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.

CLASS ACTIONS

SEVENTH CIRCUIT REVERSES CLASS CERTIFICATION AND SETTLEMENT RELATED TO SUBWAY'S "FOOTLONGS"

The United States Court of Appeals for the Seventh Circuit has reversed a district court's decision to certify a class and approve a settlement related to Subway's "Footlong" sandwiches. *In re Subway Footlong Sandwich Mktg. & Sales Practices Litig.*, 2017 WL 3666635 (7th Cir. Aug. 25, 2017). In 2013, a teenager's photo revealing his 11-inch Subway Footlong sandwich alongside a tape measure went viral. Plaintiffs' lawyers across the nation sued Subway under state consumer protection laws, and the cases were consolidated. Initial discovery indicated that the majority of Subway Footlong sandwiches are indeed at least 12 inches long, that the few that do not measure up fall short due to unpreventable vagaries in the baking process, and that the length of the bread has no bearing on the quantity of food a customer receives. Their clients having suffered no compensable injury, the plaintiffs' lawyers sought class certification for injunctive relief. They then negotiated a settlement whereby Subway agreed to institute certain quality control measures and to pay the class's attorneys $520,000 in fees. After the district court approved the settlement, Theodore Frank, a professional objector to hollow class-action settlements, appealed the decision arguing that the settlement only enriched the class's attorneys and provided no meaningful benefits to the class.

The court of appeals agreed with Frank and reversed the district court's holdings. Under federal law, class representatives must "fairly and adequately protect the interests of the class," and a class action settlement may not be approved unless it is "fair, reasonable, and adequate." The appellate court explained that, in this case, the settlement itself acknowledged that ensuring uniformity in bread length was impossible even with the newly instituted control measures. Thus, the court found the injunctive relief approved by the district judge to be "utterly worthless," and held that because the settlement's principal effect was to induce Subway to pay the class's attorneys enough to go away, the class representatives had failed in their duty to protect the interests of the class.

CHOICE OF FORUM

MARYLAND DISTRICT COURT ENFORCES FORUM SELECTION CLAUSE

In *ServiceMaster of Fairfax, Inc. v. ServiceMaster Residential/Commercial Services, L.P.*, 2017 WL 3023342 (D. Md. July 17, 2017), a multi-unit franchisee brought suit against ServiceMaster in Maryland state court for, among other things, violations of Maryland's franchise disclosure laws. ServiceMaster removed the case to federal court in Maryland and moved to transfer the case to the United States District Court for the Western District of Tennessee pursuant to the forum selection clause contained in the parties' franchise agreements. Gray Plant Mooty represented ServiceMaster in the case.

The franchise agreements' forum selection clause provided that all litigation must be venued in Tennessee unless the law to be applied under the choice of law clause required otherwise. The choice of law clause for at least one of the franchise agreements had been amended to state that Maryland's franchise disclosure law *allowed* franchisees to initiate actions in Maryland for claims arising under the franchise law. The court concluded that the permissive admonition contained in the amendment to the choice of law clause did not alter the mandatory nature of the agreements' forum selection clause. Having so concluded, the court applied the framework set forth by the Supreme Court in *Atlantic Marine* for assessing the enforceability of a valid and mandatory forum selection clause. Under that framework, the court concluded that the franchisee failed to carry its burden to establish that the public interest weighed against transferring the suit to the parties' agreed upon forum. In reaching its conclusion, the court found that the franchisee had failed to show that any of the complained-of conduct occurred in Maryland. The court also reasoned that the case did not involve difficult questions of Maryland law.

EMPLOYMENT

FEDERAL COURT FINDS SUFFICIENT EVIDENCE OF JOINT-EMPLOYER RELATIONSHIP TO SURVIVE MOTION TO DISMISS

Another decision out of the United States District Court for the District of Maryland partially granted, and partially denied, a motion to dismiss filed by franchisor Ledo Pizza Systems in an action involving one of Ledo's franchisees and the franchisee's employees. *Lora v. Ledo Pizza Sys., Inc.*, 2017 WL 3189406 (D. Md. July 27, 2017). Among the issues in dispute were claims filed by the employees of the franchised business against both Ledo and the franchisee pursuant to the Fair Labor Standards Act ("FLSA") and the Age Discrimination in Employment Act of 1967 ("ADEA"). The employees' FLSA claim was predicated on the allegation that they had been fired for raising wage issues. Similarly, the ADEA claim was based on an allegation of retaliatory termination after the franchisee's manager refused to terminate an employee based on her age, despite the urging of a Ledo corporate employee. Although the plaintiffs were employees of the franchisee, they asserted claims against Ledo as well, on the theory that Ledo was their joint-employer. Ledo filed a motion to dismiss the plaintiff's claims, arguing that it was not a joint-employer of the franchisee's employees.

The court denied Ledo's motion to dismiss after finding that the plaintiffs had adequately pled facts evidencing a joint-employer relationship. With regard to the FLSA claim, the court noted that the plaintiffs sufficiently alleged that: (1) the franchisee hired its manager at the recommendation of Ledo's president; (2) a Ledo corporate employee controlled and directed the manager's work, including requiring that the manager submit daily and weekly reports, telling the manager how to stock the bar, and directing scheduling; and (3) Ledo exerted hiring and firing power over the franchisee's employees. With respect to the ADEA claim, the court similarly noted that a joint-employer relationship had been sufficiently alleged because the employees asserted that Ledo had exercised control over hiring and firing decisions, engaged in day-to-day supervision of the employees, and provided formal or informal training.

PENNSYLVANIA COURT DISMISSES CASES CLAIMING FRANCHISOR IS JOINT EMPLOYER

Meanwhile, a federal court in Pennsylvania dismissed an auto repair services franchisor from a sexual harassment and discrimination case brought by a franchisee's former employee. In *Harris v. Midas*, 2017 WL 3440693 (W.D. Pa. Aug. 10, 2017), the plaintiff employee of a Midas Auto Service franchisee was allegedly repeatedly sexually, physically, and emotionally harassed, assaulted, and tortured by some of the franchisee's other employees. In addition to suing the franchisee, the employee sued Midas, alleging joint employer, agency, and vicarious liability.

In moving to dismiss the plaintiff's claims, Midas argued that the plaintiff failed to demonstrate a plausible basis for joint employer liability, which requires that both parties exercise significant control over the same employee. The court agreed, holding that the plaintiff failed to allege that Midas had any authority to hire or fire her, promulgate work assignments, control her compensation, benefits, or hours, supervise her day-to-day work, discipline her, pay her salary, or manage her employee records. The court further held that the plaintiff failed to plead a plausible basis for agency or vicarious liability against Midas. The decisive issue in such claims is whether the franchisor exercises control over the franchisee's business operations. The court held that the plaintiff's allegations that Midas set guidelines and requirements regarding appearance, inventory, advertising, pricing, record-keeping, operating hours, uniforms, and quality standards, are common to almost all franchise agreements, and represent the kind of controls inherent in a franchise relationship, seeking to address "the result of the work and not the manner in which it is conducted." The court held that absent more allegations of actual day-to-day control, the plaintiff failed to allege a claim for agency or vicarious liability.

VICARIOUS LIABILITY

FRANCHISOR DISMISSED FROM CUSTOMER DISCRIMINATION CASE

In another form of vicarious liability case, a court in Idaho granted summary judgment in favor of a franchisor and its corporate parent, after an employee of a franchised Taco Bell restaurant was accused of giving automatic discounts to white military customers but not to military members of color. *McKinnon v. Yum! Brands, Inc.,* 2017 WL 3659166 (D. Utah Aug. 24, 2017). The plaintiffs, members of the Army National Guard, alleged that they went to the franchised restaurant with a group of other military members that included four Caucasians. Only after the group members had purchased their food did they notice the cashier had given a 50% "Police Officer" discount to the four Caucasians but none to plaintiffs. The Caucasians had not asked for the discount.

The franchisee argued that the discounts were given by mistake because the restaurant's policy was not to give the "Police Officer" discount to military members and not to give it unless requested by the customer. The court refused to weigh witness credibility and found sufficient evidence for claims against the franchisee to survive. However, regarding the vicarious liability and apparent authority claims against the franchisor, the court applied the specific instrumentality test, deferred to the franchise agreement, and observed a lack of evidence showing control by the franchisor over the application of discounts or the training or discipline of the franchisee's employees. While the plaintiffs argued that the franchisor's branding and marketing established an expectation of agency, the court found no representation by the franchisor upon which the plaintiffs could have relied in forming a belief that the franchisor would prevent discriminatory practices. Going further, the court found that "'a person of ordinary prudence, conversant with the business usages and the nature of' chain businesses is not justified in believing a franchisor has control over any substantial aspect of the day-to-day operations of any particular franchise."

ILLINOIS APPELLATE COURT UPHOLDS DISMISSAL OF EMOTIONAL DISTRESS SUIT AGAINST FRANCHISOR

An appellate court in Illinois upheld a trial court's dismissal of a suit for emotional distress against a franchisor and a franchisee by two of the franchisee's customers who were filmed in a franchised Planet Fitness gym's tanning room without their knowledge or consent. *C.H. v. Pla-Fit Franchise, LLC*, 2017 IL App. 3d 160378 (Ill. App. Ct. Aug. 23, 2017). The court rejected the plaintiffs' arguments that the franchisor, Pla-Fit, was liable for the tortious acts of the franchisee's employee based on the special relationship between Pla-Fit and its franchisee and Pla-Fit's alleged voluntary undertaking to ensure that the franchisee was protecting customers' privacy.

The court found that, while the franchisee may have had a duty to protect the customers from the tortious acts of a third party, Illinois law does not recognize any such special relationship between a franchisor and a franchisee's customers. With regard to the voluntary undertaking theory, the court found that under Illinois law, a franchisor is not liable if the franchisee retains control of the day-to-day operations of the business. Furthermore, the court noted that the Restatement (Second) of Torts limits liability under a voluntary undertaking theory to liability for physical harms, rather than purely emotional harms. Finally, the court held that the franchisor was not liable under a premises liability theory because the franchisor was not the possessor of the premises owing a duty of care. Therefore, the appellate court affirmed dismissal of the case.

TORTIOUS INTERFERENCE

COURT GRANTS FRANCHISOR SUMMARY JUDGMENT ON FRANCHISEE'S TORTIOUS INTERFERENCE COUNTERCLAIM

A federal district court in Wisconsin recently granted summary judgment in favor of the franchisor of Dairy Queen® restaurants against a counterclaim alleging that it had improperly interfered with negotiations between a franchisee and its subfranchisee, to which the franchisee was attempting to sell its territory rights. *Am. Dairy Queen Corp. v. Universal Inv. Corp.*, 2017 WL 3701865 (W.D. Wis. Aug. 25, 2017). The subfranchisee, Universal Investment Corp., had operated a Dairy Queen unit in Wisconsin for more than 40 years. Universal's franchise rights were originally granted by Stephen Partnership, a former Dairy Queen licensee and territory operator in Wisconsin. In August 2013, American Dairy Queen terminated Stephen Partnership's territory rights for failure to submit monthly reports and payments. The franchisor subsequently sought a declaratory judgment that it had validly terminated Stephen Partnership's territory rights. In June 2014, during the pendency of the dispute between American Dairy Queen and Stephen Partnership, Universal attempted to purchase territory rights from Stephen Partnership. While negotiations were taking place between Stephen Partnership and Universal, the franchisor reached a settlement agreement with Stephen Partnership that transferred all of Stephen Partnership's rights back to the franchisor.

Universal subsequently alleged that American Dairy Queen improperly interfered with Universal's *prospective* contract with Stephen Partnership. The franchisor moved for summary judgment against the claim of tortious interference on the ground that it had legally terminated its relationship with Stephen Partnership and that Stephen Partnership had no continuing right to sell territorial rights to Universal. In granting summary judgment, the district court noted that the franchisor's actions were consistent with its right to control its trademark and license.

ARBITRATION

FEDERAL COURT DENIES FRANCHISOR'S EFFORTS TO COMPEL ARBITRATION

In *Money Mailer, LLC v. Brewer*, 2017 WL 3017539 (W.D. Wash. July 17, 2017), the United States District Court for the Western District of Washington held that a franchisor had waived its right to compel arbitration under its franchise agreement. Money Mailer's standard franchise agreement required franchisees to enter into a franchise agreement with the franchisor, Money Mailer Franchise Corporation ("MMFC"), and a separate contract for mailing services with a closely-related entity, Money Mailer, LLC ("MMLLC"). While franchisee Brewer entered into Money Mailer's standard franchise agreement, which contained a mandatory arbitration clause, there was no separate contract entered into between Brewer and MMLCC for the franchise's mailing services. After Brewer had been a franchisee for a little over four years, MMLLC sued Brewer for breach of contract and for over $1.7 million in past-due charges to recoup debts on behalf of both itself and MMFC. Brewer asserted counterclaims against both MMLLC and MMFC, including violations of the Washington Consumer Protection Act and the Washington Franchise Investment Protection Act, breach of contract, misrepresentation, and unjust enrichment. MMFC filed a motion for summary judgment, arguing that the mandatory arbitration clause in Brewer's franchise agreement foreclosed all of Brewer's counterclaims.

The court disagreed. According to the court, regardless of whether the franchise agreement's arbitration clause applied, the arbitration clause had been waived because MMLLC filed the lawsuit in part on MMFC's behalf. That fact, in addition to the fact that Brewer would suffer prejudice from defending against MMLLC's claims in federal court while being forced to arbitrate other disputes with MMFC, led the court to hold that MMFC had waived its right to compel arbitration.

PROCEDURAL DISPUTES SUBJECT TO ARBITRATION

Meanwhile, a federal court in New Jersey granted a franchisor's motion to compel arbitration finding, among other things, that a franchisee's claims fell within the scope of the parties' arbitration agreements (as contained in seven franchise agreements), and that any differences between the arbitration provisions could be reconciled. *Mitnick v. Yogurtland Franchising, Inc.*, 2017 WL 3503324 (D.N.J. Aug. 16, 2017). The franchisee had argued that the arbitration provisions contained different language, were in conflict, and did not specify a uniform method of arbitration. While the court acknowledged the differences in the various arbitration provisions, it compelled arbitration reasoning that the differences were trivial and could be reconciled in a single arbitration action.

The franchisee further argued that, based on clauses contained in the franchise agreements, the court should compel the parties to mediate their claims before proceeding with arbitration. In response, Yogurtland maintained that by filing a court action, the franchisee waived its right to invoke the mediation clauses. In declining to rule on this issue, the court found that while claims of arbitrability were within its jurisdictional scope, procedural disputes between the parties relating to the arbitration process must be decided by an arbitrator. As a result, the court held that any procedural disagreement between the parties must be resolved through arbitration.

COURT DENIES PETITION TO VACATE ARBITRATION AWARD UNDER EVIDENT PARTIALITY AND EXCEEDING POWER STANDARDS OF REVIEW

The federal court in Massachusetts has denied a franchisor's motion to vacate an arbitration award and granted a franchisee's motion to confirm the award on the grounds that the franchisor failed to show that the arbitrator was partial to the franchisee or that the arbitrator had exceeded her powers. *System4, LLC v. Ribeiro*, 2017 WL 3461292 (D. Mass. Aug. 11, 2017). In 2010, a state court putative class action was filed against franchisor System4 and master franchisee NECCS, Inc. on behalf of unit franchisee cleaning workers who claimed that System4 and NECCS had misclassified them as independent contractors in violation of the Massachusetts Wage Act. After System4 successfully moved to compel the unit franchisees to individually arbitrate under the terms of their franchise agreements with NECCS, Luis Ribeiro, one of the putative class members, filed an arbitration demand with the American Arbitration Association alleging Wage Act claims.

At the outset of the case, the arbitrator determined that Ribeiro was likely to succeed on his Wage Act claim. Therefore, instead of applying the AAA's Commercial Arbitration Rules pursuant to the franchise agreement terms, the arbitrator ruled that the proceedings would be governed by the AAA's Employment Rules, and ordered System4 to advance the cost of the arbitration. On cross-motions for summary judgment, the arbitrator ultimately determined that Ribeiro should have been classified as an employee under the Wage Act, and awarded Ribeiro damages, attorneys' fees, and costs. System4 then moved the federal court to vacate the award, arguing that there was evident partiality on behalf of the arbitrator towards Ribeiro and that she exceeded her powers in making several unfavorable rulings against System4 since she refused to adhere to the franchise agreement terms, and disregarded the applicable statutory and common law. Citing existing precedent that a party must meet a high burden to demonstrate objective facts inconsistent with impartiality, the court rejected System4's argument that the arbitrator was partial to Ribeiro.

Moreover, the court declined to find that the arbitrator had failed to adhere to the terms of the franchise agreement by applying the AAA Employment Rules in lieu of the Commercial Arbitration Rules, noting that her substantive determination that Ribeiro should have been classified as an employee, and that System4 had violated the Wage Act, would require overriding the AAA Commercial Rules in any case. Finally, the court found that the arbitrator did not act in manifest disregard of the law. It noted that, even if the arbitrator misapplied the law, that would not be enough to overturn the decision. Rather, the party challenging the decision would have to show that the reasoning in the award was so "palpably faulty" that no judge "could ever conceivably have made such a ruling."

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