

Running naked Overcoming rogue franchisees

By Jonathan Maze

A field representative for Cold Stone Creamery was driving along Merrick Boulevard in Queens, New York, last March when he passed something he didn't expect: a Cold Stone Creamery.

Cold Stone didn't have a location on Merrick Boulevard in Queens.

The rep walked in and found the store using Cold Stone's napkins and cups and its wallpaper. He also found Jerwaine Gorman, a former franchisee who had previously run a store in Huntington, New York. It would take months, tens of thousands of dollars in legal bills and the involvement of U.S. Marshals, but Cold Stone would eventually get the store to change its name.

"To this day I don't know whose ice cream they were selling," said Vincent DeBiase, attorney with the New York firm of Gartland and Rappleyea, which represented Cold Stone. "Because it didn't come from us."

The Queens case was unusual, but the situation itself is not. Breakaway franchisees—or "running naked," as some call it—is a common problem in franchising, as franchisees keep using their franchise name long after their business has been terminated.

"It's not uncommon at all," said J. Manly Parks, an attorney in Philadelphia with the Duane Morris law firm who had worked with both franchisors and franchisees in trademark cases. "It's a significant trademark or intellectual property concern because you don't want people not licensed using your intellectual property."

Franchisees usually keep the name because they dispute the termination, and they stand to lose big if their store was forced to close. So

they fight and keep the store running.

In most cases they work something out. They may win in court or sell the store. Indeed, even in situations when the franchisee doesn't necessarily disagree with the termination, it's in his or her best interest to keep the store open to work out a deal and sell the unit. "If you shut down a business, it loses value," Parks said. "If it's a going concern, it works more."

Still, trademark attorneys say violations are usually clear-cut, and the franchisor generally wins. Franchise agreements typically include boilerplate language requiring franchisees to stop identifying themselves with their brands once they've been terminated. Units get terminated for reason, often unpaid rent, royalties or both, and then the franchisee holds onto the store for as long as possible.

In most cases, DeBiase said, the rogue franchisee takes down the signs with no problem soon after they've been sent a notification.

Others take a while. In February 2004, Super 8 Motels told a Texas franchisee, Conquista Hotel Group, to stop using its marks after terminating the franchise due to unpaid fees. It would take Conquista until at least July 2005 to comply.

Expense may be one reason why a franchisee keeps the name. Switching a franchise unit, regardless of the system, can be costly. A restaurant franchise not only has to take out a sign, but any décor, menus and other items that are associated with the brand. "He's faced with maybe hundreds of thousands of dollars in expense, and maybe a shut-



Terminated franchisees usually take their signs down without incident, but sometimes they keep going, even when they've been terminated for clear-cut violations.

down of the restaurant, while he tears out all the wrought iron or anything else so he doesn't infringe," said Sam Apicelli, a trademark attorney with Duane Morris. "His first inclination may be, 'I'm not going to spend all that money.'"

Removing rogue franchisees is vital for any system. Frequently, that franchisee may not have access to supplies, and that could hurt quality and consistency, Parks said. In addition, many franchisees may be eager to cut costs they couldn't do so before.

Such efforts hurt the brand, but they also hurt consumers, who still think the unit is part of the chain. "It tricks the consumer," Parks said. "That's the underpinning of trademark rules, so the consumer isn't tricked into thinking it's one thing, when in fact it's not."

Franchises have several ways to fend off such problems. The most common method is to take a franchisee to court. Some systems, Parks said, will avoid that route by stopping short of terminating a unit, giving the franchisee time to fix its problems or work out a deal to sell the unit.

Increasingly, Parks said, franchisors will establish a system in which they lease the property themselves; then sub-lease that space to the franchisee. That system gives the franchisor the ability to use landlord-tenant laws to keep the franchisee from continuing to use the franchise's name.

Finding trademark violations is usually simple, especially because the termination has been a long time coming and the franchisor can make return visits to the location to ensure its signs are down. Smaller systems with units spread far and wide may have trouble doing so, but even larger systems can have difficulty sometimes.

Consider that Cold Stone didn't discover its rogue franchisee in Queens until a field rep happened past the store. "It was a fluke that we found out about the guy," DeBiase said.

The store was in a different location than Gorman's original franchise, which had been terminated 13 months after he signed the original franchise agreement.

Gorman never responded to the trademark lawsuit, other than through some

letters to the court. At one point, a man named Mike Bonds said he was Gorman's attorney. Then, a few weeks later, both Gorman and Bonds wrote letters to the court saying that Gorman sold the franchise to Bonds—never mind that Gorman never had a franchise in that Queens location to begin with, DeBiase said.

The store's name was changed once to "Gorman's Cold Stone," DeBiase said, though that was still a violation. The franchisor ultimately won a preliminary injunction requiring Gorman to take the sign down. When Gorman refused, a federal judge in New York found both Gorman and Bonds in contempt of court—and awarded Cold Stone \$25,000 in attorney's fees.

After that ruling, in June, Cold Stone workers went to Queens to remove the sign, accompanied by marshals to keep the peace. "What was particularly unusual about this is that he had absolutely no basis for keeping the name," DeBiase said. "He had no colorable argument why he might be entitled to continue to operate as a Cold Stone Creamery. More often than not, a terminated franchisee has some legal argument. Eventually, they work those out. Or the court decides for you." ^{FT}