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

SUPREME COURT UPHOLDS CLASS ACTION WAIVERS IN EMPLOYMENT AGREEMENTS

In a landmark non-franchise decision, the United States Supreme Court held, 5-4, that employers can require employees to individually arbitrate employment law claims without violating federal labor laws. *Epic Sys. Corp. v. Lewis*, 2018 WL 2292444 (U.S. May 21, 2018). Employees of Epic Systems Corporation entered into an arbitration agreement that required them to resolve employment disputes through individual arbitration and waive their right to participate in class actions. A former Epic employee brought an action in federal court against the company, on behalf of himself and similarly situated employees, alleging that Epic had violated federal law requiring overtime pay. Epic moved to dismiss the claim citing to the arbitration clause that prohibited class actions. The lower courts denied Epic's motion, finding that a class action waiver was unenforceable under the Federal Arbitration Act (FAA) and that the FAA was not pre-empted by the National Labor Relations Act (NLRA).

The Supreme Court majority held that the FAA plainly allows employers and employees to agree to arbitrate employment law claims on an individual basis, and that those rights are not superseded by a provision of the NLRA permitting employees to engage in concerted activities for the purpose of collective bargaining. The Court reasoned that the NLRA does not reflect a clearly expressed congressional intent to displace the FAA, as the NLRA does not discuss or mention class actions. Ultimately this decision expressly allows employers to require employees to individually arbitrate claims they may have against their employer. In the wake of the decision, employers should consider eliminating their exposure to employment law class actions by entering into arbitration agreements that require all employment disputes to be subject to individual arbitration.

PRELIMINARY INJUNCTIONS

CONTINUED PERFORMANCE OF EXPIRED FRANCHISE AGREEMENT JUSTIFIES ENFORCEMENT OF NONCOMPETE PROVISION AGAINST NEW COMPETING BUSINESS

The U.S. District Court for the Western District of Tennessee granted a motion for a preliminary injunction in favor of franchisor Amerispec, enforcing a one-year post-termination covenant against competition and rejecting the ex-franchisee's argument that the covenant expired prior to the date on which he ceased operating his franchise. *Amerispec, L.L.C. v. Omni Enters., Inc.*, 2018 WL 2248459 (W.D. Tenn. May 16, 2018). Gray Plant Mooty represented the franchisor in this case. When the parties' franchise agreement expired in March of 2017, the franchisee failed to execute a new agreement but never communicated to Amerispec that he did not intend to renew. Rather, he continued operating the franchise using Amerispec's trademarks, business systems, and a telephone number he had assigned to Amerispec, and also continued to pay franchise fees. Nearly a year later, he opened a new competing business, advertising that "Your Local Amerispec is now American Property Inspections." He then failed to respond to Amerispec's cease-and-desist letter demanding that he stop operating the new business in accordance with the franchise agreement's noncompete provision, and Amerispec filed suit.

The former franchisee argued that the franchise agreement had expired in March of 2017, that the one-year post-term noncompete began to run at that time, and that as a result the covenant was no longer enforceable. Rejecting that argument, the court held that by virtue of the franchisee's continued operation of the franchise, the parties had created an implied contract with the same terms and conditions as the franchise agreement, including the noncompete provision. The court then had little trouble finding that the covenant was enforceable and that Amerispec would be irreparably harmed absent injunctive relief. Finally, the court found that the one-year noncompete covenant began to run at the end of the cure period provided in Amerispec's cease-and-desist letter, because at that point the implied franchise agreement between the parties was terminated as a result of the franchisee's failure to cure.

COURT DENIES INJUNCTION AFTER FRANCHISOR FAILS TO SHOW BREACH OF FRANCHISE AGREEMENT

A federal court in Texas has denied a franchisor's motion for a preliminary injunction, finding that the franchisor failed to show a likelihood of success on the merits. *BL Rest. Franchises LLC v. 510 Park Inc.*, 2018 WL 2363606 (N.D. Tex. May 24, 2018). Restaurant franchisor Bar Louie filed suit against a group of franchisees and sought an injunction to require them to comply with the early termination procedures set forth in the parties' franchise agreement before closing one of their restaurants.

As an initial matter, the court held that the motion was still ripe for review, even though the franchisees had closed the restaurant prior to the injunction proceeding. The franchisees had notice of the proceeding, and thus the court could still restore the "status quo" through a mandatory injunction. Nevertheless, the court ultimately denied Bar Louie's request for injunctive relief, holding that it had failed to demonstrate a substantial likelihood of succeeding on the merits of its breach of contract claim. According to the court, Bar Louie did not carry its burden to show that it had performed under the franchise agreement and that the franchisees were obligated to comply with the early termination provision of the agreement. The franchisees alleged that Bar Louie had failed to provide adequate support and training, and they further argued that they did not need to comply with the early termination procedures because they had not intended to terminate the franchise agreement and only closed the restaurant because of financial difficulties. Bar Louie did not refute either of those arguments in response, leading the court to conclude that it was not entitled to injunctive relief.

MICHIGAN FEDERAL COURT DENIES MOTION TO ENJOIN RELATED PROCEEDINGS PENDING IN TEXAS STATE COURT

The U.S. District Court for the Eastern District of Michigan recently denied a franchisor's motion to enjoin a franchisee from proceeding with its counterclaim in a related matter pending in Texas state court. *Live Cryo, LLC v. CryoUSA Import & Sales, LLC*, 2018 WL 2355662 (E.D. Mich. May 24, 2018). The Texas action was initiated by defendant-franchisor CryoUSA. A few days later, plaintiff-franchisee Live Cryo filed the related federal suit in the Eastern District of Michigan. After the Michigan court granted in part and denied in part a motion to dismiss filed by CryoUSA, CryoUSA offered to amend its answer to assert a counterclaim in the federal case and to dismiss its first-filed state court action. However, Live Cryo refused to consent to that amendment and instead filed a counterclaim in the state court action. CryoUSA argued that the federal court should enjoin Live Cryo from bringing its counterclaim in the state suit under the "relitigation exception" to the Anti-Injunction Act, which authorizes a district court to issue injunctions to stay proceedings in a state court "to protect or effectuate its judgments."

In considering CryoUSA's motion to enjoin the Texas proceedings, the Michigan court held that the "relitigation exception" did not prohibit Live Cryo from asserting a counterclaim in the Texas suit. The court noted that the exception was designed to implement the doctrine of res judicata, which does not apply until there has been a final decision on the merits. The court explained that its prior decision granting in part and denying in part CryoUSA's motion to dismiss did not constitute a final decision; rather, it was an interlocutory denial of a motion that was not entitled to a preclusive effect. Therefore, the court reasoned, there was no basis on which to enjoin the state court proceedings.

DAMAGES

NEW JERSEY FEDERAL COURT ALLOWS FRANCHISOR TO SEEK DAMAGES FOLLOWING ENTRY OF DECLARATORY JUDGMENT

A federal court in New Jersey found that 7-Eleven could seek damages following the court's grant of a declaratory judgment determining that 7-Eleven had properly terminated the parties' franchise agreements. *7-Eleven, Inc. v. Sodhi*, 2018 WL 2289876 (D.N.J. May 18, 2018). Sodhi appealed the district court's order granting the declaratory judgment, but his motion to stay execution of the judgment was denied. 7-Eleven then filed an emergency motion for supplemental relief pursuant to 28 U.S.C. § 2202, alleging that Sodhi had stolen some $180,000 in proceeds before surrendering possession of his stores, but the district court declined to consider 7-Eleven's motion during the pendency of the appeal. Once the appeal was resolved in its favor, 7-Eleven renewed the motion, and by that time its claims had grown to include the theft of more than $560,000 in money and property.

7-Eleven argued that recovery of the stolen amounts was permitted under 28 U.S.C. § 2202 because the purpose of the statute was to "make an original declaratory judgment effective" and that Sodhi's thefts had deprived 7-Eleven of the original declaratory judgment's full benefit. Sodhi countered that 7-Eleven could not obtain damages based on a declaratory judgment and would need to pursue a new cause of action. The court sided with 7-Eleven but determined that Sodhi should be given the opportunity to challenge the damages that 7-Eleven claimed through an evidentiary hearing. The court further held that a bond Sodhi had previously posted could be used in total or partial satisfaction of any damages awarded to 7-Eleven because the bond was originally put in place to protect 7-Eleven's funds and property.

CHOICE OF FORUM/VENUE

FORUM SELECTION CLAUSE DOES NOT SURVIVE TERMINATION

A district court in Missouri recently held that a forum selection clause did not survive the mutual termination of a franchise agreement. *Serv. Team of Prof'ls, Inc. v. Folks*, 2018 WL 2051516 (W.D. Mo. May 2, 2018). The parties had previously entered into a franchise agreement with a forum selection clause dictating that all actions be brought in Kansas City, Missouri. Following a dispute between the parties, they agreed to terminate the franchise agreement and enter into a settlement agreement. The settlement agreement provided that except for certain post-termination obligations relating to the use of the franchisor's service marks and other proprietary materials, the two parties were relieved of all terms and conditions of the franchise agreement. When a dispute arose as to the franchisee's compliance with those post-termination obligations, the franchisor brought suit in Missouri. The franchisee moved to dismiss on the grounds that the forum selection clause did not survive the termination of the franchise agreement and that there was no other basis to assert personal jurisdiction in Missouri.

The court agreed with the franchisee and held that the settlement agreement had terminated the forum selection clause. The court noted that under the common law contractual provisions related to the manner in which disputes are to be resolved generally survive the contract's termination. However, that general rule assumes that the contract expired by its terms or upon the parties' agreement to terminate. In this case, the parties entered into a settlement agreement specifying that they were relieved from all provisions of the franchise agreement except for certain, specifically enumerated provisions, not including the forum selection clause. Accordingly, the forum selection clause did not survive termination of the franchise agreement and the franchisor could not rely on it to bring suit in Missouri. The court further held that the franchisee was not otherwise subject to personal jurisdiction in Missouri because the requirements of Missouri's long arm statute and the Due Process Clause had not been satisfied.

RICO

NORTHERN DISTRICT OF GEORGIA DISMISSES CLAIMS THAT FRANCHISOR, FRANCHISEES, AND CONTRACTORS COMPRISED AN "ENTERPRISE" UNDER RICO

The U.S. District Court for the Northern District of Georgia has dismissed claims that a franchisor and its franchisees violated the Racketeer Influenced and Corrupt Organizations Act (RICO) through an alleged companywide policy of buying sick puppies, certifying their health for sale, and then covering up the source of their illness after they grew sick. *Cisneros v. Petland, Inc.*, Bus. Franchise Guide (CCH) ¶ 16,177 (N.D. Ga. Apr. 17, 2018). The plaintiff bought a Shih

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Tzu puppy from a Petland franchisee that was certified as healthy but died of parvovirus soon after she brought him home. The plaintiff alleged that Petland had a policy requiring its franchisees to purchase animals at a heavily discounted price from pet “mills” where animals were bred as quickly as possible, without care for their health, and that veterinarians paid by Petland then misrepresented the animals’ health in order to encourage their sale. The plaintiff further alleged that Pawsitive, a consultant that had contracted with Petland and its franchisees, directed customers to veterinarians who were affiliated with Petland, allegedly to help conceal the fact that the puppies were already sick when they were sold.

In granting motions to dismiss filed by the defendants, the court concluded that the plaintiff had failed to plead adequately that Petland, its franchisees, the veterinarians, and Pawsitive comprised an enterprise for the purposes of RICO. Where businesses are alleged to form a RICO enterprise, a plaintiff must plead facts showing that the individual members took action beyond the scope of their normal, self-interested business objectives. According to the court, the legitimate business of Petland and the other defendants was to sell or provide medical care for animals, and it was not unusual for a franchisor such as Petland to mandate uniformity among its franchisees. The plaintiff did not allege that any of the defendants acted outside of those normal business roles, even if the alleged conduct would establish state law fraud and breach of contract claims. Such claims were not alleged, and the court declined to exercise supplemental jurisdiction over a related state RICO claim and dismissed the case.

CONTRACTS

APPEALS COURT REJECTS FRANCHISEE’S “UNCLEAN HANDS” DEFENSE

A Kansas appellate court concluded that a franchisor was entitled to enforce one clause of its franchise agreement despite its alleged breach of an unrelated clause in *Hendrix v. Sheridan*, 2018 WL 2272588 (Kan. Ct. App. May 18, 2018). Franchisee Ronald Hendrix and franchisor Sheridan’s Franchise Systems (SFS) were parties to a franchise agreement that granted Hendrix the right to operate a Sheridan’s Frozen Custard franchise. The franchise agreement allowed SFS to purchase the restaurant upon termination or expiration of the agreement. The dispute between the parties began when Hendrix brought suit against SFS for misuse of advertising fund contributions. During the course of the dispute, Hendrix allowed his franchise agreement to expire, and SFS subsequently sought specific performance of its purchase option. The trial court found that SFS was entitled to take over the restaurant, and Hendrix appealed.

Hendrix relied on an “unclean hands” argument, contending that SFS should not have been allowed to exercise its right to purchase the restaurant because it had breached the franchise agreement by using advertising funds for unauthorized purposes. The appellate court determined that the district court did not abuse its discretion in finding a lack of evidence to support application of the unclean hands doctrine, as SFS’s actions related to the advertising fund were incidental to the purpose of the franchise relationship, and Hendrix knowingly allowed the franchise agreement to expire. The court also rejected Hendrix's argument that SFS was not permitted to exercise the purchase option if he had cause to terminate the agreement, finding no support for that position in the agreement's termination provisions.

VICARIOUS LIABILITY

CASE REMANDED FOR NEW TRIAL DUE TO PREJUDICIAL CLOSING STATEMENTS BY OPPOSING COUNSEL

A Florida appellate court recently affirmed the denial of Domino's Pizza's request for a directed verdict on its vicarious liability for the actions of its franchisee's employee, but remanded the case for a new trial as a result of the opposing counsel's improper closing argument. *Domino's Pizza, LLC v. Wiederhold*, 2018 WL 2165224 (Fla. Dist. Ct. App. May 11, 2018). The plaintiff sued Domino's on a vicarious liability theory after a franchisee's delivery driver cut off the plaintiff's husband in traffic, which resulted in a serious accident, and contributed to the husband's death a year later. At trial, the jury rendered a verdict against Domino's, finding that the franchisee was Domino's agent at the time of the accident. Domino's filed a renewed motion for a directed verdict on the grounds that it was not vicariously liable because it did not exercise control over the franchisee's day-to-day operations, and also sought a new trial in light of comments made by the plaintiff's counsel during her closing argument. The trial court denied both requests.

On appeal, Domino's argued that it was not vicariously liable as a matter of law for the franchisee's actions because the only control it exercised was mere "brand maintenance activities." The appellate court held that the question of whether there was an agency relationship between Domino's and the franchisee was properly presented to the jury as a question of fact because there was evidence supporting both sides. However, the court found that opposing counsel's closing arguments were extremely prejudicial to Domino's and that the trial court failed to correct several improper statements, including opposing counsel's characterization of Domino's business and legal strategies as a "greedy charade," her attempt to invoke the "golden rule" by asking the jury to imagine itself in the plaintiff's shoes, and her encouragement of the jury to "send a message" to Domino's with the amount of its damages award. The court noted that while only some of opposing counsel's arguments were properly objected to during the trial, when taken together the comments were not designed to prompt a logical analysis of the evidence in light of the governing law.

TERMINATIONS

LICENSE AGREEMENT IS NOT A PERSONAL SERVICES CONTRACT

In the case of *Holiday Hospitality Franchising LLC v. CPTS Hotel Lessee LLC*, No. 653096/2016 (N.Y. Sup. Ct. May 7, 2018), the Supreme Court of New York granted Holiday Hospitality's motion to dismiss CPTS's claim that the license agreement between the parties was a personal services contract and, therefore, could be terminated without cause. CPTS had attempted to terminate the license agreement due to Holiday's alleged failure to properly invest in the growth and promotion of the Crowne Plaza brand. CPTS alleged, among other things, that Holiday breached the license agreement by failing to properly advertise the brand and update the reservation system, all of which negatively impacted occupancy rates and customer satisfaction. CPTS further contended that because the license agreement was a personal services contract, it was terminable at will. In response to the termination, Holiday argued that (1) CPTS did not provide personal services under the agreement; (2) CPTS had waived its right to assert that a personal services contract existed under the express language of the agreement, which was negotiated by sophisticated business entities; and (3) CPTS had waived its right to terminate the agreement.

In granting in part Holiday's motion to dismiss CPTS's claims, the court acknowledged that if a personal services relationship existed, CPTS's waiver of its right to terminate the license agreement would be unenforceable as a matter of public policy. The court held, however, that a personal services relationship did not exist because the parties specifically agreed that the contract was not one for personal services. Further, the services provided by CPTS were governed by the operations manual and did not require the unique expertise of CPTS. Thus, because the license agreement was not a personal services contract, the provision waiving CPTS's right to terminate the license agreement was not invalid.

THE GPMEMORANDUM—INTERNATIONAL

SHAREHOLDER OF NAMED PLAINTIFF ORDERED TO PAY FRANCHISOR'S COSTS OF DEFENDING CLASS ACTION INITIATED BY CORPORATE FRANCHISEE

A Superior Court of Justice in Canada last week awarded a franchisor over $1.7 million in costs against the sole shareholder and guarantor of a franchisee that had been the named plaintiff in an unsuccessful class action against the franchisor. *Pet Valu Canada Inc. v. Rodger*, 2018 O.N.S.C. 3353 (Ontario Super. Ct. May 29, 2018). The class action had been commenced in 2009, seeking some $100 million, but was dismissed on summary judgment, with the franchisor receiving cost awards totaling $1,736,675 against the named plaintiff franchisee, a corporation. When the corporation failed to pay the costs, the franchisor commenced a separate action against the shareholder, Robert Rodger, who had guaranteed all debts and obligations of the franchisee at the time the franchise agreement was signed.

Rejecting all arguments by Rodger, the Superior Court found him liable for the entire costs claim. Specifically, the court held that the franchise agreement's indemnification provision applied to costs incurred by the franchisor in defending class actions, not just individual actions by the franchisee. Further, the named plaintiff was liable for not just the costs associated with its individual claims in the case, but for the franchisor's overall cost of defending the class action. Moreover, because the shareholder's personal guaranty was not limited, the corporate franchisee's indemnification obligation for unsuccessful litigation against the franchisor was one of the categories of costs guaranteed to be paid by the individual shareholder in buying the franchise.

Along with the attorneys indicated on the next page, summer associates Kristin Stock, Madeline Davis, Matthew Frame, Abby Swanson Garney, Maria de Sam Lazaro, Adithya Sharma, Cindy Shi, Meaghan Hunt, Ben Podobinski, and Katherine Morrison contributed to this issue.

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