GRAY PLANT MOOTY

The GPMemorandum

TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS

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

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DATE: May 4, 2017—No. 217

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

EMPLOYMENT

FRANCHISED BLACK-CAR DRIVERS ARE NOT EMPLOYEES FOR PURPOSES OF FEDERAL AND STATE LABOR LAWS

The Second Circuit Court of Appeals recently affirmed a decision that franchised black-car drivers using a franchisor dispatching service were independent contractors, not employees, of the franchisor. In *Saleem v. Corporate Transportation Group*, 2017 WL 1337227 (2d Cir. Apr. 12, 2017), the plaintiffs-appellants were black-car drivers in the tri-state area who owned black-car franchises. The defendants-appellees were a group of related transportation companies known as Corporate Transportation Group ("CTG") that owned "base licenses" that allowed them to operate black-car dispatch bases in New York City, and to sell franchises to individual drivers. CTG provided billing, referral, payment, bookkeeping, accounting, voucher processing, and dispatching services for the franchisees. The black-car drivers brought an action against CTG pursuant to the Fair Labor Standards Act ("FLSA") and the New York State Labor Law ("NYLL") for, among other things, unpaid overtime. The dispositive issue was whether the black-car drivers were properly classified as independent contractors, rather than employees.

The district court granted the transportation companies summary judgment on both the FLSA and NYLL claims, concluding that as a matter of law, the black-car drivers were properly classified as independent contractors rather than employees for purposes of both statutes. The black-car drivers appealed, arguing that they should have been classified as employees because CTG exercised control over all significant aspects of its business, including its roll of institutional clients and its development and operation of the dispatch system. The drivers also argued that CTG negotiated rates with clients, charged a per-ride fee to drivers, and exerted influence over them by enforcing standards indirectly through a driver committee and occasionally through the president of CTG.

In sustaining the decision of the district court, the Second Circuit cited the facts that the black-car drivers exercised their independent business acumen in choosing the manner and extent of their affiliation with CTG; were able to work for rival black-car services, cultivated their own clients, and picked up street hails; made substantial investments in their businesses; and determined when, where, and how regularly to work. In sum, the court held that the economic reality was that the black-car drivers, with the assistance of CTG and as subscribers to its services, operated small businesses; they decided to affiliate with CTG based on their perceived economic interests, and not those of CTG.

ARBITRATION

ILLINOIS FEDERAL COURT CONFIRMS ARBITRATION AWARD FOR FRANCHISOR

A federal district court in Illinois granted a franchisor's motion to confirm an arbitration award in *Hyatt Franchising, LLC v. Shen Zhen New World I, LLC*, 2017 WL 1397553 (N.D. Ill. Apr. 19, 2017). The hotel franchisor had been awarded over $10 million in damages and fees in an arbitration to enforce the termination of a California franchisee's franchise agreement for repeated failure to meet its payment obligations and for failure to timely complete required renovations. The franchisee moved to vacate the arbitrator's award on three grounds: (1) the arbitrator engaged in misconduct under section 10(a)(4) of the Federal Arbitration Act ("FAA"); (2) the arbitrator exhibited a manifest disregard for the law under the same section of the FAA; and (3) public policy supported vacating the award. The court found that none of the franchisee's grounds were sufficient to vacate the award.

The franchisee argued that the arbitrator deprived it of fundamental fairness in the proceedings by failing to disqualify Hyatt's counsel and refusing to permit the franchisee to develop evidence related to its claim that it did not have competent representation when the franchise agreement was formed because the transactional attorney who had represented it during the negotiation of the contract had recently moved to the corporate group of the firm whose litigation department now represented Hyatt. The arbitrator found that the firm had implemented a sufficient ethical screen to prevent conflicts and that there was no evidence that any conflict could affect whether the franchise agreement or property improvement plan was ambiguous or flawed at the time of contracting. The court also rejected the franchisee's argument that it was prejudiced by its chairman's inability to understand English. The court found that the franchisee was a sophisticated business entity, had retained multiple English-speaking employees in connection with the transaction, and had sufficient time to translate the relevant documents before executing the franchise agreement. Finally, the court found that it was not permitted to overturn an arbitrator's interpretation of a contract between the parties and that it lacked authority to overturn the arbitrator's decision on public policy grounds.

TEXAS COURT CLARIFIES STANDARD FOR MODIFICATION OF AN ARBITRATION AWARD

The Texas Court of Appeals recently confirmed an arbitration award in favor of a franchisee, Adams, and against franchisor Prescription Health Network, LLC ("PHN"). *Prescription Health Network, LLC v. Adams*, 2017 WL 1416875 (Tex. App. Apr. 20, 2017). PHN had raised four principal arguments on appeal: (1) that the award should be vacated because the arbitration panel "exceeded their powers"; (2) that the award should be vacated because the arbitration panel acted with "manifest disregard"; (3) that alternatively, the award should be modified because the arbitration panel acted on a matter not submitted to them; and (4) that the award of attorneys' fees and costs to Adams should be vacated and that damages, attorneys' fees, and costs should instead be awarded to PHN as the prevailing party. In its reply brief, PHN argued for the first time that the award should be vacated because the arbitration panel failed to issue a "reasoned award." Both parties agreed that the FAA governed the case.

The appellate court rejected PHN's first argument, holding the arbitration panel had the authority to decide deceptive trade practices claims under both the Texas and Florida statutes—and not solely under the Texas statute, as PHN contended—because those claims "arose under or in connection with" the franchise agreement. The court rejected PHN's second argument, holding nonstatutory grounds such as "manifest disregard of the law" do not support vacatur of arbitration awards under the FAA. Instead, sections 10 and 11 of the FAA contain the exclusive and explicit grounds for vacating or modifying an arbitration award. The court also rejected PHN's third argument, holding that the Florida claim was "submitted" to the arbitration panel because the franchisees raised the Florida claim as an alternative to the Texas claim. As to PHN's fourth argument, the court held that PHN was not the "prevailing party," so PHN was not entitled to attorneys' fees and costs. Finally, the court held that because PHN had not raised the "reasoned award" issue in its opening brief, it had waived that issue.

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TERMINATIONS

ACTUAL NOTICE OF DEFAULT LETTER OVERRIDES FRANCHISOR'S FAILURE TO COMPLY STRICTLY WITH NOTICE PROVISION

A United States District Court in Miami, Florida rejected a franchisee's bid to invalidate a notice of default sent by email for failure to comply with the franchise agreement's notice provisions. *Tim Hortons USA, Inc. v. Singh*, 2017 WL1326285 (S.D. Fla. Apr. 4, 2017). Tim Hortons had sent a notice of default by both email and overnight mail. The notice gave the franchisee, Singh, five days to cure certain financial defaults. Tim Hortons terminated the franchise after Singh allegedly failed to cure its default within five days of receiving a copy of the emailed notice. Having proffered a cure within five days of receiving the copy of the notice sent by overnight mail, Singh challenged the validity of the emailed notice and the timeliness of the notice of termination, in addition to challenging whether Tim Hortons had adequate grounds for termination in the first place. Tim Hortons moved for summary judgment on all issues.

In granting partial summary judgment in favor of Tim Hortons, the court observed that under Florida law, strict compliance with a notice provision is not required if a party has received actual notice. Undisputed evidence on the record demonstrated that Singh received the emailed copy of the notice of default. For instance, evidence showed that Singh forwarded the emailed notice to a family member within an hour of receiving it. The court also rejected an argument by Singh that Tim Hortons was required to provide a copy of the notice to each of the franchisee's representatives and guarantors. It found that the franchise agreement's notice provision only required that notice be sent to the franchisee. Although the court granted the portion of Tim Horton's motion for summary judgment that related to the validity of the emailed notice of default and the timeliness of the notice of termination, the court denied the remainder of Tim Horton's motion for summary judgment as it related to Singh's challenges to the adequacy of the grounds for termination.

FEDERAL COURT IN ARIZONA GRANTS MOTION TO DISMISS CLAIMS ALLEGING IMPROPER TERMINATION OF HOTEL MEMBERSHIP AGREEMENT

The United States District Court for the District of Arizona recently granted a hotel membership association's motion to dismiss, holding that its termination of a hotel's membership agreement did not constitute a breach of contract. *Regency Midwest Ventures Ltd P'ship v. Best Western Int'l, Inc.*, 2017 WL 992357 (D. Ariz. Mar. 15, 2017). The membership association arrangement is akin to a franchisor-franchisee relationship. The membership association involved in this case, Best Western, initially determined that it had grounds to terminate the parties' agreement after the hotel failed two quality assurance inspections. Nevertheless, Best Western granted a conditional extension listing conditions that the hotel would have to meet in a timely manner for it to continue its membership. After the hotel failed to meet all of those conditions, Best Western terminated the membership agreement.

Following termination, the hotel brought claims against Best Western for breach of contract and breach of the covenant of good faith and fair dealing. The hotel argued that it had "substantially complied" with the agreed upon conditions for continued membership by completing 194 out of 197 requested improvements. The court disagreed, and held that because the hotel failed to meet all of the express, agreed upon conditions of continued membership, termination was warranted.

SUMMARY JUDGMENT IS GRANTED IN FRANCHISOR'S FAVOR AFTER FRANCHISEE FAILS TO RESPOND

A federal court in Illinois has granted summary judgment in favor of a franchisor on both its claims and the franchisee's counterclaims in *Fantastic Sams Franchise Corp. v. PSTEVO, LLC*, 2017 WL 1075195 (N.D. Ill. Mar. 22, 2017). Fantastic Sams brought suit after the franchisee, PSTEVO, stopped paying weekly licensing fees and national advertising fees and then abandoned its franchised salons altogether. Initially, PSTEVO actively defended the litigation, asserting counterclaims which alleged that Fantastic Sams should have let PSTEVO spend its national advertising fees on local advertising, that Fantastic Sams did not maintain the brand's goodwill, and that Fantastic Sams was unjustly enriched. However, when Fantastic Sams moved for summary judgment, PSTEVO did not respond.

Despite PSTEVO's failure to respond, the court examined the elements of all the claims asserted. The court found the license agreement was a valid contract, that it had been breached, and that Fantastic Sams sustained damages as a result. The court awarded Fantastic Sams all past due fees, as well as future fees for the rest of the contract term discounted to present value. The court also found that the record was devoid of evidence supporting PSTEVO's counterclaims, as the license agreement allowed Fantastic Sams to engage in the conduct of which PSTEVO complained. The court entered judgment against both the corporate franchisee and the franchisee's personal guarantor.

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