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WILLIAM L. KILLION

**D**o you know The Five Habits of the Highly Successful Franchisor? Neither did our editor-in-chief until he and his law partner presented a seminar on the topic, an experience that forced them to crystalize their thoughts in a hurry. Each habit will be examined in depth in future issues of the *Franchise Law Journal*.

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**B**y the end of 2004, the People's Republic of China had become the world's largest franchise market, fueled by a rapidly expanding and affluent middle class. Late last year, the Chinese adopted the Measures for the Regulation of Commercial Franchise (Franchise Measures) to address what they regarded as inefficiencies in their previous regulatory system and to ameliorate concerns of the World Trade Organization. But the new Franchise Measures, as the authors discuss, raise almost as many questions than they answer.

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# A Drama in Three Acts: How the Takeout Taxi Franchisees Gained Their Independence

ELLEN R. LOKKER AND MARK J. LORANGER

Readers may be familiar with *Brenco Enterprises, Inc. v. Takeout Taxi Franchising Systems, Inc. (Brenco)* from reading about the case in the Winter 2004 “Franchising (& Distribution) Currents.”<sup>1</sup> The case did not create new law, but was of interest as a systemwide franchise dispute that went all the way to trial. It generated several decisions on important franchise issues, including the enforceability of noncompete clauses, the scope of choice of law provisions, and disclosure obligations upon renewal. The court’s opinion, however, provides just a snapshot view of a troubled franchise system. What is not visible is of equal, if not more, interest: What drives a large group of franchisees to initiate litigation against their franchisor? What impedes resolution of the dispute? What happens to the franchise system after the litigation is over? Exploring these issues gives us insight into the franchise relationship that goes beyond the mechanical application of legal principles.



Ellen R. Lokker



Mark J. Loranger

## Prologue—Setting the Stage

### *Failure to Innovate*

By the end of the twentieth century, most franchise systems were not set up to take advantage of the newest form of distribution, the Internet, in spite of overwhelming evidence that consumers used it for buying everything from food to computers. The Takeout Taxi franchise system could have been a notable exception. Takeout Taxi provides marketing and delivery services by promoting restaurants to businesses, hotels, and residential customers who then order meals through Takeout Taxi. A driver from Taxi delivers the food. The concept is simple yet surprisingly tied to technology. Since its creation in the late 1980s, Takeout Taxi has utilized specialized computer software

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that enables Taxi operators to track orders, dispatch drivers, and complete deliveries.

In the late 1990s, some Takeout Taxi franchisees realized their businesses could expand through new technologies that now seem second nature to us. Rather than phoning in orders, customers could use the Internet to view menus and place orders online. Wireless messaging technology could be used to expedite the delivery process by apprising drivers of order status through text messaging to their cellular phones. New technology offered an even bigger opportunity: Takeout Taxi could become a predominantly e-commerce business by offering its services through a centralized Internet portal.

Although these technological advances and e-commerce opportunities were available, the franchisor Takeout Taxi Franchising Systems, Inc. (TTFSI) was unable or unwilling to capture them. The franchisor had been mired in financial difficulties since the mid-1990s as a result of a rapid expansion of its franchise network without the commensurate growth of its support and marketing systems. The restaurant marketing and delivery concept was still in its infancy and, in retrospect, perhaps TTFSI’s national roll-out had been premature. Although a number of franchisees were significantly more successful than the franchisor’s own corporate stores, the franchisor maintained a paternalistic attitude that discouraged input and suggestions for improvement from the field.

TTFSI had obtained loans through investment banking firm BA Capital Company, LP, but spent the proceeds without much impact on the health of the system.<sup>2</sup> After the loans were depleted, BA Capital essentially took control of the franchise system when its investment account executive, Douglas C. Williamson, took over as head of TTFSI. BA Capital eventually stopped funding TTFSI and had to write off loans of approximately \$5 million. Williamson continued as TTFSI chairman and also assumed the positions of TTFSI president and CEO. Williamson devoted only part-time efforts to TTFSI. He governed the northern Virginia franchisor from his office in Texas and continued his job as investment banking advisor, supervising numerous other accounts for BA Capital.

Under the part-time guidance of someone with no franchise system experience, the once thriving franchisor began to scuttle franchise services in an effort to survive. Company stores and franchised outlets closed. In time, nearly three quarters of the franchised units had shut down. Even though franchisees continued to pay royalties, those revenues were insufficient to support the franchise company. Williamson resorted to using his own money to fund TTFSI, lending more than \$1,000,000 in cash over eighteen

months. The shrinking system could no longer afford its expensive third-party operating software contract yet all efforts to renegotiate that contract failed. The result was few updates to the aging operating software, let alone any technological innovations.

Nevertheless, some franchisees were thriving. For them, TTFSI's plodding pace on technology sowed a seed of discontent that, coupled with the shrinking franchise system and services, would later reap a bountiful harvest of contempt among many. Some frustrated franchisees financed and developed technological innovations on their own, actions that would later provide litigation ammunition to a defensive franchisor that claimed the innovations were contract breaches.

#### ***Failure to Seize an Opportunity***

Despite TTFSI's inability to develop new technologies and expand into e-commerce, the opportunities for doing so were apparent to an Internet portal company, Food.com. Food.com was an Internet start-up company with some big names at the top, including a former Disney executive. Negotiations between Food.com and TTFSI began in 1999, and the parties signed a letter of intent in spring 2000 that contemplated Food.com's purchase of most of the franchise system. Food.com's true objective was to acquire the thriving franchised operations. The participating franchisees geared up for the sale, under which thirteen franchise operators would split \$13,000,000 among themselves. Another \$7,000,000 was slated to go to the franchisor. Some franchisees were slotted for management or executive level positions with Food.com after the purchase while others planned to retire from the delivery business.

While teams of lawyers worked out the details and documentation of the pending transaction, the franchisor got wind of a potentially better deal with another Internet portal company. Unable to resist the possibility of more cash, Williamson scuttled the Food.com deal. Food.com's continued efforts to purchase the franchisees' operations stopped in the wake of threats that such a move would allegedly breach and interfere with the franchise contracts. Ultimately, the competitive suitor for the system did not materialize and the window of dot-com opportunity for Takeout Taxi closed as suddenly as it had opened.

#### ***Failure to Communicate***

What happened next to impair the franchise relationship further was inaction rather than affirmative conduct. As franchise agreements in the system began to expire, the franchisor did nothing. There were no renewals or any other form of communication from corporate headquarters. A TTFSI executive later attributed TTFSI's lack of action to the fact that it "didn't have [its] act together."<sup>3</sup> By this time, the

number of franchises had continued to dwindle from its high of more than 100 to less than twenty-five. TTFSI no longer sold franchises and let its registrations expire. Virtually all services previously offered to franchisees, including its business consultant and other support programs as well as national restaurant accounts, were eliminated.<sup>4</sup> Williamson maintained a skeletal staff and continued, in part, to pay the third-party software vendor, but did little else. Although it was not providing service, TTFSI still collected royalties and threatened to shut down franchisees if they did not pay.

The threat of being shutdown was very real for Takeout Taxi franchisees because the franchisor, through the third-party software vendor, controlled the franchisees' operating software, and both TTFSI and the vendor had the ability to disconnect the software from a remote site. Without functional software, franchisees would be unable to run their businesses. TTFSI and the software vendor had repeatedly demonstrated their willingness to use their control of this crucial software to ensure compliant behavior by franchisees. The franchise agreements prohibited the use of any other software platform, leaving the franchisees with no other options.

By late 2001, franchisees were apprehensive about their continued ability to operate their businesses under expired

contracts and feared that their unpredictable franchisor would shut them down. In addition, many franchisees wanted redress for their abrupt reversal of fortune from the aborted Food.com deal. In November 2001, a group of expired or soon-to-expire franchisees

wrote to Williamson expressing their concerns about the deterioration of the franchise system, the poor financial condition of the franchisor, and the lack of leadership. They asked for information about the current organizational structure and financial condition of the franchisor, litigation in which the franchisor was involved, and the dispute with the software vendor.<sup>5</sup>

Williamson took more than two months to respond, and then only to blame the distraction of merger negotiations and a contracting economy as the primary reasons for the company's problems.<sup>6</sup> Williamson admitted that holding company Takeout Taxi Holdings, Inc. (TTHI) had lost money on a consolidated basis for the entire time that BA Capital had been associated with TTFSI, and that the losses were continuing. Conservative projections for the next two fiscal years predicted significant losses, even if the single remaining corporate Takeout Taxi location were able to double its weekly revenues. Williamson disclosed that he had in fact been making substantial advances of his personal funds to keep the system operating, and that without those advances TTFSI would have failed two years earlier.

As for the software problems, Williamson opined that the vendor bore much of the responsibility for the impasse in con-

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tract negotiations and assured the franchisees that TTFSI was looking into other software opportunities. Despite the company's problems, Williamson stated that he "still believe[d] in the Takeout Taxi concept and still believe[d] in the collective power and strength of the franchise system." His vision for turning the company around focused on a six-point improvement plan<sup>7</sup> that the franchisees viewed as an overworked rehash of failed objectives. In an effort to take control of the future of their businesses, the disillusioned franchisees decided to take affirmative action against the franchisor.

## **ACT I—The Litigation**

### ***Scene 1: A Lawsuit Begins***

Frustrated by Williamson's response, a group of franchisees initiated suit on March 7, 2002, in Virginia state court against TTFSI, its parent, Williamson, and BA Capital.<sup>8</sup> The franchisees soon came to appreciate that litigation could not provide a fast and easy remedy for the problems of the franchise system.

The franchisees' initial Bill of Complaint ("Complaint") raised claims under the Virginia Retail Franchise Act on behalf of the Virginia litigants. On behalf of all plaintiffs, the Complaint sought a declaratory judgment as to the unenforceability of the restrictive covenants and asked for damages on claims for constructive fraud, breach of contract, the duty of good faith and fair dealing, tortious interference with business expectancy, and statutory and common law conspiracy.<sup>9</sup>

The immediate goal was to prevent TTFSI from shutting down franchisees whose agreements had expired. Accordingly, the plaintiffs filed a motion for temporary injunction concurrently with their Complaint.<sup>10</sup> The crux of the plaintiffs' motion was that they would suffer irreparable harm in the absence of an injunction. Either the plaintiffs would be put out of business by the defendants' disconnecting their software for nonrenewal, or they would be forced to release all claims against the nonperforming franchisor in order to renew their franchise agreements under circumstances that they alleged violated the Virginia Act.<sup>11</sup> The plaintiffs argued that TTFSI had either unlawfully canceled their franchises by failing to engage in the renewal process, or had used undue influence, namely its unilateral control over the renewal process and critical software, to force franchisees to relinquish their renewal rights. The plaintiffs also argued that any offer of renewal without complete disclosure of all the material changes to the franchise system would violate Virginia's disclosure statute, particularly when, as here, the company was on the brink of extinction and surviving only because of Williamson's financial largesse.<sup>12</sup> The plaintiffs also focused on the unenforceability of the restrictive covenants, claiming they were overbroad in that they sought to preclude ex-franchisees from competing in any market served by the franchisor, and because the covenants were no longer necessary to protect TTFSI's interest where the franchisor was no longer franchising its business.<sup>13</sup>

The defendants failed to appear at the temporary injunction hearing. After the plaintiffs' presentation of evidence and argument, the court entered a ninety-day temporary

injunction ordering that: (1) the status quo of the franchise relationships be maintained on a month-to-month basis; (2) the defendants be prohibited from shutting down the plaintiffs' businesses for nonrenewal; and (3) the defendants be required to permit continued use of proprietary operating software by the plaintiffs.<sup>14</sup>

### ***Scene 2: The Lawsuit Expands***

After the temporary injunction was entered, the defendants did eventually become engaged in the litigation process. TTFSI answered the Complaint, and the bank and CEO filed demurrers contesting the sufficiency of the claims against them.<sup>15</sup> Meanwhile, additional plaintiff-franchisees from various parts of the country joined the lawsuit against the franchisor,<sup>16</sup> and an Amended Bill of Complaint included claims under the California Franchise Investment Law, the California Franchise Relations Act, the California Unfair Trade Practices Act, the North Carolina Unfair and Deceptive Practices Act, and the Tennessee Consumer Protection Act.<sup>17</sup>

Lawyers for the respective parties tried to bring them together for early mediation but these efforts failed when new counsel for TTFSI and its parent company entered the case. With the primary defendants taking a decidedly more litigious approach, the focus shifted to motions and discovery and away from efforts for a mediated solution to the franchise system's problems. While discovery efforts were at full throttle, the plaintiffs had the additional burden of seeking to extend the temporary injunction, which had only a ninety-day life span, and to work against the defendants' efforts to dissolve that injunction. After a full evidentiary hearing on the issue, the court ordered the injunction extended through the date of trial, scheduled at that point for four months later.<sup>18</sup>

Shortly after the injunction was extended, the scope of the litigation expanded further with the addition of the defendants' cross-bill against a handful of plaintiffs and the independent software vendor. The essence of the cross-bill was that this group of plaintiffs, with the assistance of the software company, had unlawfully developed certain enhancements, including wireless messaging to drivers and interactive online ordering features, to the basic Takeout Taxi software.<sup>19</sup>

The addition of the cross-bill further expanded the scope of discovery, which continued unabated throughout the summer 2002. A ruling in early fall 2002 on the defendants' demurrers threatened to contract the scope of the plaintiffs' case. The court sustained demurrers to the plaintiffs' first count under the Virginia Act in which they claimed, among other things, that TTFSI violated the statute by delaying the renewal process and requiring a release of claims. The court also sustained demurrers to the plaintiffs' constructive fraud claim, breach of contract claims against the nonfranchisor defendants, and statutory and common law conspiracy claims relating to the Food.com deal. All of these rulings were without prejudice to the plaintiffs' right to amend. The court took certain claims under advisement, notably the plaintiffs' second

Virginia Act claim for violation of the statute's disclosure provisions, and all statutory claims under the laws of other states.<sup>20</sup> The court questioned the plaintiffs' ability to bring claims under other state statutes in the Virginia proceeding and ordered briefing on the issue.<sup>21</sup>

The plaintiffs' franchise agreements all contained Virginia choice of law and choice of forum clauses. The plaintiffs argued that the choice of law clauses were extremely narrow, reflecting only that the parties intended for Virginia law to apply to the "validity, interpretation, and construction" of their contracts. Because the foreign state statutory claims sounded in tort, the plaintiffs argued that they were not encompassed within the narrow contractual choice of law clause. Under Virginia's choice of law rules, such tort claims were to be governed by the law of the place of injury. Principles of comity permitted the Virginia court to hear the claims. Finally, the plaintiffs pointed out that the U.S. Supreme Court has stated that it would be against public policy for a choice of law and choice of forum clause to operate in concert to deny a party's right to pursue a statutory remedy.<sup>22</sup> In response, the defendants countered that the franchise act and unfair trade practice claims were essentially contract-based claims that fell within the scope of the franchise agreements' Virginia choice of law clause.<sup>23</sup>

### ***Scene 3: The Lawsuit Matures***

While the court considered the choice of law issues, the plaintiffs filed their Second Amended Bill of Complaint in response to the court's ruling on the first round of defendants' demurrers. As expected, the defendants demurred to the amended pleading. At this point, the parties reached an agreement to mediate. The timing seemed favorable. The parties had briefed and argued the merits of the legal claims several times, and the ultimate scope of those claims was in limbo. Discovery, which had included forty-six sets of requests for production of documents, sixteen sets of interrogatories, more than 340 requests for admissions, ten depositions, and six motions, had been exhaustive.<sup>24</sup> Unfortunately, the two-day mediation failed.<sup>25</sup>

The court next entertained argument on the defendants' demurrers to the plaintiffs' Second Amended Complaint. At that hearing, the court eliminated a few claims, kept the viability of the out-of-state claims under advisement, and ruled that the bulk of plaintiffs' claims would indeed go forward to trial in January 2003, less than one month away.<sup>26</sup>

Immediately before trial started, the court released its ruling on the choice of law issue and plaintiffs' remaining Virginia Act claim. The ruling narrowed the scope of plaintiffs' case, eliminating all the out-of-state claims and the Virginia Act cause of action. According to the court, the statutory claims all arose because of the preexisting contractual relationship and therefore were contract actions for choice of law purposes. Because defendants' actions were carried out in Virginia, its law applied, regardless of the negative impact on plaintiffs in other states. The Virginia

Act claim was dismissed because, according to the court, TTFSI had no disclosure obligation in connection with renewal of the franchise agreements.

### ***Scene 4: The Trial Begins***

The core of plaintiffs' claims remained for trial and the court's ruling did not alter trial strategy. The plaintiffs presented evidence on the demise of the franchise system; the failure to provide service and support; the software problems, the franchisor's precarious financial condition; and the lack of any inspections, standards enforcement, or trademark oversight.

The plaintiffs had three main arguments against the enforceability of the post-termination covenants against competition. First, the covenants were unduly burdensome and overly broad as a matter of law because of the uncertain geographic scope; second, TTFSI had materially breached its obligations under the franchise agreements and thus the covenant obligations were unenforceable; and third, TTFSI no longer had a protectable interest to justify the restrictive covenants because TTFSI was no longer operating as a franchisor in any sense of the word.

The defendants' case, which had been foreshadowed in discovery, was that TTFSI was being transformed. Williamson testified about the company's plans to expand through new company stores in frontier markets, specifically Seattle and Phoenix,<sup>27</sup> and presented "new" marketing proposals that he had previously developed but never implemented. As to TTFSI's precarious financial condition, Williamson testified that he intended to continue to lend money to the company for the foreseeable future.

As for future franchising, TTFSI was keeping its options open. Even though TTFSI was not selling franchises, was not registered to do so in any state, and had not been able to put together a franchise renewal program, the company's expert witness testified that, if TTFSI wished to franchise, it could be in a position to sell franchises in "two to three weeks."<sup>28</sup> TTFSI witnesses also testified about the possibility of selling the system, citing two significant offers for the franchise system in 2000. The witnesses refused to acknowledge the diminished possibility of such a sale following the "tech wreck" of 2000 that had virtually eliminated the market for a Food.com-type transaction.

### ***Scene 5: The Court Decides***

The trial lasted three weeks, after which the court took four months to decide the case. The court's May 2, 2003, letter opinion ruled in favor of TTFSI on all significant issues.<sup>29</sup> According to the court, the post-termination covenants were not unenforceable due to over breadth, the alleged breaches of contract had not been material, and TTFSI still had enough of a protectable interest to warrant enforcement of the post expiration covenants against competition. The court equated the existence of some remaining goodwill with a protectable interest.

Having lost in court on the covenant issue, the franchisees were faced with the choice of renewing their existing franchise agreements or leaving the industry. As of July 2003, most of the litigants chose to renew their fran-

chise agreements and release their remaining claims in the litigation, including their Food.com claims. Two franchisees in Atlanta were not offered renewal and TTFSI's next step was an attempt to take over those businesses through litigation. TTFSI succeeded in taking over the business of one Atlanta franchisee but not the other.

## ACT II—The Bankruptcy

### *Scene 1: TTFSI's Parent Company Files Bankruptcy*

TTFSI's success was short-lived and its optimistic assurances at trial did not materialize. Within two months of signing renewal franchise agreements with the litigants, TTFSI closed its business in northern Virginia and the recently taken-over Atlanta operation. TTFSI released its employees, disconnected the telephones, and vacated its offices. Within just three months of the franchise renewals, TTFSI's parent company had filed a "no asset" voluntary Chapter 7 petition in bankruptcy.<sup>30</sup> TTFSI Chair Williamson, together with TTFSI and another subsidiary, was listed as co-debtor.<sup>31</sup>

At the first meeting of creditors, Williamson testified that the only assets of the debtor were the trademarks, which had value only to the franchisees.<sup>32</sup> Williamson testified that he had no intention of reopening subsidiary company TTFSI and stated that TTFSI's only assets were the franchise agreements. According to Williamson, income from the subsidiaries was barely sufficient to cover the costs of the software vendor and thus the subsidiaries produced no revenue for the debtor.<sup>33</sup> The only secured creditor listed in the bankruptcy petition was BA Capital, which held two promissory notes, one for \$1,000,000 and one for \$500,000.<sup>34</sup> However, BA Capital, which had long ago written off the TTHI debt, did not appear at the first meeting of creditors or at any subsequent proceeding in the bankruptcy court.

The bankruptcy trustee moved to extend the statutory sixty-day period in which the debtor had to assume or reject executory contracts. The debtor held the contract with the software vendor for the system's operating software so the fate of that relationship was in limbo. Over the vendor's objections, the court granted the trustee's motion for more time.<sup>35</sup> This was troublesome for the software vendor who was not getting paid by the debtor, and created additional instability for the franchisees, who were all experiencing fall-out from the franchisor's abrupt cessation of business. Several months later, the software vendor went out of business and sold its copyright interest in the operating software to all franchisees who were willing to purchase it.

### *Scene 2: TTHI Goes on the Auction Block*

The trustee next asked for and received court approval to employ an auctioneer and sales agent to market and sell whatever assets could be sold to maximize the value of the debtor's estate for creditors.<sup>36</sup> The auctioneer intended to

market the system as one that had had its disputes resolved. The franchisees immediately began to educate the auctioneer concerning the problems associated with any sale of the franchise system. The franchisees pointed out that, although certain issues had been settled by the litigation and subsequent releases, TTFSI's closure gave rise to a new and unarguable material breach of contract.<sup>37</sup> Nevertheless, the auctioneer prepared a glossy brochure to promote the system and began to market the opportunity.

By now accustomed to group action, the franchisees saw the potential for obtaining independence through the bankruptcy court process, joined together to pool their resources, and bid on TTHI's assets.

On December 30, 2003, the franchisees, now preferring the term "operators," submitted a letter of intent to purchase TTHI's assets to the trustee. The focus of the bid was acquisition of the debtor's trademarks and copyrights. Expressing their lack of interest in the software contract and aware that comparable software was available at a better price, the operators asked the trustee to reject that agreement before the assets were sold. The operators sought to purchase the stock of TTFSI only to ensure that they could properly deal with the franchise agreements. The operators would not assume

any liabilities as part of the deal.<sup>38</sup> The operators' bid was high enough to be taken seriously by the trustee, but no higher.

The trustee had the operators' bid in hand and there were rumors of competing bidders lurking in the background. It appeared that the trustee

would auction off the TTHI assets through a live in-court auction. Procedurally, the trustee needed court approval to sell the assets free and clear of liens and thus filed a motion requesting that permission. The trustee argued that BA Capital's lien was unenforceable because the applicable statutes of limitations on the notes had expired. BA Capital had never appeared in the bankruptcy proceeding so no opposition was expected. The trustee's motion was scheduled to be heard on February 10, 2004, immediately before the auction of the debtor's assets.

### *Scene 3: An Eleventh Hour Surprise*

Shortly before the scheduled hearing, Williamson, represented by the same firm that had led TTFSI's litigation defense, surprised everyone by filing an objection to the trustee's motion to sell free and clear of liens.<sup>39</sup> According to Williamson's objection, he was a secured creditor of the debtor and in that capacity objected to any sale that did not pay the secured creditors. Although everyone knew of Williamson's loans to the company, his objection was still shocking. Williamson was listed only as an "unsecured" creditor on the debtor's schedules, which he himself had signed on the debtor's behalf. The bankruptcy proceeding had been pending for four months and Williamson had

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**The plaintiffs had three main arguments against the enforceability of the post-termination covenants against competition.**

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never before mentioned his alleged status as a secured creditor even during his testimony about the debtor's schedules of assets and liabilities.<sup>40</sup>

The Takeout Taxi operators were deflated, especially given their contentious relationship with Williamson. Uncertain as to the Williamson objection's precise impact, the operators understood very well that he would once again have a hand in their fate. Based on the documentation Williamson submitted to the court and documents previously produced in litigation, his alleged secured status appeared questionable and incomplete. Although weary of court battles, the operators decided to challenge Williamson's secured status with the hope of salvaging their ability to purchase the TTHI assets through the auction process. Their back-up plan was to raise additional money so they could pay off Williamson's secured interest or outbid Williamson if he chose to "credit bid" on the TTHI assets.

After a day-long court battle over missing signatures and missing board meeting minutes, the court determined that Williamson's alleged secured interest was valid and that he had a first lien on all the assets of TTHI. BA Capital's interest had been subordinated to Williamson's pursuant to a subordination agreement.<sup>41</sup> The potential competing bidder had left the courthouse during the protracted testimony. The operators, however, had remained in the court room. Now, recognizing that Williamson's valid security interest would require a higher bid, the operators indicated their willingness at a court recess to increase their offer substantially. Williamson agreed in principle to a sale at the higher price. However, such a sale was not going to happen in that court on that day.

One of the surprises that surfaced during the hearing was the fact that Williamson, far from being the only secured creditor, shared that status jointly with four other creditors previously classified as "unsecured." He also identified an additional unlisted creditor with a secured claim of \$100,000. Even though Williamson assured the court that none of these other creditors had any interest in the proceedings or the assets of TTHI, the court could not permit the sale to go forward. The trustee had not given adequate notice of the motion to all secured creditors, nor had he met any of the statutory conditions for having a sale free and clear of liens.<sup>42</sup>

### **Act III—The Curtain Falls**

In a surprising and refreshing turn of events, Williamson, who now wielded power as a valid secured creditor, and the operators reached an agreement in principle before leaving the courthouse that the operators would purchase the Takeout Taxi trademarks, software copyrights, and related assets. Now the parties just had to work out the details of the deal and clear the procedural hurdles.

The planned course of action was for Williamson to seek relief from the bankruptcy court's automatic stay to exercise his remedies against the collateral outside of bank-

ruptcy. The next step would be for Williamson to notify the other secured creditors that he intended to sell the collateral at a private sale to a group of former franchisees of TTFSI. The final step would be the sale of TTHI's assets from Williamson to the franchisees.

For the first time in their long and contentious history, the parties were able to negotiate and close a deal. Williamson sought and obtained relief from the stay in bankruptcy by consent order.<sup>43</sup> By letter dated April 1, 2004, Williamson notified all other secured creditors of his intent to sell the collateral at a private sale to the former franchisees. The notice period for the sale passed without any objections from other creditors. Although the deal did not close for several months after the originally scheduled date, the parties stayed the course and all lived up to their end of the bargain.

Finally, on July 20, 2004, the operators' new limited liability company, Brand Solutions, LLC, purchased the critical assets from TTHI. Brand Solutions, LLC, became the proud assignee of the Takeout Taxi trade name, trademarks, and service marks, as well as the owner of the copyrights to the base operating software. Operators who wished to continue to use the old software product had already purchased the other software copyright piece from the now defunct software vendor. Other operators chose to purchase completely new software now that they were free to do so.

### **Epilogue**

The members of Brand Solutions, LLC, are happy with the deal that they ultimately reached with Williamson and only regret that they were unable to make the deal earlier. Most former franchisees cite poor communication between the franchisor and the franchisees and lack of franchise system leadership as principle reasons for their willingness to file suit and their desire to leave the system. In their view, those same problems continued to impede resolution of the dispute throughout the case. Another significant factor in the demise of the former franchise system were contractual agreements among the parties that simply could not make money. Many close to the case recognized that the three main players—the franchisor, the franchisees, and the software vendor—would need to renegotiate the status quo in order for them all to survive. Early mediation, before the parties became invested in the litigation, may have helped to solve those businesses problems, and perhaps the franchisor and software vendor would still be viable entities today.

It has now been a year since the former franchisees purchased TTFSI's key assets. Having joined together to gain their independence, they will remain united to maintain that freedom while protecting and promoting the brand. The members of Brand Solutions, LLC, continue to operate their independent delivery service businesses under the Takeout Taxi name in fifteen major markets across the country, including Boston, Chicago, Houston, Los Angeles, San Francisco, and Washington, D.C. Brand Solutions, LLC, does not intend to expand.

## Endnotes

1. 2003 Va. Cir. LEXIS 86, Bus. Franchise Guide (CCH) ¶ 12,596 (May 2, 2003).

2. BA Capital is the successor in interest to several other investment banking institutions and the original loans were made under a different name. For simplicity, BA Capital and its predecessors in interest are all referred to as "BA Capital."

3. Deposition of Robert Kirmse, Aug. 22, 2002, at 120.

4. At the time of his deposition, Kirmse was TTFSI's vice president of information systems and franchise relations. *Id.* at 8. Kirmse, who identified himself as the person responsible for enforcing systems standards, testified that he could not identify any of the current standards for the specifics of operating a Takeout Taxi franchise and admitted there was no system in place for inspecting franchisees to see if they were complying with system standards. *Id.* at 70-72.

5. Letter, Nov. 15, 2001, from franchisee group to TTFSI Chairman.

6. Letter, Jan. 31, 2002, from Williamson to franchisees.

7. *Id.*

8. *Brenco Enter., Inc. v. Takeout Taxi Franchising Sys., Inc.*, Ch. No. 177164 (filed Va. Cir. Ct. 2002) (*Brenco Enterprises*). Virginia does not have a class action statute and thus this suit was not on behalf of all franchisees. Also, Virginia maintains the distinction between "law" and "equity." This was predominately an equitable action and was thus filed "in chancery."

9. *Id.*

10. For most plaintiffs, the long-range goal was to gain information about the incommunicative franchisor through discovery and to negotiate either an exit from the system, or a substantially different franchise arrangement. In addition, the plaintiffs had a strong interest in seeking damages for the Food.com debacle.

11. Only Virginia plaintiffs sought an injunction on this basis.

12. Plaintiffs' Motion for Temporary Injunction, *Brenco Enter.* (Mar. 7, 2002), at 10-11.

13. *Id.*

14. Temporary Injunction, *Brenco Enter.* (Mar. 13, 2002) (Stitt, J.)

15. Demurrers challenge the sufficiency of a claim and are filed routinely in Virginia state court practice.

16. The franchise agreements all contained a forum selection clause requiring litigation of claims in Virginia.

17. The additional plaintiffs and claims were joined pursuant to Virginia's Multiple Claimant Litigation Act, VA. CODE § 8.01-267.1, which permits persons with claims arising from the same transactions and occurrences to bring those claims together where "common questions of law and fact predominate."

18. Order Modifying and Extending Temporary Injunction, *Brenco Enter.* (June 27, 2002) (Hudson, J.) The trial date was later continued until January 2003 and the parties agreed to extend the injunction until that date.

19. See Defendants' Motion for Leave to File Cross-Bills with proposed cross-bills (July 8, 2002); Order Granting Motion for Leave to File Cross-Bills, *Brenco Enter.* (July 15, 2002). The cross-bills raised claims for tortious interference with business advantage and with contract, statutory and common law conspiracy, breach of contract, conversion, and misappropriation of trade secrets.

20. Order on Defendants' Demurrers, *Brenco Enter.* (Sept. 26, 2002) (Smith, J.)

21. Some of the out-of-state plaintiffs asserted statutory claims granted by their home state's laws. Specifically, the Second Amended Complaint contained claims under the California Franchise Investment Law, the California Franchise Relations Act, the California Unfair Trade Practices Act, the North Carolina Unfair and Deceptive Trade Practices Act, and the Tennessee Consumer

Protection Act.

22. Plaintiffs' Memorandum on Choice of Law, *Brenco Enter.* (Oct. 7, 2002) (citing, inter alia, *Vimar Seguros Y Reaseguros, S.A. v. M/V Sky Reefer*, 515 U.S. 528, 540 (1995)).

23. Defendants' Response to Plaintiffs' Memorandum on Choice of Law, *Brenco Enter.* (Oct. 18, 2002).

24. Defendants propounded the bulk of this discovery.

25. The parties agreed to keep the mediation proceedings confidential. Agreement to Mediate (Nov. 2, 2002).

26. Specifically, the plaintiffs' claims for unlawful cancellation of a franchise under the Virginia Retail Franchise Act, declaratory judgment as to the unenforceability of the noncompetes, constructive fraud, breach of contract, tortious interference with contract, and tortious interference with business expectancy survived demurrer and were headed to trial. The court knocked out the plaintiffs' claim for breach of the duty of good faith and fair dealing and their conspiracy claims. The plaintiffs' claims for violation of the disclosure provisions of the Virginia Franchise Act and all the out-of-state statutory claims remained under advisement.

27. TTFSI had only one corporate operation at the time of trial, located in northern Virginia where the system originated. Corporate operations in Florida and Texas had failed and closed.

28. Testimony of Michael Seid, *Brenco Enter.* (Jan. 21, 2003).

29. Letter Opinion, *Brenco Enter.* (May 2, 2003, amended May 23, 2003) (Ney, J.).

30. *In re Takeout Taxi Holdings, Inc.*, Petition #03-14555-RGM (Bankr. E.D.Va. 2003) ("TTHI Bankruptcy").

31. Schedule H, Codebtors, *TTHI Bankruptcy* (Oct. 6, 2003).

32. The debtor's schedules of assets reflected that debtor also had an ownership interest in the base operating software used by the franchisees. See Schedule B, Personal Property, *TTHI Bankruptcy*, Oct. 6, 2003.

33. First Meeting of Creditors, *TTHI Bankruptcy*, Nov. 17, 2003.

34. Schedule D, Creditors Holding Secured Claims, *TTHI Bankruptcy*, Oct. 6, 2003.

35. Order Granting Motion to Extend Time to Assume or Reject Executory Contracts, *TTHI Bankruptcy*, (Jan. 15, 2004) (Mayer, J.)

36. Application to Employ Stephen Karbelk of Tranzon Fox, *TTHI Bankruptcy*, Dec. 30, 2003; Order Granting Application, *TTHI Bankruptcy*, Jan. 9, 2004.

37. By letter dated December 1, 2003, several franchisees advised TTFSI that it was in material breach of the franchise agreements.

38. Letter, Dec. 30, 2003, from David Dickieson to H. Jason Gold, Trustee.

39. Objection to the Motion of the Chapter 7 Trustee to Sell Property Free and Clear of Liens, *TTHI Bankruptcy*, Feb. 3, 2004.

40. Williamson's secured claim was relatively small at \$75,000. He had not perfected liens on all his loans.

41. Subordination Agreement (Apr. 6, 1998, as amended July 26, 1999).

42. Pursuant to U.S. Bankruptcy Code § 363(f), a trustee may sell property free and clear of liens only if (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest; (2) such entity consents; (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property; (4) such interest is in bona fide dispute; or (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

43. Order Granting Relief from the Automatic Stay, *TTHI Bankruptcy* (Mar. 26, 2004) (Mayer, J.). Subsequently, on June 6, 2004, the trustee filed his report concluding that there were no assets to administer for the benefit of creditors of the estate. The case was closed on August 20, 2004.