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

**EMPLOYMENT**

**D.C. CIRCUIT EMBRACES “INDIRECT CONTROL” AND “RESERVED RIGHT” JOINT EMPLOYER STANDARD, BUT REMANDS BROWNING-FERRIS CASE TO NLRB**

The long-awaited decision of the D.C. Circuit Court of Appeals in an appeal challenging the controversial joint employer test adopted by the National Labor Relations Board in *Browning-Ferris Industries*, 362 NLRB No. 186 (2015), was released on December 28, 2018. *Browning-Ferris Indus. of Cal., Inc. v. NLRB*, 2018 WL 6816542 (D.C. Cir. Dec. 28, 2018). Although the D.C. Circuit’s decision was expected to either clarify or reject the NLRB’s August 2015 decision holding that a company could be a joint employer if it had an unexercised right to directly or indirectly control an employee’s terms and conditions of employment, it did neither. Rather, in what might be called a partial victory (or defeat) for each side, the court agreed that evidence of indirect control or unexercised control over the essential terms of employment is the correct standard for determining the existence of a joint employment relationship, but remanded the case to the NLRB to distinguish between restrictions on essential employment terms and controls that are “intrinsic to ordinary third-party contracting relationships.” In a 2-1 decision, the court made three points that will shift the focus of the joint employer debate in the future.
1. The court remanded the case to the NLRB for an explanation of what evidence of “indirect control” the Board believes is indicia of control over essential terms of employment. The court cautioned that the NLRB must “differentiate between those aspects of indirect control relevant to status as an employer, and those quotidian aspects of common-law third party contract relationships” that do not relate to essential terms of employment.

2. The Board must then determine which of those elements of control over essential terms and conditions of employment permit meaningful collective bargaining. Moreover, the Board must “clarify what ‘meaningful collective bargaining’ might require in an arrangement like this.”

3. The court held that the definition of “joint employer” is a common law concept that is solely within the jurisdiction of the courts to determine. The courts owe no deference to decisions of the NLRB relating to the definition of a “joint employer.”

Recognizing that the NLRB has published a proposed joint employer rule, the court noted that the proposal would only apply prospectively. Without directly commenting on the substance of the proposed rule, the court has clearly set out benchmarks that should impact its scope. How the Board will attempt to define “indirect control,” and how it will articulate a “meaningful collective bargaining” standard will likely take on new importance now that the court has undermined the NLRB’s presumed right to define “joint employer.”

**COURT FINDS THAT DOMINO’S PIZZA IS NOT A JOINT EMPLOYER**

In three consolidated actions, the U.S. District Court for the Southern District of New York granted summary judgment in favor of franchisor Domino’s Pizza, Inc. and certain related entities (the “Domino’s defendants”), holding that they were not joint employers of current and former employees of several Domino’s Pizza franchisees and therefore could not be held liable for alleged wage violations under the Fair Labor Standards Act and the New York Labor Law. *In re Domino’s Pizza, Inc.*, 2018 WL 475944 (S.D.N.Y. Sept. 30, 2018). To make this determination, the court considered whether the Domino’s defendants exercised formal or functional control over the franchisees’ employees. Although the parties acknowledged that the Domino’s defendants established certain standards and exercised oversight related to the operation of the franchised stores, the court found that the Domino’s defendants’ actions did not rise to the level of joint employer status.

In its analysis of whether the Domino’s defendants exercised formal control over the employees, the court considered whether the Domino’s defendants had the power to hire and fire the franchisees’ employees, supervised and controlled their schedules or conditions of employment, determined their compensation, or maintained employment records. The court found that the Domino’s defendants maintained policies that could impact the franchisees’ employment decisions, including background check requirements, dictating store operating
hours and minimum staffing requirements, and mandating use of point-of-sale software used to set employee shifts and to store other employment information. However, the court concluded that Domino’s franchisees still maintained formal control over each facet of the employment relationships.

Further, in its consideration of whether the Domino’s defendants exercised functional control over the employees, the court considered factors including whether the Domino’s defendants provided the premises and equipment used by the employees and the degree to which the Domino’s defendants supervised the employees’ work. Although the Domino’s defendants maintained standards related to each store’s premises and equipment and enforced those standards through ongoing store inspections and audits, the court found that the standards were designed to ensure uniformity in the quality of the goods offered and to protect the brand image. Therefore, the court held that the Domino’s defendants also did not exercise functional control over the terms and conditions of employment.

ANTITRUST

COURT REJECTS PER SE THEORY BUT ALLOWS ANTI-POACHING CLASS ACTION TO PROCEED BASED ON QUICK-LOOK DOCTRINE

A federal district court in the Western District of Washington denied a motion to dismiss a putative class action lawsuit alleging that anti-poaching clauses in Cinnabon franchise agreements violated the Sherman Act and Washington’s Unfair Business Practices Act. Yi v. SK Bakeries, LLC, No. 3:18-cv-05627 (W.D. Wash. Nov. 13, 2018). The lead plaintiff, Kyla Yi, was a former employee at a Cinnabon franchised bakery in Washington. Franchise agreements for Cinnabon bakeries prohibited franchisees from hiring or soliciting Cinnabon’s and other franchisees’ employees without prior written consent. Yi alleged that these anti-poaching clauses, which were removed from Cinnabon’s franchise agreements in July 2018, had artificially suppressed employees’ wages by restricting franchisees’ competition for labor.

In support of its motion to dismiss, Cinnabon argued that a franchisor and its franchisees are a single entity incapable of conspiring in violation of the Sherman Act. The court rejected that argument as premature because discovery had not begun. Cinnabon also argued that the complaint failed to state a claim that the anti-poaching clauses constituted an unreasonable restraint on trade. The court held that Yi failed to allege sufficient facts to support a per se violation of the Sherman Act because it was not clear that the anti-poaching clauses lacked any redeeming virtue. Relying on a similar class action lawsuit against McDonald’s, however, the court found Yi’s allegations sufficient under a “quick-look” rule-of-reason analysis at the motion to dismiss stage. Taking Yi’s allegations as true, the court found that an observer with even a rudimentary understanding of economics could conclude that the anti-poaching clauses stifled competition for labor. But the court warned Yi that, having failed to allege facts sufficient to
support a full rule-of-reason analysis, her case could ultimately fail if the evidence failed to support use of the truncated quick-look analysis.

CHOICE OF FORUM/VENUE

MICHIGAN FEDERAL COURT DENIES VENUE-BASED MOTION TO DISMISS OR TRANSFER

A Michigan federal court denied a motion by the defendant franchisees to dismiss or, in the alternative, transfer venue in an action brought by Little Caesar to enforce the termination of the parties’ franchise agreements. *Little Caesar Enters., Inc. v. Miramar Quick Service Rest. Corp.*, 2018 WL 6002511 (E.D. Mich. Nov. 15, 2018). Gray Plant Mooty represents Little Caesar in this matter. In their motion, the Massachusetts- and Connecticut-based franchisees argued that a Michigan venue was either improper or overwhelmingly inconvenient because the events giving rise to Little Caesar’s complaint occurred where the franchisees were located. Accordingly, they sought a Massachusetts venue.

In denying the franchisees’ motion, the court first held that the franchisees had waived any objection to venue through the franchise agreements’ Michigan forum selection provision. The court further observed that even in the absence of such a clause, Michigan was a proper venue for the dispute because a substantial part of the events underlying Little Caesar’s claims occurred in Michigan since Little Caesar is headquartered there. Among Little Caesar’s reasons for terminating the parties’ franchise agreements was the franchisees’ failure to provide required financial records to Little Caesar and to make timely payments to their Michigan-based supplier. The court noted that federal law did not require venue in the district with the “most substantial contacts to the dispute.” Lastly, the court denied the franchisees’ motion to transfer the case because under the Supreme Court’s ruling in *Atlantic Marine*, the franchise agreements’ mandatory forum selection clause was to be given controlling weight in “all but the most exceptional of cases.” The franchisees’ arguments did not make the case exceptional.

ARBITRATION

LOUISIANA FEDERAL COURT DISMISSES FRANCHISEE’S LAST-MINUTE ATTEMPT TO AVOID ARBITRATION

A Louisiana federal court dismissed a franchisee’s attempt to avoid arbitrating a dispute that was arbitrable by agreement between the parties in *Kirksey v. Doctor’s Associates Inc.*, 2018 WL 66510121 (E.D. La. Dec. 19, 2018). Doctor’s Associates Inc., franchisor of the Subway brand, and Kirksey were parties to a franchise agreement containing an arbitration clause that required them to arbitrate their disputes in Connecticut. On the eve of an arbitration hearing between the parties in Connecticut, Kirksey filed suit against Subway in Louisiana state court seeking a restraining order enjoining the arbitration. Subway then filed a motion to compel arbitration in
the U.S. District Court for the District of Connecticut, removed the Louisiana case to federal court, and sought a stay of the proceedings pending the Connecticut court’s ruling. The Connecticut court granted Subway’s motion to compel arbitration, holding that (1) there was no dispute that Kirksey and Subway agreed to arbitrate the issues involved, and (2) any issue related to the arbitrability of Kirksey’s claim was a question for the arbitrator. Kirksey then filed a motion in the Louisiana federal court to stay the Connecticut court’s decision. Subway opposed Kirksey’s motion and sought to dismiss the Louisiana federal court action by way of a motion for judgment on the pleadings.

In granting Subway’s motion, the Louisiana court agreed with the Connecticut court that all issues raised between Subway and Kirksey had to be submitted to arbitration. The Louisiana court also reasoned that under Fifth Circuit precedent, courts have discretion to dismiss cases in favor of arbitration when staying an action will serve no purpose. Because there was nothing left for the Louisiana court to decide, and staying the action would serve no purpose, the Louisiana court dismissed the case.

**FRANCHISEE COMPELLED TO ARBITRATE POST-EXPIRATION DISPUTE**

The federal court in Maine also recently granted a motion to compel arbitration filed by daycare center franchisor Toddle Inn Franchising, holding that the arbitration provision included in its franchise agreement with franchisee KPJ Associates survived the expiration of the agreement. *Toddle Inn Franchising, LLC v. KPJ Assocs., LLC*, 2018 WL 6515129 (D. Me. Dec. 11, 2018). The dispute arose when, after operating for two years under an expired franchise agreement, KPJ notified Toddle Inn that it intended to open a competing daycare center at its Toddle Inn franchised business location. Toddle Inn filed suit and requested an injunction and temporary restraining order to prevent KPJ from proceeding, and then subsequently filed a motion to compel arbitration and to stay the federal court proceedings pending arbitration.

To address the motion to compel arbitration, the court applied the First Circuit’s two-pronged test for deciding the arbitrability of disputes. Under that test, a court first must determine whether the dispute “has its real source in the contract,” and second whether post-expiration arbitration of the issue is “negated expressly or by clear implication.” The court held that Toddle Inn’s suit to prevent KPJ from using its confidential information and equipment and violating the covenant against competition in the franchise agreement clearly had its “real source” in the contract, satisfying the first prong. The court further held that the agreement’s survival clause, which stated that those provisions that “expressly or by their nature survive the expiration or termination of this Agreement shall continue in full force and effect,” included within its scope the agreement’s broad arbitration provision, which was generally untethered to any particular period in time. Lastly, the court found that Toddle Inn had not waived its right to arbitrate the dispute through its conduct because Toddle Inn filed its motion seeking arbitration less than a month after commencing the federal court action, and the litigation was
at an early stage. The court therefore granted Toddle Inn’s motion to compel arbitration and stayed the case pending the outcome of the arbitration.

**CHOICE OF LAW**

**TEXAS COURT REQUIRES MORE FACTS BEFORE DECIDING WHETHER STATE FRANCHISE ACT CLAIMS ARE BARRED BY CHOICE OF LAW PROVISION**

A federal court in Texas has upheld a franchise agreement’s choice of Tennessee law but declined to dismiss counterclaims based on other states’ franchise laws. *Gigi’s Cupcakes, LLC v. 4 Box LLC*, 2018 WL 6068817 (N.D. Tex. Nov. 19, 2018). Gigi’s Cupcakes filed suit against various franchisees for enforcement and declaratory relief related to their franchise agreements. In response, the franchisees counterclaimed for breach of contract, fraud, and other claims under the franchise laws of their respective states. In denying the franchisees’ original motion to dismiss, the court applied Tennessee law pursuant to the franchise agreement’s choice of law provision. The franchisees moved the court to reconsider the choice of law issue, arguing that the application of Tennessee law would be contrary to the public policy of Minnesota, North Dakota, Indiana, and Ohio, where the franchisees were located.

Applying the Restatement (Second) of Conflicts of Laws, the court concluded that the enforceability of the choice of law provision would depend on where the contract was negotiated and performed, the subject matter of the contract, where the parties were located, and where representations about the contract were made, received, and relied upon. Because neither party provided sufficient evidence for the court to make a full inquiry, the court concluded that the franchisees failed to meet their burden of showing that Tennessee law should not apply to the contract and common law claims. The court reserved its ruling on Gigi’s motion to dismiss the counterclaims that relied on the various state franchise laws, however, noting that the parties should develop the record before the court determined whether those claims were barred by Tennessee law, or whether the application of Tennessee law would constitute an improper waiver of the benefits and protections of the other states’ franchise statutes.

**POST-TERMINATION INJUNCTIONS: NONCOMPETE COVENANTS**

**FRANCHISOR FAILS TO SECURE TRADE DRESS AND NONCOMPETE INJUNCTION AGAINST EX-FRANCHISEE**

The U.S. District Court for the Western District of Wisconsin has denied a franchisor’s renewed motion for a preliminary injunction against its former franchisee, holding that the franchisor failed to show that its trade dress was entitled to protection or that the ex-franchisee’s potential violation of the noncompete provision in its franchise agreement posed a threat of
irreparable harm to the franchisor. *E&G Fran. Sys., Inc. v. Janik*, 2018 WL 5630589 (W.D. Wis. Oct. 31, 2018). E&G Franchise Systems operates and licenses others to operate Erbert and Gerbert’s Sandwich Shop restaurants. The Janik Group previously operated an Erbert and Gerbert’s in Plano, Texas. E&G terminated Janik’s franchise agreement and sued Janik when it failed to close its restaurant. After E&G filed a motion for a preliminary injunction, Janik removed E&G’s marks from its restaurant but opened a new restaurant serving sandwiches, salads, and soup at the same location. In response, E&G filed a renewed motion for a preliminary injunction based on Janik’s continued use of E&G’s trade dress and violation of the noncompete provision of the franchise agreement.

The court found that E&G failed to demonstrate that it was likely to succeed on the merits of its trade dress claim. The court noted that, while E&G had registered a number of its trademarks, it had not registered its trade dress. Further, E&G had failed to actually describe specific elements of its trade dress in its court filings, referring instead to a “combination of interior lighting fixtures,” “the layout of the counter space,” and “the color scheme of the location.” E&G further failed to show that its trade dress was not functional, and Janik submitted evidence showing inconsistencies in trade dress between different Erbert and Gerbert’s locations. With respect to E&G’s noncompete claim, the court found that the lack of other Erbert and Gerbert’s restaurants near Plano meant that Janik’s operation of a new restaurant could not divert customers from or compete with any existing Erbert and Gerbert’s restaurants. The court discounted E&G’s suggestion that it would have difficulty attracting another franchisee to an area where a competitor was already operating by pointing to the recent closure of E&G’s other two Texas restaurants. E&G also made no representation that it was attempting to attract another franchisee to the area. As a result, the court found that E&G had either failed to show a protectable business interest justifying the noncompete provision or failed to demonstrate irreparable harm resulting from Janik’s business. Therefore, E&G failed to establish an adequate basis for a preliminary injunction based on either the appearance of Janik’s new restaurant or Janik’s potential violation of the noncompete provision of the franchise agreement.

**DISTRICT COURT GRANTS PRELIMINARY INJUNCTION ENFORCING NONCOMPETE PROVISION AGAINST FRANCHISEE**

On the other hand, a federal district court in Illinois granted in part and denied in part a franchisor’s motion for a preliminary injunction against a recently terminated franchisee who established a competing business. *Auto Driveaway Franchise Sys., LLC v. Corbett*, Bus. Franchise Guide (CCH) ¶ 16,300 (N.D. Ill Oct. 26, 2018). Auto Driveaway—a business offering vehicle transportation and shipping management services—sought a preliminary injunction and temporary restraining order against Corbett, the owner of the franchise at issue, seeking to enforce a noncompete covenant in the parties’ franchise agreement that prohibited him from engaging in a “competitive business” for two years at or within 50 miles of his formerly
franchised office or within 50 miles of any other Auto Driveaway office. Auto Driveaway alleged that Corbett had established a new business that provides similar services to those provided by Auto Driveaway in proximity to other Auto Driveaway businesses, in violation of the covenant. Auto Driveaway sought to prevent Corbett from operating the competing business in Richmond, Virginia, the city where his franchised office had been located, and from setting up a new location within 50 miles of another Auto Driveaway franchisee located in Manteca, California.

Applying Virginia law, the court held that there was a better than negligible chance that Auto Driveaway would succeed in showing a breach of the noncompete provision of the franchise agreement and that the balance of harm weighed in favor of Auto Driveaway. Auto Driveaway was able to demonstrate that its goodwill was being harmed because Corbett’s business could cause a potential loss of customers, was displaying Auto Driveaway’s trademarks while providing similar services as Auto Driveaway, and was actively soliciting and obtaining Auto Driveaway’s customers. The court further reasoned that any harm to Corbett from an injunction requiring him to uphold the terms of the franchise agreement would be minimal. While the court granted the preliminary injunction in part, it denied Auto Driveaway’s request to freeze the assets of Corbett’s new business and to obtain an accounting of records related to that business because such relief would be intrusive, alter the status quo, and was not necessary to remedy the immediate threat of harm posed by Corbett. Corbett has appealed the district court’s decision to the Seventh Circuit.
Minneapolis, MN Office

Elizabeth S. Dillon, co-chair (612.632.3284)  
Megan L. Anderson (612.632.3004)  
* Eli M. Bensignor (612.632.3438)  
Sandy Y. Bodeau (612.632.3211)  
Phillip W. Bohl (612.632.3019)  
Jennifer C. Debrow (612.632.3357)  
Ashley Bennett Ewald (612.632.3449)  
John W. Fitzgerald (612.632.3064)  
* Hannah H. Fotsch (612.632.3340)  
Olivia Garber (612.632.3473)  
Michael R. Gray (612.632.3078)  
* Karli B. Hussey (612.632.3278)  
Gaylen L. Knack (612.632.3217)

Kirk W. Reilly, co-chair (612.632.3305)  
* Raymond J. Konz (612.632.3018)  
* Richard C. Landon (612.632.3429)  
* Mark S. Mathison (612.632.3247)  
* Craig P. Miller (612.632.3258)  
Bruce W. Mooty (612.632.3333)  
Ryan R. Palmer (612.632.3013)  
Max J. Schott II (612.632.3327)  
Michael P. Sullivan, Jr. (612.632.3350)  
* James A. Wahl (612.632.3425)  
Lori L. Wiese-Parks (612.632.3375)  
Quentin R. Wittrock (612.632.3382)

Washington, D.C. Office

Mark A. Kirsch, co-chair (202.295.2229)  
* Samuel A. Butler (202.295.2246)  
* Julia C. Colarusso (202.295.2217)  
* Maisa Jean Frank (202.295.2209)  
* Jan S. Gilbert (202.295.2230)  
* Peter J. Klarfeld (202.295.2226)  
Sheldon H. Klein (202.295.2215)  
* Thomas A. Pacheco (202.295.2240)  
Iris F. Rosario (202.295.2204)

* Justin L. Sallis (202.295.2223)  
* Frank J. Sciremammano (202.295.2232)  
* Michael L. Sturm (202.295.2241)  
* Erica L. Tokar (202.295.2239)  
Stephen J. Vaughan (202.295.2208)  
Diana V. Vilmenay (202.295.2203)  
Eric L. Yaffe (202.295.2222)  
Robert L. Zisk (202.295.2202)  
* Carl E. Zwisler (202.295.2225)

* Wrote or edited articles for this issue.

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Follow us on Twitter: @GPM_Franchise

GRAY PLANT MOOTY

80 South Eighth Street  
500 IDS Center  
Minneapolis, MN 55402-3796  
Phone: 612.632.3000

600 New Hampshire Avenue N.W.  
The Watergate – Suite 700  
Washington, D.C. 20037-1905  
Phone: 202.295.2200

franchise@gpmlaw.com

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