreement, are property of the bankruptcy estate.

THE AUTOMATIC STAY

If the franchise agreement is property of the estate, the franchisor is temporarily barred under the “automatic stay” provisions of the Code from, among other things, pursuing collection efforts, terminating the franchise agreement, and compelling the franchisee to discontinue the use of the franchisor’s marks. Willful violation of the automatic stay could subject a franchisor to sanctions. Thus, where the franchise agreement is in effect at the commencement of the case, the franchisee may continue, at least temporarily, to use the franchisor’s marks and operate within the franchise system post-petition.

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which prohibits discrimination (including harassment) based on characteristics such as race, sex, national origin, and ethnicity; the Americans with Disabilities Act (“ADA”), 42 U.S.C. §12101 *et seq.*, which prohibits discrimination based on disability; and the Age Discrimination in Employment Act (“ADEA”), 29 U.S.C. §621 *et seq.*, which provides similar protections against age-based discrimination. These statutes are federal laws that apply throughout the country, regardless of the state in which the employee works. Their application is limited, however, to those employers that have a certain minimum number of employees: Title VII and the ADA cover only those employers that have 15 or more employees for a substantial portion of the year, whereas the ADEA requires a minimum of 20 employees.

In addition, states and the District of Columbia can — and generally do — enact their own civil rights laws. State and local statutes cannot remove or restrict rights granted to employees by federal law, but they *can* provide greater, additional, or more comprehensive protections. The complementary role that the states and localities play becomes apparent when one compares the federal statutes with the District of Columbia Human Rights Act (“DCHRA”), DC ST §2-1401.01 *et seq.*, Washington, DC’s primary civil rights statute. The DCHRA forbids the types of workplace discrimination already prohibited by Title VII, the ADEA, and the ADA. Unlike those federal laws, however, the DCHRA also prohibits discrimination based on sexual orientation. Moreover, the DC law applies to employers of *all* sizes — even those that employ only one

person. Likewise, while the federal civil rights statutes put caps or ceilings on the amount of damages that can be awarded to a successful employee, the DCHRA contains no such limitations.

Another difference between the federal and state/local laws involves procedure. Before suing under one of the federal civil rights statutes, an employee must proceed through the Equal Employment Opportunity Commission (“EEOC”). The EEOC cannot award relief to the employee, though it will evaluate the case. In a rare case, the EEOC will decide to sue on the claimant’s behalf — but it will usually limit its tasks to investigating the allegation, making a non-binding determination, and possibly providing services such as mediation. Assuming that the EEOC does not file suit for the employee, it will eventually authorize the employee to file suit on his or her own.

The states, on the other hand, vary with regard to procedure. For example, some states require submission of complaints to EEOC-like state/local agencies before allowing lawsuits, whereas others do not. Similarly, some states empower their administrative agencies to make binding decisions and grant relief (such as orders to reinstate fired employees and issuance of money awards), and some states allow employees to choose between proceeding through an agency or going directly to court. Still others provide little substantive help for employees on the state or local level.

THE MARYLAND ANOMALY

The Maryland Fair Employment Practices Act (“FEP”), Md. Ann. Code Art. 49B, §14 *et seq.*, is different from most employment discrimination statutes. That’s because Maryland is different from most states. Under Maryland law, certain counties enjoy a limited degree of “self-rule.”

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NEWS BRIEFS

MICHIGAN DQ FRANCHISEES SUE OVER RESTAURANT CONVERSIONS

Signaling their long-running opposition to Dairy Queen's re-branding and co-branding programs, the Michigan Dairy Queen Operators' Association filed suit in mid-January in the U.S. District Court for the Western District of Michigan against the franchisor. The suit seeks a declaratory judgment and injunctive relief to stop a mandatory restaurant conversion program instituted by International Dairy Queen ("IDQ") and American Dairy Queen ("ADQ") and an end to the levy of advertising surcharges. Dairy Queen is a wholly owned subsidiary of Berkshire Hathaway Inc., the investment company/conglomerate headed by Warren Buffett.

Several years ago, IDQ and ADQ embarked on a program to convert all restaurants to either DQ Grill & Chill or DQ/Orange Julius concepts. However, many franchisees balked at the conversions and prefer to stay as traditional Dairy Queens. "Dairy Queen has been offering conversions since 2002, so there's been a five-year history," said Carmen Caruso (Schwartz Cooper Chartered, Chicago), who is representing the Michigan franchisees. "The conversion has not

attracted all franchisees to make the investment. Some of them see that the returns are not there for conversions that typically cost tens of thousands of dollars."

DQ franchisees want the conversions to remain optional. However, the IDQ is now making them a condition of contract renewal, or relocation or transfer of ownership of a franchise, Caruso said.

The complaint about surcharges arises from new marketing and advertising programs that have been proposed for 2008. The lawsuit alleges that DQ is violating its franchise agreements by charging franchisees for these new programs but not applying those charges to partially offset required advertising fees in franchise contracts.

"The franchisee association wrote to IDQ and ADQ and asked them not to impose these surcharges. They did not respond to our letters," Caruso said.

A Dairy Queen spokesman confirmed that the company has seen the lawsuit, but he could not discuss whether Dairy Queen held discussions with franchisees over their concerns about the conversion program, nor the advertising fees. "We do not agree with the allegations in the suit," he said.

Caruso would not comment on whether other DQ franchisee associations are likely to join the lawsuit. However, he did comment that "Michigan franchisees stepped up to the plate on issues of national concern."

CHICAGO 'L.A. TAN' FRANCHISE SUED FOR PEEPHOLES IN WALLS

A Chicago-area franchise unit of L.A. Tan and the franchisor L.A. Tan Enterprises Inc. are being sued by two women who discovered peepholes drilled into the walls of the private rooms where they were tanning. The incidents occurred in April 2006 at a salon in Orland Park, IL.

"The lawsuit is ... for invasion of privacy and intentional infliction of emotional distress," said Steven Dicker, (Dicker & Dicker, Chicago), who is representing the two women. The lawsuit was filed in Cook County Circuit Court.

Contacted two weeks after the filing and after several newspaper articles about the incident, Dicker said that other customers had not come to him with additional complaints.

L.A. Tan representatives did not respond to phone messages.



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Although those counties are bound by statewide laws, they also are empowered to enact and enforce some of their own additional laws. (The relationship between the self-rule counties and the states is just like the relationship between the states and the federal government. The counties may pass laws that add to, but do not contradict, federal law.) As a result, employees located in some of the self-rule counties enjoy greater protection under the FEP than do those located in other counties.

Maryland's FEP, which applies only to those employers with 15 or more

employees, forbids the types of workplace discrimination already prohibited by Title VII, the ADEA, and the ADA — plus "sexual orientation"-based discrimination. Under the FEP, a covered Maryland employee who has suffered — or believes he or she has suffered — from unlawful workplace harassment may initiate an administrative action and appear for a hearing before the Maryland Human Rights Commission (the "MHRC"). Until recently, however, the MHRC was empowered to do little more than order reinstatement of the employee and award limited lost back pay and attorneys' fees. Further, for employees located outside of the self-rule counties, the possibility of this administrative relief was the *only* weapon avail-

able under state or local law; that is, those employees could not sue in court under Maryland state law.

In contrast, some of the self-rule counties have provided — and continue to provide — additional protections for employees. First, employees located within those counties may use the statewide remedies, proceed through county agencies, or even file lawsuits under county laws. Second, employees lucky enough to be in those counties are permitted to seek, in addition to reinstatement and back pay, "front pay," compensatory (*e.g.*, emotional distress) damages, and punitive damages — all of which have the potential to drastically increase the amount of money they

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MOVERS & SHAKERS

Les Wharton has joined the Atlanta office of **Epstein, Becker & Green, P.C.** as senior counsel. Wharton left Spherion, a \$2 billion publicly traded staffing company, at the end of 2006 and began to build a law practice, focusing on franchising, mergers-and-acquisitions, and staffing business legal issues.

"As part of my business plan, I had determined to join with another firm by the end of 2007 in order to be in a better position to accomplish the agreement and disclosure updates, as well as registration renewals that normally were needed in the January-March time frame," said Wharton. "In talking with EBG, I saw the opportunity a larger firm with a national practice (11 offices across the country) could offer. I also saw that the Business Law Group here in Atlanta

could support a more rapid practice expansion than other firms with whom I had talked."

A franchising veteran, Wharton has chaired the International Franchise Association Legal/Legislative Committee and the Corporate Counsel Committee, and he chaired the task group that produced the programs for the IFA Legal Symposiums in 2004, 2005, and 2006. He testified before a Congressional Subcommittee on the FTC's revision of its Franchising Rule in 2002, and he has served on committees of the ABA Franchise Forum.

Franchise attorneys **Leslie Smith-Porter** and **William Davis** are among nine former Buchanan Ingersoll & Rooney PC attorneys who have joined **Foley & Lardner LLP** to open Foley's Miami office. Smith-Porter

and Davis, who are partners at Foley, are being joined by **Laura Ganoza** and **Allan Poppe**, who are senior attorneys.

"This was a terrific opportunity for us to be with a national firm ... with a great deal of depth in distribution and franchising law," said Smith-Porter. "The firm has a strategy to expand its franchise business."

The nucleus of four attorneys with franchise experience has "been pleased so far with what we've seen at Foley. The firm has been a hidden gem, to some extent," she said.

Foley's expansion strategy in the past three years has included office openings in downtown Los Angeles, Silicon Valley, New York, and Boston, as well as an office in Shanghai.



Court Watch

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recovery should be offset by the amount of profit generated from the franchise. The court rejected both arguments, holding that under the Washington act, the responsibility of compliance with the pre-sale regis-

tration and disclosure requirements rests solely with the franchisor, and the fact that the franchise had been operated as a profitable business did not make rescission an inappropriate remedy to the violations or entitle the franchisor to any set-off. The court granted the rescission and ordered AWRS to return to GR8 Wheels the

full amount of the initial fee and royalties paid to AWRS from the outset, less only the stipulated value of the tangible equipment and supplies AWRS had provided, and which GR8 Wheels had effectively consumed prior to seeking the rescission.



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receive. In those counties, in fact, employees even have an advantage over those who sue under federal laws. Like the DCHRA, those county laws do not put caps on the amount of damages that one may obtain in court. Finally, some counties apply their statutes to each and every employer, regardless of the number of employees, whereas one county covers all employers that have five or more employees.

In 2007, the state of Maryland acted to reduce — but not complete-

ly eliminate — the disparities among the counties. Pursuant to recent amendments to the FEP, much greater relief has become available to employees on a statewide basis. As of last October, employees may obtain compensatory — and sometimes punitive — damages in addition to other relief. In addition, an employee proceeding under the FEP may choose between: 1) seeking such relief in an administrative hearing before the MHRC, 2) having the MHRC file suit in court on his or her behalf, or 3) directly filing the lawsuit. There are two catches, however. First, the FEP, like its federal counter-

parts, puts caps on damages. Second, the statute's 15-employee threshold remains unchanged.

WHAT THIS MEANS FOR FRANCHISORS

Franchisors and franchisees need to know what the dangers are on the federal level and in the particular state(s) where they operate. Maryland's developments offer a useful glimpse of the interaction between various discrimination laws and the issues that most employers need to consider. By remaining conscious of these dangers, you can work to avoid them.



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