

**UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
WESTERN DIVISION**

**AMERICAN CLASSIC PROVISIONS,
INC., a North Carolina Corporation,
VALLEY VENTURES, INC., a North
Carolina Corporation, HEI, INC, a
Virginia corporation, EDMUNDS &
KATRANCHA, INC., a Virginia
corporation, HICKORY FARMS OF
CHARLOTTESVILLE, INC., a Virginia
corporation, GREENSBORO CHEESES
CO., a Virginia corporation, and
DODGE ENTERPRISES., INC., a Utah
corporation,**

Case No.

JURY TRIAL DEMANDED

Plaintiffs,

vs.

**HICKORY FARMS, INC., a Delaware
corporation,**

Defendant.

COMPLAINT FOR BREACH OF CONTRACT AND OTHER RELIEF

Plaintiffs AMERICAN CLASSIC PROVISIONS, INC., a North Carolina Corporation, VALLEY VENTURES, INC., a North Carolina Corporation, HEI, INC., a Virginia corporation, EDMUNDS & KATRANCHA, INC., a Virginia corporation, HICKORY FARMS OF CHARLOTTESVILLE, INC., a Virginia corporation, GREENSBORO CHEESES CO., a Virginia corporation, and DODGE ENTERPRISES, INC., a Utah corporation, by their attorneys, for their complaint against HICKORY FARMS, INC., a Delaware corporation, state and allege as follows:

NATURE OF THE CASE

This case involves a franchise relationship between the Plaintiffs, who are longstanding franchisees of Defendant Hickory Farms, Inc. (“HF”) the franchisor.

In 1987, these Plaintiffs (and other franchisees of HF) filed suit against this Defendant in this District alleging various claims. The parties eventually settled that hard fought lawsuit. The parties’ settlement agreement, which was implemented in the form of an addendum to each plaintiff’s franchise agreement, enabled the parties to maintain their franchise relationship on terms that were highly favorable to the settling plaintiffs. Specifically, the settlement agreement provided numerous benefits to these Plaintiffs, including (without limitation) reduced royalty obligations.

Then, in 1996, the Plaintiffs and HF entered into written agreements entitled “franchise renewal addendums” that extended the Plaintiffs’ franchise agreements through and including January 2014, on terms that included the reduction in royalty payments and other terms that had been agreed upon in the settlement of the 1987 lawsuit. As more fully discussed below, the 1996 franchise renewal addendums further provided that if the Plaintiffs wished to continue their franchises after January 2014, the parties would be required to negotiate for another extension of the Plaintiffs’ franchise agreement.

The present lawsuit is now filed because the Defendant has failed, in contravention of its express and implied legal obligations that were created by the 1996 franchise renewal addenda, to negotiate in good faith for the renewal of the

Plaintiffs' franchise agreements beyond January 2014. The Defendant's failure to negotiate in good faith threatens the Plaintiffs with the loss of their franchised businesses and very substantial damages in amounts that will be proven at trial.

PARTIES

1. Plaintiff American Classic Provisions, Inc., (ACP) is a North Carolina corporation with principal offices in Burlington, North Carolina.

2. Plaintiff Valley Ventures, Inc., (VV) is a North Carolina corporation with principal offices in Burlington, Vermont.

3. Plaintiff HEI, Inc., (HEI) is a Virginia corporation with principal offices in Richmond, Virginia.

4. Plaintiff Edmunds and Katrancha, Inc., (E&K) is a Virginia corporation with principal offices in Richmond, Virginia.

5. Plaintiff Hickory Farms of Charlottesville, Inc., (HC) is a Virginia corporation with principal offices in Richmond, Virginia.

6. Plaintiff Greensboro Cheeses Company, Inc., (GC) is a Virginia corporation with principal offices in Richmond, Virginia.

7. Plaintiff Dodge Enterprises, Inc., (Dodge) a Utah corporation with offices in Salt Lake City, Utah, is the successor in interest to Neldens, Inc., which was one of the litigants in the earlier lawsuit against Hickory Farms. Dodge has more than one HF franchise and is a party to this action with regard only to the franchise agreements that were formerly Neldens agreements.

8. Defendant Hickory Farms, Inc., is a Delaware corporation with principal offices in Toledo, Ohio.

JURISDICTION

9. This court has diversity jurisdiction over this civil action pursuant to 28 U.S.C. § 1332 because the parties are residents and citizens of different states and the amount in controversy exceeds the sum or value of \$75,000, exclusive of interests and costs.

10. Defendant Hickory Farms, Inc. is subject to personal jurisdiction in Ohio because it has its headquarters in Ohio and it sold franchises in this State.

11. Venue is proper in this District under 28 U.S.C. § 1391 because the Defendant resides here and a substantial part of the events of omissions giving rise to this Complaint occurred in this judicial district.

Background of the Hickory Farms Franchise System

Leading to the 1987 Lawsuit

12. HF is a wholesaler/retailer and to a lesser extent, a franchisor. Franchising is a remnant of HF's main business 30 years ago, and there have been no new franchisees other than resales or renewals in many years. HF has changed ownership a few times and its financial position has deteriorated significantly.

13. For over 40 years Plaintiffs (and their predecessors in interest)¹ have been franchisees of Defendant HICKORY FARMS, INC. or its predecessor,

¹ Hereinafter, the term "plaintiffs" as used herein includes the predecessors of certain plaintiffs, as applicable.

pursuant to various successive iterations of a franchise agreement and addenda thereto issued by Defendant and agreed to by the Plaintiffs.

14. The Hickory Farms business has always been very seasonal. Hickory Farms franchises consist of seasonal kiosks open no more than the last 12 weeks of each year usually in mall public walkway areas (though occasionally in actual store sites). Whatever HF franchisees earn must be earned in those 12 week periods.

15. Prior to the resolution of another lawsuit brought in this court in or about 1987 by these same Plaintiffs and other HF franchisees, the HF franchise agreement required the opening and operation of a full size (roughly 3,000 square foot) year round store located in malls, plus additional kiosk stores in the fall to end of year period.

16. Prior to the 1987 lawsuit, HF franchisees had been losing money on the operation of the full size HF stores and relied upon the fall season's sales to net a profit for the year.

17. In the iteration of the HF franchise agreement of the 1980s, prior to the 1987 lawsuit, HF franchisees were stated to have quasi-exclusive rights to their Franchise Geographic Areas (FGAs), subject to certain exceptions.

18. As further background preceding the filing of the 1987 Lawsuit;

- a. During the 1980s major supermarkets began stocking and selling specialty products and gift packages for holidays. This, plus the fact that retail customers could then buy similar products as those sold by HF when they went grocery shopping without having to make a special

trip to a HF affiliated store, began a competitive process that tended to make Plaintiffs' HF franchises more difficult to operate profitably.

- b. At roughly that same time HF decided to initiate a program to sell HF specialty and gift products on the Internet and through alternative retail stores not named HF or otherwise associated with HF, including stores that operated within Plaintiffs' FGAs. HF's Internet sales also included sales to consumers located within Plaintiffs' FGAs.

19. Plaintiffs and other HF franchisees, most of who were plaintiffs in that earlier lawsuit, attempted to persuade HF to relent on the intrusions into their FGAs, to no avail. This intransigence on the part of HF resulted in the filing of the 1987 Lawsuit.

Background: The Settlement of the 1987 Lawsuit

20. In or about 1989, these Plaintiffs (and the other plaintiffs in the 1987 Lawsuit) entered into a written settlement agreement with HF, which expressed in the form of addenda to the parties' respective existing franchise agreements. These franchise agreement addenda reduced Plaintiffs' royalty obligations to HF and called for HF to compensate the HF plaintiffs for sales that infringed upon their FGAs. In addition the post termination covenant not to compete was dropped from the HF franchise agreements with those plaintiffs. Although the non-compete obligations were subsequently reintroduced into a later renewal franchise agreement/addendum in or about 1996, as discussed in further detail below. The

settlement agreement/addendum also deleted the requirement that the plaintiffs operate year round stores, leaving only the seasonal kiosk business.

21. The referenced agreements/addenda are all in the possession of Defendant.

Background: The 1996 Franchise Renewal Addendums

22. In 1996, these Plaintiffs and HF agreed to enter into a new franchise renewal addendum that is the subject of this lawsuit.

23. The relevant provisions of that 1996 franchise renewal addenda are that HF continued to pay Plaintiffs for infringing sales; Plaintiffs enjoyed continuation of the lower royalty rate of 3.25 % of gross sales, plus another 2% for the advertising fund and a specially worded renewal/extension of franchise term triggered when the term of that addendum expired in January 2014. Payment to Plaintiffs for territorial encroachment continued in the 1996 renewal, and it was at this time that the non-compete obligations were reintroduced in the renewal addenda.

24. The 1996 franchise renewal addenda between HF and Plaintiffs also contain a renewal/extension clause that states:

“If at the time of execution, Franchisor is not then offering any new franchises to prospective franchisees, Franchisee and Franchisor shall negotiate in good faith the terms of the renewal franchise agreement (including, but not limited to, the length of the renewal term) to be offered to Franchisee, and if Franchisee

and Franchisor are unable to negotiate all the terms of the renewal franchise agreement, then Franchisee and Franchisor shall execute a renewal agreement before the end of the initial term, which renewal agreement shall extend until January 31 2019, the same terms as this franchise agreement.....” Section 4.

Background: The Interval From 1996 To The Present

25. In the years after the signing of the 1996 franchise renewal addenda, the size of the HF franchisee population shrank by more than 50%. Some of these territories were purchased by HF from franchisees and many were simply closed, sold or not renewed by the franchise owners who had to pay royalties and other charges almost twice what Plaintiffs have been obligated to pay.

26. The shrinking scale of HF’s financial condition and the effective market forces described above resulted in the now expiring HF franchise agreement addendum of Plaintiffs contemplating that in 2013-4 when its term expired, HF simply would no longer be an effective franchising company or selling franchises to new franchise investors.

27. During most of this period HF had no formal franchise selling program and allowed its franchise offering registrations in states that required them to lapse.

FACTS SPECIFIC TO PLAINTIFFS' CLAIMS

28. In early 2013, each of the Plaintiffs gave HF due and proper notice of their intent to renew their franchises as called for in the then 1996 franchise renewal addenda.

29. In November 2013 (some eight (8) months after receiving Plaintiffs' respective notices to renew), Defendant HF stated that it needed more time to determine renewal issues, and offered an extension of the then in force franchise agreement to March 31 2014, supposedly to give HF some more time to deal with the renewals. There ensued additional correspondence that eventually extended the extant franchise contracts to July 31 2014, and then to the end of January 2015. Plaintiffs accepted these extensions, not knowing that Defendant really intended to attempt to subvert Plaintiffs' renewal rights under Section 4 of their extant agreements.

30. However, it has now become very clear that HF has no intention of extending the Plaintiffs' franchises as called for by the 1996 renewal addenda and is not negotiating consistent with "good faith and fair dealing" with respect to the subject of renewal.

31. For example, despite the fact that Plaintiffs all had the same contracts, with no proviso that they could not work together regarding the renewal issues, Defendant unreasonably demanded (without a shred of support in any contract) that none of them work with any other of them or share information, and refused to meet with them except separately. Plaintiffs refused to relinquish their right to

communicate among themselves, informing HF as well that they were all using the same lawyer to advise them in the premises.

32. On February 24, 2014, Plaintiffs proposed renewal terms to include royalties of 3% of gross sales and elimination of the 2% advertising fee, on the grounds that the market was shrinking, plus a 5 year renewal term. HF was specifically required to negotiate in good faith with respect to Plaintiffs' proposed 5 year renewal term per the renewal addenda.

33. On March 1st, Defendant announced its proposed renewal terms that included (without limitation) extending the term for three years; raising royalties to 6% in year two and to 7.5% in year three; and the unlimited right for Defendant to operate in any territory of Plaintiffs, including actual malls where Plaintiffs did not have established kiosk locations. Other items of Defendant's proposal were more operational than financial impact items.

34. Defendant then insisted that negotiations could only be on issues raised by the franchisor, and sent a formal agreement for Plaintiffs to sign, which provided for that. Plaintiffs refused to sign such an agreement, as it was a direct contravention of their negotiating rights under Section 4 of their franchise agreement.

35. Naively believing that Defendant really did intend to participate in good faith negotiations as set forth in the extant agreement, Plaintiffs responded with a second negotiating proposal on March 12, 2014. This proposal from Plaintiffs included that: raising the royalty from 3.25% to 5.25% of sales and removing the 2%

advertising fee (transferring the advertising fee from advertising dedication to HF general revenues); eliminating the payments by HF to Plaintiffs due to HF territory infringing sales; extend the term of the franchise to end of season in 2020; raising the period of the post term covenant not to compete from one year to two.

36. After receiving the Plaintiffs' proposal on or about March 12, 2014, the Defendant then engaged in a ruse that was intended to convey the (false) impression that it was prepared to negotiate in good faith. Specifically, Defendant agreed to extend the term of the extant franchise agreements on current terms through January 2015, which was consistent with its proposal that royalties not be raised until 2016 in Defendant's initial proposal. This was for the stated purpose of facilitating negotiations. In fact, this was a ruse to enable Defendant to engage lawyers to prepare new franchise agreements and franchise disclosure documents to pretend that Defendant was selling new franchises and thereby hope to completely subvert Plaintiff's renewal rights and impose Defendant's terms.

37. Nothing of substance happened until June 2014 when Defendant, having completed its plan to subvert Plaintiffs' renewal rights, decided to pretend it had a real program to sell franchises to new franchisees, and Defendant sent Plaintiffs its ultimatum terms, in a so called Executive Summary. These were the terms later included in Defendant's spurious franchise disclosure document, which includes a form of franchise agreement for new franchisees. Defendant submitted these franchise documents to the appropriate franchise registration authorities in the states of California and Virginia.

38. Defendant's spurious franchise disclosure document affirmatively states that Defendant projects no new franchised outlets in its next fiscal year.

39. The franchise agreement's terms as stated in the HF disclosure document calls for payment to HF by the supposed franchisee of royalties of 7.5% of gross sales and in addition to that 2.5% for advertising purposes.

40. The submitted disclosure documents were improper in at least the following respects:

- a. Perhaps the most absurd and unlawful provision of the franchise agreement, especially in a business facing stiff competition, including competition between franchisees and HF itself, is that the franchisee is required to resell its goods to the public at prices set by HF. Without the ability to meet competitors' pricing and promotional special deals, the supposed new HF franchisees would not have a reasonable opportunity to operate profitably. Defendant's only possible motive for this horizontal price fixing arrangement, Defendant might have to compete with its supposed franchisees within their own territory which would not be exclusive. This requirement is a per se violation of Section 1 of the Sherman Antitrust Act, 15 USC section 1.
- b. Defendant disclosed only in financial statement exhibits to the HF circular that HF in fact had a negative net worth, and failed to disclose that under applicable law HF was not entitled to accept into its revenues any initial franchise fees that any franchise investor would

be required to pay. The State of Virginia caught this issue and ordered HF to amend its circular too disclose conspicuously that it could not take into revenue the initial franchise initial fees of \$10,000 each until HF had fulfilled its obligations through “open for business” by the franchisee and the franchisee had signed off that he had received the services he is entitled to receive under the franchise agreement up to that point. Neither the State of Virginia nor California have yet spotted the per se illegal resale pricing requirement in Defendant’s new supposed franchise agreement, or the registration applications in those states would have been denied unless the offending provision were deleted.

- c. Defendant made only minimal financial disclosure in its financial statement exhibit that it does not make any profit from operations and lost over \$1,000,000 in its most recent fiscal year. Defendant had a duty to disclose information needed to make information given not misleading to franchise investors in the light of the circumstances in which affirmative statements were made, but did not do so.
- d. Defendant’s did not disclose that executives who would have any material involvement in its franchising had never had any experience training, supporting any new franchisee investors or any other experience in any company that was in the business of selling franchises.

- e. Defendant estimated total initial investment for one of its supposed franchises to range from \$310,425 to \$476,925, all to be paid to Defendant, with absolutely no information on which to base any reasonable belief that in the five year term of the franchise being offered any franchise investor could achieve any return on the investment. Defendant had never operated or advised any new start up HF franchisee in the market of operations for over ten years. Defendant did not disclose its lack of new franchise start up experience anywhere in its circular. No competent investment advisor would advise a positive investment decision had the truth been disclosed.
 - f. Defendant knew of, but did not disclose that the market for its products was shrinking and had been shrinking for over 15 years.
 - g. Defendant failed to disclose that its history over the last 20 years included the elimination, in one way or another, of over 60% of the franchisees in its system.
 - h. Defendant knew or should have known these deficiencies and taken steps to avoid them if Defendant had any real intention to engage in a new franchise-selling program.
41. Each of these facts are material investment decision related facts that, should be included in the disclosure documents, because they are facts that any reasonable franchise investor would want to know about before making an

investment decision. The omission of these material facts makes the disclosure document, as a whole, materially misleading to any prospective new franchisee.

42. Defendant then presented this spurious franchise disclosure document and its form of franchise agreement to Plaintiffs as their “final” position in respect of renewal terms, as though this charade did in fact represent a real program of selling new franchises, in the hope that it would suffice to thwart the exercise of Plaintiff’s renewal rights provided for in their current franchise agreements.

COUNT ONE

BREACH OF CONTRACT

43. Plaintiffs re-allege paragraphs 1 - 42 above.

44. As a matter of law, the 1996 franchise renewal addenda executed by each Plaintiff and HF imposed a duty of good faith and fair dealing upon HF (as well as upon the Plaintiffs). This duty of good faith and fair dealing requires HF to either agree to renew the Plaintiffs’ franchises on the same terms as were agreed upon in 1996, or to negotiate in good faith for any changes to those terms.

45. As alleged in the paragraphs that are incorporated into this Count, HF breached its express and implied-as-a-matter-of-law legal duties under the 1996 franchise renewal addenda by failing offer renewal on the existing terms or to negotiate in good faith. To summarize:

- a. HF wrongfully attempted to initiate a “divide and conquer” strategy by informing the Plaintiffs, without any basis in law or fact that they

were forbidden to talk to each other and were supposedly obligated to negotiate one-on-one with HF.

- b. HF has wrongfully insisted that it has the exclusive right to determine the issues upon which renewal negotiations might proceed, excluding the ability of Plaintiffs to raise negotiating issues as provided for in Section 4.
- c. HF has insisted upon dramatic changes in business terms that are out-of-proportion to any alleged economic justification.
- d. HF has insisted that its opening position in the negotiations is now its final position, i.e. HF has announced that it is not willing to negotiate, which is in direct contradiction of its Section 4 obligation.
- e. HF has engaged in the subterfuge of pretending that is once again in the business of trying to sell new franchises, but this attempt was only for show, and it was calculated to allow HF to try and justify its blatant disregard for the interests of its long-time franchisees and the history of these franchise relationships as reflected in the 1996 franchise renewal addenda and its predecessors.

46. Defendant's refusal to negotiate renewal in good faith, and Defendant's adoption of a scheme to subvert Plaintiffs' renewal negotiation rights constitute a material breach of Defendant's express and implied duties under Section 4.

47. Plaintiffs have been injured and damaged by Defendant's wrongful breach in that the value of those rights has been lost and the loss of reasonably

negotiated renewal terms in a renewal agreement has substantially reduced the value of Plaintiffs' franchised businesses. Accordingly, under Defendant's scheme, either Plaintiff's cash flow would be substantially impaired, or the value of Plaintiffs' businesses would be reduced to zero.

48. Plaintiffs have suffered injury and damages proximately caused by Defendant's wrongful conduct, and pray for judgment in their favor in the amount of their damages plus costs and attorney fees, together with such other relief as to the Court may seem appropriate in the premises.

49. In the alternative, Plaintiffs pray for specific performance, to compel the Defendant to renew each Plaintiff's franchise on the same terms that are set forth in the 1996 franchise renewal addenda.

COUNT TWO

DECLARATORY JUDGEMENT THAT DEFENDANT'S COVENANT NOT TO COMPETE IS NO LONGER ENFORCEABLE DUE TO DEFENDANT HICKORY FARMS' MATERIAL BREACH OF PLAINTIFFS' FRANCHISE AGREEMENTS

50. Plaintiffs reallege paragraphs 1 through 42 above.

51. The material breach of contract by Defendant operates to relieve the opposite parties (Plaintiffs) of provisions of their extant franchise agreements that are prospective in their application.

52. A breaching party under Ohio law is not entitled to insist that the non-breaching party continue to perform its obligations.

53. In the context of the nature of the alleged breach by Defendant in this instance, the post expiration provision prohibiting/limiting Plaintiffs' right to continue in the specialty foods retailing business as independent merchants is unreasonable and unenforceable.

54. In that Defendant has for many years placed almost all its products into general retail distribution and sells them in competition with its own franchisees on the Internet and otherwise, no legally cognizable reason for a post termination covenant not to compete exists in fact or in law, and the covenant should be declares unreasonable and unenforceable.

55. Plaintiffs therefore ask the Court for a Declaratory Judgment that the covenant against competition contained in their present HF franchise agreements is not enforceable because of Defendant's breach of Section 4 thereof regarding Plaintiffs' renewal rights.

56. Plaintiffs also ask that there be a specific finding that Defendant's enforcement of its post termination covenant not to compete would be unreasonable, as well as a finding that such characterization of Defendant's covenant not to compete shall be res judicata in any action by Defendant in which it attempts to enforce the covenant.

JURY TRIAL DEMAND

Plaintiffs demand trial by a jury of their peers.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs pray for relief in the amount of damages they have sustained; such injunctive relief as they may be entitled to as a matter of the Court's equity jurisdiction; costs incurred plus reasonable attorney fees and such additional relief as to the Court may seem appropriate in the premises.

Dated: July 21, 2014

Respectfully submitted,

s/ Gerald R. Kowalski

Gerald R. Kowalski (0022323)

COOPER & KOWALSKI, LPA

900 Adams Street

Toledo, OH 43604

Telephone: 419-241-1200

Facsimile: 419-242-5675

kowalski@cklpa.com

Counsel for Plaintiffs