

---

---

# Internet Flower Sales Fare Better in Arbitration than Virtual Drug Store

BY ELLEN R. LOKKER

Franchise lawyers are still looking for reassurance when advising clients on successful strategies to combine e-commerce opportunities with a traditional franchise system. In 2000, the franchise community received what some proclaimed to be a wake-up call in the form of the *Emporium Drug Mart, Inc. of Shreveport v. Drug Emporium, Inc.*, American Arbitration Association No. 71 114 0126 00 (Sept. 2, 2000) decision. By a vote of two-to-one, the panel of arbitrators in that case granted a preliminary injunction to stop Drug Emporium from selling its virtual drug store to another online retailer. The majority of the panel was persuaded that the Drug Emporium franchisees were likely to succeed on their claims that Drug Emporium violated the franchise agreements by operating a virtual drug store in the franchisees' exclusive territories, and that marketing of the online business within those territories would confuse consumers and dilute the value of the franchisees' licenses to use the Drug Emporium marks. The majority of the panel observed that the franchisees had a reasonable expectation not to be forced into competition with direct drugstore sales by their franchisor.

Less than a year later, practitioners have another arbitration decision on *e-croachment* to consider. In *Hale v. Conroy's Inc.*, JAMS Case No. 1220022498 (June 14, 2001), a husband and wife team franchisee of Conroy's, Inc. ("Conroy's") sought to terminate their franchise agreement and recover damages allegedly resulting, in part, from the franchisor's Internet activities. Conroy's is the franchisor in California of a flower shop system and is a subsidiary of 1-800-Flowers.Com. Conroy's and 1-800-Flowers use three channels of distribution: the Internet with wire

services, the telephone with telemarketing, and retail stores with toll-free telephone numbers and catalogs.

The Hales claimed that Conroy's breached the franchise agreement, frustrated the purpose of the contract, and competed with their own franchisees. They claimed that Conroy's infringed upon their exclusive territory through the affiliation with Internet programs and telephone marketing of the 1-800-Flowers trade name and trademark.

The Hales became Conroy retail store franchisees in 1992 and in 1995 agreed to co-brand with "1-800-Flowers." At that time, 1-800-Flowers was primarily a telephone ordering system. Since then it has become an affiliate of Conroy's parent company, 1-800-Flowers.Com, with primary emphasis on the Internet. 1-800-Flowers is affiliated with a number of web sites, Internet connections, wire services, and stores which are not franchisees of Conroy's. Orders placed through 1-800-Flowers may be filled by non-franchisees that operate within the exclusive territories of franchisees.

From 1992 until 1997, the Hales' gross sales and profitability increased annually. In 1997, they began to experience problems stemming from the 1-800-Flowers telecenter and Internet orders. The Hales' complaints included being required to fill unprofitable orders and increased customer confusion, as evidenced by the Hales' receipt of complaints relating to orders they did not prepare or deliver and requests for redemption of gift certificates and coupons they did not issue. The Hales complained that the franchisor had abandoned Conroy's Flowers and Conroy's 1-800-Flowers advertising and failed to use franchisee advertising funds to promote those marks, focusing instead on 1-800-Flowers.Com. The Hales were also discontented with the Internet yellow page listing for their store, which listed the 1-800-Flowers number before their own 800 number. According to the Hales, this ad caused customers who would otherwise have called their store directly to be diverted instead to the 1-800-Flowers number.

---

Ellen R. Lokker ([ellen@lokkerlaw.com](mailto:ellen@lokkerlaw.com)) is the principal in the Law Office of Ellen R. Lokker, PLLC in Washington, D.C. This article was published in *The Franchise Lawyer*, Vol. 5, No. 2, Fall 2001.

---

---

While the franchisee's claims in this case were similar to the claims raised in *Drug Emporium*, the results were very different. The *Conroy's* arbitrator concluded that Conroy's operation of an Internet business did not breach the franchise agreement or the implied covenant of good faith and fair dealing. Conroy's prevailed on its counterclaim for past due franchise and advertising fees and as the prevailing party was entitled to recover reasonable attorney fees and costs. The only bone thrown to the franchisee was an award for \$20,000 spent on approved local advertising.

In our never-ending quest to make case decisions explainable and reconcilable, we ask ourselves why the results in *Drug Emporium* and *Conroy's* were different. In this situation, the different outcomes are fairly easy to appreciate because the agreements at issue, and the facts, were quite different. In *Drug Emporium*, the agreements granted expansive rights to the franchisees. There were two types of franchise agreements; one which gave franchisees the exclusive rights to the Drug Emporium name in their territories and another which gave franchisees the exclusive right to build and operate drug stores within their territories. Drug Emporium explicitly agreed not to open "low-margin, high volume drug store operations" in the franchisees' protected territories. Significantly, the Drug Emporium agreements did *not* contain a provision reserving to Drug Emporium the right to use the marks to sell products through alternative channels of distribution. The Drug Emporium agreements also conveyed clearly that Drug Emporium contemplated developing the system solely through brick and mortar stores. See W. Michael Garner, *Inside the Drug Emporium Decision*, 20 Franchise Law Journal 3 (2001).

Contrast these contracts with the agreement in *Conroy's*, where the grant of the license to use the trade names and trademarks was expressly non-exclusive. While Conroy's agreed not to operate or license any third party to operate a Conroy's retail flower store within a two mile radius of the franchisees' store,

Conroy's expressly retained the unrestricted right to develop other businesses or systems and to use any of its trade names with such businesses or systems. The Conroy's agreement also provided that the franchisor could change or modify the system, including the adoption and use of new trade names, trademarks, new products, new equipment or new techniques.

Obviously, there were important distinctions between key provisions of the Drug Emporium and Conroy's franchise agreements. Equally or more important, however, were the factual differences. In

*Drug Emporium*, there was evidence that the online retailer was selling at prices well below those of the brick and mortar drug stores, and the franchisees produced evidence of the expected future economic harm that would be caused by the online competition. Garner, *supra*, at

147. In addition, the franchisor's own conduct helped sway the panel to find that Drug Emporium's online retail operation breached the agreement. The online operation was a "store" operating in the franchisees' territory, because Drug Emporium had vigorously promoted its Internet business as "your neighborhood pharmacy for over 20 years." On the question of whether Drug Emporium had the right to operate this store, the company's own conduct again helped answer the question. The franchisor had originally sought permission from the franchisees to initiate Internet activity, suggesting it was not entitled to do so without permission. *Id.*

In *Conroy's*, there was no evidence of economic harm to the franchisee from the franchisor's Internet activity. Indeed, the franchisees' Internet and telecenter business had been profitable and only declined after the franchisee chose to turn off the system that was the source of that business. The franchisee was perceived as an experienced, knowledgeable businessman who was apprised of all aspects of the franchisor's business before joining the system. Although 1-800-Flowers was mainly a telephone ordering system when the Hales agreed to participate in 1995, the arbitrator

**“Unlike in *Drug Emporium*, the arbitrator easily concluded that Conroy's had not opened a retail store in the franchisee's territory. Of course, Conroy's online activity was never described as a virtual store.”**

---

concluded that the growth of the Internet aspect of the business could not have been unforeseen to a man whose background was systems engineering. Unlike in *Drug Emporium*, the arbitrator easily concluded that Conroy's had not opened a retail store in the franchisees' territory. Of course, Conroy's online activity was never described as a virtual store. It was described and perceived as a business referral service that the Hales were entitled to benefit from. Conroy's was also able to combat the franchisee's claim of marketing abandonment with proof of actual advertising efforts. The evidence showed that the franchisor did spend advertising dollars in California to promote the Conroy's system and not to promote the .com arm of the business.

While it is interesting to compare arbitration cases and explain the likely reasons for the differing outcomes, there is little predictive value in the exercise. While proponents of either the *Drug Emporium* or *Conroy's* outcome may wish to use the decisions as persuasive authority in future court or arbitration proceedings, the fact is that no tribunal is bound to follow either of these decisions. Indeed, the claimants in *Conroy's* presented the arbitrator with a copy of the *Drug Emporium* decision. Unpersuaded, the arbitrator noted the existence of the decision but dismissed it, stating, "[s]uch an order obviously is not controlling and Arbitrator does not find it persuasive under all of the circumstances of this case." And you can't take that to the court of appeals.