

PUBLICATION

Overlapping Territories Don't Violate Territorial Exclusivity

September 20, 2010

A recent decision by the United States District Court in Kansas clarifies the interpretation of "protected territory" clauses in franchise agreements. The case of *Black Angus Holdings, LLC v. Backyard Burgers, Inc.* originated in the bankruptcy court in Kansas.¹ In its complaint in the adversary proceeding, the plaintiff/franchisee asserted that Backyard Burgers, Inc. (BYB) breached its franchise agreement by granting an additional franchise to another operator in violation of the "protected territory" provision in the franchise agreement.

The franchise agreement in question contained the following territorial provision:

"Territory." Franchisor [BYB] agrees that, during the term of this Agreement, it will not sell or establish any other franchises or company-owned Restaurant or any other restaurant which sells hamburgers and/or chicken sandwiches in the following territory: a site located at 124 North Clairborne, Olathe, Kansas, 66062 [location of plaintiff's restaurant] with a one mile exclusive radius. ("the Territory"), except in or in conjunction with any military installation, zoo, amusement park, or stadium/arena/ coliseum.

The plaintiff alleged that the franchise agreement was amended to extend the radius to two miles. The plaintiff further alleged that BYB breached this agreement by granting a franchise to another operator for a location 2.17 miles from the plaintiff/franchisee's location. BYB moved to dismiss the complaint arguing that a restaurant 2.17 miles from plaintiff's location did not breach the protected territory provision even as amended.

In opposing this motion, the franchisee asserted that the offending location was granted a one-mile area of protection under its franchise agreement. Consequently, the plaintiff argued, the "areas of protection" for the plaintiff's location and the offending location overlapped. The plaintiff focused on the term "exclusive radius" in the franchise agreement. The plaintiff asserted that if any other restaurants' radius touched plaintiff's radius, then it was not "exclusive" and the franchise agreement had been breached.

The bankruptcy court observed that BYB's interpretation of the provision was the most obvious one; however, the "exclusive radius" language was sufficiently ambiguous to warrant denial of the motion to dismiss.

BYB sought leave to appeal this decision to the United States District Court for the District of Kansas, and the appeal was accepted. In an order dated September 2, 2010, the district court reversed the ruling of the bankruptcy court and dismissed the adversary proceeding.

The district court noted that the franchise agreement provided that it was to be interpreted under Tennessee law. Tennessee courts have long held, consistent with the majority of jurisdictions, that if the language of a written contract is clear and unambiguous, a contract is interpreted according to its plain terms as written, and the language used is taken in the plain, ordinary and popular sense.² Employing those principles, the district court noted that the territorial provision in question provided that BYB could not sell or establish a restaurant "in the following territory: a site located at [plaintiff's address] with a [two] mile exclusive radius (the Territory)." Thus, under the ordinary meaning of this prohibition of a restaurant "in" the territory defined by a two-mile radius around plaintiff's restaurant, a restaurant could not physically be situated or located two miles or less from plaintiff's restaurant. By that interpretation, a new restaurant more than two miles from plaintiff's

restaurant was not prohibited, regardless of any other circumstance (for instance, the operation of a territorial provision benefiting the new restaurant).

The district court rejected the plaintiff's argument regarding "exclusive radius." The court held that the use of the word "exclusive" meant that other restaurants were physically excluded from the defined territory.

Finally, the court notes that the franchisee's proposed interpretation simply did not pass the common sense test. When the franchisee executed the franchise agreement, it could not have known what kind of protected radius that a future restaurant might have. For instance, under the plaintiff's interpretation, a new restaurant with a five-mile protected radius could not be located within seven miles of the plaintiff's restaurant, while a new restaurant with no protected territory could be as close as two miles away. Consequently, the plaintiff would not have known how close other restaurants could be to its own, and therefore, would not have known the extent of the benefit for which it had bargained.

The court held that the protected territory provision was not ambiguous and, interpreting that provision according to its plain and ordinary terms, a restaurant located 2.17 miles from the plaintiff's restaurant did not constitute a breach. The adversary proceeding was dismissed.

Mr. Podesta is an attorney in our Memphis office.

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1. Bankr. Case No. 09-21349-11
 2. *Maggart v. Almany Realtors Inc.*, 259 S.W.2d 700, 703 (Tenn. 2008).