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.

JURISDICTION AND PROCEDURE

CONTINUED INTERACTION BETWEEN FRANCHISOR AND SUBFRANCHISOR AFTER FRANCHISOR MOVED ITS HEADQUARTERS SUPPORTS JURISDICTION OVER SUBFRANCHISOR IN FRANCHISOR'S NEW HOME STATE, APPEALS COURT HOLDS

In *Baskin-Robbins Franchising LLC v. Alpenrose Dairy, Inc.*, the United States Court of Appeals for the First Circuit held that an Oregon subfranchisor's continuing interaction with Baskin-Robbins after Baskin had moved its headquarters from California to Massachusetts was sufficient to support specific personal jurisdiction over the subfranchisor in Massachusetts. 2016 WL 3147645, __ F.3d __ (1st Cir. June 6, 2016). Gray Plant Mooty represented Baskin-Robbins in the case.

The focus of the court's decision was primarily on whether the subfranchisor had "purposefully availed" itself of the benefits of doing business in Baskin-Robbins's new home state. Although the subfranchisor had sent renewal notices to Baskin in Massachusetts in 2001 and 2007, that alone was not deemed sufficient to confer personal jurisdiction. Similarly, the court found that regular payments to and from Baskin after it had moved to Massachusetts and visits by the subfranchisor's executives to Baskin-Robbins in Massachusetts were jurisdictionally significant, but not in themselves conclusive. Instead, the linchpin for the court was that for many years after its move to Massachusetts, Baskin had provided substantial services in Massachusetts in support of the subfranchisor, including quality assurance activities, customer service maintenance, and development of new products. The court held that those activities were properly viewed as having been performed by Baskin-Robbins on the subfranchisor's behalf and were therefore attributable to the subfranchisor. Therefore, the court held that the subfranchisor had "purposely availed" itself of the opportunity to do business in Massachusetts, rendering it susceptible of specific personal jurisdiction there.

COURT DISMISSES AFFILIATE OF FRANCHISOR FROM PUTATIVE CLASS ACTION BASED ON LACK OF PERSONAL JURISDICTION

An Alabama federal court granted the motion of a franchisor's affiliate to be dismissed from a putative class action in *Lee v. Hyundai Motor America, Inc.*, 2016 WL 3194532 (N.D. Ala. June 9, 2016). Lee had sued both Precision Tune Auto Care, an entity related to Precision Franchising, LLC, the franchisor of retail automotive repair shops, along with automaker Hyundai, alleging that a defective aftermarket oil filter purchased from a Precision Tune franchise in Alabama had caused the engine to fail in his Hyundai car. Lee sued for violations of the Alabama Deceptive Trade Practices Act and breach of warranty. Lee argued that Precision Tune was subject to the court's supplemental jurisdiction and that the complaint had stated a direct claim and an agency claim based upon the franchise system's national warranty. Precision Tune argued that Lee had sued the wrong entity because it is distinct from the franchising entity that administered the national warranty program. Precision Tune further explained it "is not licensed, qualified, registered, or authorized to do business in Alabama and does not own or operate any retail automotive repair shops in Alabama or any state."

In its decision, the court found, first, that it did not have general jurisdiction over Precision Tune because it was not incorporated in Alabama and did not have its principal place of business there. Then, the court found that it did not have specific jurisdiction because Precision Tune is a different corporate entity than the franchisor that had entered into the franchise agreement with the Alabama franchisee at issue. Therefore, the court found that Precision Tune had neither purposefully availed itself of the benefits and protections of Alabama's laws nor established minimum contacts within the state. Because Lee only argued that fact questions existed as to personal jurisdiction and did not submit evidence to counter Precision Tune's evidence that it was a distinct entity, the court found that Lee had not met his burden of proof as to jurisdiction.

CLASS ACTIONS

CLASS OF McDONALD'S WORKERS CERTIFIED IN CALIFORNIA

A federal judge in California last week certified for class action treatment a case brought by a group of workers at five franchised McDonald's restaurants. *Ochoa v. McDonald's Corp.*, No. 3:14-cv-02098 (N.D. Cal. July 7, 2016). Because the franchisee in this closely-followed case has settled with the plaintiffs, the class was certified to pursue claims against only McDonald's Corp. and McDonald's USA, LLC, which remain in the case on the theory of "ostensible agency." As reported in Issue 198 of *The GPMemorandum*, summary judgment already has been denied on ostensible agency, although a direct "joint employer" theory was dismissed on summary judgment.

The court certified the class of "crew members" at the franchised outlets to continue their wage-related claims against the franchisor and attempt to prove they reasonably believed their franchisee-employer was an "agent" of McDonald's. The franchisor had argued it is impossible to determine this ostensible agency issue on a classwide basis. Citing non-franchise cases in which classes had been certified to pursue ostensible agency claims, however, the court agreed to allow the plaintiffs to proceed collectively on claims for miscalculated wages, overtime, maintenance of uniforms, and related derivative claims. The court held that the plaintiffs had "tendered substantial and largely undisputed evidence that the putative class was exposed to conduct in common that would make proof of ostensible agency practical and fair on a class basis." As examples of this evidence, the court cited declarations stating the plaintiffs were "required to wear McDonald's uniforms, packaged food in McDonald's boxes, received paystubs, orientation materials, shift schedules and time punch reports all marked with McDonald's name and logo, and in most cases applied for a job through a McDonald's website." The court noted that whether the plaintiffs ultimately will prevail based on this proof is the question for trial, rather than on class certification.

NEW JERSEY COURT DECLINES TO FIND LIABILITY FOR FRANCHISOR IN CLASS ACTION SALES TAX COLLECTION DISPUTE

A New Jersey state court granted a franchisor's motion to dismiss a class-action complaint because the court found that, based on the language of the franchise agreements, only the franchisees could be at fault. *Frate v. Dunkin' Brands, Inc.*, 2016 WL 3542402 (N.J. Super. Ct. Law Div. June 28, 2016). Gray Plant Mooty represented the franchisor in this case. The plaintiffs alleged that various New Jersey franchisees had improperly assessed sales tax on bottled water and prepackaged coffee, which are goods that may qualify as grocery items and thus be exempt from New Jersey sales tax. They brought claims against franchisor Dunkin' Brands and franchisees alleging, among other things, that the franchisor played a role in setting prices and collecting sales taxes.

The court held that the plaintiffs improperly named Dunkin' Brands as a defendant because it had no responsibility for collecting sales tax and it had no role in setting prices at individual stores. Further, the court held that the plaintiffs had failed to allege any benefits accruing to Dunkin' Brands from the assessment of sales tax. The franchise agreements relied on in the complaint made individual franchisees directly responsible for the collection and remittance of any sales taxes and the setting of prices in stores. The court noted that when a document referred to in the complaint contradicts conclusory allegations in the complaint, the document controls. Absent evidence of Dunkin' Brands' role in setting sales taxes, the court was unwilling to impute liability to it for the independent actions of its franchisees, and thus the court dismissed the complaint against Dunkin' Brands.

ARBITRATION

ARBITRATION PANEL FINDS ENTIRELY IN FAVOR OF DEL TACO IN CASE INVOLVING ALLEGED MISREPRESENTATIONS

Former Florida franchisees brought a complaint for $14 million in damages against Del Taco, a Mexican and American food quick service restaurant franchisor headquartered in California. Following a five-day arbitration in Los Angeles, a panel of three arbitrators found in Del Taco's favor on all counts. *Floridel, LLC v. Del Taco, LLC*, AAA No. 01-14-0001-9403 (June 15, 2016). Gray Plant Mooty represented Del Taco in the arbitration. The claimants, a corporation and its principals who had developed three Del Taco restaurants in Florida, brought claims in late 2014, alleging that Del Taco had engaged in fraud, misrepresentation, negligence, breach of contract, and violations of the franchise laws of California and Florida. They alleged, among other things, that Del Taco had provided them with false information concerning the cost of constructing their stores and the earnings they could achieve for each store, had failed to adequately investigate the Florida market before deciding to locate franchises there, and had provided inadequate training, marketing support, and supervision.

Del Taco prevailed on summary judgment on the fraud, misrepresentation, and franchise law claims, leaving the breach of contract and negligence claims for trial. Eleven witnesses testified at the trial, including four experts. Several weeks after the trial, in a lengthy opinion, the arbitration panel found for Del Taco on all of the remaining counts. It held that Del Taco adequately investigated the Florida market before deciding to locate franchises there; that the market was not materially different from other markets in which Del Taco had an established presence; that Del Taco had no contractual obligation to change its system for the Florida market; that Del Taco had provided adequate training, marketing support, and supervision to the franchisees; that Del Taco had no obligation to perform expanded marketing services; and that the franchisees had no evidence of damages consistent with their theory of liability. As a result, the panel awarded Del Taco its attorneys' fees and costs under the prevailing party provisions in the relevant contracts.

PRACTICE OF FRANCHISE LAW

SEVENTH CIRCUIT AFFIRMS DISMISSAL OF $20 MILLION CLAIM BASED ON FDD

The United States Court of Appeals for the Seventh Circuit last week issued a decision upholding the dismissal of claims challenging the publication of a settlement in a franchise disclosure document. *Caudill v. Keller Williams Realty, Inc.*, No. 15-3313 (7th Cir. July 6, 2016). Franchisor Keller Williams had settled a case brought by a former franchisee who later had become a regional director of the franchisor. The settlement, like many, was subject to a confidentiality provision that specifically covered the amount paid to the plaintiff in the settlement. Importantly, the confidentiality term of the settlement agreement also contained a liquidated damages provision stating that damages for breach of confidentiality would be difficult to quantify precisely, so any violation would entitle the other party to an award of $10,000. Three months after the settlement, Keller Williams issued its FDD, which eventually went to some 2,000 existing or potential franchisees and others, disclosing the information about the settled case and the amount paid.

In her subsequent lawsuit, the plaintiff contended that the widespread dissemination of the settlement terms through the FDD was a breach of confidentiality, and she sought $10,000 in liquidated damages per recipient, for a total of $20,000,000. Applying Texas law, the district court dismissed the case because liquidated damages cannot be awarded unless the amount established in the provision is a "reasonable forecast of just compensation." The lower court believed any non-actual-damages amount would be punitive, and punitive damages are not allowed in contract cases. The Seventh Circuit agreed there was no evidence that $20,000,000 (or even $10,000 per violation) reasonably approximated the plaintiff's damages. In fact, the plaintiff had not tendered any evidence that she was damaged by any one of the 2,000 people having seen the FDD. The Seventh Circuit said that while actual damages many be conceivable for an inappropriate disclosure, there was nothing other than speculation on which to base an award in this case.

TRADEMARKS

APPEALS COURT UPHOLDS CANCELLATION OF FRAUDULENTLY PROCURED TRADEMARK UNDER "ACTUAL KNOWLEDGE" STANDARD

In *MPC Franchise, LLC v. Tarntino*, 2016 WL 3512500 (2d Cir. June 27, 2016), the United States Court of Appeals for the Second Circuit affirmed a ruling cancelling a federal trademark registration on the grounds that it was obtained by fraud in violation of the Lanham Act. MPC, a franchisor of Pudgie's pizza restaurants in upstate New York, brought suit against a nephew of the original Pudgie's founder after the nephew, Brent Tarntino, applied for and received registration of the mark PUDGIE'S for use with restaurant services. MPC alleged that Tarntino procured the mark fraudulently when he certified in his application that he was the sole owner of the mark, despite knowing that MPC was already franchising pizzerias using the same mark.

The court's ruling centered on whether Tarntino *actually knew* that the statements in his trademark application were false, or whether he merely *should have known* about those falsehoods. Relying largely on the precedent set by *In re Bose Corp.*, 580 F.3d 1240 (Fed. Cir. 2009), Tarntino argued that the standard for fraud on the PTO is actual knowledge. The court agreed, but found that even under this more stringent standard, Tarntino still committed fraud because there was abundant evidence that he knew at the time of his application that other Pudgie's restaurants were using the same mark.

STATE FRANCHISE LAWS

NEW JERSEY FEDERAL COURT GRANTS FRANCHISOR'S MOTION FOR SUMMARY JUDGMENT ON FRANCHISEE'S COUNTERCLAIMS

A federal court in New Jersey granted 7-Eleven's motion for summary judgment on a franchisee's four counterclaims that 7-Eleven: (1) violated the New Jersey Franchise Practices Act ("NJFPA"); (2) breached the implied covenant of good faith and fair dealing; (3) violated the federal Fair Labor Standards Act ("FLSA"); and (4) violated the New Jersey Law Against Discrimination ("NJLAD"). *7-Eleven, Inc. v. Sodhi,* 2016 WL 3085897 (D.N.J. May 31, 2016). After identifying accounting discrepancies in the records of Sodhi, its franchisee, 7-Eleven terminated the parties' franchise agreements and subsequently filed suit due to Sodhi's breach. Sodhi counterclaimed, and 7-Eleven sought both summary judgment and a declaratory judgment that the franchise agreements were properly terminated.

Examining the first counterclaim, the court rejected Sodhi's argument that termination was improper because it was based on racial or other animus. Given that Sodhi had, indeed, breached the franchise agreement, and that 7-Eleven complied with the requisite cure period under the NJFPA, the court held that animus was irrelevant. Moreover, the court rejected Sodhi's third and fourth counterclaims that 7-Eleven violated the FLSA and NJLAD. Noting that Sodhi did not maintain a regular work schedule at the stores, received a share of profits, spent millions of dollars on licenses and other goods or services related to the stores, and had invested his own entrepreneurial acumen into the businesses, the court found insufficient indicia of an employment relationship. Since the court determined that Sodhi was not an "employee"—and "employee" status was necessary for a violation of either statute—the FLSA and NJLAD claims failed as a matter of law. After otherwise finding in favor of 7-Eleven on every claim, the court granted 7-Eleven the relief sought.

FRANCHISOR NOT LIABLE UNDER TEXAS BUSINESS OPPORTUNITY ACT FOR FAILURE TO PROVIDE FRANCHISEE WITH DISCLOSURE DOCUMENT

Following a bench trial, a Missouri federal court found an automobile cosmetic repair franchisor not liable to a former master franchisee under the Texas Business Opportunity Act ("TBOA"). *Restored Images Consulting, LLC v. Dr. Vinyl & Assocs., Ltd.,* 2016 WL 3064142 (W.D. Mo. May 31, 2016). Restored Images had been a franchisee of Dr. Vinyl before entering into a master franchise agreement with Dr. Vinyl. The master franchise agreement obligated Restored Images to sell a minimum number of franchises, though Restored Images repeatedly repudiated this obligation, and the obligation was never enforced. In turn, Dr. Vinyl agreed to provide Uniform Franchise Offering Circulars ("UFOCs") which Restored Images could then provide to prospective franchisees. Restored Images, however, claimed it never received the UFOCs. The relationship between Restored Images and Dr. Vinyl deteriorated, and Restored Images brought a myriad of claims against Dr. Vinyl, including breach of contract and TBOA claims based on Dr. Vinyl's failure to provide UFOCs.

The court found that the failure to provide UFOCs had not caused Restored Images any damages. Restored Images submitted no evidence that lacking a UFOC prevented it from promoting, selling, or growing franchises, that any sales had been imminent or likely, or that any sale was hindered by a potential franchisee's inability to review a UFOC. Because damages are an essential element of both a claim for breach of contract and claims for violation of the TBOA, the court found for Dr. Vinyl on those claims, though the court did award Restored Images damages for a commission on the single franchise sale it made.

DAMAGES TO FRANCHISEE

GEORGIA APPELLATE COURT DECLINES TO AWARD DAMAGES TO FRANCHISEE FOR NEGLIGENT MISREPRESENTATION

The Court of Appeals of Georgia held that a franchisee was not entitled to damages for negligent misrepresentation because the franchisee failed to prove that it suffered actual economic damages as a result of the alleged misrepresentation. *Legacy Acad., Inc. v. Dole-Smith Enters., Inc.*, 2016 WL 3208751 (Ga. Ct. App. June 9, 2016). In so holding, the court overturned a jury verdict in the franchisee's favor. In 2006, Dole-Smith Enterprises spoke to several potential franchisors about purchasing a daycare franchise. During those discussions, Legacy Academy provided Dole-Smith with a UFOC which contained disclosures about Legacy Academy's litigation history and projections regarding potential profits. After reviewing the UFOC, Dole-Smith decided to purchase a daycare franchise from Legacy Academy, and the parties entered into a franchise agreement. Dole-Smith subsequently terminated its franchise agreement and filed suit, alleging that the UFOC contained false and misleading information.

Georgia has adopted the Restatement definition of the proper measure of damages in negligent misrepresentation cases, which allows for both an out-of-pocket measure of direct damages and additional consequential damages, if proven. Out-of-pocket damages are those necessary to compensate the plaintiff for the difference between the purchase price and the value of what was received in the transaction. Consequential damages, on the other hand, are additional expenses or losses incurred, not as a direct result of the transaction, but in reliance on the representations. Here, Dole-Smith did not present any evidence of out-of-pocket direct damages resulting from Legacy Academy's alleged misrepresentations. Instead, it sought to recover a portion of the purchase price for the daycare franchise as well as other costs inherent in the purchase. These costs, however, are not recoverable as consequential damages because they were incurred as a direct result of the transaction. Moreover, although Dole-Smith alleged other consequential damages, it failed to prove those damages with sufficient particularity. Therefore, the court determined Dole-Smith was not entitled to any damages for negligent misrepresentation.

Along with the attorneys indicated on the next page, summer associates Cade Cross, Amy Erickson, Dion Farganis, Robert Gallup, Olivia Garber, and Amanda McAllister all contributed to this issue.

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