

AMERICAN ARBITRATION ASSOCIATION  
DALLAS, TEXAS

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EMPORIUM DRUG MART, INC. OF SHREVEPORT

Case No.:

71 114 00126 00

f/k/a Gibson Drug, Inc. of Shreveport; :  
EMPORIUM DRUG MART, INC. OF LONGVIEW; :  
EMPORIUM DRUG MART, INC. OF TYLER; :  
GIBSON RETAIL GROUP, L.P.; :  
GIBSON MERCHANDISE GROUP, INC.; :  
EMPORIUM DRUG MART, INC. OF LAFAYETTE; :  
EMPORIUM DRUG MART, INC. OF AMARILLO; :  
EMPORIUM DRUG MART, INC. OF LITTLE ROCK; :  
EMPORIUM DRUG MART, INC. OF ABILENE; :  
EMPORIUM DRUG MART, INC. OF LUBBOCK; :  
EMPORIUM DRUG MART, INC. OF WACO; :  
DISCOUNT EMPORIUM, INC. OF WICHITA; :

DECISION AND ORDER

DISCOUNT EMPORIUM, INC. OF DENTON; :  
NORTEX DRUG DISTRIBUTORS, INC.; :  
MANN DRUG INC. OF VICTORIA; and :  
MANN DRUG INC. OF BROWNSVILLE, :

Claimants,

and

DRUG EMPORIUM, INC., and :  
DRUGEMPORIUM.COM, INC., :

Respondents.

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ISSUE

This case presents the question: whether a virtual drug store is a drug store  
for purposes of a franchise agreement.

## ARGUMENTS

Claimants are franchisees who operate in their respective territories high volume low margin drug stores bearing the service mark Drug Emporium. Respondents are Drug Emporium, Inc. ("DEI") the franchisor, and its subsidiary, Drug Emporium.com, ("DE.com") a virtual drug store on the internet.

Claimants move for a preliminary injunction to prevent Respondents from conducting the business of DE.com in their respective territories. They claim that the operation of DE.com is in breach of the license DEI granted to them to operate high volume low margin drug stores and to the use of the service mark "in the business of said drug stores."

The essence of Claimants' argument is that the license granted to them is the exclusive license to use the service mark in their respective territories in the business of purchasing and selling drugs and related items, and that the operation of DE.com infringes that license. Some of the Claimants entered agreements that contain the grant of an "exclusive license." Other Claimants entered franchise agreements that are claimed to be exclusive by virtue of other contract provisions that limit Respondents' right to operate competing drug stores in their territory to situations when Claimants are in breach of their obligations, and no such breach is claimed here.

Claimants contend that DE.com is unlawfully engaged in the same business as franchisees in their territories. Among other things, Claimants point to the concession of Respondents' counsel at oral argument that Respondents' business is the very same as the franchisees' business: namely, the purchase and sale of drugs and related products.

drugstores.” “The full-service online drugstore,” “Our online drugstore,” “the first online drugstore.” They also point to Respondents’ SEC 10Q where DEI states that DE.com is an “e-commerce drugstore,” “an online drug store” and “a superior online drug store.” Finally, they refer to the web page where DE.com holds itself out as “Your neighborhood pharmacy for over 20 years.”

Claimants argue that their businesses will be irreparably damaged if DE.com is not enjoined. The balance of the hardships, they argue, is in their favor because the assets of DE.com are to be sold on September 5 and the acquiring company has refused to subject itself to the jurisdiction of this panel.

Other arguments are made as well.

Respondents’ position is that Claimants are asserting rights that the franchise agreements do not grant. DEI claims that by granting Claimants the right to use the service mark “in the business of said drug stores,” the grant was limited to said drug stores, i.e. high volume low margin brick and mortar operations. For support, Respondents point to §3.10 for the proposition that the Agreement contemplated that the drug stores to be created were “potentially highly susceptible to theft by customers and store employees”—a description that can only apply to a “brick” store as opposed to a “click” store. Respondents dismiss the notion that DE.com should be bound by the language that they are drug stores in their advertisements, because those expressions are marketing devices and do not alter the reality that they are only a virtual store, not a brick and mortar store. Respondents also argue that DE.com should not be deemed to be a store at all, but rather an alternative means of distribution—something Respondents claim is permitted by

DE.com's business of selling drugs and related items is the same as Claimants' business, DE.com contends its method of operating is entirely different. Whereas franchisees operate physical businesses where goods are stored, DE.com is a website that resides in a computer. The computer contains information that can be accessed by users nationwide who, in turn, can instruct a warehouse located elsewhere to ship the items into the territory. Respondents contend that the marketing and appearance of the website as a virtual store should not be mistaken for the reality that it is not a store.

Respondents argue that the franchise agreements simply do not preclude DEI from its reserved right under the contracts to exploit its own mark. Indeed, they point to Claimants' concession that the internet was not in anyone's mind when the franchise agreements were written. In order to grant the relief sought, they argue, the panel would have to reform the contract to add new language which is not authorized by the doctrine of good faith and fair dealing.

Respondents make other arguments as well, including that the hardship in implementing a preliminary injunction and public policy are in their favor, especially given the paucity of evidence of damages to Claimants from the operation to date of DE.com.

### **DECISION**

Franchisees have the exclusive right to operate high volume low margin drug stores within their territory using the name Drug Emporium unless they are in breach of their franchise agreements, and none is in breach at this time. This is true for the franchisees under both the "old" and "new" agreements. Franchisees have demonstrated a likelihood of success in proving that Respondents have violated this term of the franchise

It is not for this panel to divine whether a virtual reality is real or whether it is a phantom. We will take Respondents at their word. Respondents have marketed DE.com as “The full service online drugstore” and have certified DE.com to be a “drugstore” in its filings to the SEC. We also infer from the Respondents’ conduct that honored the Claimants’ territories until now—including the offer of compensation during the test period for DE.com—that the parties’ reasonable expectation was that the Claimants would not be forced to compete with direct drug store sales by Respondents. This inference is bolstered by the failure of the franchise agreements to permit the Respondents to operate drug stores within the territory absent a breach by the franchisees.

We also find that the Claimants have established a likelihood of success in proving dilution of the license granted in the mark and consequent harm. DE.com’s use of the service mark on the website used by customers in Claimants’ territories and the Respondents’ marketing practices also demonstrate a likelihood of confusion in the future which will not be able to be remedied if an injunction is not issued at this time.

Respondents’ conduct supports this conclusion. Respondents have chosen to hold themselves out on the very website accessed in the affected territories as “Your neighborhood pharmacy for 20 years.” Respondents have also attempted to build market share by offering special sales at prices that vastly undercut prices available at the Claimants’ stores. The obvious purpose of this practice is to increase DE.com’s sales volume. The contemplated sale of assets of DE.com on September 5 and the refusal of Respondents to include a contractual provision to require the purchase to be subject to this panel’s ruling lead to the inference that the intention is to exploit the DEI mark in

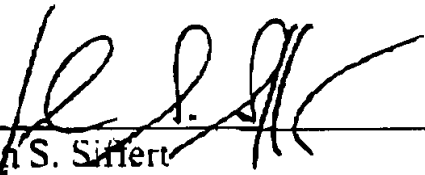
Claimants' territories with even greater zeal. Indeed, the \$17 million purchase price, which includes the acquisition of DE.com's assets, creates a big motive to do so.

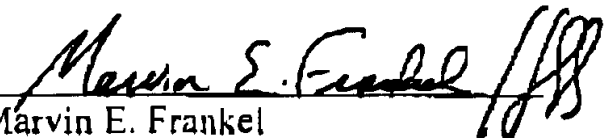
Any harm to Respondents can be mitigated by fashioning relief that defers the effective date of the injunction that we issue. There is no adverse effect on the public interest in granting this injunction. No bond is required to be posted for this preliminary injunction, the effectiveness of which is delayed by the following Order.

### **ORDER**

The undersigned Arbitrators, having considered the motion of Claimants for a preliminary injunction, together with all of the declarations, affidavits, memoranda, exhibits and testimony and other evidence in support thereof, and all of the declarations, affidavits, memoranda, exhibits and testimony in opposition thereto, and having heard the arguments of counsel and being fully informed in the premises, hereby

ORDER, pending final hearing, determination and entry of judgment in this matter, that Respondents, their officers, directors, agents, employees and all others in active concert or participation with them be and they are hereby enjoined and restrained from selling drugs and related goods or products at retail to any customer or purchaser physically within the Claimants' territories (as those territories are defined in the Claimants' franchise agreements) and, further, that Respondents are directed to place a clear notice to prospective customeres within Claimants' territories on the DrugEmporium.com web site that states that DrugEmporium.com is unable to ship orders to the above-identified territories, and to direct such customers to the nearest Drug Emporium franchised outlet in the enjoined territory. Respondents shall be permitted 12 weeks to put in place the terms of

  
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John S. Sifert

  
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Marvin E. Frankel

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William J. Schwartz

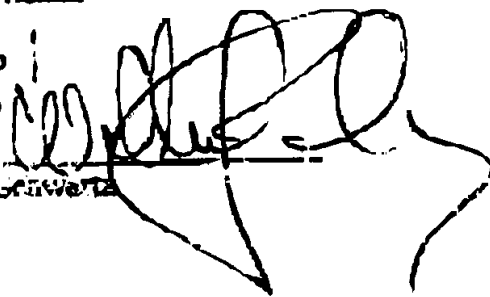
Dated: September \_\_, 2000

John S. Siffert

Marvin E. Frankel

Dissenting:

William J. Schwartz

A large, stylized handwritten signature in black ink, appearing to be 'W. J. Schwartz', written over the printed name 'William J. Schwartz'.

Dated: September 2, 2000