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.

ARBITRATION

ELEVENTH CIRCUIT AFFIRMS DISTRICT COURT'S DISMISSAL OF FRANCHISEE'S CHALLENGES TO ARBITRATION AWARD

The United States Court of Appeals for the Eleventh Circuit denied a franchisee's appeal of a district court's confirmation of an arbitration award in *Careminders Home Care, Inc. v. Kianka*, 2016 WL 7228808 (11th Cir. Dec. 14, 2016). In arbitration, Compassionate Care, a former franchisee of CareMinders Home Care, claimed that the franchisor had breached the franchise agreement and committed fraud as to the parties' business relationship. After the arbitrator found in favor of CareMinders, the franchisor petitioned the district court to confirm the arbitration award. Compassionate Care responded by filing an answer generally stating that the award should be vacated on the grounds that the arbitrator refused to grant a few continuances, among other things, and stated that it would file a formal motion to vacate the award. Compassionate Care, however, never filed its motion within the 90-day deadline, as required by the Federal Arbitration Act ("FAA"). When the district court entered an order confirming the arbitration award, Compassionate Care filed a motion for reconsideration, but that was denied.

On appeal, Compassionate Care argued that the district court should have considered its answer as a motion to vacate. The appellate court disagreed and explained that the FAA imposes a heavy presumption in favor of confirming arbitration awards. Compassionate Care was aware of its responsibility to file a motion to vacate the award, but failed to do so within the FAA's strict 90-day deadline. Additionally, the court held that because Compassionate Care failed to identify any newly discovered evidence, a change in law, or a need to correct a clear error of law or fact, the district court was correct in denying Compassionate Care's motion for reconsideration. The appellate court affirmed the district court's ruling to confirm the arbitration award in favor of the franchisor.

CONSOLIDATION OF INDIVIDUAL ARBITRATIONS MUST BE DETERMINED BY ARBITRATOR

A federal court in California has denied franchisees' motion for an order to consolidate their claims into a single arbitration. *Meadows v. Dickey's Barbecue Rests., Inc.*, 2016 WL 7386138 (N.D. Cal. Dec. 21, 2016). This case arose from a dispute regarding whether franchisor Dickey's Barbecue Restaurants made false and misleading representations to the plaintiffs, all of whom are owners and former owners of Dickey's franchises in California. The court had previously determined that the franchisees' claims in this matter must be submitted to arbitration. Subsequent to that determination, the franchisees filed a group arbitration demand with the AAA. In response, the AAA informed the plaintiffs that they must instead file individual arbitration demands and that consolidation could only be requested from the appointed arbitrator after satisfying all initial filing requirements. In response, the franchisees sought a court order to consolidate their individual arbitrations, noting that California law permits consolidation into a single arbitration and that the AAA rules do not provide a mechanism for consolidation.

The court denied the franchisees' motion, holding that once the parties are obligated to submit a dispute to arbitration, procedural questions arising out of the dispute must be decided by the arbitrator. The court further held that the availability of class arbitration is considered a procedural question to be decided by the arbitrator, noting that California courts, the Ninth Circuit, and other federal appellate courts have reached the same conclusion. As a result, the court stated that each plaintiff must first individually file its claims with the AAA, and the plaintiffs may then subsequently request consolidation in accordance with AAA rules.

GRAY PLANT MOOTY

DISTRICT COURT ORDERS FRANCHISOR AND FRANCHISEE TO PROCEED TO ARBITRATION AFTER GRANTING FRANCHISOR'S PRELIMINARY INJUNCTION

A federal court in Florida recently ordered a franchisor and franchisee to proceed to arbitration following an earlier entry of a preliminary injunction against the franchisee. *Pirtek USA, LLC v. Twillman*, 2016 WL 7116205 (M.D. Fla. Dec. 7, 2016). The case involved claims of unfair competition, fraud, and breach of the noncompete and confidentiality provisions of a franchise agreement between the parties. Following entry of the preliminary injunction order, Twillman, a Pirtek franchisee, filed several motions seeking, among other things, relief from and/or modification of the order. Pirtek responded by objecting to the requested relief, filing an arbitration action with the AAA, and moving to compel arbitration pursuant to the terms of the franchise agreement between the parties.

The court denied Twillman's motions and granted Pirtek's motion to compel arbitration. In granting the motion to compel, the court rejected Twillman's argument that Pirtek had either waived its right to arbitrate or should be estopped from asserting such a right because it acted inconsistently with the right to arbitrate by filing a lawsuit seeking preliminary injunctive relief. The court held that Pirtek's initiation of its lawsuit was not inconsistent with its right to arbitrate the issue of permanent injunctive relief because the parties had contractually agreed that they could seek preliminary injunctive relief and reserve all other issues—including permanent injunctive relief—for arbitration. Further, the court noted that the brief delay between Pirtek's filing of its complaint and its arbitration demand did not amount to a waiver. Finding Twillman's waiver and estoppel arguments unavailing, the court ordered the parties to proceed to arbitration pursuant to the terms of their franchise agreement.

COURT ENFORCES ARBITRATION AGREEMENT CONTAINED IN FRANCHISE APPLICATION

A Connecticut federal court granted a petition to compel arbitration filed by Subway sandwich restaurant franchisor Doctor's Associates, Inc. ("Subway") enforcing an arbitration clause contained in Subway's application to become a franchisee. *Doctor's Assocs. Inc. v. Burr*, 2016 WL 7451620 (D. Conn. Dec. 28, 2016). Prospective franchisees, the Burrs, submitted a Subway franchise application that included the arbitration clause, but Subway declined to grant the Burrs a franchise. In response, the Burrs initiated an action against Subway's third-party development agent, the Marwaha Group, claiming that it had used its position as Subway's development agent to interfere with the transaction and secure the Subway franchise for itself. Subway initiated arbitration against the Burrs for declaratory relief relating to facts underlying the Burrs' lawsuit and thereafter filed the petition to compel arbitration. Because the arbitration clause covered "any and all claims . . . arising out of or relating to" the Burrs'

"application or candidacy" for a Subway franchise, the court found that a dispute between the Burrs and the Marwaha Group was subject to arbitration.

The court rejected the Burrs' claim that the dispute was not subject to arbitration because the Marwaha Group and its owners were not parties to the arbitration agreement. It noted that the Burrs' causes of action, which included interference with contractual relations, were directly related to their Subway franchise application and/or their candidacy for a Subway franchise. The court further found that the owners of the Marwaha Group were acting as agents of Subway when the causes of action arose. Hence, even though the Marwaha Group and its owners were not signatories to the Subway franchise application, the Burrs were obligated to arbitrate their claims against the Marwaha Group and Subway.

ILLINOIS COURT AFFIRMS DISMISSAL OF FRANCHISEE'S COMPLAINT IN LIGHT OF ARBITRATION CLAUSE

Similarly, the Appellate Court of Illinois affirmed an order dismissing a franchisee's complaint and ordering the parties to submit to arbitration, despite the fact that the defendants were not signatories to the franchise agreement. In *Kim v. Kim*, 2016 IL App. (1st) 153296-U (Ill. App. Ct. Nov. 30, 2016), a franchisee sued employees of the franchisor claiming that the employees had fraudulently induced him to enter into a franchise agreement with the franchisor. The franchisor itself was not a defendant. Citing to the franchise agreement's arbitration clause, the employees initially responded to the complaint by filing a motion to dismiss and compel arbitration. The court denied the first motion, finding it unclear whether one of the employees had been acting in his capacity as an employee of the franchisor. After the franchisee admitted in deposition testimony that he thought the employee was acting as a representative of the franchisor, the employees renewed their motion to dismiss. The trial court granted the second motion, and the franchisee-plaintiff appealed.

The Appellate Court affirmed. The court began by analyzing choice of law. The trial court had applied the FAA, but the Appellate Court determined the FAA did not apply, since the franchise agreement designated Delaware as the exclusive choice of law, without reference to the FAA. Delaware law, however, did not change the result. First, the court found that the employees had acted consistently with their right to compel arbitration. Therefore, waiver had not occurred. Second, the court refused to consider the claim that complying with the arbitration clause would be too expensive, since the franchisee failed to present that argument to the trial court. Finally, the court rejected the argument that the franchise agreement's arbitration clause did not apply. While the employees themselves were not signatories to the franchise agreement, the franchisee's claims depended on the existence of the agreement. Therefore, applying principles of

equitable estoppel, the court found that the franchisee could not avoid application of the franchise agreement's arbitration provision.

EMPLOYMENT

FRANCHISOR FOUND NOT TO BE JOINT EMPLOYER OF FRANCHISEE'S STAFF

In December, an Oregon federal court found that a franchisor was not a joint employer of its franchisee's employees and granted portions of the franchisor's motion for summary judgment. *Gessele v. Jack in the Box, Inc.*, 2016 WL 7223324 (D. Or. Dec. 13, 2016). The plaintiffs had brought a putative class action alleging violations of the minimum wage and overtime provisions of the Fair Labor Standards Act ("FLSA") and various state wage-and-hour laws. The plaintiffs had been employed in several of the company-owned restaurants run by franchisor Jack in the Box at the time the restaurants were sold to the franchisee. The court found that the franchisor was not a joint employer and was not liable for any of the employees' claims that arose after the date on which the franchise agreements became effective.

The court applied the Ninth Circuit's test for joint employer status by examining whether the defendant: (1) had the power to hire and fire employees; (2) supervised and controlled employee work schedules or conditions of employment; (3) determined the rate and method of payment of wages; and (4) maintained employment records. Although Jack in the Box offered some training to store managers and provided some optional human resources advisory manuals, the court found those facts insufficient to show that Jack in the Box effectively exercised control under the four-factor analysis. Similarly, although franchisees were required to use the franchisor's payroll system which aggregated the data before sending it to the franchisees' payroll companies, the court found that a ministerial function did not establish true control over labor relations within the franchised businesses.

The court also granted Jack in the Box's motion for summary judgment as to the individual claims of one plaintiff who had entered into an arbitration agreement at the time of his employment with the franchisee. The court found that a provision of the arbitration agreement prohibiting employees from concerted action was illegal under the Ninth Circuit's interpretation of the FLSA. However, the court severed that portion of the agreement and found that the individual plaintiff's claims in the case were governed by the remaining provisions of the arbitration agreement.

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NONCOMPETES

TEXAS DISTRICT COURT AWARDS PRELIMINARY INJUNCTION ENFORCING POST-TERMINATION OBLIGATIONS AND NONCOMPETE

A United States District Court for the Southern District of Texas recently granted a motion by Fantastic Sams to enforce a post-termination noncompetition obligation against a nonrenewing franchisee. *Fantastic Sams Franchise Corp. v. Mosley*, 2016 WL 7426403 (Dec. 23, 2016). The franchise agreement contained a noncompetition provision prohibiting the franchisee, Mosley, from operating a hair salon business within five miles of the location of his former Fantastic Sams salon for two years after the expiration of the agreement. Soon after the expiration of the franchise agreement, Mosley opened a new hair salon business, under a new name, approximately two miles from his former Fantastic Sams location.

The court found the post-termination obligations, including the obligation to cease using Fantastic Sams' trademarks and the telephone number associated with the franchise, to be valid and enforceable under Texas law. The court further held that Fantastic Sams was likely to succeed on its claim that Mosley had violated his post-termination obligations and that Fantastic Sams would suffer irreparable harm absent injunctive relief because Mosley's conduct hurt existing franchisees, posed a threat to Fantastic Sams' goodwill, and inhibited the opening of a new Fantastic Sams franchise in the area. The court also held that the balance of hardships favored the grant of injunctive relief because Fantastic Sams would suffer irreparable harm without the injunction, while the harm that Mosley would suffer was self-induced. Moreover, the court held that the public interest would be served through the enforcement of a valid noncompete agreement. Fantastic Sams also sought preliminary injunctive relief on the grounds that Mosley had infringed Fantastic Sams' trademarks and trade dress. The court declined to award injunctive relief on those grounds, finding Fantastic Sams presented insufficient evidence of consumer confusion and that its claimed trade dress consisted primarily of functional elements.

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