LEXSEE 2003 VA. CIR. LEXIS 86

Brenco Enterprises, Inc., et al. v. Takeout Taxi Franchising Systems, Inc., et al.

Chancery No. 177164

CIRCUIT COURT OF FAIRFAX COUNTY, VIRGINIA

2003 Va. Cir. LEXIS 86

May 2, 2003, Decided; As Amended May 23, 2003

DISPOSITION: [*1] Injunction issued in these consolidated cases dissolved.

CASE SUMMARY:

PROCEDURAL POSTURE: Plaintiffs, restaurant delivery service franchisees and former franchisees, filed suit against defendants, the franchisor, the service mark and software owner, a parent company, and others, alleging various statutory and tortious breaches arising from their franchise agreement. The trial court had previously issued a temporary injunction (TI) against defendants pursuant to *Va. Code Ann. § 8.01-624*.

OVERVIEW: The franchise was for restaurant food delivery, and franchisees paid a royalty. Upon filing their action, the trial court granted a TI to allow the franchisees to continue in their franchise relationship pending resolution of the claims. After resolution of demurrers and a motion to strike, a bifurcated trial was held on the remaining claims as to defendants' breach of their duties and a declaratory judgment that the non-compete covenant and other post-termination provisions were either inapplicable or unenforceable. The court found that the telephone assignment agreement, return of franchise material, and take-over provisions all applied in the event of termination or expiration of the relationship. The telephone numbers, directory listings, and customer databases were intended to vest in the franchisor upon expiration of the agreement. The restrictive covenants, analyzed under the applicable lesser standard, were sufficiently definite and reasonable as to be enforceable. Breaches by defendants were not material such as to excuse the obligations of the franchisees. The court noted that defendants had protectible interests to support the enforcement of the non-compete clause.

OUTCOME: The court dissolved the TI and held that the non-compete restrictive covenant was enforceable.

LexisNexis(R) Headnotes

Contracts Law > Contract Interpretation > Ambiguities & Contra Proferentem > General Overview
Contracts Law > Defenses > Ambiguity & Mistake > General Overview

[HN1] A court must give effect to the intention of the parties as expressed in the language of their contract. Where provisions of a contract appear to conflict with one another, a court should attempt to reconcile the apparent inconsistency if a reasonable basis for such reconciliation exists. In the event of an ambiguity in the written contract, however, such ambiguity must be construed against the drafter of the agreement.

Contracts Law > Contract Interpretation > General Overview

[HN2] In reconciling two provisions of a contract, a court should, as a general rule, resolve any apparent

inconsistency between a clause that is generally and broadly inclusive in character, and a clause that is more specific in character in favor of the latter, as specific and exact terms are given greater weight than general language.

Contracts Law > Contract Interpretation > General Overview

[HN3] When a business transaction is based on more than one document executed by the parties, the integrated business transaction principle requires a court to construe multiple documents together to divine the intent of the parties. In ascertaining the parties' intent, a court considers the plain meaning of the language the parties used in the documents.

Contracts Law > Contract Interpretation > General Overview

[HN4] In the context of an integrated business transaction, a court should not construe one document in a manner that negates or nullifies the provisions of another document. A corollary principle of contract construction requires courts to interpret exhibits and attachments incorporated into an agreement in accordance with the purpose of the parties.

Contracts Law > Contract Interpretation > General Overview

[HN5] Writings referred to in a contract are construed as a part of the contract for the purpose and extent indicated.

Contracts Law > Contract Interpretation > General Overview

[HN6] The plain meaning rule is the cardinal rule of contract construction in Virginia.

Contracts Law > Types of Contracts > Covenants
Labor & Employment Law > Employment Relationships > Employment Contracts > General Overview
Labor & Employment Law > Wrongful Termination > Breach of Contract > General Overview

[HN7] Within the context of employment contracts, where an agreement provides that a provision is applicable only upon "termination," such a provision is not applicable upon "non-renewal," that is to say, expiration.

Trademark Law > Conveyances > Franchises
Trademark Law > Conveyances > Licenses
Trademark Law > Subject Matter > Names > General Overview

[HN8] The Lanham Act (federal trademark act) expressly provides that a licensee's use of a mark inures to the benefit of the licensor. *15 U.S.C.S. § 1055*. "Franchise" is the name for the relationship that results when one person grants another a license to use a trademark and a proprietary system for operating a business.

Labor & Employment Law > Employment Relationships > Employment Contracts > Conditions & Terms > Trade Secrets & Unfair Competition > Noncompetition & Nondisclosure Agreements

[HN9] To be enforceable, a restraint on trade must (1) be no greater than necessary to protect a legitimate business interest; (2) not be unduly harsh or oppressive in curtailing an employee's right to earn a livelihood; and (3) not offend sound public policy.

Business & Corporate Law > Distributorships & Franchises > Assignments & Transfers
Business & Corporate Law > Distributorships & Franchises > Franchise Relationships > Franchise Agreements
Business & Corporate Law > Distributorships & Franchises > Terminations > General Overview

[HN10] Franchise agreements generally result in a transfer of good will. The first transfer occurs from the franchisor to the franchisee at the outset of the franchise. The second transfer is a re-transfer of the good will from the franchisee back to the franchisor upon termination or expiration of the agreement.

Business & Corporate Law > Distributorships & Franchises > Franchise Relationships > General Overview
Contracts Law > Contract Conditions & Provisions > General Overview
Tax Law > State & Local Taxes > Franchise Tax > General Overview

[HN11] Fundamental principles of a franchise relationship would be destroyed if the franchisees are permitted to use telephone numbers and customer databases associated with the franchisor's proprietary mark after the expiration of the agreements. Where post-term obligations are enforceable contractual

provisions, no showing of "legitimate protectable interest" is required.

Contracts Law > Types of Contracts > Covenants
Evidence > Procedural Considerations > Burdens of Proof > General Overview
Real Property Law > Restrictive Covenants > General Overview
[HN12] Under Virginia law, a defendant has the burden of showing that a restrictive covenant is reasonable.

Labor & Employment Law > Employment Relationships > Employment Contracts > General Overview
[HN13] In Virginia, the employee is generally viewed as having little bargaining power and typically must take or leave the offer made by the employer.

Contracts Law > Types of Contracts > Covenants
Labor & Employment Law > Employment Relationships > Employment Contracts > Conditions & Terms > Trade Secrets & Unfair Competition > Noncompetition & Nondisclosure Agreements
Mergers & Acquisitions Law > Sales of Assets > General Overview
[HN14] Greater latitude is allowed in determining the reasonableness of a restrictive covenant when the covenant relates to the sale of business than in those ancillary to an employment contract.

Business & Corporate Law > Distributorships & Franchises > Causes of Action > Covenants Not to Compete
Business & Corporate Law > Distributorships & Franchises > Franchise Relationships > Franchise Agreements
Contracts Law > Types of Contracts > Covenants
[HN15] The standard applicable to restrictive covenants in franchise agreements differs from state to state. While some states apply the same strict standard that is used in determining the reasonableness of an employment agreement, other states apply a more lenient standard, viewing franchise agreements as similar to the sale of a business, and yet other states apply a standard which addresses elements of both relationships.

Contracts Law > Types of Contracts > Covenants
Labor & Employment Law > Employment Relationships > Employment Contracts > Conditions & Terms > Trade Secrets & Unfair Competition > Noncompetition & Nondisclosure Agreements
[HN16] Virginia courts generally disfavor covenants against competition in the context of employment agreements.

Business & Corporate Law > Distributorships & Franchises > Terminations > General Overview
Business & Corporate Law > Distributorships & Franchises > Trademark Licensing
Contracts Law > Types of Contracts > Covenants
[HN17] There are several marked distinctions between franchise arrangements -- and their ancillary covenants not to compete -- and employment contracts. First, a franchise agreement contemplates the association of the franchisee with the franchised system's goodwill. This type of association tends to be, at most, an incidental effect of the employment relationship. Second, the franchisor's essential trademarks, as well as the use of trade secrets, are much more likely to be entrusted to a franchisee than to an employee. Third, unlike most employees, franchisees may lose upon termination any capital investments made by them. Fourth, the competitive activities that an ex-franchisee undertakes may directly affect the economic interests of present franchisees. An ex-employee's former co-workers usually have fewer such concerns arising from the ex-employee's post-termination competition.

Business & Corporate Law > Distributorships & Franchises > Franchise Relationships > General Overview
Mergers & Acquisitions Law > Sales of Assets > General Overview
[HN18] Franchise relationships differ from a business sale arrangement in several respects as well. For example, franchises typically involve long-term contracts in which the franchisor retains considerable control over the franchisee's operations. The ordinary sale of business, however, presents a "clean break" with the seller's involvement ending and the buyer taking over the business completely. Moreover, unlike sellers of a business, franchisees typically are not compensated for the value of their business when the franchise relationship ends.

Contracts Law > Types of Contracts > Covenants

Mergers & Acquisitions Law > Sales of Assets > General Overview
Real Property Law > Restrictive Covenants > General Overview
[HN19] The lesser standard applied in analyzing covenants accompanying the sale of a business is more appropriate in determining the reasonableness of restrictive covenants in a franchise agreement.

Contracts Law > Types of Contracts > Covenants
Labor & Employment Law > Employment Relationships > Employment Contracts > Conditions & Terms > Trade Secrets & Unfair Competition > Noncompetition & Nondisclosure Agreements
Tax Law > State & Local Taxes > Franchise Tax > General Overview
[HN20] Virginia courts hold that for a restrictive covenant to be enforceable, the drafter of the restraint on competition must demonstrate that the restraint is no greater than necessary to protect a legitimate business interest, is not unduly harsh or oppressive in curtailing an employee's ability to earn a livelihood, and is reasonable in light of sound public policy. In determining the reasonableness of a restrictive covenant, it is relevant to consider the parties involved, their respective positions, and the circumstances of the transaction. Specifically, courts assess (i) the geographic scope of the restraint, (ii) the temporal scope of the restraint; and (iii) the scope of the restricted activities.

Business & Corporate Law > Distributorships & Franchises > Causes of Action > Covenants Not to Compete
Contracts Law > Types of Contracts > Covenants
Real Property Law > Restrictive Covenants > General Overview
[HN21] A territory that expands with the business of a franchisor is not sufficiently definite and renders the covenant void. Since the franchisor could open additional franchises at any time and at any location, such a restrictive covenant was effectively without any territorial limitation.

Contracts Law > Types of Contracts > Covenants
Labor & Employment Law > Employment Relationships > Employment Contracts > Conditions & Terms > Trade Secrets & Unfair Competition > Noncompetition & Nondisclosure Agreements
[HN22] An employee must be able to forecast with certainty the territorial extent of the duty owing with respect to a restrictive covenant.

Commercial Law (UCC) > General Provisions (Article 1) > Application & Construction > Good Faith
Contracts Law > Breach > General Overview
Contracts Law > Contract Interpretation > Good Faith & Fair Dealing
[HN23] See *Va. Code Ann. § 8.01-203* (2001).

Business & Corporate Law > Distributorships & Franchises > Causes of Action > Breach of Contract
Contracts Law > Breach > Causes of Action > General Overview
Contracts Law > Breach > Material Breach
[HN24] A party who commits the first breach of a contract is not entitled to enforce the contract. There is, however, an exception to that general rule, as when the breach did not go to the "root of the contract" but only to a minor part of the consideration. Nonetheless, when the first breaching party commits a material breach, that party cannot enforce the contract.

Contracts Law > Breach > Material Breach
Contracts Law > Breach > Nonperformance
Contracts Law > Performance > Discharges & Terminations
[HN25] A material breach is a failure to do something that is so fundamental to the contract that the failure to perform that obligation defeats an essential purpose of the contract. If the initial breach is material, the other party to the contract is excused from performing his contractual obligations. The type of evidence required to establish a material breach of contract will vary depending on the facts surrounding a particular contract. Although in many cases, a material breach is proved by establishing an amount of monetary damages flowing from the breach, proof of a specific amount of monetary damages is not required when the evidence establishes that the breach was so central to the parties' agreement that it defeated an essential purpose of the contract.

Contracts Law > Contract Interpretation > General Overview
[HN26] Recital or prefatory provisions not set forth in the main text of a contract are superceded by the provisions

set forth in the main body of the contract in the event of a conflict.

Contracts Law > Types of Contracts > Covenants
Labor & Employment Law > Employment Relationships > Employment Contracts > Conditions & Terms > Trade Secrets & Unfair Competition > Noncompetition & Nondisclosure Agreements
[HN27] Restrictive covenants of a character which reasonably protect an employer's business and are incident and ancillary to the contract of employment and limited as to area and duration are enforceable. Such covenants will be enforced unless found to be contrary to public policy, unnecessary for the employer's protection, or unnecessarily restrictive of the rights of the employees, due regard being had to the subject-matter of the contract and the circumstances and conditions under which it is to be performed.

Contracts Law > Types of Contracts > Covenants
Real Property Law > Restrictive Covenants > Enforcement
Tax Law > State & Local Taxes > Franchise Tax > General Overview
[HN28] In considering the issue of whether an otherwise reasonable restrictive covenant may be enforced absent the existence of any legitimate protectable interests, a court examines the legitimate protectable interests of the franchisor, the nature of the former and proposed subsequent businesses of each of the franchisees, and the nature of the restraint in light of all the circumstances. In addition, the court considers the language of the restrictive covenant in the context of the facts of the specific case.

Business & Corporate Law > Distributorships & Franchises > Causes of Action > Covenants Not to Compete
Real Property Law > Restrictive Covenants > General Overview
Tax Law > State & Local Taxes > Franchise Tax > General Overview
[HN29] It is not necessary for a franchisor to currently be in the business of offering franchises in order to claim any protectable interests with respect to a restrictive covenant.

Bankruptcy Law > State Insolvency Laws
Business & Corporate Law > Distributorships & Franchises > Causes of Action > Agency Relationships
Tax Law > State & Local Taxes > Franchise Tax > General Overview
[HN30] In order to prove insolvency, both the value of the debtor's assets and the amount of its liabilities must be established. Even if a franchisor's debts may in fact exceed its assets, such a capital structure is not necessarily indicative of insolvency. *Va. Code Ann. §§ 49-26, 55-81* (2002). A debtor is insolvent within the meaning of these statutory provisions when it has insufficient property to pay all its debts.

Business & Corporate Law > Distributorships & Franchises > Causes of Action > Covenants Not to Compete
Contracts Law > Types of Contracts > Covenants
[HN31] A covenant not to compete may be necessary to protect a franchisor's good will after the reconveyance.

Contracts Law > Contract Interpretation > General Overview
Contracts Law > Types of Contracts > Covenants
[HN32] A court must give effect to the intention of the parties as expressed in the language of their contract, and the rights of the parties must be determined accordingly.

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JUDGES: R. Terrence Ney.

OPINION BY: R. Terrence Ney

OPINION

OPINION LETTER

This case was heard by the Court on January 13, 14, 15, 21, 22, 27, 28, and 29.

FACTS

The Plaintiffs in this matter consist of franchisees, or former franchisees (the "franchisees"), of the Takeout Taxi franchise system. The Plaintiffs include: Brenco Enterprises, Inc. ("Brenco"), a Virginia corporation; Richard Baran ("Baran") [1]; Convenience Cab, Inc. ("Convenience Cab"), a Virginia corporation; Bernard H. Marshall and Karen Marshall (the "Marshalls") [2]; C3 Marketing ("C3"), a Georgia corporation; Michael Castro ("Castro") [*2] [3]; Worldwide Cargos, Inc. ("Worldwide"), a Virginia Corporation; Stephen Druhot [4]; D&S Group Inc. ("D&S"), a Virginia corporation; Brant Druhot [5]; Albuquerque, Tucson Investment Group, L.P. ("ATIG"), a New Mexico limited partnership; Bob Oyen ("Oyen") [6]; Kim and Mark Boutwell (the "Boutwells") [7]; Takeout Taxi of LA, LLC ("Takeout Taxi LA"), a Louisiana corporation [8]; B/J Marketing, Inc. ("B/J Marketing"), a California corporation; Don and Duncan Bedard (the "Bedards") [9]; Miami Enterprises, Inc. ("Miami Enterprises"), a North Carolina corporation; J. Bailie Morlidge ("Morlidge") [10]; Poipu Enterprises, Inc. ("Poipu"), a California corporation; Mark Loranger ("Loranger"), Katie Lichtig ("Lichtig"), and Dennis Labriola ("Labriola") [11]; BP2 Corporation ("BP2"), a Tennessee corporation; Bluegrass Enterprises, Inc. ("Bluegrass"), a Tennessee corporation; and Bruce Pavlovsky ("Pavlovsky"). [12]

1 Baran is a principal and personal guarantor of the Brenco Franchise and Software Agreements. See note 18, *infra*.

2 The Marshalls are principals in Convenience Cab and personal guarantors of the Convenience Cab Franchise and Software Agreements. See note 19, *infra*.

[*3]

3 Castro is a principal of C3 Marketing and personal guarantor of C3 Marketing's Franchise and Software Agreements. See note 20, *infra*.

4 Stephen Druhot is an officer and director of Worldwide. See note 21, *infra*

5 Brant Druhot is a principal and a personal guarantor of the D&S Franchise and Software Agreements. See note 22, *infra*

6 Bob Oyen is a party to the ATIG Franchise and Software Agreements. See note 23, *infra*

7 The Boutwells are parties to the Boutwell Franchise Agreement. See note 24, *infra*.

8 Takeout Taxi LA operates a franchise pursuant to the Boutwell Franchise Agreement. See note 24, *infra*.

9 The Bedards are the principals in B/J Marketing, Inc. and are the personal guarantors of the B/J Marketing Franchise and Software Agreements. See note 25, *infra*.

10 Morlidge is the principal of Miami Enterprises and is the personal guarantor of the Miami Enterprises Franchise and Software Agreements. See note 26, *infra*.

11 Loranger and Labriola are principals in Poipu Enterprises. Loranger and Lichtig are personal guarantors of the Poipu Enterprises Franchise and Software Agreements. See note 27, *infra*.

[*4]

12 Pavlovsky is the principal in BP2 and Bluegrass, and is the guarantor of the BP2 Franchise and Software Agreements. See note 28, *infra*.

The Defendants are Takeout Taxi Franchising Systems, Inc., ("TTFSI"), the franchisor of a restaurant food delivery business; Takeout Taxi, Inc. ("TTI"), the owner of the Takeout Taxi service mark and certain proprietary software, and operator of a company-owned Takeout Taxi operation within the Takeout Taxi franchise system; and Takeout Taxi Holdings, Inc. ("TTHI"), the parent company of TTI and TTFSI. The Court refers to this group of affiliated companies collectively as "Takeout Taxi". [13]

13 Other Defendants named in the suit, but not parties to this aspect of the litigation, are Bank of America Capital Investors ("BACT"), a Texas corporation and the largest shareholder of TTHI which directs and controls the operations of Takeout Taxi; and Douglas Williamson, an employee of BACI and President, Chief Executive Officer, and Chairman of Takeout Taxi.

[*5] The Takeout Taxi idea had its beginnings in 1987. The concept consists of a system and process whereby consumers, by contacting a single delivery

service, may obtain home (or business) delivery of food from multiple independent restaurants that do not traditionally provide food delivery. [14]

> 14 The Takeout Taxi delivery service process begins with a customer contacting a Takeout Taxi franchisee directly with a food order for a restaurant included on a list of selected restaurants. Takeout Taxi contacts the restaurant and places the food order, then picks up the food and delivers it to the customer. Customers pay the menu price for the food plus a fee to Takeout Taxi for the delivery service.

A prime feature of the Takeout Taxi concept is the proprietary software system - DeliveryNet(R) - which the franchisees use to manage their order and delivery networks and interaction with delivery drivers. [15] The proprietary software system facilitates delivery of food from restaurants to customers [16] who contact Takeout [*6] Taxi to order meals for delivery to their homes and businesses.

> 15 DeliveryNet, the current software used by the franchisees in the Takeout Taxi System, was developed through an agreement between Takeout Taxi and Lane's Computer Solutions, Inc. ("LCS").
>
> Pursuant to the agreement's terms and addenda (known as the "Strategic Alliance"), Takeout Taxi has the exclusive worldwide license to the proprietary Base Software, and the exclusive right to license the Base Software to franchisees and licensees for use in connection with their businesses.
>
> Also pursuant to the Strategic Alliance, LCS agreed to develop further enhancements to the Base Software in order to increase the software's functionality. Takeout Taxi owns the rights to these enhancements.

> 16 The franchisees service three types of clientele: residential, hotel, and corporate. Residential and hotel delivery orders are usually for small amounts of food, and are received on-demand. Corporate delivery orders are generally made in advance and tend to generate a much higher bill than residential and hotel clients. Approximately 50% of the franchise's revenues are generated by residential and hotel orders combined, while the remaining revenues are generated by corporate clients.

[*7] The printed menu guides serve as the primary marketing tool for Takeout Taxi. These menu guides, which are distributed by mail to area businesses and individual residences located within the respective franchise territories, are labeled with the Takeout Taxi trademark on the cover and contain the menus of the various restaurants from which the franchisees deliver food. [17]

> 17 The franchisees are responsible for printing their own menu guides, either through Takeout Taxi's graphics services or an outside contractor.

The customers' use of this menu guide, in conjunction with the DeliveryNet software, facilitates the creation of a customer database. The customer database is a catalog of names and addresses of those customers who have ordered food from Takeout Taxi. Takeout Taxi franchisees utilize the customer database as both a mailing list to deliver updated menu guides directly to prior customers' residential and corporate addresses and as a record of the types of food and restaurants from which customers like [*8] to order.

Takeout Taxi began to franchise the Takeout Taxi concept in 1991. For those interested in owning a small business, the Takeout Taxi concept was viewed as an attractive business opportunity, the Plaintiffs being no exception.

In the early 1990s, the Takeout Taxi franchise experienced significant growth and expansion. By 1995, there were approximately 100 Takeout Taxi franchises and three company-owned stores located in the United States and Canada.

The Agreements Between the Parties

Many of the franchisees involved in this litigation have been franchisees of Takeout Taxi almost from the inception of the franchise system.

Specifically, the Brenco Franchise Agreement was executed by the parties on June 5, 1991 [18]; the Convenience Cab Franchise Agreement was executed on March 9, 1992 [19]; C3 Marketing entered into two separate franchise agreements with Takeout Taxi, the first of which was executed on March 20, 1992 and the second

on March 29, 1994 [20]; the Worldwide Cargoes Franchise Agreement was executed on March 24, 1992 [21]; D&S is the assignee of a Franchise Agreement with Takeout Taxi dated November 19, 1992 [22]; the ATIG Franchise Agreement was executed on [*9] September 21, 1992 [23]; the Boutwell Franchise Agreement was executed on June 9, 1995 [24]; the B/J Marketing Franchise Agreements were executed on September 18, 1992 [25]; the Miami Enterprises Franchise Agreement was executed on March 20, 1992 [26]; the Poipu Franchise Agreement was executed on January 24, 1992 [27]; the BP2 Franchise Agreement was executed on September 21, 1992 [28]; and Bluegrass was granted, upon certain terms and conditions, a partial assignment of the BP2 franchise rights pursuant to a July 24, 1998 addendum to the BP2 Franchise Agreement. [29]

18 Pls. Ex. 14. Brenco is also a party to a computer software license agreement ("Brenco Software Agreement") with Takeout Taxi.

19 Pls.' Ex. 7. Convenience Cab is also a party to a computer software license agreement and DeliveryNet 96 Software License ("Convenience Cab Software Agreement"). In addition, Convenience Cab is the assignee of a franchise agreement with Takeout Taxi dated October 31, 1991, Pls.' Ex. 5, and the assignee of a 1991 software agreement ("1991 Convenience Cab Software Agreement").

20 Pls.' Exs. 18 and 19. C3 Marketing is also a party to two separate computer software license agreements and DeliveryNet 96 Software Licenses - the 1992 C3 Marketing Software Agreement and 1994 C3 Marketing Software Agreement.

[*10]

21 Pls.' Ex. 21. Worldwide Cargoes is also a party to a computer software license agreement and DeliveryNet 96 Software License with Takeout Taxi ("Worldwide Cargoes Software Agreement").

22 Pls.' Exs. 23 and 24. D&S is also a party to a computer software agreement ("D&S Software Agreement").

23 Pls.' Ex. 34. ATIG is also a party to a computer software agreement ("ATIG Software Agreement") with Takeout Taxi.

24 Pls. Ex. 13.

25 Pls. Exs. 30 and 31. B/J Marketing is a party to two franchise agreements which are virtually identical to the D&S Franchise Agreement. B/J Marketing is also a party to two software agreements with Takeout Taxi ("B/J Marketing Software Agreements").

26 Pls.' Ex. 32. The Miami Enterprises Franchise Agreement is virtually identical to the Brenco Franchise Agreement. Miami Enterprises is also a party to a computer software agreement with Takeout Taxi ("Miami Enterprises Software Agreement").

27 Pls.' Ex. 1. The Poipu Franchise Agreement is virtually identical to the Brenco Franchise Agreement.

28 Pls.' Ex. 25. The BP2 Franchise Agreement is virtually identical to the D&S Franchise Agreement. BP2 is also a party to a computer software agreement (BP2 Software Agreement), which is attached as part of Exhibit 18 to the Second Am. Compl.

[*11]

29 Pls.' Ex. 29. Pursuant to this assignment, Bluegrass operates a Takeout Taxi franchise in Louisville, Kentucky.

The franchisees of the Takeout Taxi franchise system own and operate their own restaurant food delivery service business. Pursuant to their franchise agreements and software license agreements with Takeout Taxi, the franchisees are licensed to use the Takeout Taxi service mark and software in connection with their businesses. [30]

30 Under Section I of the Franchise Agreement, ("Grant of Franchise"), Takeout Taxi granted to its franchisees the nonexclusive right and license to operate a Takeout Taxi business.

The franchise agreements provide for a 10-year term, [31] and contain same or similar provisions regarding the use and ownership of the Takeout Taxi service mark, confidential and proprietary information, default and termination, covenants not to compete, and payment of royalty fees to the franchisor. [*12] [32]

31 As of the date of trial, a majority of the Plaintiffs' franchise agreements had technically expired by their own terms. Several of the franchise agreements, including those of Plaintiffs Baran, Brenco, the Marshalls, Convenience Cab, Stephen Druhot, and Worldwide, remain in effect by virtue of a temporary injunction issued by the Court on March 13, 2002.

32 The 1996 "New Deal" addenda to some of the franchise agreements provided for the restructuring of royalty fees. Pls.' Exs. 6, 9, 15, and 27.

At the outset of the franchise relationship, Takeout Taxi provided the franchisees with advisory assistance and support in establishing the franchisees' respective businesses and was involved in the initial growth and development of each franchise territory.

Specifically, Takeout Taxi provided each franchisee with a franchise business consultant, as well as education and training programs, workshops and seminars. Takeout Taxi also provided to its franchisees a Confidential Operations Manual, and some updates [*13] to that manual. Takeout Taxi worked to promote the Takeout Taxi proprietary mark via its website and by pursuing relationships with national and regional chain restaurants and negotiating contracts for the franchise system.

Pursuant to the franchise agreements, the franchisees were obligated to use their best efforts to operate a Takeout Taxi franchise and pay a specified royalty fee [33] to Takeout Taxi on a monthly basis.

33 The royalty fee paid to Takeout Taxi ranges from 1.5% to 3% of the respective franchisees' gross revenues.

Beginning in 1998, the relationship between Takeout Taxi and some of its franchisees became strained by various disputes regarding software updates and development, [34] maintenance and enforcement of system standards, promotion of the proprietary mark, royalty payments, [35] the potential sale of the franchise system, [36] and the overall growth, stability, and viability of the Takeout Taxi franchise system. [37]

34 The software dispute arose out of a perceived need by some of the franchisees for certain enhancements to the software, such as menus on the web and online ordering. Takeout Taxi and the franchisees disagreed on how such enhancements would be developed or purchased. In 1996, LCS released an updated version of DeliveryNet. In 1999, Takeout Taxi established an advisory Software Development Committee ("SDC") that included LCS, representatives of Takeout Taxi, and representative franchisees to address the franchisees' concerns and discuss plans for development of certain enhancements to the software.

[*14]

35 As franchisees, Plaintiffs pay royalties to Takeout Taxi based on a percentage of the gross revenues from the individual businesses. In the most recent calendar year, the Plaintiffs paid in excess of $ 200,000 in royalties to Takeout Taxi from the gross revenue of their businesses. Plaintiffs claim they have received virtually no benefit under their franchise agreements in exchange for their payment of royalty fees since 1998.

36 In 1999, Takeout Taxi was presented with its first of two opportunities to sell the company. First, Takeout Taxi received a $ 7 million offer to purchase the franchise system from Food.com (now called GeoComm Systems), a software company and provider of online ordering solutions to restaurants and retailers. Takeout Taxi and Food.com entered into an agreement, and as part of the deal, all the Plaintiffs except Oyen, C3, and Castro entered into a letter of intent with Food.com to sell their businesses. Takeout Taxi eventually withdrew its approval for the sale of the franchises. As a result, the franchisees were unable to complete the deal with Food.com on their own, even though many wished to do so.

In June 2000, Takeout Taxi was again presented with an offer in the amount of $ 13 million for the purchase of the Takeout Taxi franchise from Easy-to-Get, another food delivery company and competitor of Food.com. As with the Food.com offer, Takeout Taxi again withdrew its approval and the sale did not occur.

[*15]

37 Plaintiffs point out that the Takeout Taxi entities have been operating on a negative cash-flow basis for several years. In 1995, Takeout Taxi sought funds from outside investors, namely Bank of America Capital Investors ("BACI"), a co-Defendant in this suit. Pursuant to an agreement between Takeout Taxi and BACI, BACI obtained in excess of a 45% interest in TTHI and is currently responsible for running TTHI and its subsidiaries. Today, Takeout Taxi no longer receives funding from BACI, but rather from its President and CEO, Douglas Williamson.

Under these circumstances, the Plaintiffs characterize Takeout Taxi as "under-capitalized and virtually insolvent" and project that Takeout Taxi will continue to operate at a loss in the future.

Between 1998 and 2002, the franchisees became increasingly frustrated with Takeout Taxi's management and performance under the franchise agreements. The franchisees were particularity dissatisfied over the deterioration of Takeout Taxi's relationship with its software vendor [38] and the overall steady decline of the franchise system, which by 2002 consisted [*16] of only 26 franchises and one company-owned store.

38 In 2001, Takeout Taxi attempted to renegotiate the DeliveryNet contract with LCS, but was unsuccessful. As of April 2002, the DeliveryNet software was no longer exclusively made for or sold to Takeout Taxi. Contract matters between Takeout Taxi and LCS are currently being litigated in a separate case.

By March 2002, the franchise agreements of Plaintiffs Brenco, Baran, Worldwide, Stephen Druhot, Convenience Cab, the Marshalls, C3, and Mike Castro had either expired [39] or were on the brink of expiration. Although each of these franchisees possessed a right to renew their agreement for another ten-year term, the franchisees did not do so on various grounds, including Takeout Taxi's alleged failure to take the steps necessary to effectuate the renewal process and Takeout Taxi's alleged attempt to attach certain conditions to the renewal of the franchise agreements. [40]

39 For those agreements which had already expired and had not been formally renewed, the Plaintiffs continue to operate as franchisees under the Takeout Taxi system on a month-to-month basis.

[*17]

40 Specifically, Plaintiffs claim that Takeout Taxi did not comply with its obligations under the franchise agreement to inspect the franchised businesses six months prior to expiration of the agreements as part of the renewal process, nor did Takeout Taxi provide the plaintiffs with a disclosure document in connection with the offer of renewal.

Plaintiffs also contend that the terms of the renewal agreements entail a more comprehensive personal guarantee, telephone assignment, and payment method provision, and that Takeout Taxi refused to negotiate these and other terms.

Under such circumstances, some of the franchisees were faced with the choice of either (1) renewing their franchisee agreements for another ten-year term, or (2) allowing their existing agreements to expire and be subject to the one-year covenant not to compete [41] and other post-term obligations, [42] the effect of which would purportedly put the franchisees out of business.

41 See Section XIV(2) of the 1994 C3 Marketing franchise agreement and Section XV(C) of the remaining franchise agreements.

[*18]

42 See the Telephone Assignment Provision: Section XIII(7) of the 1994 C3 Marketing franchise agreement, Section XIV(K) of the D&S and ATIG franchise agreements, and Section XIV(J) of the remaining franchise agreements. See also the Software Provision: Section XIII(2) of the 1994 C3 Marketing Agreement, Section XIV(J) of the D&S and ATIG franchise agreements; and Section XIV(I) of the remaining agreements.

PROCEDURAL HISTORY

On March 7, 2002 the Plaintiffs filed a nine-count Bill of Complaint against Takeout Taxi alleging a violation of the *Virginia Retail Franchise Act* (Count I); seeking declaratory judgment pursuant to *§ 8.01-184 of the Virginia Code* with respect to the alleged violation of the *Virginia Retail Franchise Act* (Count II) and the unenforceability of the restrictive covenants contained in the franchise agreements (Count III); and alleging constructive fraud (Count IV); breach of contract and breach of implied covenant of good faith and fair dealing (Count V); tortious interference with contract (Count VI); tortious interference with business [*19] expectancy (Count VII); statutory conspiracy pursuant to §§ *8.01-499* and 500 of the Virginia Code (Count VIII); and common law conspiracy (Count IX).

On March 13, 2002 the Court issued a Temporary Injunction pursuant to *§ 8.01-624 of the Virginia Code* pending resolution of the franchisees' claims. [43] Specifically, the injunction permitted certain Plaintiffs to continue as franchisees on a month-to-month basis on the

same terms and conditions in place under their respective franchise agreements and prohibited Takeout Taxi from treating such agreements as expired or terminated. [44]

43 The temporary injunction was extended by subsequent Court Orders dated June 27, 2002 and October 23, 2002.

44 See note 31, *supra*. At the March 13, 2002 hearing, some of the Plaintiffs asserted that Takeout Taxi failed to comply with its obligations under the franchise agreements to complete the renewal process and intentionally delayed the process, thereby preventing the franchisees from exercising their right to renew. In addition, the Plaintiffs asserted that Takeout Taxi conditioned any renewal of the franchise agreements on the franchisees' release of all claims against Takeout Taxi. Under either result the Plaintiffs alleged that they would be "irreparably injured", either by Takeout Taxi's enforcement of the agreements' post-expiration restrictions in the event of non-renewal which, if enforced, would effectively put the Plaintiffs out of business, or by being forced to sign a release of all claims against Takeout Taxi depriving the Plaintiffs of their rights under the franchise agreements.

[*20] Takeout Taxi subsequently filed separate Cross-Bills in equity, one against certain Plaintiff franchisees [45] and the other against Lane's Computer Systems. [46]

45 On July 9, 2002 Takeout Taxi filed a Cross-Bill against Plaintiffs Convenience Cab, the Marshalls, C3, Castro, Brenco, Baran, Worldwide, Poipu, and Loranger, alleging tortious inference with the contract between Takeout Taxi and LCS, tortious inference with a business advantage/expectancy, statutory and common law conspiracy, and breach of contract (i.e., the franchise and software agreements between Takeout Taxi and the Plaintiff franchisees). On August 23, 2002 Takeout Taxi filed an Amended Cross-Bill, naming only Plaintiffs Convenience Cab, the Marshalls, C3, Castro, Poipu, and Loranger as Cross-Defendants, and which included additional allegations of conversion and misappropriation of trade secrets.

46 On July 25, 2002 Takeout Taxi filed a Cross-Bill against LCS and Delivery Technologies, LLC (an alleged subsidiary of LCS) alleging tortious interference with the contracts between Takeout Taxi and the franchisees, tortious interference with a business advantage/expectancy, statutory and common law conspiracy, conversion, and misappropriation of trade secrets.

[*21] On June 4, 2002 the Plaintiffs filed an Amended Bill of Complaint, adding additional parties, factual allegations, and claims arising out of the same transactions and occurrences which gave rise to the original claims. [47]

47 The Court entered a Stipulated Order granting the Plaintiffs leave to amend, endorsed by both parties, on June 4, 2002. Plaintiffs' Amended Bill of Complaint included additional Plaintiffs and their respective claims under the *California Franchise Investment Law* (Count X), the *California Franchise Relations Act* (Count XI), the *California Unfair Trade Practices Act* (Count XII), the *North Carolina Unfair and Deceptive Practices Act* (Count XIII), and the *Tennessee Consumer Protection Act of 1977* (Count XIV).

On June 27, 2002 the Court bifurcated the case and set Counts I, II, III, IV, X, XI, XII, XIII, and XIV of the Amended Bill of Complaint for trial. [48]

48 Trial was initially set for October 28, 2002. On October 23, 2002 the Court continued the trial date to January 13, 2003 and modified its June 27, 2002 Order to include Count V (breach of contract) as a matter to be heard at the January 13, 2003 trial.

[*22] On October 17, 2002, in response to the Court's sustaining of Defendants' demurrer to some of the counts of the Amended Bill of Complaint, [49] the Plaintiffs filed a Second Amended Bill of Complaint. [50]

49 On September 26, 2002 the Court sustained the Defendants' demurrers to Counts I, IV, V, VIII, and IX of the Amended Bill of Complaint.

50 In response the Second Amended Bill of Complaint, the Defendants demurred to all counts. On December 16, 2002, the Court sustained the Defendants' demurrers to Count II (Declaratory Judgment -- *Virginia Retail Franchise Act*), Count V (Breach of Contract and Implied Covenant of

Good Faith and Fair Dealing, only as to the Plaintiffs' allegations of a breach of implied covenant of good faith and fair dealing), Count VIII (Statutory Conspiracy), and Count IX (Common Law Conspiracy) of the Second Amended Bill of Complaint, taking Count X (*California Franchise Investment Law*), Count XI (*California Franchise Relations Act*), Count XII (*California Unfair Trade Practices Act*), Count XIII (*North Carolina Unfair and Deceptive Trade Practices Act*), and Count XIV (*Tennessee Consumer Protection Act*) under advisement.

On January 13, 2003 the Court sustained the Defendants' demurrer to Counts X, XI, XII, XIII and XIV of the Second Amended Bill of Complaint, without leave to amend, leaving Count I (violation of the *Virginia Retail Franchise Act*), Count III (Declaratory Judgment -- Enforceability of Post-Term Obligations), Count IV (Constructive Fraud), and Count V (Breach of Contract) for the January 13, 2003 trial; and Count VI (Tortious Interference with Contract) and Count VII (Tortious Interference with Business Expectancy) for the damages phase of the litigation to be heard at a later date.

[*23] Trial commenced on January 13, 2003. After opening statements, the Defendants' made a motion to strike Counts I, III and V. Upon consideration of the arguments presented by counsel, the Court sustained the Defendants' motion to strike as to Count I only, allowing the Plaintiffs to proceed on Counts III and V. [51]

51 On January 13, 2003, prior to the commencement of trial, the Court deferred Count IV (Constructive Fraud) to the damages phase of the case upon the Plaintiffs' representation that they were no longer seeking equitable relief for the fraud claim.

Under the remaining counts, the franchisees seek both a determination that Takeout Taxi breached its duties owed to the franchisees under the franchise agreements and a declaratory judgment that the covenant not to compete and certain post-termination provisions contained in their franchise agreements are either inapplicable or unenforceable. [52]

52 Given that certain of the franchise agreements have expired, and that the remainder are near expiration, the case is ripe for decision.

[*24] **DISCUSSION**

The issues presented are whether (1) the one-year restrictive covenants and the post-expiration provisions contained in the Franchise Agreements are unreasonable and unduly burdensome as a matter of law, thus rendering the covenants unenforceable; (2) whether Takeout Taxi materially breached its obligations under the Franchise Agreements, thereby releasing the franchisees from their obligations to perform; and (3) whether Takeout Taxi continues to retain a protectable interest in the franchise to justify enforcement of the restrictive covenants.

Applicability of the Post-Termination Provisions Upon Expiration

As a preliminary matter, the franchisees ask this Court to determine which events -- "expiration" or "termination" of the Agreement -- are necessary to trigger the applicability of the disputed provisions of the Franchise Agreements.

Specifically, the franchisees assert that the application of the Telephone Assignment Provision, [53] the Return of Franchise Material Provision, [54] and the Take-over Provision [55] of the Franchise Agreements is limited to those circumstances involving *termination* of the Agreement, not expiration. The franchisees argue [*25] that the terms "expiration" and "termination" are not synonymous, and that the franchise agreements plainly distinguish between the two terms.

53 There are three versions of the Franchise Agreement among the franchisees. Seven of the fourteen franchise agreements set forth the Telephone Assignment Provision in Section XIV(J) (Version 1), five of the fourteen agreements set forth the Telephone Assignment Provision in Section XIV (K) (Version 2), and the remaining two agreements set forth the Telephone Assignment Provision in Section XIII(8) (Version 3).

54 Pls.' Ex. 7, Section XIV(I) (Version 1) of the Franchise Agreement.

55 Pls.' Ex. 7, Section XIV(E) (Version 1) of the Franchise Agreement.

Takeout Taxi contends that both of the terms "expiration" and "termination", although used

interchangeably throughout the Agreement, give the franchisor specific contractual rights to "take-over" the franchisees' businesses, retrieve the DeliveryNet Software, and obtain the franchise telephone number upon [*26] *expiration* of the Franchise Agreements.

Each of the provisions -- and its applicability given termination or expiration -- will be addressed separately.

1. Telephone Assignment [56]

> 56 Each version of the franchise agreement requires the franchisee to execute a telephone assignment agreement in conjunction with entering into a franchise agreement. The Telephone Assignment Provision provides that "the Franchise shall execute a Telephone Assignment Agreement in form of Exhibit C attached hereto."

The franchisees contend that upon expiration of their franchise agreements, the franchisees own the telephone number for their respective franchise. The Telephone Assignment Provision provides, in relevant part, that the

> "Franchisee shall promptly notify the appropriate telephone company and all telephone directory listing agencies of the *termination or expiration* of its right to use any telephone number and any regular, classified or other telephone directory listings associated with any Proprietary Marks [*27] and authorize transfer of same to or at the direction of Franchisor. In connection therewith, the Franchisee shall execute a Telephone Assignment Agreement in the form of Exhibit C attached hereto" [57] (emphasis added).

> 57 Excerpt from Pls.' Ex. 7, Section XIV(J) (Version 1) of the Franchise Agreement.

Although this provision makes reference to both termination and expiration, the Telephone Assignment Agreement referenced therein explicitly states that it applies only "in the event of *termination* of the Franchise Agreement" and expressly provides that it "shall not be effective unless and until the Franchise Agreement is *terminated* in accordance with the provisions for *termination* contained therein" (emphasis added). [58]

> 58 See Telephone Assignment Agreement, Pls.' Ex. 7. As another example to illustrate that the Agreement distinguishes between "termination" and "expiration", the franchisees point to Section XIII of the Franchise Agreement, which sets forth the manner in which the Agreements can be "terminated" prior to the designated end (i.e., expiration) of the Franchise Agreement.

[*28] In addition, the described purpose of the Telephone Assignment Agreement is "to secure continuity and stability of the operation of the System." [59] The franchisees argue that this stated purpose relates to Takeout Taxi's "take over" of a terminated franchise business, and that "take over" is a right had only upon termination of the agreement, not expiration. [60]

> 59 See Telephone Assignment Agreement, Pls.' Ex. 7.
>
> 60 The applicability of the "take over" provision of the Agreement in the event of expiration is discussed, *infra*.

Takeout Taxi, in response, contends that the Telephone Assignment Provision, as it appears in all three versions of the franchise agreement, permits the franchisor to obtain the telephone number in the event of termination or expiration.

Specifically, Takeout Taxi notes that in Version 1 of the Franchise Agreement, the Telephone Assignment Provision appears in the second sentence of Section XIV(J). [61] Although this sentence contains no reference to the terms "expiration" or [*29] "termination", Takeout Taxi asserts that the opening clause of that sentence -- "in connection therewith" -- plainly refers back to the first sentence of the section, which expressly uses the phrase "termination or expiration."

> 61 See Pls.' Ex. 7, Section XIV(J) (Version 1) of the Franchise Agreement.

With respect to the other versions of the franchise agreement, Takeout Taxi contends that although the Telephone Assignment Provisions do not expressly refer to either termination or expiration, the prefatory language to each of these respective provisions controls as to which triggering events apply. [62]

62 In Version 2 of the Franchise Agreement, the Telephone Assignment Agreement clause is contained in the first sentence of Section XIV(K). Although this sub-section does not expressly refer to either termination or expiration, Takeout Taxi contends that the prefatory language of Article XIV controls. The prefatory language to Section XIV states that "upon termination or expiration, this Agreement and all rights hereunder to Franchisee shall forthwith terminate, and Franchisee shall observe and perform the following provisions."

Similarly, in Version 3 of the franchise agreement, the Assignment Agreement clause is contained in the third sentence of the Telephone Assignment Provision, Section XIII (8). Although this sub-provision does not expressly refer to either termination or expiration, Takeout Taxi contends that the prefatory language in Section XIII, which references both termination and expiration, controls as to which triggering events apply.

[*30] Takeout Taxi further contends that although the Telephone Assignment Agreement refers only to termination, this term matters little given the purpose for which the Assignment Agreement was incorporated into the Franchise Agreements, namely, for illustrating the form of the Assignment Agreement and nothing more.

[HN1] The Court must give effect to the intention of the parties as expressed in the language of their contract. [63] Where provisions of a contract appear to conflict with one another, a court should attempt to reconcile the apparent inconsistency if a reasonable basis for such reconciliation exists. [64] In the event of an ambiguity in the written contract, however, such ambiguity must be construed against the drafter of the agreement. [65]

63 *Rash v. Hilb, Rogal & Hamilton Co., 251 Va. 281, 286, 467 S.E.2d 791, 794 (1996)*; *Foti v. Cook, 220 Va. 800, 805, 263 S.E.2d 430, 433 (1980)*; *accord, Worrie v. Boze, 191 Va. 916, 925, 62 S.E.2d 876, 880 (1951)*.

64 *First American Bank of Virginia v. J.S.C. Concrete Construction, Inc., 259 Va. 60, 69, 523 S.E.2d 496, 501 (2000)*; *Hutchinson v. King, 206 Va. 619, 624-25, 145 S.E.2d 216, 220 (1965)*.

[*31]

65 *See Martin v. Martin, Inc. v. Bradley Enterprises, Inc., 256 Va. 288, 504 S.E.2d 849 (1998)*.

[HN2] In reconciling two provisions, the Court should, as a general rule, resolve "any apparent inconsistency between a clause that is generally and broadly inclusive in character, and a clause that is more specific in character" in favor of the latter, [66] as specific and exact terms are given greater weight than general language. [67]

66 *Chantilly Construction Corp. v. Commonwealth, 6 Va. App. 282, 294, 369 S.E.2d 438, 445, 4 Va. Law Rep. 2811 (1988)*.

67 *Restatement (Second) Contracts § 203(c). See also, Donnelly v. Donatelli & Klein, Inc., 258 Va. 171, 180, 519 S.E.2d 133, 138 (1999)*.

Here, in reconciling the language of the Telephone Assignment Provision in the Franchise Agreements and the Telephone Assignment Agreement itself, the Court addresses two *separate and distinct* agreements with [*32] apparent inconsistent provisions.

[HN3] When a business transaction is based on more than one document executed by the parties, the integrated business transaction principle requires a court to construe multiple documents together to divine the intent of the parties. [68] In ascertaining the parties' intent, a court considers the plain meaning of the language the parties used in the documents. [69]

68 *See Musselman v. The Glass Works, L.L.C., 260 Va. 342, 346, 533 S.E.2d 919, 921 (2000)*; *First American Bank of Virginia v. J.S.C. Concrete Construction, Inc., 259 Va. 60, 67, 523 S.E.2d 496, 500 (2000)*.

69 *Musselman, 260 Va. at 346, 533 S.E. at 921*.

[HN4] In the context of an integrated business transaction, a court should not construe one document in a manner that negates or nullifies the provisions of another document. [70] A corollary principle of contract construction requires courts to interpret exhibits and attachments incorporated into an agreement in accordance [*33] with the purpose of the parties. [71]

70 *See Foothill Capital Corp. v. East Coast Building Supply Corp., 259 B.R. 840, 845 (Bankr. E.D. Va. 2001)*.

71 *See Guerini Stone Co. v. Carlin, 240 U.S.*

264, 60 L. Ed. 636, 36 S. Ct. 300 (1916); *VNB Mortgage Corporation, ETC. v. Lone Star Industries, 215 Va. 366, 370, 209 S.E.2d 909, 913 (1974)*; *W.D. Nelson &Company, Inc. v. Taylor Heights Development Corp., 207 Va. 386, 391, 150 S.E.2d 142, 146 (1966).*

[HN5] Writings referred to in a contract are construed as a part of the contract for the purpose and extent indicated. [72] Here, the Telephone Assignment Agreement referred to in the Telephone Assignment Provision served to put the franchisees on notice of their requirement to execute a separate formal agreement memorializing their duty to "promptly notify the appropriate telephone company and all telephone directory listing agencies of the *termination or expiration* of [their] right to use any telephone number . . .." [73] As such, [*34] the Court finds that the incorporation of the Telephone Assignment Agreement by reference in the Telephone Assignment Provision is restricted to this purpose only. [74]

72 *W.D. Nelson & Company, Inc. v. Taylor Heights Development Corp., 207 Va. 386, 391, 150 S.E.2d 142, 146 (1966)* .

73 Excerpt from Pls. Ex. 7, Section XIV (J) (Version 1) of the Franchise Agreement.

74 *See VNB Mortg. Corp. v. Lone Star Industries, Inc., 215 Va. 366, 370, 209 S.E.2d 909, 913 (1974).*

In addition, the Court finds nothing in the Telephone Assignment Agreement that suggests the parties intended the exhibit to abrogate the plain meaning of multiple provisions within the body of the franchise agreement. [75] Specifically, the Court finds nothing in the Telephone Assignment Agreement that reflects any mutual intent for the exhibited Assignment Agreement to waive, expand, or diminish rights previously granted under the franchise agreement. [76]

75 *See Musselman v. The Glass Works, L.L.C., 260 Va. 342, 346, 533 S.E.2d 919, 921 (2000)*(reiterating that [HN6] the plain meaning rule is the cardinal rule of contract construction in Virginia.)

[*35]

76 Quite the contrary is evidenced by Section 2(d) of Assignment Agreement, which provides, in part, that "the execution and performance of the Assignment does not conflict with, violate, breach, or constitute a default under any contract, agreement, or instrument . . ." to which the franchisee is a party.

In short, the Court finds that the Telephone Assignment Agreement, with its limited reference to termination, does not extinguish the franchisor's right under the Telephone Assignment Provision in the event of expiration of the franchise agreements.

2. Return of Franchise Material

The franchisees also assert that the Return of Franchise Material Provision [77] applies only in the event of termination of the franchise agreement. The franchisees contend that the use of the word "termination" in sentence two of the provision limits the scope of the first sentence to that of termination of the Agreement.

77 Section XIV (I) (Version 1) of the Franchise Agreement provides: "Franchisee shall immediately turn over to Franchisor all copies of all materials in Franchisee's possession, including the Manual, all records, files, instructions, correspondence, Software systems and customer database, brochures, agreements, disclosure statements and any and all other materials relating to the operation of the Franchised Business in Franchisee's possession, and all copies thereof *(all of which are acknowledged to be Franchisor's property)* . . . In addition to the foregoing, Franchisee shall deliver to Franchisor a complete list of all persons employed by Franchisee during the three (3) years immediately preceding termination, together with all employment files of each employee on such list . . .."

[*36] Takeout Taxi, again relying on the general prefatory language of Section XIV, states that Section XIV (I) requires the franchisee to return all materials related to the operation of the franchised business upon either termination or expiration of the franchise agreement. Moreover, Takeout Taxi asserts that the opening clause of the second sentence -- "in addition to the foregoing" -- further undermines the franchisees' position because this language on its face supplements, not supplants, the first sentence of Section XIV(I). [78]

78 *Id.*

The franchisees' contention that the second sentence of Section XIV (I) with reference to "termination" limits the scope of the first sentence is without merit. Such construction fails to give effect to the plain language of the franchise agreement. [79] A careful reading of Section XIV (I), and the prefatory language to that entire Section, makes clear that, unless specifically limited by subsequent language set forth in a particular sub-section, all of the obligations imposed [*37] on the franchisee in Section XIV apply in the event of either termination or expiration.

79 *See Musselman, 260 Va. at 346, 533 S.E.2d at 921 (2000)*; *Berry v. Klinger, 225 Va. 201, 208, 300 S.E.2d 792, 796 (1983)*.

As such, the Court finds that the franchisees' requirement to return all materials related to the operation of the franchise business applies to both termination and expiration.

3. Take-over Provision

Lastly, with regard to the "take-over" provision found in Section XIV(E) of the Franchise Agreements, [80] unlike the language contained in other sub-sections of Section XIV, [81] the introductory language contained in Section XIV(E) is expressly limited to situations in which the agreement has been *terminated*.

80 Section XIV(E) (Version 1) of the Franchise Agreement provides, "In the event this Agreement is *terminated*, the Franchisor may, at its option, immediately enter the premises of the Franchised Business and continue to provide services to clients or customers of the Franchised Business and continue to provide services to clients or customers of the Franchised Business and apply receipts therefrom to the debts owed to the Franchisor by the Franchisee . . . and Franchisor shall have not other obligations to the Franchisee in connection with Franchisor's operation of the Franchised Business following said termination." (Emphasis added).

[*38]

81 In perhaps an unintended concession, the franchisees urge here that the language in Sections XIV(C), (H), (J), (K) and (O) is not limited to just termination, as it refers to *both* "termination" and "expiration."

The franchisees rely on several decisions addressing [HN7] employment contracts, noting that where an agreement provides that a provision is applicable only upon "termination", such a provision is not applicable upon "non-renewal", that is to say, expiration. [82]

82 *See e.g., Clinch Valley Physicians, Inc. v. Garcia, 243 Va. 286, 414 S.E.2d 599, 8 Va. Law Rep. 2202 (1992)* (restrictive covenant not applicable where employment agreement stated only that the covenant would come into play "upon termination of this agreement, for any reason whatsoever."); *see also, Valley Juice Ltd., Inc. v. Evian Waters of France, Inc., 87 F.3d 604, 609 (2d. Cir. 1996)* (word "termination" in a distributor contract held to be a term of art and distinct from "expiration."); *In the matter of the Arbitration Between Postal Annex+, Inc. and Donald MacDonald*, Case No. 73-114-0024-201-RWH (March 21, 2002) (arbitrator found that franchisor had no right to require a franchisee to surrender its premises upon "expiration" of the agreement where the agreement called for the surrender only upon "termination").

[*39] Takeout Taxi, again, relies on the prefatory language to Section XIV in support of its contention that the "take-over" provision is applicable upon either termination or expiration of the agreement.

The introductory phrase to Section XIV(E) *expressly* provides for Takeout Taxi's right to take-over only upon termination. The Court has no basis to broaden the scope of that provision to include take-over rights in the event of expiration as well. Such would be to impermissibly re-write the parties' agreement.

In short, the Court finds that the take-over provision set forth in Section XIV(E) of the Franchise Agreement is applicable only within the context of termination, not expiration.

Ownership Rights

The franchisees also assert that they possess ownership rights in the telephone numbers, directory listings, and customer databases used to conduct the franchise business upon expiration of their Agreements.

With regard to the telephone numbers and directory

listings, the Court finds that all three versions of the Telephone Assignment Provision, [83] which governs the franchisees' obligations in the event of expiration or termination, make clear Takeout Taxi's ownership of such [*40] numbers and listings.

83 See note 57, *supra*. All three versions of the Telephone Assignment Provision provide, in part, with some variation in the language, that the "Franchisee shall promptly notify the appropriate telephone company and all telephone directory listing agencies of the termination or expiration of its rights to use any telephone number and any regular, classified or other telephone directory listings associated with any Proprietary Marks and authorize transfer of same to or at the direction of the Franchisor . . . Franchisee agrees to execute updated letters of direction to any telephone companies and telephone directory listing agencies directing termination and/or transfer of Franchisee's right to use any telephone number associated with the Proprietary Marks, which the Franchisor may hold until termination or expiration hereof."

Version 1 of the Telephone Assignment Provision [84] contains a Declaration of Ownership Clause which expressly vests the franchisor with all rights and interests [*41] in the telephone numbers and directory listings. [85] And, as previously discussed, the Telephone Assignment Agreement does not override or abrogate the plain statement contained within the Telephone Assignment Provision regarding the ownership of the telephone numbers and directory listings.

84 See note 57, *supra*.

85 Section XIV (J) (Version 1) of the Franchise Agreement provides, in part: "Franchisee acknowledges that as between the Franchisor and Franchisee, *Franchisor has the sole right to and interest in all telephone numbers and directory listings* associated with Proprietary Marks." (Emphasis added).

Moreover, the Authorization of Transfer and Letter of Direction Clauses [86] contained within all three versions of the Telephone Assignment Provision serve as additional mechanisms for Takeout Taxi to reclaim control over the telephone numbers and directory listings upon either expiration or termination of the Agreements. [87] In conjunction with these clauses, the Telephone Assignment Provision [*42] also requires the franchisee to appoint the franchisor, or any of its officers, to act as the franchisee's attorney-in-fact in directing the appropriate telephone company and all listing agencies to transfer all of the franchisee's listings to the franchisor. [88]

86 See note 83, *supra*.

87 *Id.* These clauses require the require the franchisee to notify the appropriate telephone company of its terminated or expired right to use the telephone number, and to execute a letter commanding the telephone company or directory listing agency to either transfer and/or terminate franchisee's right to use the telephone number. The Court notes that all three versions use the phrase "termination or expiration" in connection with the Authorization of Transfer and Letter of Direction Clauses.

88 See note 57, *supra*. With respect to the clause providing for the Appointment of an Attorney-in-Fact, the Court notes that Versions 1 and 2 empower the franchisor to act as attorney-in-fact "upon termination" only. Version 3, on the other hand, permits the franchisor to act as the franchisee's attorney-in-fact "upon termination or expiration of this Agreement."

[*43] Takeout Taxi's ownership of the telephone numbers and directory listings, as well as the customer database, is further evidenced by the Cessation of Use Provision [89] and the Return of Franchise Material Provision, [90] both of which underscore the parties' intent to shift control over the telephone numbers, directory listings, and software back to Takeout Taxi in the event of either expiration or termination of the franchise agreement.

89 As Takeout Taxi points out, all three versions of the Telephone Assignment Provision follow a provision (located in either a different sub-section of Section XIV or in Section XIII) that broadly prohibits the franchisee from using any article or device that is associated with the Franchise System and/or Proprietary Marks. For example, Section XIV(B) (Version 1) provides, in part, that:

> "Franchisee shall immediately and permanently cease to use, in any manner whatsoever, any

> equipment, format, confidential methods, proprietary Software, customer database, programs, literature, procedures and techniques associated with the System . . .."

In construing the Telephone Assignment Provision in light of the broad prohibitions set forth in the Cessation of Use Provision, and considering that the franchisees' telephone numbers play a fundamental role in carrying out the franchised businesses, the Court finds that the telephone numbers fall within the scope of the Cessation of Use Provision. As Takeout Taxi points out, the telephone number is the primary, if not the sole, link between the franchisee and the customer database. Thus, retention of the telephone number is tantamount to retention of the customer database.

[*44]

90 All three versions of the Telephone Assignment Provision follow a provision that requires the franchisee to return to the franchisor all materials relating to the franchised business in the event of expiration or termination of the franchise agreement. For example, Article XIV(I) provides, in part, that:

> "Franchisee shall immediately turn over to Franchisor all copies of materials in Franchisee's possession including the Manual, all records, files, instructions, correspondence, Software systems and customer database, brochures, agreements, disclosure statements *and any and all other materials relating to the operation of the Franchised Business in the Franchisee's Possession . . .*." (Emphasis added).

By its very language, the Return of Franchise Material Provision encompasses not only the software, but also any and all of the franchisees' records related to its telephone numbers and directory listings. As the franchisees are required under this provision to return all records *related to* its telephone numbers and directory listings, the Court finds that the parties intended for the return of the telephone numbers and directory listings themselves.

[*45] Finally, well-settled principles of federal trademark law also support Takeout Taxi's ownership of the telephone numbers, directory listings, and customer databases. [91]

> 91 [HN8] *The Lanham Act* (federal trademark act) expressly provides that a licensee's use of a mark inures to the benefit of the licensor. See *15 U.S.C. § 1055 (2003)*. As Takeout Taxi points out, the franchise agreements here are in effect a license of the "Takeout Taxi" mark to the franchisees. See *Brenco Agreement*, Section VI(C)(4); *see also* David Gurnick and Steve Vieux, *Case History of the American Business Franchise, 24 Okla. City U.L. Rev. 37, 50 (Spring/Summer 1999)*(stating that "franchise is the name for the relationship that results when one person grants another a license to use a trademark and a proprietary system for operating a business.") Thus, any use of the mark by the franchisees here, under *§ 1055 of the Lanham Act*, inures to the benefit of Takeout Taxi.

In sum, numerous contractual [*46] provisions evince the parties' intent to vest in the franchisor ownership of the telephone numbers, directory listings, and customer databases. The Telephone Assignment Provision taken as a whole plainly reflects an agreement between the parties that the franchisor would own the telephone numbers and corresponding directory listings upon either termination or expiration. [92] Similarly, the Return of Franchise Material Provision expressly states that the customer databases are owned by Takeout Taxi. Although the Court finds that Takeout Taxi has the right to take-over the franchisees' businesses only in the event of termination, such a finding does not abrogate the property rights of Takeout Taxi in the event of expiration.

> 92 *See Musselman v. The Glass Works, L.L.C., 260 Va. 342, 346, 533 S.E.2d 919, 921 (2000)*.

Post Termination Obligations -- Restraints on Trade

The franchisees additionally ask this Court to construe two of the post-term obligations -- the

Telephone Assignment Provision [*47] [93] and the Software Provision [94] -- as impermissible restraints on trade, and to declare them unenforceable as a matter of law.

93 Excerpt from Pls.' Ex. 7, Section XIV (J) (Version 1) of the Franchise Agreement.
94 Excerpt from Pls.' Ex. 7, Section XIV (I) (Version 1) of the Franchise Agreement.

Specifically, the franchisees argue that the Software Provision is designed to eliminate the ability of former franchisees to compete with Takeout Taxi by requiring them to forfeit all of their business materials under the guise that the materials are proprietary or confidential. [95] In addition, the franchisees argue that the franchisor seeks to regulate the post-term promotion of the franchisees' telephone numbers by means of the Telephone Assignment Provision. [96] To the extent that the Telephone Assignment and Software provisions seek to limit competition, restrain how franchisees conduct business, and safeguard allegedly protectable interests of Takeout Taxi, the franchisees assert that such provisions [*48] are subject to the same level of scrutiny as other restraints on trade, [97] such as covenants not to compete. [98]

95 See note 89, *supra*.
96 Section XIV(J) of the Franchise Agreement provides that upon expiration or termination of the agreement, the franchisee no longer has the right "to use any telephone number and any regular, classified or other telephone directory listing associated with any Proprietary Marks [of Takeout Taxi] . . ."
97 [HN9] To be enforceable, a restraint on trade must 1) be no greater than necessary to protect a legitimate business interest; 2) not be unduly harsh or oppressive in curtailing an employee's right to earn a livelihood; and 3) not offend sound public policy. *See Modern Environment Inc. v. Stinnett, 263 Va. 491, 493, 561 S.E.2d 694, 695 (2002).*

In applying this three-part test to the Telephone Assignment and Software Provisions here, the franchisees contend that neither of these provisions are enforceable, as such are more restrictive than necessary to protect Takeout Taxi's legitimate interests.
98 *See Eden Hannon & Co. v. Sumitomo Trust & Banking Co., 914 F.2d 556 (4th Cir. 1990)*(applying Virginia law, "nondisclosure and noncircumvention" agreement held to be a "twist on employment noncompetition agreements" and thus subject to same level scrutiny as covenants not to compete); *Roto-Die Co. v. Lesser, 899 F. Supp 1515 (W.D. Va. 1995)*(covenant not to compete in employment agreement strictly construed against the employer); *see also Carolina Chem. Equip. Co. v. Muckenfuss, 322 S.C. 289, 471 S.E.2d 721 (S.C. App. 1996)*(where court found a "Covenant Not to Divulge Trade Secrets" to substantially restrict one's competitive employment activities, court held such a covenant to be subject to the same scrutiny as a covenant not to compete); *Service Ctrs. of Chicago, Inc. v. Minogue, 180 Ill.App.3d 447, 535 N.E.2d 1132, 129 Ill. Dec. 367 (1989)*(confidentiality agreement amounts in effect to a post-employment covenant not to compete).

[*49] In response, Takeout Taxi argues that the Telephone Assignment and Software provisions should not be viewed with the same scrutiny as restrictive covenants, as these provisions are primarily a mechanism for enabling Takeout Taxi to obtain the return of its property, such as the telephone numbers and customer databases.

[HN10] Franchise agreements generally result in a transfer of good will. The first transfer occurs from the franchisor to the franchisee at the outset of the franchise. [99] The second transfer is a re-transfer of the good will from the franchisee back to the franchisor upon termination or expiration of the agreement. [100]

99 *See Quiznos's Corp. v. Kampendahl*, No. 01-C-6433, *2002 U.S. Dist. LEXIS 9124 (N.D. Ill. May 20, 2002).*
100 *Id.*

In the franchise agreements here, the first transfer of good will occurred when Takeout Taxi granted to each Plaintiff "the nonexclusive right and license . . . to operate a Takeout Taxi business" [101] and to use Takeout Taxi's proprietary marks [*50] in conjunction with that business. The second transfer of good will occurs when the franchisees return to the franchisor all equipment, devices, assets, instrumentalities, customer databases, associated customer lists, and all telephone numbers and directory listings upon conclusion of the parties'

relationship. [102]

101 Excerpt from Pls.' Ex. 7, Section I (Version 1) of the Franchise Agreement.

102 Excerpt from Pls.' Ex. 7, Sections XIV(I) and (J) (Version 1) of the Franchise Agreement.

Under the express terms of the franchise agreements, the parties plainly did not intend for the franchisees to own any good will, service marks, or any other assets associated with the franchise system after they left it. [103]

103 See notes 101 and 102, *supra*.

Several courts have enforced franchise agreement provisions virtually identical to [*51] the post-term obligations here. Not one court has held that such franchise agreement obligations amount to disfavored restraints on trade. [104] Moreover, the Court finds that the post-term obligations here stand in sharp contrast to those competition-restricting provisions which were held unenforceable in cases relied on by the franchisees. [105]

104 *See Snelling & Snelling, Inc. v. Martin I, 1998 WL 56995 (N.D. Cal. 1998); Mr. Rooter Corp. v. Cottone*, Bus. Franchise Guide (CCH) P11,655 (C.D. Ill. 1999); *Meineke Discount Muffler Shops, Inc. v. Smith*, Bus. Franchise Guide (CCH) P9930 (E.D. Ill. 1991).

105 See note 98, *supra*. The Court finds all the cases cited by the Plaintiffs distinguishable from the present case. Although the respective contract provisions referenced in the various cases were held to have the effect of a covenant not to compete, as they each contained language prohibiting a former employee's use or disclosure of confidential information, none of the agreements cited from these cases contain provisions similar to the those contained in the Takeout Taxi Franchise Agreements, the latter of which provide for the *return* of certain proprietary information to the owner upon expiration of the agreement.

[*52] [HN11] Fundamental principles of a franchise relationship would be destroyed if the franchisees are permitted to use telephone numbers and customer databases associated with Takeout Taxi's proprietary mark after the expiration of the agreements. Neither the Telephone Assignment Provision nor the Software Provision qualifies as, or has the effect of, a restraint on trade. Instead, these provisions merely require a return of Takeout Taxi's assets and property.

In sum, the post-term obligations here are enforceable contractual provisions for which no showing of "legitimate protectable interest" is required. If the franchisees elect not to renew their franchise agreements, thereby removing themselves from the franchise system, then they must do so without a concomitant right to use Takeout Taxi's marks or related franchise assets.

Covenant Not to Compete

The franchisees assert that the one-year covenant not to compete contained in the Franchise Agreements is not binding, and as a result, the franchisees are permitted to conduct business in the restaurant delivery service market immediately upon the expiration of their Franchise Agreements.

Standard to be applied

[HN12] Under Virginia [*53] law, the defendant has the burden of showing that a restrictive covenant is reasonable. [106] In addressing the issues of enforceability and whether the covenants in the present case are "reasonable" in the context of *franchise* agreements, the franchisees urge the Court to apply the same strict standard applicable to employment contracts under Virginia law.

106 *Foti v. Cook, 220 Va. 800, 805, 263 S.E.2d 430, 433 (1980)*.

Specifically, the franchisees argue that in the franchise context the relative bargaining position of the parties is akin to that in an employment relationship. [107] They urge that the Court view the franchisees here as having possessed little bargaining power at the time they entered into the franchise agreements and being in the position of either taking or leaving the offer made by the franchisor with little or no room to negotiate. [108]

107 [HN13] In Virginia, the employee is generally viewed as having little bargaining power and typically must take or leave the offer made by the employer.

[*54]

108 Specifically, the franchisees note that the price of the franchise and fees to be paid were non-negotiable, and that for most franchisees the

terms of the franchise agreements were also non-negotiable. In this sense, the franchisees assert that their situation is comparable to a "take it or leave it" employment offer, not to the sale of a business. The franchisees point out that in a typical sale of business negotiation, however, the buyer and seller negotiate until an agreement is reached on all material terms, such as price and effective date of sale.

Takeout Taxi, however, asserts that the franchisee-franchisor relationship is more akin to that of a buyer-seller relationship in a business context, and that covenants not to compete ancillary to a business sale are subject to a more lenient standard of reasonableness than covenants contained in employment agreements. [109] Takeout Taxi suggests that the more lenient standard governing covenants in business sale agreements is applicable to the franchise agreements here. [110]

109 *Alston Studios, Inc. v. Lloyd v. Gress & Associates, 492 F.2d 279, 284 (4th Cir. 1974)* [HN14] ("greater latitude is allowed in determining the reasonableness of a restrictive covenant when the covenant relates to the sale of business than in those ancillary to an employment contract."); *Richardson v. Paxton Company, 203 Va. 790, 795, 127 S.E.2d 113, 117 (1962)* (the scope of permissible restraint is more limited between employer and employee than between seller and buyer, and the covenant is construed favorably to the employee).

[*55]

110 *Wells v. Wells, 9 Mass. App. Ct. 321, 400 N.E.2d 1317 (1980)*; *Grow Biz International, Inc. v. MNO, Inc., No. 01-1805 2002 U.S. Dist. LEXIS 1427 (D. Minn. January 25, 2002)*; *Wilkinson v. ManPower, Inc., 531 F.2d 712 (5th Cir. 1976)*.

[HN15] The standard applicable to restrictive covenants in franchise agreements differs from state to state. While some states apply the same strict standard that is used in determining the reasonableness of an employment agreement, [111] other states apply a more lenient standard, viewing franchise agreements as similar to the sale of a business, [112] and yet other states apply a standard which addresses elements of both relationships. [113]

111 *See e.g., H&R Block, Inc. v. Lovelace, 208 Kan. 538, 493 P.2d 205 (1972)*.

112 *See e.g., McCarty v. H&R Block*, Bus. Franchise Guide (CCH) P8261 (Ind. App. 1984).

113 *See e.g., Budget Rent-A-Car v. Fein, 342 F.2d 509 (5th Cir. 1965)*.

[*56] To date, no Virginia court has addressed the issue of which standard to apply in analyzing the reasonableness of a franchise covenant. [114] Although the franchisees are correct in that [HN16] Virginia courts generally disfavor covenants against competition in the context of employment agreements, [115] the Court notes [HN17] several marked distinctions between franchise arrangements -- and their ancillary covenants not to compete -- and employment contracts.

114 The franchisees point to one reported federal decision that has analyzed the restrictive covenant under the same analysis applicable to employment contracts under Virginia law. *See Jackson Hewitt, Inc. v. Greene, 865 F. Supp. 1199, 1208 (E.D.Va. 1994)*.

115 *See Modern Environment Inc. v. Stinnett, 263 Va. 491, 561 S.E.2d 694 (2002)*; *see also Richardson v. Paxton Co., 203 Va. 790, 127 S.E.2d 113 (1962)*.

First, a franchise agreement contemplates the association of the franchisee with the franchised system's goodwill. [*57] This type of association tends to be, at most, an incidental effect of the employment relationship. [116]

116 Robert W. Emerson, *Franchising Covenants Against Competition, 80 Iowa L. Rev. 1049, 1052 (1995)*.

Second, the franchisor's essential trademarks, as well as the use of trade secrets, are much more likely to be entrusted to a franchisee than to an employee. [117]

117 *Id.*

Third, unlike most employees, franchisees may lose upon termination any capital investments made by them. [118]

118 *Id.*

Fourth, the competitive activities that an ex-franchisee undertakes may directly affect the economic interests of present franchisees. An ex-employee's [*58] former co-workers usually have

fewer such concerns arising from the ex-employee's post-termination competition. [119]

119 *Id.*

Notwithstanding, [HN18] franchise relationships differ from a business sale arrangement in several respects as well. For example, franchises typically involve long-term contracts in which the franchisor retains considerable control over the franchisee's operations. [120] The ordinary sale of business, however, presents a "clean break" with the seller's involvement ending and the buyer taking over the business completely. [121] Moreover, unlike sellers of a business, franchisees typically are not compensated for the value of their business when the franchise relationship ends. [122]

120 *Id.*
121 *Id.*
122 *Id. at 1052-53.*

The franchise relationship is arguably incomparable to either employment [*59] contracts or contracts of sale. Yet, as there is no evidence of disparity in bargaining power between the parties, the Court declines to apply the stricter standard of reasonableness used in analyzing employment covenants. Instead, the Court finds that [HN19] the lesser standard applied in analyzing covenants accompanying the sale of a business is more appropriate.

Reasonableness of the Restrictive Covenants

Section XV(C), the post-termination covenant against competition, provides, in relevant part, that the:

> "franchisee covenants that, except as otherwise approved in writing by the Franchisor, Franchisee shall not, for a continuous period commencing upon the expiration or termination of this Agreement, regardless of the cause for termination, and continuing for one (1) year thereafter, either directly or indirectly . . . own, maintain, engage in, be employed by, advise, assist, invest in, franchise, make loans to, or have any interest in any business which is the same as or substantially similar to the Franchised Business and which is located within a radius of ten (10) miles [123] of the Designated Territory hereunder or the location of any Franchised Business under the System [*60] which is in existence on the date of expiration or termination of this Agreement." [124]

123 For those franchisees who operate in more rural areas, the franchise agreements indicate a fifty (50) mile radius.
124 Excerpt from Pls.' Ex. 7, Section XV(C) (Version 1) of the Franchise Agreement. This section in the 1991 Convenience Cab Franchise Agreement was modified to eliminate the restriction on competition within ten miles of "any Franchised Business."

[HN20] Virginia courts have repeatedly held that for a restrictive covenant to be enforceable, the drafter of the restraint on competition must demonstrate that the "restraint is no greater than necessary to protect a legitimate business interest, [125] is not unduly harsh or oppressive in curtailing an employee's ability to earn a livelihood, and is reasonable in light of sound public policy. [126]

125 The franchisees make the argument, along with their arguments that the scope and duration of the covenant are overly broad and unduly harsh, that the covenant-not-to-compete is greater than necessary to protect the franchisor's interest because Takeout Taxi is no longer selling franchises. The Court addresses this specific argument, *infra*.

[*61]

126 *See Modern Environment, Inc. v. Stinnett, 263 Va. 491, 493, 561 S.E.2d 694, 695 (2002)*; *New River Media Group, Inc. v. Knighton, 245 Va. 367, 368, 429 S.E.2d 25, 26, 9 Va. Law Rep. 1183 (1993)*; *Blue Ridge Anesthesia & Critical Care, Inc. v. Gidick, 239 Va. 369, 370, 389 S.E.2d 467, 468, 6 Va. Law Rep. 1581 (1990)*.

In determining the reasonableness of a restrictive covenant, "it is relevant to consider the parties involved, their respective positions, and the circumstances of the transaction." [127] Specifically, courts assess (i) the geographic scope of the restraint, (ii) the temporal scope of the restraint; and (iii) the scope of the restricted activities. [128]

127 *Foti, 220 Va. at 806, 263 S.E.2d at 433.*
128 *New River Media Group, Inc. Knighton, 245 Va. 367, 429 S.E.2d 25, 9 Va. Law Rep. 1183 (1993)*; *Modern Environment, Inc. v. Stinnett, 263 Va. 491, 561 S.E.2d 694 (2002).*

[*62] 1. Geographic Scope

The franchisees assert that the covenant not to compete is unenforceable on the grounds that the geographic scope [129] is uncertain and therefore overly broad. They argue that because the impact of the restrictions will vary depending on the number of franchises in existence at the end of the franchise agreement, and because no franchisee can determine the scope and impact of its restrictive covenant until after expiration or termination, the covenants not to compete are void for indefiniteness.

129 In some franchise agreements, where the franchise territories are situated in rural areas, Section XV(C) provides for a fifty-mile radius from the "Designated Territory hereunder or the location of any Franchised Business under the System", while other Franchise Agreements provide for either a five or ten-mile radius for those franchise territories situated in urban areas.

In support of this contention, the franchisees rely primarily on two cases, one federal and one state, both of which apply [*63] Georgia law. In *Kwik-Kopy v. Bershad*, [130] the United States District Court held that [HN21] a territory that expands with the business of the franchisor is not sufficiently definite and renders the covenant void. [131] The Court reasoned that since the franchisor could open additional franchises at any time and at any location, the restrictive covenant in the Kwik-Kopy franchise agreement was effectively without any territorial limitation. Finding that Kwik-Kopy had failed to specify a territorial limitation in which the restrictive covenant was intended to operate, the Court found such rendered the covenant unenforceable.

130 *Kwik-Kopy v. Bershad, No. C-85-1898A, 1985 U.S. Dist. LEXIS 19562 (N.D. Ga. May 23, 1985).*
131 *Id.*

Similarly, the Georgia Court of Appeals, in *New Atlanta Ear, Nose, and Throat Associates, P.C. v. Pratt et al.*, [132] held that an eight-mile territorial restriction was too indefinite because the scope of the restriction could not be determined until the date of [*64] the employee's termination. [133] The Court, in finding that the restriction was not "strictly limited in time and territorial effect," reasoned that [HN22] an employee must be "able to forecast with certainty the territorial extent of the duty owing." [134] As the restrictive covenant permitted the medical group to shift and expand the proscribed territory during the term of the agreements, the Court held that the restriction was unenforceable. [135]

132 *253 Ga. App. 681, 560 S.E.2d 268 (2002).*
133 *Id.*
134 *253 Ga. App. at 685, 560 S.E.2d at 272.*
135 *Id.*

Here, the franchisees argue that the covenant not to compete should be void for the same reasons, as it limits former franchisees from competing within a certain radius of "any other franchised business," the number and location of which can only be determined at the time of expiration.

Neither of these cases is dispositive. First, in *Kwik-Kopy*, the covenant not to compete was significantly broader in scope than [*65] the covenant here. Specifically, the restrictive covenant in the Kwik-Kopy Center Franchise Agreement prohibited a franchisee from competing "within fifty miles of the location designated in Paragraph 1, or within fifty miles *of any city* in which the Franchisor and/or other Franchisee of Franchisor . . . operates a business similar to the franchise business provided herein" (emphasis added). [136]

136 *Kwik-Kopy, No. C-85-1898A, 1985 U.S. Dist. LEXIS 19562 (N.D. Ga. May 23, 1985).*

Conversely, the restrictive covenant here prohibits competition only within ten (or fifty) miles "of the Designated Territory hereunder *or the location of any Franchised Business under the System* which is in existence on the date of expiration or termination of this Agreement" [137] (emphasis added). Similar restrictive covenants have been enforced when tied to all of the franchise locations. [138]

137 Pls.' Ex. 7, Section XV(C) of the Franchise Agreement.

[*66]

138 *See Advanced Marine Enterprises, Inc. v.*

PRC, Inc., 256 Va. 106, 501 S.E.2d 148 (1998); *See also My Favorite Muffin, Too, Inc. v. Wu, No. 00-C-7820, 2002 U.S. Dist. LEXIS 7743 (N.D. Ill. April 29, 2002)*; *Servpro Industries, Inc. v. Pizzillo, No. M2000-00832-COA-R3-CV2001, 2001 Tenn. App. LEXIS 87 (Ct. App. Tenn. February 14, 2001)*.

In addition, the *Kwik-Kopy* court considered the fact that at the time the franchisee terminated his contract, the franchisor had approximately 700 franchises located throughout the continental United States. The large number of franchises in existence at the time of termination, combined with the broad language of the covenant itself, factored into the court's determination that the 50-mile restrictive covenant was effectively without any territorial limitation. [139]

139 *Cf. Advanced Marine Enterprises, Inc. v. PRC, Inc., 256 Va. 106, 501 S.E.2d 148 (1998)* (in upholding a fifty-mile restrictive covenant, the court concluded that the "agreement's geographic limitation is not rendered too burdensome because PRC has approximately 300 offices worldwide.")

[*67] The facts of *New Atlanta Ear, Nose, and Throat Associates, P.C. v. Pratt et al.,* [140] are similarly not on point, as the restrictive covenant held unenforceable there was contained within an employment contract, not a franchise agreement. In considering the covenant not to compete here under the more lenient standard, [141] this Court finds the restrictive covenant reasonable under the circumstances.

140 *253 Ga. App. 681, 560 S.E.2d 268 (2002)*.

141 See Court's discussion of the standard of review applicable to restrictive covenants in the context of franchise agreements, *supra*.

As to the uncertainty of the territorial extent of the restrictive covenants, the franchisees assume that the number of franchisees in the system will be greater at the time of expiration than at the beginning of the franchise term. But any alleged uncertainty during the franchise term regarding the number of franchises that will be in existence at the time of expiration can also work to the benefit of the franchisees. [*68] Just as the number of franchises may increase during the term of the franchise agreement -- making it more difficult for those leaving the system to compete in the same business -- the number of franchises may also decrease, a circumstance which would dramatically lessen the burden of the restrictive covenants on the franchisees. [142]

142 *See Grow Biz International, Inc. v. MNO, Inc., No. 01-1805, 2002 U.S. Dist. LEXIS 1427, at *21 (D. Minn. January 25, 2002)*("the alleged 'ambiguity' of the covenant does not necessarily operate to the detriment of the franchisee; if the number of PIAS franchises were to decrease over the course of the 10-year agreement, the geographic scope of the covenant not to compete would similarly shrink.")

The Court finds this latter point particularly relevant given the franchisees' emphasis on the decline of the Takeout Taxi franchise system. Given the decrease in the number of total franchises over the past ten years, the restrictive covenants have less of an impact [*69] on the franchisees' ability to compete than the covenants addressed in other cases. [143]

143 The Court also notes that while the franchisees argue that the potential growth of the franchise system renders the covenants indefinite and thus unenforceable, later the franchisees complain about the lack of growth in the franchise system in the context of protectable interests and Takeout Taxi's purported failure to perform its obligations under the contract.

In sum, the Court finds that the covenants not to compete are sufficiently definite and reasonable as to their geographic scope. To hold otherwise on the grounds that Takeout Taxi may expand and open additional franchises at any time in any location would be to void all covenants restricting competition appearing in any franchise agreement, as the number of existing franchises in any franchise system is susceptible to change over time. [144] No court has ever so held. This Court declines to do so as well.

144 *See Grow Biz International, Inc. v. MNO, Inc., No. 01-1805, 2002 U.S. Dist. LEXIS 1427, at *21 (D. Minn. January 25, 2002)*("Given that the franchise agreements are on 10-year terms, there is no way, when the agreements are signed, to know the specific locations of PIAS franchises as they will exist at the expiration of the franchise agreement [the point at which the post-term covenant becomes relevant]. Accordingly, the covenant could not be more narrowly tailored to

protect Grow Biz's legitimate business interests.")

[*70] 2. Temporal Scope -- Duration

As the reasonableness of the time period covered by the restrictive covenant is not in dispute, the Court finds that the one-year time period of the covenant not to compete is sufficiently tailored and reasonable under the circumstances.

3. Scope of Restricted Activities

The franchisees argue that the covenant not to compete is unduly harsh and oppressive in curtailing the franchisees' rights to earn a livelihood.

But in examining the scope of restricted activities set forth in Section XV of the Franchise Agreement, the covenant does not *generally* preclude the franchisees from working for a competitor, but rather *specifically* prohibits the franchisees for a period of one year from seeking employment in "any business that is the same or substantially similar to" the restaurant delivery service business within ten (or fifty) miles of another Takeout Taxi franchise. [145]

145 *See Advanced Marine Enterprises, Inc. v. PRC, Inc., 256 Va. 106, 501 S.E.2d 148 (1998).*

[*71] In sum, the evidence supports a finding that the non-competition provision here is valid and enforceable. In the context of the brief time period involved and the narrow scope of restricted activities, the geographic restriction does not pose an unreasonable restraint on departing franchisees.

Material Breach

The franchisees attack the enforceability of the franchise agreement, as a whole, on the ground that Takeout Taxi's alleged material breaches of the contract preclude enforcement. Specifically, the franchisees assert that the Takeout Taxi's failure to perform certain "material" contractual obligations effectively excuses the franchisees' performance under the franchise agreements. [146]

146 *Cf. Worrie v. Boze, 191 Va. 916, 923, 62 S.E.2d 876, 879 (1951)* (injunctive relief against appellant's operation of a dancing school upheld where appellant not found to have been wrongfully terminated by his employer), with *In re Teligent, Inc., 268 B.R. 723, 730-31 (Bankr. S.D.N.Y. 2001)* (material breach precludes party from seeking enforcement of post-term covenants); *Williams v. Riedman, 339 S.C. 251, 529 S.E.2d 28 (S.C. Ct. App. 2000)*(prior breach by employer operates to preclude employer from enforcing restrictive covenant contained in contract).

[*72] In support of their contention, the franchisees point to Section III of the Franchise Agreement, which sets forth the obligations of the franchisor. With respect to the franchisor's obligations following the opening of a franchised business, Section III (B) provides that:

> 1. Franchisor shall provide such general advisory assistance deemed by it to be helpful to the Franchisee in the ongoing operation, advertising and promotion of the Franchised Business;
>
> 2. Franchisor shall also provide to the Franchisee updates, revisions and amendments to its Manual and the Software;
>
> 3. Franchisor shall continue its efforts to establish and maintain high standards of quality, cleanliness, safety, customer satisfaction, and service, and to the end shall, on a quarterly basis (i) conduct, as it deems advisable, inspections of the Franchised Business and its operations, evaluations of methods and the staff employed therein, and (ii) upon request and subject to the terms of the Agreement, disseminate the Franchisor's standards and specifications for items not deemed to be trade secrets to the Franchisee or its suppliers;
>
> 4. Franchisor shall coordinate and conduct periodic training [*73] programs for its network of franchisees as it deems necessary in its sole discretion; and
>
> 5. Franchisor may, but is under no obligation to, be available to provide management consulting services for the Franchisee for special projects or assistance based upon availability of

> Franchisor's personnel at the rate of Three Hundred Dollars ($ 300.00) per day, plus reimbursement of all reasonable travel, lodging and meal expenses incurred by the Franchisor in connection with the rendering of such services. Franchisor reserves the right from time to time to make reasonable adjustments to such daily rate at its discretion; and
>
> 6. Franchisor may, but is under no obligation to, provide assistance to Franchisee in lease negotiations with the landlord of the site selected for establishment of the Franchised Business.

Section III(B) of the Franchise Agreement. [147]

147 Pls.' Ex. 7, Section III(B) of the Franchise Agreement.

In addition to these obligations, the franchisees also point to the "Whereas" clauses [*74] located at the beginning of the Franchise Agreement as an additional source of contractual duties which Takeout Taxi is allegedly obligated to perform.

With regard to these contractual obligations, several of the franchisees testified that Takeout Taxi failed to perform several, if not all, of these obligations, particularly since 1998. [148] In addition, the franchisees assert that Takeout Taxi failed to act in good faith in the exercise of its discretion in the performance of its obligations. [149] As a result of these breaches in performance, the franchisees contend that Takeout Taxi is not entitled to enforce the post-term obligations that limit the franchisees' ability to compete.

148 Testimony of Karen Marshall and Mark Boutwell, January 13, 2003; Testimony of Mark Loranger, Duncan Bedard and Bob Oyen, January 14, 2003; Testimony of Bruce Pavlovsky and Michael Castro, January 15, 2003; and Testimony of Richard Baran and Brant Druhot, January 21, 2003.

149 The franchisees contend that Takeout Taxi's failure to act in good faith in itself gives rise to a breach of contract. See *Va. Code Ann. § 8.01-203* (2001) [HN23] ("Every contract or duty within this act imposes an obligation of good faith in its performance or enforcement."); *see also Charles E. Brauer Co. v. NationsBank, 251 Va. 28, 466 S.E.2d 382 (1996)* (breach of implied duty gives rise to a cause of action for breach of contract).

[*75] As to whether Takeout Taxi materially breached its obligations under the franchise agreement, generally, [HN24] a party who commits the first breach of a contract is not entitled to enforce the contract. [150] There is, however, an exception to that general rule, as "when the breach did not go to the 'root of the contract' but only to a minor part of the consideration." [151] Nonetheless, when the first breaching party commits a *material* breach, that party cannot enforce the contract. [152]

150 *Horton v. Horton, 254 Va. 111, 115, 487 S.E.2d 200, 203 (1997)* (citing *Federal Ins. Co. v. Starr Elect. Co., 242 Va. 459, 468, 410 S.E.2d 684, 689, 8 Va. Law Rep. 1407 (1991)*; *Hurley v. Bennett, 163 Va. 241, 253, 176 S.E. 171, 175 (1934))*.

151 *Horton, 254 Va. at 115, 487 S.E.2d at 203* (quoting *Federal Ins. Co., 242 Va. at 468, 410 S.E.2d at 689*; *Neely v. White, 177 Va. 358, 366, 14 S.E.2d 337, 340 (1941)*.

152 *Horton, 254 Va. at 115, 487 S.E.2d at 204*.

[*76] [HN25] A material breach is a failure to do something that is so fundamental to the contract that the failure to perform that obligation defeats an essential purpose of the contract. [153] If the initial breach is material, the other party to the contract is excused from performing his contractual obligations. [154]

153 *Id.*

154 *Id.*

The type of evidence required to establish a material breach of contract will vary depending on the facts surrounding a particular contract. [155] Although in many cases, a material breach is proved by establishing an amount of monetary damages flowing from the breach, [156] proof of a specific amount of monetary damages is not required when the evidence establishes that the breach was so central to the parties' agreement that it defeated an essential purpose of the contract. [157]

155 *Horton, 254 Va. at 116, 487 S.E.2d at 204*.

156 *See, e.g., Federal Insurance Co., 242 Va. at 468, 410 S.E.2d at 689*.

[*77]

157 *Horton, 254 Va. at 116, 487 S.E.2d at 204*.

The essential purpose of the franchise agreements here was to allow the individual franchisees to operate a business under the Takeout Taxi's franchise system, obtain a license from Takeout Taxi for the use of Takeout Taxi's software and proprietary marks, and receive training and other assistance from Takeout Taxi in running a restaurant delivery business.

The Court does not find that the evidence supports a showing of material breach on the part of Takeout Taxi.

First, with respect to Takeout Taxi's obligations purportedly set forth in the "Whereas" clauses of the franchise agreements, the Court notes that [HN26] recital or prefatory provisions not set forth in the main text of a contract are superceded by the provisions set forth in the main body of the contract in the event of a conflict. [158]

158 *United Virginia Bank v. Best, 223 Va. 112, 115, 286 S.E.2d 221, 223 (1982)*; *Scott v. Albermarle Horse Show Ass'n, 128 Va. 517, 526, 104 S.E. 842, 846 (1920)*.

[*78] That said, the Court finds that the franchisees' attempt to supplement Takeout Taxi's post-opening obligations with those purported to be contained within the "Whereas" clauses directly conflicts with the self-limiting language of Section III (B) of the franchise agreement, which expressly states that "tthe obligations of the Franchisor following the opening of the Franchised Business are as follows . .." [159] As such, the Court declines to impose additional contractual obligations on Takeout Taxi that are not incorporated into the main body of the franchise agreement.

159 Excerpt from Pls.' Ex. 7.

Second, the Court notes that although Takeout Taxi did not perform certain of its post-opening obligations [160] to the satisfaction of some of the franchisees, or may have failed to perform some of its post-opening obligations altogether, [161] such deficiencies or failures to perform on the part of Takeout Taxi hardly go to the root of the franchise agreements, or defeat an essential purpose of those agreements. [*79] Rather, quite the contrary occurred, as some franchisees testified to the success of their individual franchises and their continued ability to perform, sometimes at a profit, Takeout Taxi's alleged failure to perform notwithstanding. [162]

160 See note 147, *supra*.

161 See note 148, *supra*. For example, several of the franchisees testified to Takeout Taxi's failure in recent years to provide the franchisees with any type of training or advisory assistance, and its failure to conduct regular inspections of any of the franchised businesses.

162 Testimony of Karen Marshall, January 13, 2003; Mark Loranger and Duncan Bedard, January 14, 2003; Bruce Pavlovsky, January 15, 2003; and Brant Druhot, January 21, 2003.

In addition, other franchisees who testified on behalf of Takeout Taxi stated that after just a few years with the Takeout Taxi franchise system, they no longer found the training or assistance provided to them by Takeout Taxi necessary to operate their respective businesses. Testimony of Perry Margulis, January 15, 2003; Testimony of Andrew Grisebaum, January 22, 2003.

[*80] In sum, the Court finds that the evidence fails to support the franchisees' contention that Takeout Taxi's failure to perform certain post-term obligations amounted to a material breach of the agreement, [163] thereby precluding enforcement and excusing the franchisees' from performing their obligations under the agreements. The record is bare of any such complaints from the franchisees, at least until prior to the present dispute. [164] Any failures on the part of Takeout Taxi to perform -- which the Court considers to be insubstantial parts of the consideration for the franchise agreements -- do not serve to exempt the franchisees from performing their obligations to Takeout Taxi upon expiration of their franchise agreements.

163 The evidence demonstrates that Takeout Taxi continued to perform its material obligations to the franchisees during the term of the franchise agreements. For example, Executive Vice-President of Franchise Relations, Mr. Robert Kirmse, testified extensively about the efforts undertaken by Takeout Taxi with respect to software training and development, in particular the development of uniform software enhancements such as on-line ordering, its discord with LCS notwithstanding. Testimony of Robert Kirmse, January 22, 2003.

[*81]

164 Robert Kirmse testified that he served as the

point of contact for franchisees who had any questions or concerns regarding franchise operations and that franchisees would typically call him directly for advice and assistance. Kirmse further testified that at no time during the term of the various franchise agreements did he receive a request from the franchisees for updates to any manuals, additional training, or business consultants.

In addition, Kirmse testified that in the past year, he received approximately a dozen complaints from the franchisees, all of which had been satisfactorily resolved. Testimony of Robert Kirmse, January 22, 2003.

Protectable Interests

Lastly, the franchisees contend that the covenant-not-to-compete set forth in Section XV(C) of the Franchise Agreement is unenforceable on the grounds that such a restraint on trade is greater than necessary to protect any cognizable legitimate business interests of Takeout Taxi. [165]

165 In looking at the issue of protectable interests, the franchisees initially asserted that several provisions of the franchise agreement -- including the Telephone Assignment Provision, Software Provisions, and the covenant not to compete -- were unenforceable restraints on trade on the grounds that Takeout Taxi had no legitimate business interests to protect. But because this Court holds that the Telephone and Software Provisions are not restraints on the franchisees' ability to compete, the Court addresses only the enforceability of the one-year covenant not to compete in analyzing what, if any, protectable business interests Takeout Taxi possesses.

[*82] [HN27] Restrictive covenants of a character which reasonably protect an employer's business and are incident and ancillary to the contract of employment and limited as to area and duration are enforceable. [166] Such covenants will be enforced "unless found to be contrary to public policy, unnecessary for the employer's protection, or unnecessarily restrictive of the rights of the employees, due regard being had to the subject-matter of the contract and the circumstances and conditions under which it is to be performed." [167]

166 *Worrie v. Boze, 191 Va. 916, 62 S.E.2d 876 (1951)*.
167 *Id., 191 Va. at 926, 62 S.E.2d at 881*.

The issue whether an otherwise reasonable restrictive covenant may be enforced absent the existence of any legitimate protectable interests is one of first impression in Virginia.

[HN28] In considering this issue, the Court examines the legitimate protectable interests of the franchisor, the nature of the former and proposed subsequent businesses of each of the franchisees, [*83] and the nature of the restraint in light of all the circumstances. [168] In addition, the Court considers the language of the restrictive covenant in the context of the facts of the specific case. [169]

168 *Modern Environments, Inc. v. Johnetta R. Stinnett, 263 Va. 491, 561 S.E.2d 694 (2002)*.
169 *Id.*

With respect to Takeout Taxi's legitimate protectable interests, the franchisees make several arguments in support of their contention that Takeout Taxi currently possesses no such interests.

First, the franchisees contend that Takeout Taxi is not capable of offering any new franchises, as it is not registered to do so in any state. In addition, Takeout Taxi has no current form of a franchise agreement or Uniform Franchise Offering Circular ("UFOC"), both of which are required to sell franchises. [170]

170 *See Disclosure Requirements and Prohibitions Concerning Franchising And Business Opportunity Ventures*, 16 C.F.R. § 436 (2003); *see also* Testimony of Edward Kochell, January 14, 2003.

[*84] Second, the franchisees argue that Takeout Taxi is an insolvent entity with little or no value, and, as such, no longer possesses any protectable business interests. [171] In support of this claim, the franchisees make reference to Takeout Taxi's debt-to-asset ratio and specifically allege that Takeout Taxi's debts currently exceed its assets. In addition, the franchisees argue that without Douglas Williamson's regular infusions of cash to Takeout Taxi from his personal bank account, [172] Takeout Taxi would fail to meet its financial obligations and cease operating as a company.

171 Testimony of Edward Kochell, January 14, 2003.

172 Testimony of Jude Medeiors, January 15, 2003; Testimony of Douglas Williamson, January 27 and 28, 2003. As of the date of trial, Douglas Williamson had invested approximately $ 1.7 million in the Takeout Taxi franchise system.

Third, the franchisees argue that, with respect to some franchise territories, upon expiration of the franchise agreements the franchisees would no longer [*85] be in a business that was the "same or substantially similar to the Franchised Business" in a geographical area covered by the covenant not to compete. To the extent that the covenant not to compete seeks to eliminate competition in areas where Takeout Taxi is no longer conducting, or seeking to conduct, any franchising business, [173] combined with Takeout Taxi's inability, both contractually and financially, to take-over any of the franchisees' businesses upon expiration, [174] the franchisees argue that the covenant not to compete does not qualify as a permissible restraint on trade.

173 *PHP Healthcare Corp. v. EMSA, 14 F.3d 941 (4th Cir. 1993)*(applying Florida law, U.S. Court of Appeals refused to enforce restrictive covenant where the company was no longer doing business in the restricted area, despite its claims that it was making efforts to re-establish business in those areas); *see also, Liautaud. v. Liataud, 221 F.3d 981 (7th Cir. 2000)*(restrictive covenant overly broad where its restrictions sought to eliminate competition in areas where the franchisor was not currently seeking to do business); *Kwik-Copy Corp. v. Klein, 218 B.R. 787 (W.D. Pa. 1998)*(where franchisor had not marketed in the area, an injunction prohibiting the former franchisee from competing within 3-mile area from its current location was unreasonable); *Physicians Weight Loss Centers of America v. Creighton, No. 90-CV-2066, 1992 U.S. Dist. LEXIS 12720 (N.D. Ohio March 30, 1992)* (enforcement of restrictive covenant found unreasonable where franchisor has no business with which to compete with former franchisee, even where franchisor claimed it was seeking new franchises in the area covered by the franchise agreement); *O.V. Marketing Assocs., Inc. v. Carter, 766 F. Supp. 960 (D. Kan. 1991)* (restrictive covenant in franchise agreement found invalid where franchisor not actively seeking franchises and main purpose of covenant no longer existed.)

[*86]

174 See generally discussion of applicability of take-over provision of Franchise Agreement in event of termination versus expiration, *supra*. As the Court previously discussed, Section XIV(E) of the Franchise Agreement permits the Franchisor to take-over a franchisee's business only upon *termination* of the Agreement. As none of the franchisees' agreements were terminated prior to their natural expiration dates, the franchisees are correct in their assertion that Takeout Taxi is not currently in a position to take-over any of the franchisees' businesses.

Finally, the franchisees assert that because Takeout Taxi has ceased providing certain key services to its franchisees, engaged in gross mismanagement of franchisee royalty payments and other funds, lost its exclusivity arrangement with the software vendor, and caused the franchise system to decline by at least 75% of its former size, Takeout Taxi no longer has any legitimate business interests in need of protection.

First, [HN29] it is not necessary for a franchisor to currently be in the business of offering franchises in order to claim any [*87] protectable interests. The evidence presented at trial demonstrates that Takeout Taxi's alleged inability to offer new franchises was in fact a conscious business decision made by the Takeout Taxi management, [175] and that Takeout Taxi is currently exploring opportunities for business growth and expansion that do not necessarily include creating new franchises. [176]

175 Testimony of Douglas Williamson, January 28, 2003.

176 Testimony of Ralph Romano, January 27, 2003.

Second, although the franchisees make several references to Takeout Taxi's deficient capital structure and inability to pay its debts, the franchisees failed to present any evidence in the form of financial statements or statements of accounts to support their claim that Takeout Taxi is insolvent. [177] [HN30] Even if Takeout Taxi's debts may in fact exceed its assets, such a capital structure is not necessarily indicative of insolvency. [178]

177 Outside of the expert testimony presented by Edward Kochell on behalf of the franchisees -- offered in part to demonstrate Takeout Taxi's financial difficulties -- the franchisees provided no evidence establishing the value of, or quantifying, Takeout Taxi's assets and liabilities. In order to prove insolvency, both the value of the debtor's assets and the amount of its liabilities must be established. *See Darden v. George G. Lee Co., 204 Va. 108, 109-11, 129 S.E.2d 897, 898-99 (1963)*; *Gray v. McCormick, 181 Va. 52, 63-64, 23 S.E.2d 803, 808-09 (1943)*.

[*88]

178 *See e.g., Va. Code Ann. §§ 49-26 and 55-81*(2002). A debtor is insolvent within the meaning of these statutory provisions when it has insufficient property to pay all its debts. *See also Courson v. Simpson, 251 Va. 315, 468 S.E.2d 17 (1996)*; *McArthur v. Chase, 54 Va. (13 Gratt.) 683, 694 (1857)*.

Moreover, Takeout Taxi has not at any time during its existence filed for bankruptcy protection as a result of its purported inability to pay its debts. With respect to its debts, the evidence shows that Takeout Taxi currently is able to pay its debts as they become due, due largely in part to Douglas Williamson's continued financial commitment to Takeout Taxi. [179]

179 Testimony of Douglas Williamson, January 27 and 28, 2003. Douglas Williamson testified that he has provided significant infusions of capital to Takeout Taxi. The franchisees assert that Mr. Williamson's "commitment to continue providing capital" has never been reduced to writing and attempt to portray these financial contributions as evidence of financial difficulties on the part of Takeout Taxi.

The Court is not persuaded by these arguments. First, Mr. Williamson's financial contributions to Takeout Taxi are plainly documented as investments in the company which are to be repaid. See Pls.' Exs. 177 and 202. Second, what the Court deems relevant here is not the source of Takeout Taxi's funds, but rather that such funds exist and are currently available to Takeout Taxi for it to meet its financial obligations.

[*89] With respect to the franchisees' contentions that Takeout Taxi as a franchise system possesses little or no value, such arguments also lack merit. Takeout Taxi's expert witness, Mr. Michael Seid, testified about many examples of faltering franchise systems that were turned around, [180] often through the sale to a third party. Moreover, Takeout Taxi has received two separate offers within the last four years from interested third parties seeking to purchase the Takeout Taxi franchise system. [181]

180 In addition, Michael Seid testified that a franchise system such as Takeout Taxi which is not offering new franchises could put itself in a position to do so in 2-3 weeks. He also testified that franchise opportunities can be pursued by means of company-owned stores, joint ventures, or the licensing of proprietary marks. Testimony of Michael Seid, January 21, 2003.

The Court also notes that Douglas Williamson's business history prior to Takeout Taxi was as a turn-around specialist of failing or faltering companies. Testimony of Douglas Williamson, January 27 and 28, 2003.

181 See note 36, *supra*.

[*90] Next, with respect to franchisees' argument that Takeout Taxi cannot claim a protectable interest in those franchise territories where it is not conducting, or seeking to conduct, franchise business, the Court finds that the cases on which the franchisees rely are distinguishable from the facts presented here. [182]

182 *See Kwik-Kopy v. Klein, 218 B.R. 787 (1998)*(where the franchisor did not intend to market or compete with the franchisee within the protected geographical area, court found restrictive covenant unreasonable); *see also PHP Healthcare Corporation v. EMSA Limited Partnership, 14 F.3d 941 (4th Cir. 1993)*(applying Florida law, court held that where an employer had completely gone out of business in the geographical area covered by the covenant, the restrictive covenant was unenforceable); *Liautaud v. Liautaud, 221 F.3d 981 (7th Cir. 2000)*(covenant not to compete overly broad where restriction sought to eliminate competition in areas where the franchisor was not currently seeking to do business); *O.V. Marketing Assoc., Inc. v. Carter, 766 F. Supp. 960 (D. Kan. 1991)*(restrictive covenant in franchise agreement

found invalid where franchisor not actively seeking franchises and main purpose of covenant no longer existed); *Grow Biz International, Inc. v. MNO, Inc., No. 01-1805, 2002 U.S. Dist. LEXIS 1427 (D. Minn. January 25, 2002)*(restrictive covenant held unenforceable where franchisor offered only speculative claim of obtaining another franchise in the market).

[*91] Takeout Taxi offered substantial evidence of not only its *intention* to compete in the restaurant delivery service business, but also its *ability* to market in those areas where the franchisees have conducted business. Specifically, Takeout Taxi's customer service representative, Ralph Romano, testified to Takeout Taxi's new and specific business plans to implement a "call-center" approach whereby the Takeout Taxi franchise operation will be conducted out of a single central location rather than by individually run franchise locations, and to open two new company stores in Seattle and Phoenix. [183]

183 Testimony of Ralph Romano, January 27, 2003.

Moreover, Takeout Taxi's evidence demonstrated that failure to enforce the covenant in those areas currently occupied by the franchisees would pose a realistic threat of competition to Takeout Taxi. [184]

184 *See Physicians Weight Loss Centers of America v. Creighton, 1992 U.S. Dist. LEXIS 12720 (N.D. Ohio 1992)*; *see also Kwik-Kopy v. Klein, 218 B.R. 787, 793 (1998).*

[*92] Finally with respect to Takeout Taxi's purported failures to provide certain services, manage royalty payments and other funds, police the use of its marks, [185] and maintain the exclusivity of its software product, [186] the Court finds no material breaches in performance on the part of Takeout Taxi. [187]

185 With respect to Takeout Taxi's failure to police the use of its marks, the Court finds no evidence to support any inappropriate uses of the mark by anyone not affiliated or otherwise outside the Takeout Taxi franchise system. Absent any reported misuse of the marks to Takeout Taxi, the franchisees certainly cannot fault Takeout Taxi for not taking affirmative measures to correct a problem that Takeout Taxi is unaware exists.

186 The franchisees contend that by virtue of losing its exclusivity to the software, Takeout Taxi can no longer claim that its software is proprietary.

187 See note 163 and discussion on material breach, *supra*.

The Court finds that Takeout Taxi as a franchise system [*93] possesses numerous protectable business interests warranting enforcement of the covenant not to compete. One of the most important interests possessed by Takeout Taxi, not addressed at all by the franchisees, is its good will, which Takeout Taxi conveyed to the each of the franchisees for the term of the franchise agreements.

As noted previously, a franchise agreement is a conveyance of the franchisor's good will to the franchisee for the length of the franchise. [188] When the franchise terminates, the good will is transferred back to the franchisor. [189] Given this exchange of good will, [HN31] a covenant not to compete may be necessary to protect a franchisor's good will after the reconveyance. [190]

188 *The Quiznos Corporation v. Kampendahl, No. 01-C-6433, 2002 U.S. Dist. LEXIS 9124* (N.Dist. of Ill. May 20, 2002).

189 *Id.*

190 *The Quiznos Corporation v. Kampendahl, No. 01-C-6433, 2002 U.S. Dist. LEXIS 9124* (N. Dist. of Ill. May 20, 2002).

Takeout Taxi developed a [*94] system for operating a restaurant delivery service and thereby developed good will in its trademarks. The franchisees, in electing to become a part of Takeout Taxi franchise system, placed significant value on the strength of Takeout Taxi's marks and brand identity. Once a part of the franchise system, the franchisees then traded off the strength of Takeout Taxi's service marks and brand identity by attracting customers through promotional efforts predicated exclusively on the brand awareness of such marks. [191]

191 See notes 197 and 198, *infra*.

Takeout Taxi bargained for the covenants not to compete with a view towards maximizing the good will after the parties' relationship concluded. The covenants were designed to protect both Takeout Taxi and other franchisees from the injurious consequences which could

flow from the use of good will acquired by the departing franchisee in the course of its association with the franchise system.

If the covenants were invalidated, a substantial portion of the consideration [*95] tendered to the franchisees in connection with the original franchise transaction would be nullified and would foreclose Takeout Taxi from rightfully enjoying the good will reconveyed to it.

In addition to the transfer of its good will to the franchisees, Takeout Taxi also guaranteed the exclusivity of each of the franchisees' respective franchise territories during the term of the franchise agreement. [192] The franchise territories receive further protection by means of the covenant not to compete, which functions to foreclose other franchisees from entering the geographic territory and competing for business. [193] As such, the covenant not to compete, coupled with the exclusivity provision, ensures that each franchisee can use and benefit from the value of Takeout Taxi's marks and good will during the term of the franchise agreement.

192 Pls.' Ex. 7, Section I(C) of the Franchise Agreement. This exclusivity provision arguably gives rise to a contractual duty on the part of Takeout Taxi to protect its franchisees from competition by former franchisees. *See* Servpro Industries, Inc. v. Pizzillo, No. M2000-00832-COA-R3-CV, 2001 Tenn. App. LEXIS 87 (Ct. App. Tenn. February 14, 2001).

[*96]

193 Pls.' Ex. 7, Section XV(C) of the Franchise Agreement.

The Court also recognizes that Takeout Taxi possesses a protectable interest in its proprietary information and knowledge disclosed to the franchisees as part of the training process of the franchise system. [194] Each of the franchisees understood the value to Takeout Taxi of the DeliveryNet software system, the customer databases (products of the software system), the Takeout Taxi's trademarks, advertising, and other promotional materials.

194 *See My Favorite Muffin, Too, Inc. v. Wu, No. 00-C-7820, 2002 U.S. Dist. LEXIS 7743 (N.D. Ill. April 29, 2002)*; *Servicemaster Residential/Commercial Services, L.P. v. Westchester Cleaning Services, Inc., No. 01-Civ.-2229, 2001 U.S. Dist. LEXIS 4807 (S.D.N.Y. April 18, 2001)*; *Carvel Corp. v. Eisenberg, 692 F. Supp. 182 (S.D.N.Y. 1988)*.

In addition, Takeout Taxi possesses [*97] a protectable interest in the confidential information provided to the franchisees in the course of the franchise relationship, namely those methods of doing business and the mechanics of operating a restaurant delivery business, [195] especially as those methods relate to Takeout Taxi's proprietary software.

195 Examples of Takeout Taxi's confidential information include its specialized reporting, bookkeeping and accounting methods. In addition, the Court recognizes that most, if not all, of the franchisees' marketing techniques and general knowledge of the restaurant delivery service business were cultivated during the franchise relationship with Takeout Taxi.

Lastly, the Court recognizes Takeout Taxi's business interest in preventing customer confusion. [196] As both parties testified, the menu guides distributed to the public serve as the primary vehicle to solicit and acquire customers. These menu guides contain only the mark of Takeout Taxi and in no way reference or identify the individual franchisees. [*98] [197] As such, when customers place orders to a particular franchise, they do so based on their awareness of Takeout Taxi's brand, and not simply on the basis of their familiarity with the individual franchisees. [198] Under such circumstances, the risk of customer confusion is great if the covenants not to compete are not enforced against the franchisees. [199]

196 *See Duct-O-Wire Co. v. U.S. Crane, Inc., 31 F.3d 506 (7th Cir. 1994)*(preliminary injunction enjoining use of expired phone number affirmed on the grounds that use of the number caused customer confusion); *Dial-A-Mattress Franchise Corp. v. Page, 880 F.2d 675, 679 (2nd Cir 1989)*; *Domino's Pizza, Inc. v. El-Tan, Inc.*, No. 95-C-180-B, 95-C-181-B, 95-C-182-BU, 1995 U.S. Dist. LEXIS 20550 (N.D. Ok. April 28, 1995); *Express Mortgage Brokers, Inc. v. Simpson Mortgage, Inc., No. 94-71056, 1994 U.S. Dist. LEXIS 8764 (E.D. Mich. May 6, 1994)*.

197 See Pls.' Exs. 238 and 243; Defs.' Ex. B-21.

198 The Court recognizes, however, that Takeout Taxi's corporate clients may have more familiarity with the individual franchisees by

virtue of the franchisees' personal contacts and efforts in setting up corporate accounts.

[*99]

199 As discussed previously, the telephone numbers and customer databases are property of Takeout Taxi, not the franchisees, and therefore must be returned to Takeout Taxi upon expiration of the Franchise Agreements. That said, even if the Court did not enforce the covenant not to compete, such a decision would have no affect on the franchisees' ability to access the customer database and use the former telephone number listed on the menu guide -- both property of Takeout Taxi -- post-expiration of the franchise agreement. This transfer of the customer database and telephone number back to Takeout Taxi would mitigate the likelihood of customer confusion dramatically.

In sum, the Court finds that Takeout Taxi possesses numerous legitimate protectable business interests warranting enforcement of the covenants not to compete.

CONCLUSION

The Court finds the type of business the franchisees wish to conduct post-expiration to be identical to the type of business they perform as franchisees under the Takeout Taxi System, save the business name. In reviewing the nature of the restraint in light [*100] of all the circumstances in this case, the Court finds the covenant to be no greater than necessary to protect the legitimate business interests of Takeout Taxi.

The very language of the covenant not to compete also renders the franchisees' arguments untenable. [HN32] A court must give effect to the intention of the parties as expressed in the language of their contract, and the rights of the parties must be determined accordingly. 200 The Court finds the covenant not to compete to be clear and unambiguous and has no difficulty in ascertaining the intent of the parties.

200 *Foti v. Cook, 220 Va. 800, 805, 263 S.E.2d 430, 433 (1980).*

Simply stated, the franchisees and Takeout Taxi agreed that upon either expiration or termination of the franchise agreement, the franchisee would not, for a period of one year, engage in any business "which is the same or substantially similar" to that of Takeout Taxi within a certain geographical range. The restrictive covenant was placed in the franchise agreement [*101] for the benefit of both current franchisees and Takeout Taxi. The covenant was designed to protect the legitimate business interests of Takeout Taxi and to prevent the use by a withdrawing franchisee of confidential information to the disadvantage of Takeout Taxi, other franchisees, and the entire franchise system.

To construe the provision otherwise would not only render the restrictive covenant meaningless and without effect in the event of expiration of the Agreement, but would undo a significant part of the bargain reached by both parties at the inception of the franchise agreements.

For these reasons, the Court finds that the franchise agreements are enforceable in all respects, and the Injunction issued in these consolidated cases is hereby dissolved. The one-year period for the covenant not to compete will commence upon either the expiration date of the respective agreements or as of the date of the end of this litigation, whichever occurs later.

R. Terrence Ney

VIRGINIA:

IN THE CIRCUIT COURT OF FAIRFAX COUNTY

BRENCO ENTERPRISES, INC., ET AL. Plaintiffs, v. TAKEOUT TAXI FRANCHISING SYSTEMS, INC., ET AL. Defendants.

Chancery No. 177164

ORDER

[*102] This matter came before the Court on January 13, 14, 15, 21, 22, 27, 28 and 29, 2003 on Counts III and V of Plaintiffs' Second Amended Bill of Complaint seeking declaratory judgment and equitable relief. For the reasons stated in this Court's opinion letter dated May 2, 2003, which is attached hereto and made a part hereof, the Plaintiffs' request for declaratory judgment and the breach of contract claim are hereby DENIED. It is furthered

ORDERED that the temporary injunction issued by this Court on March 13, 2002 is hereby DISSOLVED.

The Court notes the Plaintiffs' exceptions to this Order.

ENTERED this 2nd day of May, 2003.

JUDGE R. TERRENCE NEY

ENDORSEMENT OF THIS ORDER BY COUNSEL OF RECORD FOR THE PARTIES IS WAIVED IN THE DISCRETION OF THE COURT PURSUANT TO RULE 1:13 OF THE RULES OF THE VIRGINIA SUPREME COURT.