The GPMemorandum

TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS

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

Quentin R. Wittrock, Editor of The GPMemorandum
Maisa Jean Frank, Assistant Editor
Julia C. Colarusso, Assistant Editor

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Below are summaries of recent legal developments of interest to franchisors. At the end of this issue, we also have included an analysis of the new amendments to California’s franchise relationship law and an update on the proposed commentary on financial performance representations issued by the North American Securities Administrators Association.

ARBITRATION

SUPREME COURT REITERATES STRONG FEDERAL POLICY FAVORING ARBITRATION AND OVERTURNS CALIFORNIA APPELLATE COURT’S INVALIDATION OF ARBITRATION AGREEMENT

The United States Supreme Court recently reaffirmed the strong federal policy favoring arbitration under the Federal Arbitration Act. In DIRECTV, Inc. v. Imburgia, 136 S. Ct. 463 (U.S. Dec. 14, 2015), the court overturned a decision by a California Court of Appeals, which had invalidated an arbitration provision that included a class action waiver. In doing so, the court held that the arbitration agreement had to be enforced.

After DIRECTV customers commenced a putative class action seeking damages for violation of various California consumer protection laws, DIRECTV moved to compel arbitration pursuant to a provision in the service agreements at issue. The contracts expressly provided that the arbitration requirement would be voided if the applicable state law would render the waiver of class arbitration unenforceable. Ultimately, both the California trial court and appellate court refused to compel arbitration of the
customers’ claims on the grounds that the class action waiver that formed part of the arbitration provision was unenforceable under California law, thereby making the entire arbitration provision unenforceable according to its own terms.

Relying on its prior holding in *AT&T Mobility v. Concepcion*, 563 U.S. 333 (2011), the court held that the Federal Arbitration Act preempted any state law that attempted to invalidate class action waivers in arbitration provisions. Accordingly, the court determined that DIRECTV’s class action waiver (and the arbitration provision as a whole) was valid and enforceable. Although this is not a franchise case, it marks yet another instance in which the Supreme Court has upheld arbitration provisions under the Federal Arbitration Act.

**CALIFORNIA FEDERAL COURT ORDERS ARBITRATION OF FRANCHISEE’S EMPLOYMENT CLAIMS**

Meanwhile, a federal court in California has granted a franchisor’s motion to compel arbitration in a putative class action lawsuit filed by one of its franchisees. *Jacobson v. Snap-on Tools Co.*, 2015 WL 8293164 (N.D. Cal. Dec. 9, 2015). Jacobson argued that his work was so closely regulated by Snap-on Tools, a franchisor of automotive and shop equipment, that he should be treated as an employee under California law, rather than as an independent franchisee, and that Snap-on Tools failed to properly pay him for employment-related expenses, overtime, and meal and rest breaks. Snap-on Tools responded by moving to compel arbitration of the dispute based on the arbitration clause in its standard franchise agreement, which provided that any controversy relating to the franchisee’s business or the performance of the agreement would be subject to binding arbitration.

The court held that the arbitration clause was valid and enforceable, and it ordered Jacobson to pursue his claims for violation of California employment laws and unfair business practices in arbitration. Jacobson had argued that the arbitration clause was procedurally and substantively unconscionable because he had not read it, it was hidden, and Snap-on Tools failed to make him aware of it. The court rejected each of those arguments, finding that the arbitration provision was clear and visible and that Snap-on Tools was not required to call the provision to Jacobson’s attention. The court did, however, find merit in Jacobson’s argument that the fee-splitting provision contained in the franchise agreement was unconscionable under the circumstances of this case because it only obligated Snap-on Tools to pay “expenses up to $7,500 for demands less than $75,000.” The court also exempted Jacobson’s representative claim under the Private Attorneys General Act from arbitration because the franchise agreement specifically exempted class actions from arbitration.
HOTEL COMPANY AND FTC ENTER INTO STIPULATED ORDER FOR INJUNCTION IN CYBERSECURITY CASE

After the United States Court of Appeals for the Third Circuit recently affirmed the denial of Wyndham Hotel’s motion to dismiss claims that it allegedly violated Section 5 of the FTC Act (as reported in Issue No. 197 of The GPMemorandum), a federal court in New Jersey entered a stipulated order for an injunction resolving the case. FTC v. Wyndham Worldwide Corp., No. 2:13-cv-01887 (D.N.J. Dec. 11, 2015). The complaint filed by the FTC alleged that Wyndham engaged in unfair practices by failing to maintain reasonable and appropriate data security for consumers’ sensitive personal information. Under the stipulated order, Wyndham agreed—at least as to its company-owned hotels—to establish and maintain a comprehensive information security program to protect the security and confidentiality of consumer credit and debit card data for twenty years. This program must include the designation of employees to coordinate and be accountable for the program, the identification of potential internal and external risks to cardholder data and the development of safeguards to manage those risks, the development of a process to identify vendors and service providers who can adequately protect customer data, and the evaluation and adjustment of corporate-owned hotels’ information security programs where appropriate.

Further, Wyndham must obtain an annual assessment of its corporate-owned hotels’ compliance with these requirements. If there is a data breach involving more than 10,000 card numbers, further assessment of the hotels at issue will be required. Wyndham must also submit compliance reports to the FTC one year after the entry of the order and within two weeks of any change to its corporate structure or relevant points of contact, and must engage in ongoing compliance monitoring by the agency. Under this provision, the FTC may seek further discovery without leave of the court.

It is important to note, however, that the stipulated order specifically does not apply to Wyndham’s “branded” (i.e., franchised) hotels.

AMERICANS WITH DISABILITIES ACT

NEW YORK FEDERAL COURT DISMISSES CLAIM THAT “FREESTYLE” SODA MACHINES VIOLATE THE AMERICANS WITH DISABILITIES ACT

The United States District Court for the Southern District of New York dismissed a claim brought by blind patrons of the Moe’s restaurant chain that the restaurants’ “freestyle” touch screen Coca-Cola machines were discriminatory under the Americans with Disabilities Act (ADA). West v. Moe’s Franchisor, LLC, 2015 WL 8484567 (S.D.N.Y. 2015).
Because the machines did not incorporate “adaptive features” like the tactile buttons found on ATMs, the plaintiffs claimed that they were unable to use the machines independently. They further contended that Moe’s employees failed to provide assistance upon request. The plaintiffs asserted that they were therefore “excluded, denied services, segregated or otherwise treated differently . . . because of the absence of auxiliary aids and services” in violation of Title III of the ADA.

The court found no ADA violation. It held that the availability of Moe’s employees to act as “qualified readers” was sufficient to meet Moe’s obligation to provide “auxiliary aids and services” under the ADA. Rejecting the plaintiffs’ argument that Moe’s was obligated to integrate technology that would enable blind users to use the machines independently, the court distinguished the privacy concerns associated with ATMs that necessitate independent use. The court also dismissed the plaintiffs’ claim that qualified readers were unavailable, observing that the record reflected only one visit to a Moe’s restaurant in which a blind patron was not properly assisted. That isolated incident did not give rise to an inference that Moe’s failed to train its employees on how to provide “auxiliary aids and services” to disabled patrons. Accordingly, the court dismissed the plaintiffs’ claims.

STATE FRANCHISE LAWS

COURT DISMISSES MINNESOTA FRANCHISE ACT CLAIMS ASSERTED BY A FRANCHISOR BECAUSE NO FRANCHISE RELATIONSHIP EXISTED

The United States District Court for the Southern District of Indiana dismissed a franchisor’s claims under the Minnesota Franchise Act (“MFA”) in a case recently transferred from a Minnesota federal court. Rogovsky Enterprise, Inc. v. Masterbrand Cabinets, Inc., 2015 WL 7721223 (S.D. Ind. Nov. 30, 2015). Rogovsky, the franchisor of Kitchen & Home Interiors remodeling franchises, brought suit against Masterbrand, a manufacturer and distributor of cabinets, following Masterbrand’s termination of the exclusive distribution agreement between the parties. Under the distribution agreement, Masterbrand agreed to sell cabinets to Rogovsky’s franchisees and to pay rebates to Rogovsky in connection with those sales, provided that Rogovsky required all of its future franchisees to purchase cabinets exclusively from Masterbrand. Rogovsky argued before the Minnesota court that the relationship between the parties constituted a franchise under the MFA and other state franchise laws and that Masterbrand had wrongfully terminated the distribution agreement without good cause in violation of those laws. Masterbrand sought to transfer the case to Indiana based on the forum selection clause in the distribution agreement and ultimately moved to dismiss Rogovsky’s claims.
The Minnesota court rejected Rogovsky’s argument that an anti-waiver regulation promulgated under the MFA prohibited a transfer of the litigation, reasoning that the relationship between the parties did not satisfy the threshold requirements for application of the statute. First, the court concluded that the distribution agreement did not constitute a franchise because Rogovsky had not paid any franchise fee for the right to enter into business with Masterbrand, which is a prerequisite for the establishment of a franchise relationship under the MFA. Next, the court concluded that Rogovsky did not separately qualify as an area franchisor within the meaning of the statute because it could not establish that it sold franchises in the name of or on behalf of Masterbrand. Because the distribution agreement did not create a franchise relationship but merely identified Masterbrand as the sole supplier of cabinets for Kitchen & Home Interiors franchises, the MFA did not apply to void the agreement’s forum selection clause.

After the case was transferred, the court in Indiana found no reason to depart from the Minnesota court’s conclusions under the law of the case doctrine, and it dismissed all claims in the lawsuit that were based on the MFA.

FORUM SELECTION

FEDERAL COURT IN NORTH CAROLINA ENFORCES FORUM SELECTION CLAUSE IN HOTEL FRANCHISE AGREEMENT AND TRANSFERS CASE

The United States District Court for the Eastern District of North Carolina has granted a hotel franchisor’s motion to transfer venue based on the forum selection clause in the parties’ franchise agreement. Generation Companies, LLC v. Holiday Hospitality Franchising, LLC, 2015 WL 7306448 (E.D.N.C. Nov. 19, 2015). Generation, a franchisee of the Staybridge Suites brand, brought suit alleging that Holiday Hospitality (the franchisor of the Staybridge Suites system) was liable for tortious interference with contract, slander, and unfair trade practices as a result of its having incorrectly informed a competitor, Hilton Hotels, that Generation was not permitted to terminate its Staybridge Suites franchise agreement. At the time of the alleged communication, Generation was working to switch to the Hilton Hotels brand, but Hilton Hotels allegedly backed out of signing a franchise agreement with Generation following the statements by Holiday Hospitality.

Generation initially filed suit in North Carolina state court, but Holiday Hospitality removed the case to federal court and then brought a motion to transfer the case to a federal court in Georgia. The forum selection clause in the franchise agreement stated that claims “concerning” the agreement were not required to be filed in Georgia but that the franchisor could elect to litigate “all matters of construction, validity, enforceability and performance” in DeKalb County, Georgia. Additionally, the guaranty accompanying the franchise agreement required the franchisee to “consent and
submit, at Licensor’s election” to venue in Georgia. The franchisee argued that its claims were based in tort and therefore fell outside the scope of the forum selection clauses found in the franchise agreement and guaranty. The court disagreed, holding that the tort claims required construction of the franchise agreement and were therefore encompassed by the forum selection clause. On that basis, the court granted Holiday Hospitality’s motion to transfer the case to the United States District Court for the Northern District of Georgia.

PERSONAL LIABILITY

COURT UPHOLDS ENFORCEMENT OF PERSONAL GUARANTY

A federal court in Texas recently decided that a franchisor may recover on a guaranty agreement despite the guarantor’s claim that the guaranty was unenforceable because he did not receive the value that he was allegedly promised in exchange for executing it. *Burger King Europe GMBH v. Groenke*, 2015 WL 6751121 (N.D. Tex. Nov. 5, 2015). Groenke had an ownership interest in multiple entities that owned and operated a number of Burger King franchises in and around Berlin, Germany. After the opening of insolvency proceedings for Groenke’s entities, Burger King brought claims against him, seeking payment of past due fees under a guaranty, which Groenke had executed in June 2010 in connection with his company’s acquisition of 15 Burger King franchises that were suffering heavy losses. He also received a development agreement to open as many as 38 new franchises. In response to Burger King’s claims in the lawsuit, however, Groenke asserted the affirmative defenses of failure of consideration and frustration of purpose. He claimed that he agreed to execute the guaranty in exchange for an oral promise to allow him to acquire 91 additional Burger King stores and a larger development agreement. Because he never received those stores or that development agreement, Groenke said there was no consideration for the guaranty.

The court decided otherwise. It first noted that none of the terms material to the acquisition of the restaurants or the development agreement, including the exact price, the amount of development fees, the number of restaurants to be developed, or the geographic territory, were agreed to prior to signing the guaranty. In fact, the parties were still negotiating the terms in the fall of 2011, as evidenced by a term sheet. Additionally, the term sheet provided that any party could terminate negotiation of the transaction at any time for any reason. In August 2012, Groenke acknowledged in a letter that the parties had broken off negotiations for the 91 stores, belying Groenke’s contention that the alleged promises constituted an enforceable deal. Finally, the court found that integration clauses in the contemporaneous agreements relating to the acquisition of the 15 franchises and the 38 store development agreement barred any oral promises. Therefore, the court found that the evidence did not support Groenke’s affirmative defenses and entered a judgment in favor of Burger King.
JURY DEMAND AND WAIVER

FEDERAL COURT DENIES MOTION TO STRIKE JURY TRIAL DEMAND DESPITE JURY WAIVER PROVISIONS, BUT DOES SO WITHOUT PREJUDICE

A magistrate judge for the United States District Court for the Eastern District of Michigan has denied, without prejudice, a motion to strike an untimely demand for a jury trial made by a group of franchisees. L.A. Insurance Agency Franchising, LLC v. Montes, 2015 WL 9314738 (E.D. Mich. Dec. 23, 2015). The franchisees waited until five months after filing their answer to the complaint to assert their demand for a jury. L.A. Insurance, the franchisor, then sought to strike the jury demand, arguing that the franchisees had waived their right to a jury because each franchise agreement contained a jury-waiver provision, and the jury demand was made after the deadline. The franchisees responded that the jury-waiver provisions were unenforceable because the franchise agreements were contracts of adhesion and were procured by fraud, and the importance of the right to a jury trial outweighed their failure to make a timely jury demand.

Regarding the jury waiver provisions, the court held that the proceedings had not yet progressed to the stage where the enforceability of the franchise agreements could be determined. The court observed, however, that discovery and further motion practice could ultimately show, as a matter of law, that the jury-waiver provisions were enforceable. Regarding the timeliness argument, the court held that the franchisees’ failure to make their jury demand before the deadline, without more, did not warrant an order striking the demand.

PRACTICE OF FRANCHISE LAW

UPDATE ON NASAA’S PROPOSED FPR COMMENTARY

As reported in Issue No. 199 of The GPMemorandum, the North American Securities Administrators Association (“NASAA”)—the state franchise examiners—issued a “Proposed Franchise Commentary on Financial Performance Representations” on October 1, 2015. NASAA is seeking to create new interpretations and guidelines for financial performance representations (“FPRs”), including (a) when franchisors can and cannot use data from company-owned or affiliate-owned outlets; (b) when franchisors can and cannot use a subset of the entire pool of franchised or company-owned outlets; and (c) the types of disclaimers, notes, and explanations that may be used in FPRs. Gray Plant Mooty submitted comments to the proposed commentary, and the comment period ended on November 2, 2015. Our comment letter is linked here.
NASAA received approximately 13 public comments, which are currently under review. The proposed commentary is not expected to be finalized for at least several months, after the upcoming 2016 franchise registration renewal season. Accordingly, NASAA has advised the public that state examiners will continue to comment on FPRs based on previously adopted NASAA Commentaries, the FTC FAQs on Item 19, and the FTC Compliance Guide. In addition, NASAA has indicated that state examiners will utilize “their interpretation of what constitutes a ‘reasonable basis’ for making an FPR.”

**LEGISLATION AND RULEMAKING**

**CALIFORNIA AB 525 CREATES MYRIAD PROBLEMS FOR FRANCHISORS, BUT SOME CAN BE ADDRESSED WITH FRANCHISE AGREEMENT REVISIONS**

As we reported in Issue No. 198 of *The GPMemorandum*, AB 525, which amends the California Franchise Relations Act (“CFRA”), applies to all franchise agreements entered into or renewed after January 1, 2016. Under the amendments, franchisors that prevent a terminated or nonrenewed franchisee from “retaining control of the principal place of the franchise business” will be required to purchase the franchisee’s assets. One issue raised by this new provision is whether language in franchise agreements, conditional lease assignments, or leases that gives a franchisor certain approval rights with respect to the franchise premises will be considered to have deprived a franchisee of “control.”

AB 525 vaguely outlines the terms of the franchisor’s repurchase obligation but provides no practical guidance about how to comply with the requirement. For example, franchisors must purchase from a franchisee who is terminated in compliance with the CFRA the assets of the franchise business “at the value of the price paid minus depreciation.” If the franchisor does not know the identity of each of the franchisee’s assets, the price paid by the franchisee, or the extent to which those assets have depreciated, how will it know the base compensation to offer?

Only by establishing standards for reporting on the date of purchase and acquisition costs of each asset and by setting depreciation standards in the franchise agreement and manuals can franchisors be prepared for this eventuality and have some understanding of what the cost of a termination might be before sending a notice.

In addition, when a franchisor receives a request for approval of a sale or transfer of a franchise, AB 525 requires the franchisor to notify the franchisee within 15 days of the franchisor’s then-current standards for “approving new or renewing franchisees.” The franchisor will be prohibited from refusing to approve a transfer if a proposed transferee is in compliance with the standards, even if other previously unarticulated standards for denial exist. Moreover, the franchisor may be required to prove that the standards
invoked for the disapproval of a transfer have been consistently applied to similarly situated franchisees.

How can a franchisor meet this burden within 15 days if it has not already prepared the standards and developed records of previous rejections of new or renewing franchisees? By preparing written standards now, franchisors can be prepared to meet the two-week deadline.

Gray Plant Mooty has identified at least 50 issues that arise from the language of AB 525, and has developed a template that can be used to prepare transfer standards. On December 9, 2015, the firm hosted a webinar on how to comply with AB 525. The recorded webinar and slides are available here: http://www.gpmlaw.com/updates-Events/Events/115209/How-to-Deal-with-California-AB-525.

For a copy of the issues memo or transfer template, contact any member of Gray Plant Mooty’s Franchise and Distribution Practice Group, as identified on the following page.

Along with the attorneys indicated on the next page, Gregory R. Merz, a principal in the Litigation practice group, and Ellen J.Y. Davis, a Manager in the Business Development & Marketing Department, contributed to 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.