GRAY PLANT MOOTY

The GPMemorandum

TO: **OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS**

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

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DATE: **June 5, 2019—No. 242**

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

TRADEMARKS

SUPREME COURT HOLDS THAT REJECTION OF A TRADEMARK LICENSE BY A BANKRUPT LICENSOR DOES NOT DEPRIVE THE LICENSEE OF ITS RIGHTS TO THE TRADEMARKS

The U.S. Supreme Court has resolved a circuit court split by holding that a bankrupt licensor's rejection of a trademark license under section 365 of the Bankruptcy Code does not deprive the licensee of its rights to the licensed trademarks. *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 587 U.S. ___, 2019 WL 2166392 (May 20, 2019). The decision holds that the licensor's rejection of the trademark license under bankruptcy law constitutes a breach of the license by the licensor and that the legal effects of that breach on the licensee's rights to the trademarks are determined under applicable non-bankruptcy law. The decision overrules a number of lower court decisions, including the First Circuit's decision in *Mission*, holding that a licensor's rejection of a trademark license in bankruptcy effectively rescinds the license, thereby depriving the licensee of its rights to the licensed trademarks.

This case arose when Tempnology entered into a five-year trademark license agreement with Mission Product Holdings that authorized Mission to utilize the "Coolcore" trademarks in connection with its distribution of clothing and accessories. Tempnology then filed a Chapter 11 bankruptcy case during the term of the trademark license. The trademark license constituted an executory contract (*i.e.*, a contract under which performance remained due by both parties) that could either be rejected or assumed by Tempnology under section 365 of the Bankruptcy Code. After authorizing Tempnology to reject its contractual duties under the trademark license, the bankruptcy court held that Tempnology's rejection of the license terminated Mission's rights to use the trademarks, a holding that was affirmed by the First Circuit. The Supreme Court reversed, holding that Tempnology's election to reject its trademark license with Mission constituted a breach of the trademark license under the Bankruptcy Code, but not a rescission or termination of the license. The Supreme Court noted that, under applicable non-bankruptcy law (*i.e.*, trademark and contract law), a breach of a trademark license by the licensor would not result in the rescission or termination of the licensee's rights to use the trademarks. Consequently, the Court concluded that since rejection of a trademark license by the licensor in bankruptcy only constitutes a breach and not a rescission of the license, the licensee's right to use the trademarks under the rejected license continues for the remaining term of the license. However, as noted in Justice Sotomayor's concurrence, the licensee remains bound by other terms of the license and trademark law. This arguably would include the obligations to maintain the nature and quality of the goods or services offered under the trademarks.

This decision will be the subject of an upcoming Gray Plant Mooty webinar scheduled for July 11, 2019, where the panelists will discuss its applicability in the franchise context. Registration details for the webinar will be announced soon.

EMPLOYMENT

NINTH CIRCUIT DISREGARDS *PATTERSON* IN FINDING *DYNAMEX* "ABC TEST" APPLIES TO DECADES-OLD FRANCHISE DISPUTE

The U.S. Court of Appeals for the Ninth Circuit announced an onerous standard that could potentially make all franchisors liable to California franchisees for wage-and-hour claims in *Vazquez v. Jan-Pro Franchising Int'l, Inc.*, 923 F.3d 575 (9th Cir. 2019). The case arose over a decade ago when unit franchisees claimed that Jan-Pro was their employer and had failed to comply with state wage-and-hour laws. Originally filed as a putative class action in Massachusetts federal court, the claims by California unit-franchisees were severed and transferred to California, while the Massachusetts court adjudicated and dismissed one unit franchisee "test case" based on the preclusive effect of a Georgia decision that Jan-Pro was not the unit franchisee's employer. Jan-Pro moved for summary judgment in the California lawsuit, arguing that the California Supreme Court's decision in *Patterson v. Domino's Pizza, LLC*, 333 P.3d 723 (Cal. 2014), required the court to consider the unique characteristics of franchising. The district court agreed, applying a "*Patterson* gloss" to California wage-and-hour laws, and granted summary judgment in favor of Jan-Pro.

While the franchisees' appeal of that decision was pending, the California Supreme Court issued an employment law decision that departed from the focus on a defendant's control of the alleged employee's work under prior precedent. *Dynamex Operations West, Inc. v. Superior Court*, 416 P.3d 1 (Cal. 2018), involved claims by non-franchise delivery drivers who, prior to 2004, had been classified as employees. Pointing to public policy concerns, the court in *Dynamex* embraced a new standard that presumes workers are employees for purposes of wage-and-hour claims unless the putative employer can prove *each* of the following: (A) that the worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work, and in fact; (B) that the worker performs work that is outside the usual course of the hiring entity's business; and (C) that the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.

In light of the ruling in *Dynamex*, the Ninth Circuit determined that this new "ABC test" should apply retroactively to the *Jan-Pro* case and reversed summary judgment in favor of Jan-Pro. The Ninth Circuit instructed the district court to disregard the rulings in Massachusetts and Georgia that Jan-Pro was not the unit franchisee's employer, and to also disregard the *Patterson* decision that guided the original ruling. According to the Ninth Circuit, no "*Patterson* gloss" should be applied on the new ABC test because *Patterson*'s analysis of the franchise model was mere "dicta" that had "little to do with the rationale for wage orders." Although it remanded for further proceedings at the district court level, the Ninth Circuit further indicated that it thought Jan-Pro's defense would likely fail under prong "B" of the new test because (1) Jan-Pro's business relies on janitorial work performed by unit franchisees; (2) unit franchisees continuously perform cleaning services; and (3) Jan-Pro's website says it is a cleaning company. Jan-Pro is expected to petition the Ninth Circuit to rehear the appeal *en banc*. The California legislature is also considering dueling legislative proposals, one of which would restore the old multi-factor test that focused on an entity's actual control of alleged employees, while the other would codify *Dynamex*.

PRELIMINARY INJUNCTIONS

FRANCHISEE'S MOTION TO ENJOIN TERMINATION DENIED FOR FAILURE TO ESTABLISH IRREPARABLE HARM

A federal court in Minnesota recently denied a Wisconsin franchisee's motion for a temporary restraining order to prevent the termination of its license agreement. *Izabella HMC-MF, LLC v. Radisson Hotels Int'l, Inc.*, 2019 WL 2067141 (D. Minn. May 10, 2019). After learning that Izabella was conducting unapproved renovations at its franchised hotel, Radisson issued a default notice giving Izabella an opportunity to cure. In the default notice, Radisson warned Izabella that if it did not cure the renovation default within 60 days, the license agreement would automatically terminate on May 1, 2019. Izabella did not cure the default and instead filed a motion on April 30 seeking an order to prevent the impending termination, arguing that Radisson had violated the Wisconsin Fair Dealership Law because the default notice was not sufficiently detailed.

In denying the motion, the court focused on Izabella's burden to show a threat of irreparable harm. Izabella argued that the termination — and resulting loss of Radisson's goodwill and reservation system — would cause irreparable harm by reducing the number of bookings at the hotel. However, Izabella had estimated its damages in its motion papers, claiming it would lose approximately $175,000 per month if the termination became effective. In light of this estimate, the court found that any harm to Izabella could be adequately compensated by monetary damages and that any presumption of irreparable harm under the Wisconsin Fair Dealership Law was rebutted under the circumstances. Because Izabella failed to show irreparable harm, the court declined to enjoin the termination. Radisson was represented by Gray Plant Mooty in this matter.

KENTUCKY FEDERAL COURT PARTIALLY GRANTS FRANCHISOR'S REQUEST FOR A PRELIMINARY INJUNCTION

Meanwhile, the U.S. District Court for the Western District of Kentucky has partially granted a tax preparation franchisor's motion for a preliminary injunction against a former franchisee operating a competing tax return preparation business. *JTH Tax, Inc. v. Freedom Tax, Inc.*, 2019 WL 2062519 (W.D. Ky. May 9, 2019). JTH Tax, the franchisor of the Liberty Tax Service system, sued the franchisee for, among other things, trademark infringement under the Lanham Act and violation of the Defend Trade Secrets Act. JTH alleged that the former franchisee was using logos and slogans similar to JTH's trademarked material as well as JTH's proprietary practices in operating its new business.

The court granted a preliminary injunction against the franchisee on the basis of the trademark infringement claim, holding that the relevant marks — "Liberty Tax" and "Freedom Tax" and their respective logos — shared several commonalities, including the fact that they both (1) prominently featured the head of Lady Liberty, (2) were composed of red, white, and blue colors, and (3) were styled in all capital letters. The court further observed that even though the word "Freedom" was different from "Liberty," the words evoked the same connotations and were synonyms of each other. Accordingly, the court held that the marks' commonalities made it likely that their overall impression would lead an average consumer to assume that they were related.

The court also granted the preliminary injunction on the basis of the Defend Trade Secrets Act claim, holding that an officer of the former franchisee, who was an officer of the new competing tax preparation business, had a duty to maintain the secrecy of JTH Tax's proprietary information. The court enjoined the officer from using trade secrets learned as a result of her position at the formerly franchised business and from using trade secrets that she knew or had reason to know were acquired by the former franchisee because of its relationship with JTH.

ANTITRUST

FEDERAL COURT IN MICHIGAN DENIES FRANCHISOR'S MOTION TO DISMISS ANTI-POACHING COMPLAINT

A court in the Eastern District of Michigan recently denied a franchisor's motion to dismiss a franchisee employee's anti-poaching complaint, finding that the employee had pled sufficient facts to show that the anti-poaching provision of the franchise agreement could be an unlawful restraint of trade. *Blanton v. Domino's Pizza Franchising LLC*, 2019 WL 2247731 (E.D. Mich. May 24, 2019). The plaintiff, Harley Blanton, was a former employee of a Florida Domino's franchisee who alleged that he quit his job after his hours were cut. He filed suit against franchisor Domino's Pizza Franchising LLC, as well as its supplier entity, parent company, and an associated investment entity, claiming that they had violated the Sherman Antitrust Act by orchestrating an anti-poaching agreement among Domino's franchisees. The provision barred Domino's franchisees from hiring current employees of other Domino's franchisees without the approval of the employee's current employer.

In denying the motion to dismiss, the court first ruled that Blanton had pled facts sufficient to establish Article III and antitrust standing. In so ruling, the court found sufficient Blanton's allegations that his wages had been suppressed as a result of the anti-poaching provision. Next, the court concluded that Blanton had sufficiently alleged that the anti-poaching provision constituted a horizontal restraint of trade. Although it noted that horizontal restraints ancillary to procompetitive agreements are typically judged under the fact-intensive rule of reason standard, the court declined to rule out the applicability of even the *per se* standard of analysis. The court concluded that Blanton had sufficiently alleged that Domino's orchestrated an anti-competitive conspiracy by including the anti-poaching provision in its form franchise agreements.

DEPUTY ASSISTANT ATTORNEY GENERAL FOR ANTITRUST EXPLAINS DOJ FILINGS IN ANTI-POACHING CASES

As reported in the last issue of *The GPMemorandum*, the Department of Justice Antitrust Division filed statements of interest in three franchise anti-poaching class actions pending in federal court in Washington. The statements urged application of the rule of reason to the Sherman Act claims asserted by the putative class members and explained why *per se* and quick-look analyses were improper. The cases in which the DOJ filed its statements of interest were settled and dismissed shortly thereafter, but similar class actions remain pending against many other franchisors.

In a speech delivered March 1, 2019 at the Santa Clara University School of Law, Deputy Assistant Attorney General for Antitrust Michael Murray discussed the DOJ's recent filings and expounded upon the reasons why anti-poaching agreements in the franchise context should be assessed under the rule of reason. *See* https://www.justice.gov/opa/speech/deputy-assistant-attorney-general-michael-murray-delivers-remarks-santa-clara-university. Murray explained that "[f]ranchisors and franchisees . . . are primarily in a vertical relationship in their industry and generally not competitors with respect to the labor market. Consequently, agreements among them likely are subject to the rule of reason." To the extent that franchisees themselves are deemed to be horizontal competitors, they "must actually have entered into an agreement, as opposed to merely engaged in parallel conduct," such as entering into similar vertical agreements with the franchisor. Even a horizontal anti-poaching agreement should be assessed under the rule of reason so long as it is ancillary to a separate and legitimate transaction and not a "naked" anti-poaching agreement. Thus, according to Murray, "there are two ways for a no-poach agreement to be subject to the rule of reason and not the *per se* rule: verticality and ancillarity." Murray further suggested that recent franchise anti-poaching cases in which the quick-look doctrine was deemed a potential alternative "deserve further scrutiny" and that the doctrine should not be applied merely because a particular restraint is difficult to classify.

CLASS ACTIONS

PENNSYLVANIA COURT GRANTS PRELIMINARY APPROVAL OF CLASS ACTION SETTLEMENT

After ten years of litigation, the U.S. District Court for the Eastern District of Pennsylvania granted a motion for preliminary class action settlement approval in a case against the franchisor of the Jani-King janitorial system alleging violations of Pennsylvania's Wage Payment and Collection Law. *Myers v. Jani-King of Philadelphia, Inc.*, 2019 WL 2077719 (E.D. Pa. May 10, 2019). Two franchisees had initiated the lawsuit on behalf of themselves and others similarly situated claiming that Jani-King misclassified them as independent contractors and improperly deducted their wages. In 2015, the court certified a class of nearly 290 franchisees who had signed a Jani-King franchise agreement and performed cleaning services in Pennsylvania between March 20, 2006 and March 11, 2015.

Just two weeks before trial, the parties reached a settlement agreement pursuant to which Jani-King agreed to pay $3,700,000 in damages and to make changes to its business practices. Specifically, franchisees who wish to continue to do business with Jani-King will be offered a new franchise agreement that omits any post-termination noncompete provision, shortens the nonsolicitation period with respect to Jani-King accounts to 12 months, and allows the franchisee to contract with new clients without paying Jani-King a finder's fee. Additionally, Jani-King agreed to make buy-out payments to franchisees with monthly revenues of less than $5000, at the franchisees' option. When class members submit their claim, they will collect their damages, as well as choose to either sign the updated franchise agreement or accept a buy-out offer from Jani-King. The court found that the proposed settlement was the result of arm's length negotiations by experienced counsel with the help of an experienced mediator and that the class members will substantially benefit from the settlement terms. Accordingly, barring any exceptional testimony at the August fairness hearing, the parties will begin administering the settlement agreement.

ARBITRATION

COURT DENIES FRANCHISOR'S MOTION TO DISMISS OR COMPEL ARBITRATION OF FRANCHISEE'S CLAIMS

A federal court in Washington denied a franchisor's motion to dismiss or compel arbitration of a franchisee's claims after finding that material questions of fact remained as to whether a valid and enforceable franchise contract existed between the parties. *Garrett v. Rothschild*, 2019 WL 1957929 (W.D. Wash. May 2, 2019). Morgan Rothschild, the owner of the Party Princess International franchise system, sold a franchise to Sean and Stephanie Taylor that they planned to operate in Washington. Party Princess had filed paperwork to register in Washington as a franchisor but the registration was not effective at the time of the sale. When the Taylors failed to achieve the amount of revenue Rothschild had allegedly promised them, they filed a complaint about Party Princess with the Securities Division of the Washington Department of Financial Institutions. Rothschild then commenced arbitration proceedings against the Taylors seeking to terminate their franchise, and the Taylors responded by filing a lawsuit against Rothschild asserting claims of intentional and negligent misrepresentation, violation of Washington's Franchise Investment Protection Act, and unjust enrichment. Rothschild filed a motion to dismiss the Taylors' claims or in the alternative to compel the Taylors to arbitrate them pursuant to the franchise agreement's arbitration clause.

Among other things, Rothschild argued that the case could not proceed because the issues in dispute were already being litigated in the arbitration proceeding and that the claims were barred by representations in the underlying contract. The court disagreed, holding that whether the issues were being fully litigated in the ongoing arbitration, or whether a valid and enforceable contract even existed between the parties, were disputed questions of fact. The court also ruled that Rothschild did not sufficiently establish that an enforceable arbitration agreement existed between the parties and noted that the question was better suited for resolution on summary judgment. Accordingly, the court denied Rothschild's motion.

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JURISDICTION AND PROCEDURE

COURT DENIES DEFENDANTS' MOTION TO DISMISS FOR LACK OF PERSONAL JURISDICTION

A federal district court in Massachusetts has denied a motion to dismiss for lack of personal jurisdiction jointly filed by Marriott International, Inc. and franchisee Reluxicorp in a premises liability action brought against them, finding that a franchise agreement between Marriott's affiliate and Reluxicorp created sufficient contacts with the forum to satisfy specific jurisdiction requirements. *Nandjou v. Marriott Int'l, Inc.*, 2019 WL 1903382 (D. Mass. Apr. 29, 2019). The plaintiff, Chimene Mbague Nandjou, filed wrongful death, vicarious liability, and negligent infliction of emotional distress claims against Marriott and Reluxicorp following the deaths of her husband and son at a swimming pool located at a franchised Residence Inn by Marriott hotel in Montreal owned and operated by Reluxicorp. Nandjou was a resident of Massachusetts and allegedly received Marriott marketing materials at her home, which she claimed influenced her family's decision to visit the hotel. Marriott is a Delaware corporation with its principal place of business in Maryland, and Reluxicorp is a Canadian corporation with its principal place of business in Montreal. The defendants moved to dismiss, arguing that the Massachusetts court lacked personal jurisdiction over them because the claims did not arise from actions taken in the state.

The court first determined that Marriott's alleged actions could be attributed to Reluxicorp for purposes of the jurisdictional analysis on the grounds that the franchise agreement between Marriott's affiliate and Reluxicorp created a principal-agent relationship that authorized certain contacts with Massachusetts, including the marketing of Reluxicorp's hotel in exchange for annual fees. Next, given that neither defendant was located or incorporated in Massachusetts, the court considered whether it could exercise specific jurisdiction over them. According to the court, because the alleged advertising at issue was sent via direct mail to Nandjou's residence in Massachusetts, and was the first step in a series of events that led to Nandjou's injury, Nandjou's claims directly arose out of or related to the defendants' forum-state activities. Further, because the alleged advertisements were part of Marriott's ongoing marketing efforts, the court found that it was foreseeable that the defendants could be haled into court in Massachusetts, satisfying the purposeful availment requirement. Finally, the court held that exercising jurisdiction over the defendants would be reasonable, taking into consideration the potential burden on them, the forum state's interest in adjudicating the dispute, and the plaintiff's interest in obtaining convenient and effective relief. As a result, the defendants' motion to dismiss for lack of personal jurisdiction was denied, and the court also declined to dismiss Nandjou's complaint on the grounds of *forum non conveniens*. The defendants have since filed a motion requesting that the court reconsider its decision.

STATE FRANCHISE LAWS

ALABAMA LEGISLATURE ADJOURNS BEFORE TAKING UP COMPREHENSIVE FRANCHISE RELATIONSHIP BILL

In the last issue of *The GPMemorandum*, we covered the "Protect Alabama Small Businesses Act," the first major state franchise relationship bill to be considered this year. The Alabama State Senate version of the bill (SB129) passed the Alabama Senate on March 16, 2019. The identical House companion bill (HB352) was voted out of committee with a favorable recommendation on April 4, 2019. While a final vote on the bill was expected by many to occur this month, the Alabama Legislature did not take the bill up for final vote before adjourning the 2019 regular session on May 31, 2019.

Along with the attorneys on the next page, summer associates Jonathan Husted, Cameron Johnson, Amanda Kruse, Leeja Miller, Navin Ramalingam, and Brooke Robbins contributed to this issue.

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