The GPMemorandum

TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS

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

Maisa Jean Frank, Editor of *The GPMemorandum*

Julia C. Colarusso, Editor of *The GPMemorandum*

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

ANTITRUST

DOJ WILL FILE STATEMENT SUPPORTING APPLICATION OF THE RULE OF REASON TO NO-POACHING CLAUSES IN FRANCHISE AGREEMENTS

The U.S. Department of Justice recently announced its intent to file a statement of interest in three pending class action lawsuits, which each challenge no-poaching agreements, filed against franchisors in federal court in Washington. In its notice, the DOJ stated that "[a] no-poaching agreement between a franchisor and a franchisee, within the same franchise system, . . . merits rule of reason analysis at the proper procedural stage." In so writing, the DOJ made clear its disagreement with the plaintiffs' arguments in these cases that the less rigorous per se or quick-look methods of analysis apply. The DOJ also wrote that, "the franchise model by itself, absent other facts, cannot constitute a 'hub and spoke' conspiracy that would trigger per se or quick-look treatment," which directly counters another argument made by the plaintiffs. No-poaching cases that have survived the motion to dismiss stage have done so because the courts have found that either the per se or quick-look analysis might be applicable, so the DOJ's statement might be very impactful. Gray Plant Mooty will continue to monitor and report on developments in the litigation of no-poaching clauses.

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EMPLOYMENT

NLRB OVERRULES 2014 *FEDEX* DECISION AND RETURNS INDEPENDENT CONTRACTOR ANALYSIS TO COMMON LAW TEST

The National Labor Relations Board has overruled its 2014 decision in *FedEx Home Delivery*, 361 NLRB No. 610 (2014), finding that *FedEx* improperly limited the significance of a worker's "entrepreneurial opportunity for gain or loss" when evaluating whether a party is an independent contractor or an employee*. SuperShuttle DFW, Inc.*, 367 NLRB No. 75 (Jan. 25, 2019). In *SuperShuttle*, the NLRB considered whether SuperShuttle franchisees, who operate shared-ride vans to and from the airport, were employees for purposes of the National Labor Relations Act, or whether the franchisees instead qualified as independent contractors and thus were excluded from the Act's coverage. The NLRB historically has used a variety of common law factors when conducting its employee vs. independent contractor analysis, such as the extent of control exercised by the employer, method of payment, supervision, and other considerations. Pre-*FedEx*, factors supporting a worker's entrepreneurial opportunity generally weighed heavily in favor of finding independent contractor status, whereas factors indicating control over the individual weighed in favor of finding employee status. Then, in *FedEx*, the NLRB refined the test by recasting entrepreneurial opportunity as just "one aspect of a relevant factor."

Holding that it had improperly refined the test in *FedEx*, the NLRB returned its analysis to the pre-*FedEx* common law factors and ruled that the SuperShuttle franchisees were independent contractors. The NLRB reasoned that SuperShuttle franchisees lease or own their vans, pay weekly flat fees to SuperShuttle rather than a percentage of profits, and have nearly complete control over their work schedules and working conditions, all of which provide SuperShuttle franchisees with significant entrepreneurial opportunity for economic gain. While overruling *FedEx*, the NLRB still noted that entrepreneurial opportunity is not a "super factor" and that the NLRB should evaluate the common law factors through the prism of entrepreneurial opportunity when the facts of the case make such evaluation appropriate.

CALIFORNIA COURT FINDS FRANCHISOR IS NOT JOINT EMPLOYER, BUT DENIES SUMMARY JUDGMENT ON OSTENSIBLE AGENCY THEORY

A federal court in California granted a franchisor's motion for summary judgment on all but one claim brought by a franchisee's employees, holding that there was a fact question on the reasonableness of the employees' belief that the franchisee was operating as an agent of the franchisor. *Cruz v. MM 879, Inc.*, 2019 WL 266458 (E.D. Cal. Jan. 18, 2019). The plaintiffs are a class, which the court certified in a separate order on the same day, of approximately 181 current and former employees of MM 879, a California-based Merry Maids franchisee. They alleged that several of MM 879's wage and hour policies violated California law, and that they were jointly employed by franchisor Merry Maids, as well as its parent company, an affiliate, and a payroll and staffing company used by MM879. Merry Maids and its related companies moved for summary judgment arguing that they were not joint employers and could not be held liable for any of MM 879's wage and hour policies or practices.

The plaintiffs attempted to show that Merry Maids was their employer by highlighting sections of the franchise agreement and operations manual dictating policies relevant to their claims. The court found that, while these documents may have shown that Merry Maids had the authority to control franchisees indirectly, there was insufficient direct control to establish an employment relationship. While parts of the challenged compensation scheme were discussed in the operations manual, MM 879's owner testified that he never read the operations manual and ignored Merry Maids' compensation policies. The court agreed that Merry Maids did not control the plaintiffs' wages, hours, or working conditions and was not a joint employer under California law and therefore dismissed the plaintiffs' joint employer claims.

However, the court denied summary judgment on the plaintiffs' alternative theory that MM 879 was the ostensible agent of Merry Maids. The court held that the plaintiffs' declarations about Merry Maids' "pervasive branding" on employee handbooks, paystubs, training materials, and uniforms was sufficient to create a genuine issue of fact as to whether the plaintiffs reasonably believed MM 879 was an agent of Merry Maids. Notably, this decision is in direct opposition to the ruling in *Salazar v. McDonald's Corp.*, 2017 WL 950986 (N.D. Cal. Mar. 10, 2017), where another California federal district court held that an employment relationship cannot be created through ostensible agency without establishing that the defendant had control over the employees' wages, hours, or working conditions. Merry Maids has filed a motion for reconsideration of this portion of the court's order.

OHIO FEDERAL COURT APPROVES $1 MILLION WAGE AND HOUR CLASS ACTION SETTLEMENT INVOLVING FRANCHISEE AND FRANCHISOR

A federal court in Ohio recently approved a class action settlement of a wage and hour lawsuit brought on behalf of a class of pizza delivery drivers against a Domino's franchisee and various Domino's corporate entities, including the franchisor of the Domino's system. *Mullins v. S. Ohio Pizza, Inc.*, 2019 WL 275711 (S.D. Ohio Jan. 18, 2019). The plaintiff, a pizza delivery driver for Southern Ohio Pizza, a 19-unit Domino's franchisee, alleged that the franchisee and Domino's were his joint employers, and that as such they under-reimbursed him and similarly situated workers for their expenses related to using their own vehicles to deliver pizzas. The plaintiff also alleged that the defendants improperly paid him and similarly situated workers a tipped wage rate for hours worked in a nontipped capacity and failed to properly provide notice of the tip credit requirements of the Fair Labor Standards Act. The defendants denied the allegations, and the Domino's corporate defendants asserted that they were not joint employers of the plaintiff.

Following mediation, the parties reached a settlement without any admissions of culpability, and the court approved their agreement. Under the settlement, the defendants agreed to pay $1,070,000.00 to class members, $348,689.50 in attorneys' fees, $6,310.50 in litigation expenses, and $10,000.00 as a service award to the class representative. It is not publically known how the settlement payment was allocated between Domino's and the franchisee. This past fall, Domino's won dismissal of three nearly identical lawsuits filed in the Southern District of New York on the basis that it was not a joint employer.

CLASS CERTIFICATION GRANTED IN EMPLOYEE MISCLASSIFICATION CASE

Meanwhile, the federal court in Connecticut has granted a motion for class certification, allowing the lead plaintiffs to pursue employee misclassification claims on behalf of all Connecticut franchisees of the Jani-King system. *Mujo v. Jani-King Int'l, Inc.*, 2019 WL 145524 (D. Conn. Jan. 9, 2019). The plaintiffs alleged that franchisees had been misclassified as independent contractors under their franchise agreements with Jani-King and were actually employees of the franchisor, citing operational standards and their dependence on Jani-King for work assignments. They originally alleged that Jani-King had violated Connecticut's Minimum Wage Act, but the court dismissed those claims, leaving only claims that Jani-King was unjustly enriched by franchise fees paid by class members.

In analyzing the motion for class certification, the court had little trouble finding that an ascertainable class of numerous members had claims based on common questions of fact and law, that the claims made by the lead plaintiffs were typical of the class, and that the plaintiffs' counsel would adequately represent the class. In fact, Jani-King did not challenge many of these issues. Rather, Jani-King's challenge rested primarily on Rule 26(b)'s predominance and superiority requirements. Specifically, Jani-King argued that class certification was inappropriate because each franchisee ran their business as they saw fit, subject only to limited standardization requirements necessary to protect the brand. Thus, Jani-King argued, issues common to each franchisee's claim did not predominate. The court disagreed, finding that each class member had entered a similar franchise agreement and had worked in Connecticut, Connecticut law applied to each class member's claim, and all of the evidence would focus on whether Jani-King improperly conditioned initial or continued employment on payment of fees. Therefore, common issues predominated over all of the class members' claims.

Jani-King also argued that individual lawsuits would be superior to a class action, since each claim rested on facts and evidence unique to each franchisee. The court again disagreed, finding that a class action was superior because class members may fear retaliation if forced to litigate on their own, the cost of litigating individual claims may be prohibitive for class members with small damages claims, and a class action would eliminate the risk of inconsistent results.

PRELIMINARY INJUNCTIONS

OHIO FEDERAL COURT PRELIMINARILY ENJOINS FRANCHISEE'S BREACH OF POST-TERMINATION COVENANT AGAINST COMPETITION

The U.S. District Court for the Southern District of Ohio had no trouble preliminarily enjoining a franchisee and its principals ("Pivotal") from violating a one-year covenant against competition, when Pivotal's principals formed a competing company, hired Pivotal's employees for the same roles in the new business, sent notices to industry contacts that Pivotal was "rebranding," and declared the franchise agreement terminated. *Relo Franchise Servs., Inc. v. Gilman*, 2019 WL 324215 (S.D. Ohio Jan. 25, 2019). Pivotal attempted to avoid the injunction by arguing that its franchise agreement with Relo was unenforceable under the Ohio Business Opportunity Act and common law because Relo had fraudulently induced Pivotal to enter into the agreement with improper financial performance representations. However, the court found that any financial performance representations were made only *after* Pivotal had executed the franchise agreement and thus could not have induced Pivotal to enter into the relationship.

FORMER FRANCHISEE HELD IN CONTEMPT OF PRELIMINARY INJUNCTION ORDER

An Illinois federal court ruled in favor of franchisor BrightStar Franchising, LLC, holding former franchisee Northern Nevada Care and its owners Stephen and Teresa Neff in contempt for failing to comply with the terms of a preliminary injunction. *BrightStar Franchising, LLC v. N. Nevada Care, Inc.*, 2019 WL 194369 (N.D. Ill. Jan. 15, 2019). The Neffs previously operated a franchised BrightStar agency offering at-home personal care and medical services in Carson City, Nevada. BrightStar filed an action alleging a violation of the parties' franchise agreement and sought preliminary injunctive relief. The court granted BrightStar's motion and ordered the Neffs to immediately cease operating a competitive business in the Carson City area and to stop their use of any telephone number associated with their former BrightStar franchise. The order also required the Neffs to transition their patients to other providers. Approximately one month after the order was issued, BrightStar filed a motion to show cause, arguing that the Neffs were still in violation of the order because they had not ceased use of the phone number and continued to provide care services to patients in the Carson City area.

While the court denied the request to hold the Neffs in contempt as to the telephone number, since the Neffs had cancelled the number and were no longer in control over its use, the court granted BrightStar's motion in all other respects. In particular, the Neffs had disregarded their requirement to stop providing services to patients. The Neffs argued in response that they could not properly transition patients since the nearest BrightStar franchise had recently filed for bankruptcy and other providers were not allegedly licensed and qualified. The court disagreed with the Neffs, finding that they had never made the court aware of any difficulty complying with its injunction order. The court further found that the Neffs had not taken any meaningful steps to facilitate the transition. As a result, the court found that the Neffs' disregard of the court's injunction warranted a finding of contempt, set a deadline for compliance, and ordered the Neffs to pay BrightStar's reasonable attorneys' fees and costs incurred in the contempt proceedings.

CALIFORNIA FEDERAL COURT GRANTS DEALER'S MOTION FOR PRELIMINARY INJUNCTION UNDER PMPA

The U.S. District Court for the Northern District of California granted a dealer's motion for a preliminary injunction to halt the termination of its franchise in *S.A. Mission Corp. v. BP West Coast Products LLC*, 2019 WL 99042 (N.D. Cal. Jan. 3, 2019). S.A. Mission owned and operated a gas station as part of its franchise agreements with BP. The franchise agreements contained an "image standards" provision, under which S.A. Mission would need to conform to certain standards and its station would be subject to periodic inspections. S.A. Mission failed six consecutive inspections, after which BP provided notice of termination. In response, S.A. Mission filed a motion to enjoin the termination of its franchise.

The court issued a preliminary injunction under the Petroleum Marketing Practices Act, which permits injunctive relief to prevent the termination or nonrenewal of a gas station franchise if there are serious questions going to the merits of the claim and if, on balance, the hardships faced by termination outweigh the hardships caused by the issuance of the injunction. The court found that BP's inspectors acted in an arbitrary manner, by creating standards that did not exist in policy manuals provided to S.A. Mission, unfairly deducting points, moving the target for S.A. Mission, establishing arbitrary point allocations, and scoring questions differently without providing a reasonable summary of the inspection and scores. The court then found that the balance of hardships tilted in favor of S.A. Mission, reasoning that although S.A. Mission's shortcomings with regard to the inspections could negatively impact BP's brand image, the owner of S.A. Mission and her family relied on the business to earn a living. Finally, the court found that irreparable harm would fall on S.A. Mission and that the public interest favored enjoining the termination.

The court, however, dismissed S.A. Mission's action to quiet title in which it challenged a restrictive covenant requiring exclusive use of BP's fuel, convenience store, and fast food restaurant for 20 years at the gas station property. Although S.A. Mission alleged that the restrictive covenant was unconscionable, the court held that similar restrictions had been upheld previously and that the covenant was not commercially unreasonable.

ARBITRATION

COURT UPHOLDS ARBITRATION AWARD CONCLUDING THAT TERMINATION OF LICENSE AGREEMENT WAS NOT "ENFORCEMENT" OF THE AGREEMENT

A New York federal district court upheld an arbitral award that denied attorneys' fees to Benihana in a dispute with its licensee, Benihana of Tokyo ("BOT"). *Benihana Inc. v. Benihana of Tokyo, LLC*, 2019 WL 251729 (S.D.N.Y. Jan. 17, 2019). BOT had initiated an arbitration against Benihana for breach of the parties' license agreement, and Benihana counterclaimed for breach of the agreement and requested that the arbitrator uphold its earlier termination of the agreement. In conjunction with its counterclaim, Benihana sought to recover attorneys' fees pursuant to the license agreement, under which BOT had agreed to pay attorneys' fees incurred by Benihana "in connection with the enforcement" of certain sections of the agreement. Although the arbitrator found in favor of Benihana on the merits of the dispute, the arbitrator declined to award attorneys' fees on the grounds that Benihana had sought to terminate the license agreement—and therefore had not sought to "enforce" it.

Benihana then sought to vacate the portion of the award that denied its request for attorneys' fees. The court noted that it was obligated to confirm the arbitral award if there was "even a barely colorable justification for the outcome reached." The court found support for Benihana's argument that, because the license agreement provided for termination as a remedy for certain breaches, termination was one mechanism for contractual enforcement. Given the level of deference to which the arbitrator was entitled, however, the court concluded that it was obligated to uphold the award in full.

SETTLEMENT

NEW JERSEY APPELLATE COURT DENIES FORMER FRANCHISEE'S CHALLENGE TO SETTLEMENT AGREEMENT

The Appellate Division of the New Jersey Superior Court recently held that a former Gulf Oil franchisee must comply with the terms of a settlement agreement and affirmed the denial of the franchisee's motion to vacate the agreement. *S&M Gulf Inc. v. Gulf Oil, LP*, 2019 WL 333055 (N.J. Super. Ct. App. Div. Jan. 28, 2019). The dispute initially arose after the franchisee, Gulf Express, sued to enforce its right to purchase the franchise premises pursuant to a right of first refusal clause in its franchise agreement with Gulf Oil. The parties then entered into a settlement agreement granting Gulf Express the option to purchase the property at a certain price, employing a two-step valuation model to set the price of the "franchise premises." The parties first obtained separate appraisals of the property, but their experts differed in price by more than 10 percent. Under the terms of the settlement agreement, this gap triggered the appointment of a court-selected appraiser, whose valuation would set the purchase price. After the court-appointed appraiser valued the property significantly higher than Gulf Express's own valuation, Gulf Express moved to vacate the settlement agreement and reinstate its complaint, arguing that the settlement agreement was void because there was a mutual mistake regarding the meaning of "franchise premises."

The Appellate Division affirmed the denial of Gulf Express's motion to vacate, finding that its arguments regarding a lack of common intent and mutuality of mistake were meritless. Gulf Express argued the term "franchise premises" was ambiguous because it was not defined, but the court found no facts to support that claim. All appraisals, including Gulf Express's, used the same methodology to value the property—each specifically appraised the property interest, and none included a valuation of the business as a going concern, as Gulf Express alleged. Because there was no evidence that the parties had a different understanding of the term "franchise premises," the settlement agreement was enforceable and Gulf Express was obligated to comply with its terms.

GRAY PLANT MOOTY

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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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