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The GPMemorandum

TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS

FROM: GRAY PLANT MOOTY'S FRANCHISE AND DISTRIBUTION PRACTICE GROUP

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Below are summaries of recent legal developments of interest to franchisors.

POST-TERMINATION INJUNCTIONS: NONCOMPETE COVENANTS

COURT GRANTS PRELIMINARY INJUNCTION ENFORCING COVENANT NOT TO COMPETE AGAINST FORMER FRANCHISEE

The United States District Court for the Northern District of New York has preliminarily enjoined a former franchisee from operating a competing business in violation of her covenant not to compete with the franchisor. *H&R Block Tax Servs., LLC v. Strauss*, Case No. 1:15-cv-0085 (N.D.N.Y. Feb. 4, 2015). Gray Plant Mooty represents H&R Block in this case. The franchisee, Strauss, had agreed that upon termination of her franchise agreement she would neither solicit clients to whom her franchise had provided tax return preparation services nor compete with H&R Block in the business of preparing tax returns for a period of one year within 45 miles of her formerly franchised territory. When her franchise expired, Strauss declined Block's offer to enter into its current form of franchise agreement and continued to operate an independent tax return preparation business at the same location as her former franchise. She also continued to schedule appointments with clients seeking tax return preparation services using the local telephone number that was listed under the name H&R BLOCK in the area.

In granting Block's motion for a temporary restraining order and preliminary injunction, the court held that Block was likely to succeed on the merits of its claim that the franchisee had breached the noncompete provision in her franchise agreement and that the provision was reasonable and

enforceable under Missouri law, which governed the contract. The court also found that Block would suffer irreparable harm to its goodwill and its ability to establish a new tax return preparation office in the area if Strauss was not enjoined from diverting past clients to her new business. Turning to the balance of equities, the court observed that Strauss had reaped the benefits of her association with Block over the 30-year period that she had operated her franchise and that she had freely agreed to the terms of the franchise agreement. Accordingly, the court ordered that Strauss cease operating a tax business within 45 miles of her formerly franchised territory and immediately transfer to Block the telephone number that had been used by the formerly franchised business. The court held that the injunction against competition also applied to employees of Strauss's formerly franchised business who were acting in concert with her to operate the independent tax return business at that same location.

TERMINATIONS

NINTH CIRCUIT AFFIRMS SUMMARY JUDGMENT IN FRANCHISOR'S FAVOR

The United States Court of Appeals for the Ninth Circuit upheld the termination of a group of franchisees based on their failure to make required payments and their abandonment of one of their franchised offices. *Century 21 Real Estate LLC v. All Prof'l Realty, Inc.*, 2015 U.S. App. LEXIS 645 (9th Cir. Jan. 15, 2015). After Century 21 filed suit to enforce termination of the parties' franchise agreements, the franchisees asserted a variety of counterclaims, including breach of contract, unfair competition, breach of the implied covenant of good faith and fair dealing, and violation of the California and Hawaii franchise sales laws. The district court entered summary judgment in Century 21's favor on all claims and counterclaims.

On appeal, the Ninth Circuit affirmed the district court's decision. The court held that Century 21 was entitled to summary judgment on its contract claims because the undisputed evidence showed that the franchisees breached the franchise agreements by not paying required fees, not paying the principal due on a promissory note, and abandoning one of their franchise locations. Likewise, the franchisees failed to establish that Century 21 had not fully performed under the franchise agreements. The franchisees' claims for unfair competition and breach of the implied covenant duplicated their contract claims and, therefore, failed as a matter of law. The court also upheld the dismissal of the franchisees' claims under the California and Hawaii franchise investment laws because Century 21 had good cause to terminate the franchise agreements. The Ninth Circuit further determined that the district court did not err in enforcing the liquidated damages provision in the franchise agreements because the damages were reasonably calculated. Finally, treble damages were appropriate because the franchisees' post-termination use of Century's 21 trademarks was willful and likely to cause confusion.

ARBITRATION

SEVENTH CIRCUIT FINDS NO "MANIFEST DISREGARD OF THE LAW"

Affirming a district court decision that had in turn confirmed an arbitration award for a franchisor, the United States Court of Appeals for the Seventh Circuit last Friday ruled that an arbitrator's alleged error of law would not constitute manifest disregard of the law. *Renard v. Ameriprise Fin. Servs., Inc.*, 2015 U.S. App. LEXIS 1558 (7th Cir. Jan. 30, 2015). Ameriprise, the franchisor in this case, had won an arbitration award against the Wisconsin-based franchisee, Renard, of more than $448,000 on promissory notes. In the arbitration hearing, Renard had argued that he did not have to repay the notes because Ameriprise had breached the franchise agreement between the parties, and that it had violated the Wisconsin Fair Dealer Law (WFDL). He lost, but the three-arbitrator panel did not explain its award. Renard then sought to vacate the award, and Ameriprise sought to have it confirmed. In the federal district court, Ameriprise prevailed again.

On appeal, the Seventh Circuit first held that the Federal Arbitration Act (FAA), rather than Wisconsin state arbitration law, controlled the proceedings. Importantly, the FAA preempts certain state law, particularly any WFDL provision that could be claimed to require Wisconsin franchisees to have the benefit of the state law on arbitration. In addition, under the FAA, an arbitral award cannot be vacated by a court even if the losing party shows that the arbitrators made an error of law. In this case, even Renard conceded that the arbitrators had considered and analyzed the law that he claimed applied; they just determined that it did not apply to the fact situation at issue. For that reason, the Seventh Circuit held that the arbitrators had not "disregarded" the law at all, and the award was upheld.

ENFORCING ARBITRATION PROVISION, DISTRICT COURT DISMISSES PUTATIVE CLASS ACTION BY FRANCHISEE

A federal court in Illinois recently held that it lacked subject-matter jurisdiction over a putative franchisee class action in light of the binding arbitration provision in the governing franchise agreement. *Sanchez v. CleanNet USA, Inc.*, 2015 U.S. Dist. LEXIS 5383 (N.D. Ill. Jan. 15, 2015). The named plaintiff, Sanchez, filed suit against franchisor CleanNet USA and area operator CleanNet IL claiming violation of the Fair Labor Standards Act. Both defendants moved for dismissal based on a mandatory arbitration provision in the franchise agreement. In response, Sanchez argued that the arbitration provision was procedurally and substantively unconscionable and therefore unenforceable. Sanchez claimed that the agreement was presented in a "take-it-or-leave-it" manner, the arbitration provision was "buried" in the lengthy agreement and

CleanNet failed to explain every term of the agreement in Spanish, his native language. Sanchez also argued that the cost sharing scheme and damages limitation clause in the arbitration provision rendered it unconscionable.

The court generally found Sanchez's arguments unpersuasive. Applying Illinois law, the court held that absent evidence of an abuse of power, disparate bargaining power between parties does not render an agreement unenforceable. The court also found that the arbitration provision was not "buried" in the agreement because it was presented in the same font and format as the other terms in the agreement. As to the translation claim, the court held that CleanNet had no obligation to translate the entire franchise agreement into Spanish, or to explain every provision in Spanish. A CleanNet representative discussed the agreement with Sanchez in Spanish before he signed and initialed every page. Although the court found that the cost sharing scheme in the arbitration provision was not unfair, it agreed that the damages limitation clause in the arbitration provision was unconscionable because it precluded Sanchez from seeking unwaivable statutorily remedies. However, the court found that the unconscionable damages limitation clause did not make the entire arbitration provision unenforceable; rather, it could be severed from the agreement.

LIMITATION OF ACTIONS

CONTRACTUAL LIMITATIONS CLAUSE REDUCES AVAILABLE RECOVERY BUT DOES NOT BAR CLAIMS

A federal court in California recently denied a motion by former franchisees to dismiss a franchisor's claims for breach of contract and trademark infringement based on the contractual limitations period in the parties' franchise agreement. *Fantastic Sam's Salons, Corp. v. Moassesfar*, 2015 U.S. Dist. LEXIS 6934 (C.D. Cal. Jan. 21, 2015). Moassesfar had operated one Fantastic Sam's salon for three years and a second for over two years without paying franchise fees. In 2014, Fantastic Sam's sent Moassesfar a notice of default and provided an opportunity to cure the financial defaults, and then in August 2014 filed a complaint after the franchisees had failed to cure. The parties then entered into a stipulation agreeing to the termination of the franchise agreements and requiring Moassesfar to return Fantastic Sam's confidential information, leaving only breach of contract and trademark infringement claims. Moassesfar filed a motion to dismiss, contending the claims were contractually time-barred. The franchise agreement stated that any claim for rescission or damages had to be brought within the later of one year from the date of the act or failure to act or six months from the date when claimant knew or should have known of the act or failure to act.

Moassesfar argued that the agreement had terminated when two consecutive payments were missed, as provided in the termination clause, thus barring the claims entirely. The

court rejected this theory, noting that the termination clause was contrary to California law, which provides that a franchise agreement cannot automatically terminate without notice to the franchisee and an opportunity to cure. However, the court did find that the limitations period applied to the acceleration clause, which stated that upon termination the franchisees must immediately pay all monies due through the later of the last date the trademarks were used or the expiration of the franchise agreement. The court found that termination was a condition precedent for the acceleration clause, and that termination was triggered when Moassesfar ceased making payments, meaning that the contractual limitations clause barred any claim for accelerated fees.

FRAUD

COURT BARS EVIDENCE RELATED TO AFFIRMATIVE DEFENSE OF INDUCEMENT

A federal court in Pennsylvania recently barred a franchisee from introducing evidence at trial that a franchisor had fraudulently induced the franchisee to enter into a contract through extra-contractual assurances. In *G6 Hospitality v. HI Hotel Group, LLC*, 2015 U.S. Dist. LEXIS 5125 (M.D. Pa. Jan. 15, 2015), G6 Hospitality brought suit for breach of contract and infringement of G6's Motel 6 trademarks. As trial approached, G6 anticipated that HI would assert an affirmative defense to the contract claim by arguing that it entered into the franchise agreement only because of promises from G6 that a competing Motel 6 would close down and HI would have a right of first refusal to buy the competing motel.

G6 moved for a pretrial order barring evidence of this defense because the contract was governed by Texas law, which did not allow a fraudulent inducement claim when a contract included a disclaimer-of-reliance provision. HI tried to recast its defense as one based on G6's breach of the duty of good faith and fair dealing. The court noted that Texas does not recognize a duty of good faith in a franchise agreement because there is not a special relationship between the parties. Because HI could not provide any defense based on the alleged extra-contractual assurances, the court granted G6's motion and ruled that HI would be barred from introducing such evidence at trial.

VICARIOUS LIABILITY

FEDERAL COURT IN CALIFORNIA APPLIES *PATTERSON* TO FIND FRANCHISOR NOT EMPLOYER OF FRANCHISEE EMPLOYEES

In *Vann v. Massage Envy Franchising, LLC*, 2015 U.S. Dist. LEXIS 1002 (S.D. Cal. Jan. 6, 2015), the United States District Court for the Southern District of California found that Massage Envy Franchising was not the employer or a joint employer of its franchisees' employees, and therefore was not liable for any alleged wage and hour law violations.

Vann, a former employee of two franchised spas, alleged Massage Envy exercised control over hiring and firing because it: (a) provided franchisees with operations manual containing suggested personnel policies; (b) hired district managers to monitor franchisee compliance; (c) required personnel to follow scripts when interacting with customers; and (d) required franchisees to conduct background checks. Vann further alleged that Massage Envy must have instigated the alleged wage law violations because all franchisees in the region had adopted nearly identical wage policies.

Applying the test for employer liability established by the California Supreme Court in *Patterson v. Domino's Pizza*, on which we reported in Issue 184 of *The GPMemorandum*, the court found that Massage Envy could not be held liable for alleged wage and hour law violations committed by franchisees because it did not have the authority to hire, fire, or train franchisees' employees, or to dictate their schedules or wages. The court cited franchise agreement and operations manual provisions stating that Massage Envy was not the joint employer of its franchisees' employees, that any personnel policies made available to the franchisees by Massage Envy were optional, and that Massage Envy would refrain from controlling the franchisees' employment practices. Accordingly, the court granted Massage Envy's motion for summary judgment dismissing Vann's joint employer liability claims. This outcome stands in contrast to case on which we reported in Issue 187 of *The GPMemorandum*, *Hahn v. Massage Envy Franchising, LLC*, 2014 U.S. Dist. LEXIS 147899 (S.D. Cal. Sept. 25, 2014), in which the court determined that the same franchisor could be liable for violations of California's Unfair Competition Law based upon the content of membership agreements used by franchisees but originated by Massage Envy.

RECENT EVENTS IN *NLRB V. MCDONALD'S* OFFER LITTLE INSIGHT INTO CONDUCT ALLEGED TO SUPPORT JOINT EMPLOYER FINDING

Despite various procedural efforts by McDonald's, it remains unclear what specific conduct the NLRB contends makes a franchisor—even McDonald's—a "joint employer" with its franchisees. As is well known in franchising circles, on Dec. 19, 2014, the NLRB Office of the General Counsel (GC) issued 13 complaints involving McDonald's USA, LLC and 21 of its franchisees, consolidating 78 alleged violations of labor laws including "discriminatory discipline, reduction in hours, discharges and other coercive conduct directed at employees in response to union and protected concerted activities." The complaints fail to allege any factual basis for the joint employer claim beyond the existence of a franchise agreement, alleging only that "McDonald's possessed and/or exercised control over the labor relations policies of [the franchisees]." In opposition to a McDonald's motion, however, discussed below, the GC asserted:

> The evidence will show that McDonald's USA imposes identical requirements and means of control across all of its franchises, including

> uniform imposition of operating and employment practices through such things as franchise agreements, operating manuals, required hardware and software, training, franchise review processes, and direct supervision. The evidence will also show that McDonald's USA engaged in a nationwide, coordinated response to what it perceived to be a nationwide campaign by the Service Employees International Union and that much of the response was implemented by the franchises. Given this uniformity of operations, common control, and coordinated conduct, the General Counsel expects much of the evidence regarding McDonald's USA's relationship with any one franchise will also be evidence regarding McDonald's USA's relationship to its other franchises.

McDonald's unsuccessfully responded in New York case with a motion seeking to require the GC to allege the facts underpinning the joint employer allegation. McDonald's and each of the franchisees also assert that severance is appropriate because the alleged unfair labor practices arose in cities throughout the U.S., that each claim is based upon unique facts, and because it would be unduly costly and unfair to require them to travel to New York, Chicago, and Los Angeles to be part of similar hearings that involve factual allegations irrelevant to their cases. McDonald's and the franchisees argue that the existence of a joint employer status will depend on unique facts involving each franchisee, if the relationship exists at all. The hearings are scheduled to begin March 30, 2015.

DAMAGES TO FRANCHISOR

COURT DENIES SUMMARY JUDGMENT AGAINST ONE GUARANTOR BECAUSE SIGNATURES OF CO-GUARANTORS MAY HAVE BEEN FORGED

A federal court in New Jersey last week refused to grant judgment to a franchisor without a trial to enforce a guaranty because the target guarantor submitted evidence that, while his own signature was undisputed, the signatures of his fellow guarantors were forged. *Ramada Worldwide Inc. v. Jafri*, 2015 U.S. Dist. LEXIS 10050 (D.N.J. Jan. 29, 2015). There were four guarantors to the franchisee's obligations under the hotel franchise agreement in this case. The party against which the franchisor sought summary judgment opposed the motion on the theory that he would not have committed to the guaranty agreement had he known he might be the only one against which the agreement could be enforced. In accepting this theory for purposes of the pending motion, the court noted that above the signatures the agreement said that "*each of us* has signed this Guaranty" and that the agreement refers to the guarantors in the plural with words such as "we" and "us." The court also pointed out that the agreement could have been drafted to say it was enforceable against each individual based on his signature alone, and that liability was not contingent on others signing.

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