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Case Number 485,2012

### IN THE SUPREME COURT OF THE STATE OF DELAWARE

| BONANZA RESTAURANT COMPANY, | ) |                               |
|-----------------------------|---|-------------------------------|
|                             | ) |                               |
| Plaintiff Below,            | ) |                               |
| Appellant                   | ) | NO. 485, 2012                 |
|                             | ) |                               |
| V •                         | ) | ON APPEAL FROM SUPERIOR COURT |
|                             | ) | OF THE STATE OF DELAWARE      |
| ROBERT E. WINK,             | ) | IN AND FOR SUSSEX COUNTY      |
|                             | ) | C.A. No. S10C-10-018 RFS      |
| Defendant Below,            | ) |                               |
| Appellee.                   | ) |                               |

### APPELLANT'S REPLY BRIEF AND ANSWERING BRIEF ON CROSS-APPEAL

Eric W. Pinker (pro hac vice)
Texas Bar No. 16016550
Richard A. Smith (pro hac vice)
Texas Bar No. 24027990
LYNN TILLOTSON PINKER & COX, LLP
2100 Ross Avenue, Suite 2700
Dallas, Texas 75201
epinker@lynnllp.com
rsmith@lynnllp.com

Telephone: 214-981-3800 Facsimile: 214-981-3839

James D. Taylor, Jr.(#4009)
Jennifer M. Becnel-Guzzo (#4492)

SAUL EWING LLP

222 Delaware Avenue, Suite 1200

P.O. Box 1266
Wilmington, Delaware 19899
jtaylor@saul.com
jbecnel-guzzo@saul.com
Telephone: (302) 421-6800
Facsimile: (302) 421-6813

ATTORNEYS FOR PLAINTIFF-BELOW APPELLANT BONANZA RESTAURANT COMPANY

DATED: December 19, 2012

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## SUMMARY OF ARGUMENT ON CROSS-APPEAL

1. Denied. The Superior Court correctly determined that the future royalties sought by Bonanza were direct damages that are recoverable under the parties' contracts.

#### ARGUMENT

# I. THE SUPERIOR COURT ERRED BY RULING THAT WINK HAD NO LIABILITY FOR DAMAGES ATTRIBUTABLE TO FUTURE ROYALTIES DUE UNDER THE FRANCHISE AGREEMENTS.

In its Opening Brief, Bonanza pointed out that this appeal provides the Supreme Court with the opportunity to put its stamp on an emerging issue of franchise contract law. This will be at least the third case in the last two years in which a franchisee (or in this case, a former franchisee/guarantor) has attempted to avoid paying future royalties that would have been owed under the terms of the franchise agreement. See Meineke Car Care Ctrs., Inc. v. RLB Holdings, LLC, 423 F. App'x 274 (4th Cir. 2011); Hardee's Food Sys., Inc. v. Hallbeck, 2011 WL 4407435 (E.D. Mo. 2011) (Exhibit A). has drawn no meaningful distinction between his guaranty obligations and the contracts in the Meineke and Hardee's cases, and his attempts to avoid his quaranty obligations are based on a misreading of the contract. Accordingly, the Supreme Court should reverse the judgment of the Superior Court and affirm that Wink has breached his guaranty by refusing to pay the royalties owed by the new franchisees due to their breach of the Franchise Agreements.

## A. Wink Guaranteed All of the New Franchisees' Payment and Performance Obligations, Not Just the First Year.

Wink's response brief claims that "Bonanza's appeal rests entirely" on the *Meineke* and *Hardee's* cases. Ans. Br. at 9. But while those two cases amply demonstrate the merits of Bonanza's appeal, this case rests, first and foremost, on the terms of the parties' written contracts. Mr. Wink does not challenge the validity of his Consent Agreements with Bonanza. He seeks only to have them

construed in a manner that limits liability for his personal guaranty obligations to a period of one year. That argument is contradicted by the terms of the Consent Agreements, which plainly and unambiguously require Wink to guaranty all of the new franchisees' contractual obligations, not just their first year.

contractually obligated to "unconditionally Wink is personally guarantee to [Bonanza] the performance of all of the Assignee's obligations (monetary and other) under the New Franchise Agreement[s]." (A734 at  $\P$  6). (emphasis added). Thus, if the new franchisees were obligated to pay royalties to Bonanza after the first year of the Franchise Agreements, Wink was required to personally guaranty those royalty payments. There is no dispute that the franchisees were so obligated, as each of them were required to pay Bonanza "a continuing non-refundable royalty fee" for the entire term of their Franchise Agreements, and that it was a material breach by the franchisees to cease operating the restaurants before the end of their terms. (A74, A88 & A120; A210, A224 & A256; A347, A361 & A393; A489, A503 & A535). The payment of royalties to Bonanza for the entire term of the Franchise Agreements is therefore squarely within the scope of Wink's personal guaranty.

Nor is there any conflict between that conclusion and each Consent Agreement's provision that Wink's personal guaranty would expire after one year. That one-year "Guaranty Period" simply provides a limit for the length of time that Wink's guaranty would be in effect. It does not impose any kind of limitation on the types of damages that Wink was required to guaranty during the Guaranty Period:

Notwithstanding anything contained in this Agreement or the New Franchise Agreement to the contrary, [Bonanza] agrees that [Wink's] obligations under the Personal Guaranty shall be limited to a period of one (1) year from the effective date of the New Franchise Agreement (the "Guaranty Period"). If the Guaranty Period does not end prior to the expiration or termination of the Franchise Agreement, [Wink's] Personal Guaranty will survive beyond such expiration or termination and will be subject to the Assignee's post-termination obligations.

(A735 at ¶ 6). It is undisputed that the Franchise Agreements were terminated prior to the end of the 1-year Guaranty Period. As a result, the guaranty continued to be fully effective even after the Franchise Agreements were terminated, and Wink remained obligated to guaranty "all of the Assignee's obligations (monetary and other) under the New Franchise Agreement[s]." (A734 at ¶ 6) (emphasis added).

Wink asserts that he cannot be required to guaranty payment of royalties that would have only become due after the expiration of the 1-year Guaranty Period. That argument fails because the franchisees' breach occurred within the Guaranty Period. As a matter of basic contract law, a plaintiff's damages are measured at the time of breach. Miga v. Jensen, 96 S.W.3d 207, 214 (Tex. 2002). Texas law specifically provides that in an action for breach of a contract to make future payments, the plaintiff's lost value is measured by the total of all accrued payments plus the present value of the unaccrued payments that the plaintiff would have received if the contract had been fully performed. Universal Life & Accident Ins. Co. v. Sanders, 102 S.W.2d 405, 406 (Tex. 1937); Republic Bankers Life Ins. Co. v.

 $<sup>^{\</sup>rm 1}$  The Superior Court correctly concluded that the contracts are governed by Texas law. (Mem. Op. at 6; A702 at § 20.F). Wink does not challenge that ruling on appeal.

Hornburg, 551 S.W.2d 30, 31 (Tex. App. 1976). Thus, when the Franchise Agreements were terminated during Wink's Guaranty Period, the damages owed by the franchisees (and guaranteed by Wink) are measured at the time of the breach, including the present value of all the future royalty payments that the new franchisees were required to pay to Bonanza under the terms of the Franchise Agreements. As a result, there is no merit to Wink's claim that the only royalties he could be liable for were those that were already owing at the time the franchises were terminated.

There is no dispute that the new franchisees breached the Franchise Agreements within the first year of their term, and that the Franchise Agreements were terminated as a result of that breach. Because the breach and termination of the Franchise Agreements 1-year Guaranty Period, his occurred during Wink's obligations remained fully effective, and he is liable to Bonanza for caused by the new franchisees' breach. of the damages all Accordingly, the Supreme Court should rule that Wink breached the Consent Agreements by failing to pay Bonanza as required by his personal guaranty.

## B. Lost Royalties Are Benefit-of-the-Bargain Damages That Are Recoverable for Breach of a Contract to Pay Royalties.

Wink next argues that Bonanza cannot recover damages for royalties it was entitled to receive during the remaining terms of the Franchise Agreements, because "neither the Consents nor the Franchise Agreements obligates the payment of future royalty fees." Ans. Br. at 13. In essence, Mr. Wink is asking the Supreme Court to adopt a rule that a plaintiff may not recover damages for breach of contract unless

the specific measure of those damages is expressly stated in the contract. Needless to say, that is not a valid statement of the law. As the Fourth Circuit put it in *Meineke*:

The district court is correct that the [franchise agreements] do not specifically provide for recovery of future damages in the event of a breach of contract. However, nothing in the [franchise agreements] precludes such damages either. No principle of North Carolina contract law suggests that in all circumstances a contract must specifically provide for recovery of future damages in order to preserve a party's right to recover them. To the contrary, cases discussing recovery of lost profits do not refer to the parties' contracts as the basis for the nonbreaching party's right to such a recovery. While the parties were certainly free to contract for liquidated damages or to bar a right to recover lost profits under North Carolina law, they did not do so in this case. the extent the district court's decision required the agreements] to specifically provide [franchise prospective damages as a mandatory condition precedent to preserve a non-breaching party's right to recover such damages, this was error.

Meineke Car Care Ctrs., Inc. v. RLB Holdings, LLC, 423 F. App'x 274, 279-80 (citations and footnote omitted); see also Hardee's Food Systems at \*3 ("[T]he absence of an explicit contract provision as to future damages and of a liquidated damages provision does not warrant summary judgment in favor of a franchisee that breaches a franchise agreement mid-term.").

The result is precisely the same under Texas contract law. In Texas, benefit-of-the-bargain damages include the net profit that the claimant would have earned on the contract if the defendant had performed it as agreed. See Formosa Plastics Corp. v. Presidio Engineers & Contractors, Inc., 960 S.W.2d 41, 50 (Tex. 1998). If the new franchisees had performed their Franchise Agreements as they had agreed, Bonanza would have received a stream of weekly royalty

payments as required by section 5.D of the Franchise Agreements. Because the franchisees closed each of the four restaurants within the 1-year Guaranty Period provided by Wink's Consent Agreements, Wink is contractually obligated to "unconditionally and personally guarantee" the performance of those royalty payments to Bonanza. (A734 at § 6).

Finally, Wink briefly contends that even if the franchisees were obligated under general contract law to pay future royalties to Bonanza, Mr. Wink's guaranty was still "limited to the obligations set out in the Franchise Agreements, not to any other obligations the Franchisees owed." Ans. Br. at 14.2 That argument is once again contrary to the language of the contracts, which plainly required the franchisees to pay royalties to Bonanza under the Franchise Agreements for their entire terms. (A74, A88 & A120; A210, A224 & A256; A347, A361 & A393; A489, A503 & A535). Because the Franchise Agreements obligated the franchisees to pay those royalties, it is necessarily an obligation that he agreed to "unconditionally and personally guarantee." (A734 at ¶ 6). Thus, he is liable for the damages that Bonanza suffered as a result of the franchisees' failure to keep their restaurants open and to pay their weekly royalties to Bonanza.

Wink describes his guaranty as covering "obligations set out in the Franchise Agreements," but the Consent Agreements actually require Wink to guarantee "the performance of all of the Assignee's obligations (monetary and otherwise) under the New Franchise Agreement . . . ." (A734 at  $\P$  6). Thus, the guaranty expressly covers all obligations that arise "under" the Franchise Agreements, even if the obligations are not expressly stated "in" those agreements.

# II. THE SUPERIOR COURT PROPERLY DETERMINED THAT THE FUTURE ROYALTIES CLAIMED BY BONANZA WERE DIRECT DAMAGES THAT ARE RECOVERABLE UNDER THE PARTIES' CONTRACTS.

### A. Question Presented

On Cross-Appeal, Wink contends that the Superior Court erred in ruling that future royalties were direct damages that are recoverable under the parties' contracts. That issue was raised by Wink in his motion for summary judgment and his response to Bonanza's motion for summary judgment. (A637 & A866). However, Wink also attempts to argue that Bonanza cannot recover damages for future royalties because such damages were "not foreseeable," and that issue was not presented to the Superior Court. Compare Ans. Br. at 17-18 (arguing that future royalties were "not foreseeable") with A639-40 (arguing that "the lost royalty fees are speculative").

### B. Scope of Review

The Superior Court's summary judgment ruling is reviewed de novo. See Grabowski v. Mangler, 938 A.2d 637, 641 (Del. 2007). Likewise, the interpretation of a contract is a question of law subject to de novo review. See Emmons v. Hartford Underwriters Ins. Co., 697 A.2d 742, 744-45 (Del. 1997).

### C. Merits of Argument

 Bonanza's Claim for Lost Royalties Is a Claim for Direct Damages and Is Therefore Not Barred as Consequential Damages by the Franchise Agreements.

In his cross-appeal, Wink challenges the Superior Court's ruling that Bonanza's claim for recovery of future royalties was a claim for direct damages under Texas law. Bonanza raised and discussed that same issue in its opening brief, and it therefore incorporates by

reference pages 16-18 of that opening brief in partial response to Wink's cross-appeal. None of the arguments made by Wink in his cross-appeal alter the Superior Court's conclusion that future royalties are recoverable under the parties' contracts.

Wink's argument is based on section 20.J of the Franchise Agreements, which provides that the parties waive any right to recover "punitive, exemplary, consequential or speculative damages against the other," and that each party will instead "be limited to the recovery of actual damages sustained by it." (A128, A264, A401 & A543). Wink contends that the lost royalties Bonanza seeks to recover are consequential damages, and that section 20.J therefore prevents their recovery. That argument fails because it does not recognize the crucial distinction between lost profits that would have been earned under the parties' own contract, as compared to lost profits that may have been earned from some other source.

The Superior Court correctly determined that Texas law permits the recovery of lost profits as a form of direct damages for a defendant's breach of contract. See Mem. Op. at 9-10. In fact, Texas law draws a clear distinction between lost profits that are recoverable as direct damages, versus lost profits that are only recoverable as consequential damages. As one recent case summarized that distinction:

At common law, actual damages may be either "direct" or "consequential." Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 816 (Tex. 1997). Direct damages, which flow naturally and necessarily from a defendant's wrongful act, compensate the plaintiff for a loss that is conclusively presumed to have been foreseen by the defendant as a usual and necessary consequence of its wrongdoing. See id. By contrast, consequential damages

"result naturally, but not necessarily, from the defendant's wrongful acts." Stuart v. Bayless, 964 S.W.2d 920, 921 (Tex. 1998) (quoting Arthur Andersen, 945 S.W.2d at 816).

The category of "consequential damages" may encompass some, but not all, claims for loss of profits and, in fact, [defendant's] argument necessarily depends upon its description of [plaintiff's] damages as "profits lost on other contracts," a label [plaintiff] eschews. profits" consist of damages for the loss of net income to a business. Miga v. Jensen, 96 S.W.3d 207, 213 (Tex. 2002). Lost profits may be classified as either direct or consequential damages, depending on their nature. Mood v. Kronos Prods., Inc., 245 S.W.3d 8, 12 (Tex. App. 2007); Cont'l Holdings, Ltd. v. Leahy, 132 S.W.3d 471, 475 (Tex. App. 2003); Tenn. Gas Pipeline Co. v. Technip USA Corp., No. 01-06-00535-CV, 2008 WL 3876141, at \*11 (Tex. App. 2008) (mem. op.) (Exhibit B). That is, profits lost on the contract itself - such as the amount a party would have received on the contract minus its saved expenses - are direct damages. See Mood, 245 S.W.3d at 12; Leahy, 132 S.W.3d at 475.

On the other hand, profits lost on other contracts or relationships resulting from the breach may be classified as "indirect" or consequential damages. Mood, 245 S.W.3d at 12; Leahy, 132 S.W.3d at 475. Stated differently, if "a party's expectation of profit is incidental to the performance of the contract, the loss of that expectancy is consequential." Tenn. Gas Pipeline, 2008 WL 3876141, at \*11 (citing Naegeli Transp. v. Gulf Electroquip, Inc., 853 S.W.2d 737, 739 (Tex. App. 1993)).

Cherokee County Cogeneration Partners, L.P. v. Dynegy Mktg. & Trade, 305 S.W.3d 309, 314 (Tex. App. 2009) (emphasis added & citations conformed).

With that distinction in mind, it is readily apparent that the "lost profits" Bonanza seeks are direct damages, not consequential damages. The unpaid royalties that Bonanza seeks to recover are "profits on the contract itself," not "profits lost on other contracts or relationships resulting from the breach." Cherokee, 395 S.W.3d at 314. And in fact, the Cherokee court rejected the very same argument

that Wink is attempting to put forward here, ruling that the plaintiff's claim for lost profits was not barred as consequential damages under their contract because "the damages [plaintiff] seeks to recover represent built-in profits lost on the Agreement itself." Id. at 315. Likewise, Bonanza's own claim for damages seeks the "built-in" revenues that were to be received under the Franchise Agreements. Accordingly, it is not a claim for consequential damages, and is not barred by section 20.F of the Franchise Agreements.

# 2. Wink Has Failed to Preserve Any Challenge to the Foreseeability of Bonanza's Damages, But Lost Royalties Would Be Eminently Foreseeable in Any Event.

Finally, Wink argues that Bonanza cannot recover damages for its lost royalties because "the occurrence of those 'damages' was not foreseeable as the usual and necessary consequence of any wrongdoing." Ans. Br. at 17. But Wink cannot be heard to make that complaint on appeal because he never made such an argument to the Superior Court. In the court below, Wink instead challenged Bonanza's evidence of damages as "speculative under Delaware law and pursuant to the Franchise Agreements not recoverable." (A640). Likewise, Wink's response to Bonanza's cross-motion for summary judgment only claimed that the lost profits were barred as "speculative." (A869). Wink therefore has abandoned any claim on appeal that Bonanza's damages

<sup>&</sup>lt;sup>3</sup> Speculative damages and unforeseeable damages are not the same thing. Damages are "speculative" when the plaintiff cannot establish with reasonable probability the nature and extent of the claimed injury. Henne v. Balick, 51 Del. 369, 373 (1958). The foreseeability requirement for consequential damages, on the other hand, relates to whether the harm was a "natural, probable, and foreseeable consequence of the defendant's conduct," similar to a proximate cause inquiry. See Employees Retirement Sys. of Tex. v. Putnam, LLC, 294 S.W.3d 309, 316, 318 (Tex. App. 2009).

were barred as being "unforeseeable." See Roca v. E.I. du Pont de Nemours & Co., 842 A.2d 1238, 1242 (Del. 2004). Similarly, Wink has failed to preserve any appellate challenge to Bonanza's damages as being unforeseeable because he failed to present any such claim to the Superior Court. See, e.g., Pierson v. De La Warr Sch. Dist. Bd. Of Educ., 300 A.2d 3, 3 (Del. 1972).

But even if Wink had actually presented the Superior Court with his claim that future royalties are "not foreseeable," that argument would still be without merit. The Franchise Agreements obligate the franchisees to make weekly royalty payments to Bonanza for the full term of the agreements. (A74, A88 & A120; A210, A224 & A256; A347, A361 & A393; A489, A503 & A535). The royalty payments are calculated as a simple percentage of each restaurant's gross sales. (A74 & A88; A210 & A224; A347 & A361; A489 & A503). Thus, it is not just foreseeable, but functionally inevitable, that the franchisees' breach in closing down their restaurants would deny Bonanza the weekly royalty payments it was entitled to receive under the Franchise Agreements. The Supreme Court should therefore reject Wink's argument that Bonanza cannot recover its lost royalty fees as not being foreseeable.

### CONCLUSION

For the foregoing reasons, and for the reasons stated in its opening brief, Bonanza respectfully requests the Supreme Court to reverse the judgment of the Superior Court, grant judgment establishing that Wink breached his personal guaranty obligations in the Consent Agreements with Bonanza, and remand the case to the Superior Court for a determination of Bonanza's damages. Bonanza further requests all additional and alternative relief to which it may be justly entitled, including the recovery of its costs and expenses.

### SAUL EWING LLP

/s/ James D. Taylor, Jr.

James D. Taylor, Jr.(#4009)

Jennifer M. Becnel-Guzzo (#4492)

222 Delaware Avenue, Suite 1200

P.O. Box 1266

Wilmington, Delaware 19899

jtaylor@saul.com

jbecnel-guzzo@saul.com

Telephone: (302) 421-6800

Facsimile: (302) 421-6813

Eric W. Pinker
Texas Bar No. 16016550
Richard A. Smith
Texas Bar No. 24027990
LYNN TILLOTSON PINKER & COX, LLP
2100 Ross Avenue, Suite 2700
Dallas, Texas 75201
epinker@lynnllp.com
rsmith@lynnllp.com
Telephone: 214-981-3800
Facsimile: 214-981-3839

ATTORNEYS FOR PLAINTIFF-BELOW APPELLANT BONANZA RESTAURANT COMPANY

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