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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.

CHOICE OF LAW

FRANCHISEE'S WRONGFUL TERMINATION AND BREACH OF GOOD FAITH CLAIMS REJECTED UNDER MISSOURI LAW

The United States District Court for the Northern District of New York recently rejected a franchisee's counterclaims that her franchisor wrongfully refused to renew her franchise agreement and breached its implied covenant of good faith and fair dealing when (as previously reported in Issue 190 of *The GPMemorandum*) it thereafter obtained enforcement of the franchisee's post-termination covenant against competition. *H&R Block Tax Servs. LLC v. Strauss*, 2017 WL 395119 (N.D.N.Y. Jan. 27, 2017). Gray Plant Mooty represents H&R Block in this case.

The franchise agreement provided for an initial term of five years and for automatic renewal every five years thereafter unless the franchisee elected not to renew. But the agreement also contained a Missouri choice of law provision, and precedent under Missouri law required that such agreements be construed to allow either party to decline to renew. The franchisee argued that the laws of New York, where the franchisee operated and where the case was venued, rather than Missouri law should be applied. Although the court found that New York law differed from Missouri law on the

renewal issue, the franchisee had not satisfied her heavy burden to show that the relevant Missouri law offended "a fundamental policy" of New York such that the agreement's choice-of-law provision should not be enforced.

Having found that H&R Block was entitled under Missouri law to not renew the agreement, the court still had to determine whether the franchise agreement's post-termination covenant against competition was triggered in those circumstances. The franchisee argued that her covenant against competition was triggered by termination for cause but not by expiration of the agreement. The court held that based on language in the agreement providing that the covenant applied upon the termination or "other disposition" of the franchise, H&R Block was entitled to enforce the covenant after electing not to renew the agreement.

STATE FRANCHISE LAWS

SIXTH CIRCUIT AFFIRMS DISTRICT COURT'S FINDING THAT SALE OF UPGRADED EQUIPMENT WAS GRANT OF FRANCHISE

The United States Court of Appeals for the Sixth Circuit has affirmed a judgment granting rescission of a purported franchise agreement and holding the franchisor and its salesperson jointly and severally liable for damages. *Lofgren v. AirTrona Canada*, 2017 WL 384876 (6th Cir. Jan. 27, 2017). The lower court's judgment was summarized in Issue 202 of *The GPMemorandum*. AirTrona Green Technologies had previously sold an "ozone process" automobile deodorizer business plan and related equipment to the plaintiff, Lofgren. In 2011, AirTrona Canada (the apparent "alter-ego" of AirTrona Green Technologies) sold Lofgren a new plan for a "sanitation process" deodorization business, which provided for training and new equipment for which Lofgren was charged a premium. The business plan also required Lofgren to regularly report to AirTrona Canada. Neither the salesperson nor AirTrona Canada delivered a franchise disclosure document to Lofgren in connection with the sale. When the business failed, Lofgren sued AirTrona Canada and the salesperson on the grounds that the Michigan Franchise Investment Law ("MFIL") makes "an employee of a person [liable under the statute] who materially aids" in a violation of the statute jointly and severally liable for damages. The defendants appealed the district court's judgment in favor of Lofgren, arguing that they did not grant a franchise to Lofgren, the salesperson should not have been found jointly and severally liable, and the court's remedy was improper.

The Sixth Circuit disagreed with the defendants on each point. First, the court found that all three elements of a franchise were present in the 2011 sale given that (1) AirTrona Canada had never previously transacted with Lofgren, the new equipment changed the nature of the services provided by Lofgren's business, and the sales invoice listed "1 *Franchise* Michigan location"; (2) Lofgren's business relied on procedures

"prescribed" by the defendants; and (3) the defendants had no explanation for the purpose of the extra amount charged to Lofgren over the value of the equipment, if it was not a "franchise fee" within the meaning of the MFIL. Second, the court disagreed with the salesperson's contention that he was an independent contractor, which would have shielded him from joint and several liability under the MFIL, since he had held himself out as an employee of AirTrona Canada, had made personal promises to Lofgren, was Lofgren's primary contact, and had full knowledge of the nature of the sale. Lastly, the court found that the lower court's grant of rescission and award of damages was not improper, since those remedies were explicitly allowed by the MFIL regardless of causation. The court found that the defendants had committed more than a mere technical violation of the statute in failing to provide a disclosure document to Lofgren and that there was no evidence that Lofgren had acted in bad faith. The court declined, however, to award Lofgren his attorneys' fees for the appeal.

DUTY OF GOOD FAITH AND FAIR DEALING

OKLAHOMA DISTRICT COURT DISMISSES BAD FAITH AND UNFAIR PRACTICES CLAIMS AGAINST FRANCHISOR

Last month, an Oklahoma district court dismissed a bad faith counterclaim against a franchisor in *Sonic Industries LLC v. Halleran*, 2017 WL 239388 (W.D. Okla. Jan. 19, 2017). Oklahoma law recognizes an implied covenant of good faith and fair dealing in every contract but only allows recovery for breach of that covenant as an independent claim if there is a "special relationship" between the parties and evidence of adhesion. The court dismissed the bad faith claim after finding no evidence of adhesion in the contracts at issue.

The court further held that, under Florida law, a franchisee cannot pursue a statutory claim for deceptive and unfair trade practices against a franchisor if there is a written contract whose terms contradict the misrepresentations on which the franchisee claims to have relied. In such circumstances, the court reasoned, the franchisee cannot have reasonably relied on the alleged misrepresentations.

TRANSFERS

FRANCHISEE'S INTENTIONAL INTERFERENCE CLAIM SURVIVES MOTION TO DISMISS

Meanwhile, a federal court in Kentucky held that a franchisee sufficiently pled a claim against a franchisor for intentional interference with a prospective economic advantage. *Raheel Foods, LLC v. Yum! Brands, Inc.*, 2017 WL 217751 (W.D. Ky. Jan. 18, 2017). Raheel was party to several franchise agreements with Yum! Brands and eventually

decided to sell its franchised stores. Under the franchise agreements, prior to selling the stores, Raheel was required to obtain Yum! Brands' approval of the proposed purchaser. Raheel alleged that it presented proposed purchasers to Yum! Brands for approval and that Yum! Brands undercut Raheel either by offering the proposed purchasers corporate-owned stores at below-market prices, or by refusing to approve the proposed purchasers as franchisees when presented but later approving them to purchase corporate-owned stores. In ruling on a motion to dismiss filed by Yum! Brands, the court held that, taking Raheel's allegations as true (which the court was obligated to do for purposes of deciding the motion), Yum! Brands' conduct could potentially constitute intentional interference with a prospective economic advantage, and the case could proceed to discovery.

Yum! Brands had argued that because it had the right under the parties' franchise agreements to deny any sale proposed by Raheel, its denial of Raheel's proposals was not improper interference as a matter of law. The court disagreed, holding that Raheel did not allege that the mere denial of the proposed sales was improper interference but rather that Yum! Brands used its disapproval rights for an improper purpose—to take Raheel's buyers for itself. Yum! Brands had further argued that it was a competitor with Raheel (in the respect that both parties were engaged in selling franchised stores), and that competition alone was not an improper basis for interference. Again, the court disagreed, reasoning that Yum! Brands was privy to the terms of the proposed deals and allegedly used its contractual right of approval to handcuff Raheel and purloin its potential purchasers.

EMPLOYMENT

WISCONSIN DISTRICT COURT DECLINES TO IMPOSE JOINT-EMPLOYER LIABILITY ON FRANCHISOR UNDER FLSA AND STATE LAW

A Wisconsin federal court recently granted a motion for summary judgment filed by franchisor Fish Window Cleaning Services, Inc., finding that it was neither an employer of its franchisee's employees under the Fair Labor Standards Act ("FLSA") nor under Wisconsin state wage and hour laws. *Pope v. Espeseth, Inc.*, 2017 WL 108081 (W.D. Wis. Jan. 11, 2017).

The court held that the test for joint-employer liability was substantially similar under both the FLSA and Wisconsin state law and looked to the following four factors: (1) whether Fish had the power to hire and fire the franchisee's employees, (2) whether Fish supervised and controlled employee work schedules or conditions of payment, (3) whether Fish controlled the rate or method of payment, and (4) whether Fish maintained employment records. The parties conceded that the first and fourth factors were not present. With regard to the second factor, the franchisee argued that Fish

controlled its employees through guidelines contained in Fish's manual, which addressed issues like employees' work schedules. The record also reflected that Fish required the franchisee to provide Fish's manual to employees. However, the court found insufficient evidence of control because the franchisee was free to modify the manual and, in fact, did vary its requirements from those stated in the manual in some instances. Addressing the third factor (the franchisor's control over the rate and method of payment), the court further held that Fish did not require the franchisee to adhere to a commission-based compensation schedule and again pointed to instances in which the franchisee's payment policies diverged from the franchisor's recommendations. Concluding that the "minimal" control exerted by Fish was "nothing like" the type of control that would support a finding of joint-employer liability under the applicable statutes, the court granted Fish's motion for summary judgment.

SYSTEM SUPPLY

COURT DISMISSES PROSPECTIVE SUPPLIER'S CLAIMS AGAINST DOMINO'S

A district court in California has granted Domino's motion to dismiss claims asserted against it by Prostar Wireless Group, a prospective supplier to Domino's franchisees. *Prostar Wireless Grp., LLC v. Domino's Pizza, Inc.*, 2017 WL 67075 (N.D. Cal. Jan. 6, 2017). Prostar alleged that it had worked with Domino's and its franchisees over the course of ten years to develop technology to assist franchisees in driver tracking and navigation. Domino's ultimately elected to develop technology of its own, which Prostar alleged was functionally identical to Prostar's. Prostar then filed a seven-count complaint alleging that Domino's breached its fiduciary duty to Prostar (arising from an alleged joint venture relationship); breached an implied contract between the parties; breached the implied covenant of good faith and fair dealing; breached California's trade secrets act and unfair competition laws; and intentionally and negligently interfered with Prostar's prospective economic relations with Domino's franchisees.

In dismissing Prostar's fiduciary duty claim, the court held that Prostar's complaint failed to adequately allege the existence of a joint venture relationship. Allegations that Domino's would benefit from the technology did not amount to allegations that Prostar and Domino's *agreed to share joint profits* from Prostar's undertaking—a necessary element of a joint venture relationship. In dismissing Prostar's implied contract claim, the court held that Prostar's complaint failed to plead facts to demonstrate the terms of the putative contract between the parties or the consideration that Domino's was to receive for its performance. Because Prostar had failed to adequately allege the existence of an implied contract, its implied covenant claim also failed. The court also dismissed Prostar's interference claims because its allegations concerning *potential* economic relationships with franchisees failed to show *existing* relationships, which were required by law to state such a claim. Next, the court dismissed Prostar's claim under

California's unfair competition law, which required Prostar to have alleged an "unlawful, unfair or fraudulent business act or practice." According to the court, Prostar could not rely on a common law violation (the alleged breach of fiduciary duty claim) to support its contention that Domino's conduct was "unlawful" within the meaning of the unfair competition law. Finally, the court held that Prostar had failed to adequately allege its misappropriation of trade secrets claim because it failed to allege facts from which it could be inferred that it had made "reasonable efforts" to maintain the secrecy of its trade secrets, beyond generically alleging that it had not shared the information with unnecessary parties. Prostar's complaint was dismissed without prejudice.

ARBITRATION

DISTRICT COURT GRANTS NONSIGNATORY-FRANCHISOR'S MOTION TO COMPEL ARBITRATION

In *Rahmany v. T-Mobile USA, Inc.*, No. C16-1416-JCC (W.D. Wash. Jan. 5, 2017), a federal court in Washington granted defendant Subway's motion to compel arbitration based on the plaintiffs' cellular telephone contracts with T-Mobile, which mandated arbitration. Shortly after entering into those agreements, T-Mobile sent the plaintiffs a text message promoting free Subway sandwiches for T-Mobile customers. The plaintiffs filed a putative class action against T-Mobile and Subway, alleging violations of the Telephone Consumer Protection Act. The plaintiffs then voluntarily dismissed T-Mobile from the case but did not amend their complaint.

In moving to compel arbitration, Subway argued that it should be allowed to enforce—even as a nonsignatory—the arbitration provision of the agreements between T-Mobile and the plaintiffs. The court found that the plaintiffs' claims related to T-Mobile's services and devices and therefore fell within the scope of the arbitration agreements. Further, the court found that under California law, the plaintiffs failed to meet their burden of proving that the arbitration agreement was unconscionable. The mere fact that the terms and conditions containing the arbitration clause were incorporated by reference was insufficient to constitute procedural unconscionability. The court also held that the plaintiffs were equitably estopped from avoiding arbitration by suing Subway, a nonsignatory defendant, because their claims against Subway were based on the same facts and were inherently inseparable from their arbitrable claims against the signatory defendant, T-Mobile. Finally, notwithstanding the fact that the Federal Arbitration Act provides for a stay of proceedings once a court finds that the action should be arbitrated, because all of the plaintiffs' claims were subject to arbitration, the court found that it lacked jurisdiction over the matter and dismissed the complaint.

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