The GP Memorandum

TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS
FROM: GRAY PLANT MOOTY’S FRANCHISE AND DISTRIBUTION PRACTICE GROUP
   Quentin R. Wittrock, Editor of The GP Memorandum
   Maisa Jean Frank, Assistant Editor
   Julia C. Colarusso, Assistant Editor
DATE: February 10, 2016—No. 202

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

ARBITRATION

THIRD CIRCUIT ADOPTS RIGOROUS STANDARD REGARDING WHAT IS REQUIRED FOR PARTIES TO DELEGATE QUESTION OF CLASS ARBITRABILITY TO ARBITRATORS

The United States Court of Appeals for the Third Circuit recently weighed in on an issue that often arises in the franchise and distribution context – class arbitrability. In Chesapeake Appalachia, LLC v. Scout Petroleum, LLC, 809 F.3d 746 (3d Cir. Jan. 5, 2016), the court concluded that, while no magic language is required to overcome the presumption in favor of judicial control over this issue, the adoption by the parties of the rules of the American Arbitration Association (which provide for arbitrators to decide the issue) does not “clearly and unmistakably” delegate the question of class arbitrability to the arbitrator. Rather, unlike other circuits, which have found the adoption of the AAA rules to constitute sufficient evidence that the parties agreed to arbitrate arbitrability, the Third Circuit now requires a clearer manifestation of the parties’ intent to allow an arbitrator to decide the issue of class arbitrability.
INSURANCE

FEDERAL COURT IN COLORADO RULES FRANCHISOR IS NOT ENTITLED TO INSURANCE-PAID DEFENSE OF LAWSUIT BROUGHT BY FRANCHISEES

The United States District Court for the District of Colorado has granted an insurer’s motion for summary judgment, holding that it had no duty to defend its insured, Carpet World, in an underlying lawsuit brought by a group of Carpet World’s current and former franchisees. AMCO Ins. Co. v. Carpet Direct Corp., 2016 WL 284827 (D. Colo. Jan. 22, 2016). The franchisees alleged that while they were initially promised they would “become independent business owners, with rights of ownership” in the Carpet World businesses in which they were investing, they subsequently learned that they were merely employees of the organization. Among other things, the franchisees asserted claims under the Michigan Franchise Investment Law and sought the return of their capital contributions and compensation in the form of lost wages.

Finding that Carpet World’s general liability insurance policy did not cover the type of losses the franchisees were claiming, the court granted the insurer’s motion for summary judgment and held that it had no duty to provide defense counsel for Carpet World in the underlying lawsuit. Carpet World had argued that the underlying lawsuit fell within the policy’s coverage of “property damage,” but the court rejected that argument on the grounds that the franchisees were not asserting claims for injury to tangible property. The court also dismissed Carpet World’s theory that coverage was available under the policy’s “personal and advertising injury” provision because the franchisees were not alleging that they were divested of a right in real property.

FRAUD

COURT DISMISSES FRANCHISEE’S FRAUDULENT MISREPRESENTATION CLAIM BASED ON DISCLAIMER IN FRANCHISE AGREEMENT

A federal district court in Illinois granted a franchisor’s motion to dismiss a franchisee’s fraudulent misrepresentation counterclaim in Fantastic Sams Salons Corp. v. PSTEVO, LLC, No. 15-cv-3008 (N.D. Ill. Jan. 15, 2016). Baker, the franchisee, alleged that prior to entering into the parties’ franchise agreement, Fantastic Sams presented him with financial disclosure documents falsely stating that he would only need three months of working capital to open a franchise, and that he could expect the franchise to be profitable thereafter. Baker asserted that these disclosure documents were consistent with oral representations made by Fantastic Sams’ agents and with statements published on its website.
Fantastic Sams argued that two disclaimers in the franchise agreement precluded Baker from claiming that he relied on Fantastic Sams’ or its agents’ representations regarding projected profitability. The disclaimers stated: (1) “No oral, written or visual claim or representation which contradicted the disclosure document was made to me, except,” and (2) “No oral, written or visual claim or representation which stated or suggested any sales, income, or profit levels was made to me, except.” After each disclaimer, Baker wrote the word “none” and initialed his response. The court found that the first disclaimer was not effective to bar Baker’s claims because the alleged misrepresentation made by Fantastic Sams’ agents and contained on its website was consistent with, rather than contradicted by, the disclosure documents. However, Fantastic Sams successfully argued that the second disclaimer expressly disclaimed the representation on which Baker had allegedly relied, and the court dismissed the claim with prejudice.

CONNECTICUT FEDERAL COURT ASSESSES APPLICATION OF THE ECONOMIC LOSS DOCTRINE TO MISREPRESENTATION CLAIMS

The United States District Court for the District of Connecticut recently considered whether the economic loss doctrine barred allegations that a franchisor’s purported misrepresentations induced a group of franchisees to enter into their franchise agreements. *Family Wireless #1, LLC v. Automotive Techs. Inc.*, 2016 WL 183475 (D. Conn. Jan. 14, 2016). Nearly 40 franchisees brought suit against Automotive Technologies, a master franchisee of Verizon Wireless, for breach of contract, fraud, common law negligent and innocent misrepresentation, and violations of state and consumer protection laws, based on allegations that the company had made misrepresentations concerning the royalty structure of its franchise program. ATI moved to dismiss the franchisees’ negligent and innocent misrepresentation claims on the grounds that they were barred by the economic loss doctrine.

The court applied the law of the state where each individual franchised business was located and held that the economic loss doctrine barred the misrepresentation claims of some, but not all of the franchisees. Specifically, the court dismissed misrepresentation claims by franchisees that had businesses located in Pennsylvania and Michigan, holding that the law in those states barred tort claims relating to the performance of the underlying agreement. On the other hand, the court held that the economic loss doctrine under New York, Ohio, and Virginia law did not bar the misrepresentation claims because in those states the doctrine does not bar tort claims that concern a duty independent of the underlying contract (here, a duty to abide by disclosure requirements). The court also dismissed certain of the franchisees’ misrepresentation and related statutory claims without prejudice for failure to plead the claims with sufficient particularity.
STATE FRANCHISE LAWS

FEDERAL COURT IN MINNESOTA DISMISSES FRANCHISEE’S FRAUD CLAIM UNDER MINNESOTA FRANCHISE ACT

A Minnesota federal court has dismissed a franchisee’s claim against The UPS Store, Inc. (“TUPSS”) under the Minnesota Franchise Act (MFA) and has transferred the rest of the case to a California federal court in accordance with the forum selection clause contained in the parties’ franchise agreement. Moxie Venture L.L.C. v. The UPS Store, Inc., 2016 WL 128136 (D. Minn. Jan. 12, 2016). Moxie alleged that TUPSS had fraudulently induced it to enter into the franchise agreement by misrepresenting the best location for Moxie’s UPS Store and the franchise’s anticipated revenue, cash flow, and operating profits in violation of the MFA. TUPSS moved, first, to dismiss Moxie’s MFA claim on the grounds that Moxie could not demonstrate that it reasonably relied on any alleged misrepresentations in light of the franchise agreement’s express disclaimers, and, second, to transfer the remaining common law claims pursuant to the contract’s forum selection clause.

The court granted both of TUPSS’ motions, finding that the disclaimer provisions in the franchise agreement barred Moxie’s MFA claim and that the forum selection clause was fully enforceable. In dismissing the MFA claim, the court observed that Moxie had expressly acknowledged through the disclaimer provisions that it had not relied on any representations regarding anticipated earnings before entering into the franchise agreement. Moxie argued that because the MFA voids any contractual provision that purports to waive a franchisee’s rights under the statute (including the statute’s prohibition against material false statements), the disclaimer provisions were invalid as a matter of law. The court held, however, that the disclaimers did not have the effect of waiving any of Moxie’s statutory rights and merely served as an acknowledgment of Moxie’s non-reliance. The court’s conclusion on that point is contrary to an earlier decision by another judge in the District of Minnesota (Randall v. Lady of America Franchise Corp., 532 F. Supp. 2d 1071 (D. Minn. 2007)), indicating a split in authority in the district regarding the validity of contractual disclaimers in defeating claims of unlawful pre-sale representations brought under the MFA.

SALE OF UPGRADED EQUIPMENT CONSTRUED AS GRANT OF A FRANCHISE UNDER MICHIGAN FRANCHISE INVESTMENT LAW

Following a bench trial, a Michigan federal court granted rescission of a contract relating to a vehicle deodorizing and sanitation business on the grounds that the business met the definition of a “franchise” under the Michigan Franchise Investment Law (MFIL). Lofgren v. AirTrona Canada, 2016 WL 25977 (E.D. Mich. Jan. 4, 2016). Lofgren had originally purchased equipment for the business from non-party AirTrona
Green Technologies in 2009 and subsequently purchased upgraded equipment from AirTrona Canada in 2011. While the parties did not sign a formal, written agreement regarding their relationship, the invoice from the 2011 transaction expressly provided that for $35,000, Lofgren would receive “1 Franchise Michigan Location.” The business was ultimately unsuccessful, and Lofgren filed suit seeking, among other things, damages and rescission for violations of the MFIL.

The court held that Lofgren’s business satisfied all of the elements of a franchise under the MFIL and concluded that AirTrona Canada had violated the statute by failing to provide a disclosure statement at the time of the 2011 sale. The court first determined that the 2011 upgrade was a “grant” of a franchise under the statute, both because the MFIL applies to “substitution of a modified or amended franchise agreement” and because the upgrade was Lofgren’s first transaction with AirTrona Canada. The court next found that Lofgren had paid a “franchise fee” within the meaning of the statute because the amount he paid exceeded the bona fide wholesale price of the equipment he received. Finally, the court found that AirTrona Canada had granted Lofgren the right to operate under a marketing plan or system when it promised him training and promotional materials, prescribed or suggested pricing, and monitored his sales. Although Lofgren had failed to demonstrate any causal relationship between his alleged harm and AirTrona Canada’s failure to provide a disclosure statement, the court determined that causation was not a necessary element of Lofgren’s claim under the MFIL and granted rescission with respect to the 2011 sale.

Along with the attorneys indicated on the next page, Nicholas N. Nierengarten, a principal in the Insurance Counseling & Litigation practice group, contributed to this issue.
Minneapolis, MN Office

John W. Fitzgerald, co-chair (612.632.3064)
Megan L. Anderson (612.632.3004)
Sandy Y. Bodeau (612.632.3211)
Phillip W. Bohl (612.632.3019)
Jennifer C. Debow (612.632.3357)
Danell Olson Caron (612.632.3383)
Elizabeth S. Dillon (612.632.3284)
Ashley Bennett Ewald (612.632.3449)
* Michael R. Gray (612.632.3078)
* Kathryn E. Hauff (612.632.3261)
Karli B. Hussey (612.632.3278)
Franklin C. Jesse, Jr. (612.632.3205)
Gaylen L. Knack (612.632.3217)

Kirk W. Reilly, co-chair (612.632.3305)
* Raymond J. Konz (612.632.3018)
Richard C. Landon (612.632.3429)
* Craig P. Miller (612.632.3258)
Bruce W. Mooty (612.632.3333)
Kevin J. Moran (612.632.3269)
Kate G. Nilan (612.632.3419)
* Daniel J. Ringquist (612.632.3299)
* Max J. Schott II (612.632.3327)
Michael P. Sullivan, Jr. (612.632.3350)
Lori L. Wiese-Parks (612.632.3375)
* Quentin R. Wittrock (612.632.3382)

Washington, DC Office

Robert L. Zisk, co-chair (202.295.2202)
Julia C. Colarusso (202.295.2217)
Maisa Jean Frank (202.295.2209)
Jan S. Gilbert (202.295.2230)
* Virginia D. Horton (202.295.2237)
Mark A. Kirsch (202.295.2229)
* Peter J. Klarfeld (202.295.2226)
Sheldon H. Klein (202.295.2215)

Iris F. Rosario (202.295.2204)
* Justin L. Sallis (202.295.2223)
* Frank J. Sciremammano (202.295.2232)
Erika L. Tokar (202.295.2239)
Stephen J. Vaughan (202.295.2208)
Eric L. Yaffe (202.295.2222)
Carl E. Zwisler (202.295.2225)

* Wrote or edited articles for this issue.

For more information on our Franchise and Distribution practice and for recent back issues of this publication, visit the Franchise and Distribution Practice Group at http://www gpmlaw com/Practices/ Franchise-Distribution.

GRAY PLANT MOOTY

80 South Eighth Street 600 New Hampshire Avenue, N.W.
500 IDS Center The Watergate – Suite 700
Minneapolis, MN 55402-3796 Washington, DC 20037-1905
Phone: 612.632.3000 Phone: 202.295.2200

franchise@gpmlaw.com

The GPMemorandum is a periodic publication of Gray, Plant, Mooty, Mooty & Bennett, P.A., and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own franchise lawyer concerning your own situation and any specific legal questions you may have.