# The GPMemorandum


**TO:** OUR FRANCHISE CLIENTS AND FRIENDS

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

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**DATE:** March 18, 2009—No. 117


This section of *The GPMemorandum* addresses non-judicial developments, trends, and best practices of interest to franchisors. Reports of recent judicial developments begin on page 3.

## UNIONIZATION OF WORKFORCES

### EMPLOYEE FREE CHOICE ACT INTRODUCED IN CONGRESS

The union-backed and much-talked-about Employee Free Choice Act (EFCA) was introduced in Congress on March 10, 2009. The legislative fight over the EFCA will begin soon. In the meantime, franchisors and other employers should ensure that they are familiar with the requirements and ramifications of the new law, that they contact their representatives in Congress to express their views, and that they begin taking lawful steps to prevent unionization, which will help whether or not the EFCA becomes law.

### WHAT THE EFCA WOULD DO

**Card Check Recognition Without Secret Balloting.** The EFCA would amend the National Labor Relations Act in numerous significant respects. The most troublesome provision for employers and the one receiving a lot of media attention is the abolishment of the right to a "secret ballot" election process by which employees decide if they will be represented by a union. The EFCA seeks to change existing procedure by eliminating an employer's right to a secret ballot election before requiring the employer to accept unionization of its workforce. The law would require employers to recognize a union upon being presented with "authorization" cards signed by a majority of its employees, presumably indicating that they desire union representation.

The bill's elimination of an employer's right to a secret ballot election is problematic for several reasons. Most notably, an employer may not be aware that organizing activity is occurring and thus may not be able to present the employer's position on unionization, creating a likelihood that the workers, who will not be able to vote in private, will be coerced by organizers.

In short, the EFCA would streamline the process of union organizing and weight the process much more heavily in favor of unions than it has ever been. Conversely, it would make it more difficult for employers to fight union organization efforts and would also limit employers' bargaining power.

**Further Information.** The text of the bill is available at: http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.1409. Contact information for members of Congress is available at www.usa.gov/Contact/Elected.shtml.

## DEVELOPING AN ACTION PLAN TO PREVENT UNIONIZATION

Despite the present uncertainty over the EFCA's ultimate form, union-free employers should consider actions that can be taken now to keep their operations union free. Following are just two examples of many such possible action steps.

**Adopt an Internal Position Statement on Unions and Labor Relations.** To help focus your business on the issue of unions and guide development of its labor relations strategy, it may be useful to develop an internal position statement on these matters. This statement could subsequently be modified as needed for communications with management and with employees.

**Review Employment Policies and Practices.** Certain policies, enacted before union organizing occurs, can help prevent unionization activity or provide useful tools in the event organizing begins. Because implementing any policy in response to organizing is likely to be construed as an unfair labor practice, it is critical to review policies and revise or implement new policies *before* organizational activity is present. Policies employers should consider include:

- A policy on visitors in the workplace that can be used to keep unwanted visitors, including union organizers, out of the workplace
- An open-door policy that encourages employees to bring concerns directly to management
- A dispute-resolution policy
- A no-solicitation policy
- An e-mail policy covering personal and other uses of business e-mail

In addition, a thorough policy review with labor law in mind will screen for policies that may be problematic. The basic rule is that merely maintaining any policy that a reasonable employee would likely interpret as interfering with his or her basic labor law rights is an unfair labor practice.

**Conclusion.** The action steps recommended above make sense regardless of when, if, and in what form the EFCA passes. If the EFCA passes in its current form, many more changes will be required. Because of the significant ramifications the EFCA will have on union organizing, it is a good idea for employers to get started now on their efforts to remain union free.

## RECENT CASES

Here are summaries of recent cases of interest to franchisors:

## ARBITRATION

### UNITED STATES SUPREME COURT HOLDS COURT MUST "LOOK THROUGH" PETITION TO COMPEL ARBITRATION TO FIND IF THERE IS A FEDERAL QUESTION SUFFICIENT FOR REMOVAL FROM STATE COURT

In *Vaden v. Discover Bank, et al.*, No. 07-773 (U.S. Sup. Ct. March 9, 2009), the United States Supreme Court held last week that under the Federal Arbitration Act (FAA), the district court is to "look through" a petition to compel arbitration to determine whether the underlying claim states a federal question that would allow for removal of the case from state court to federal court. As part of its holding, the Court noted that the FAA does not itself confer subject matter jurisdiction and such jurisdiction does not arise because of the content of a counterclaim, much like the traditional rule that a counterclaim will not supply the jurisdictional basis for removal of a case from state to federal court.

### PENNSYLVANIA FEDERAL COURT CONFIRMS FRANCHISOR'S ARBITRATION AWARD

A Pennsylvania federal court has confirmed an arbitrator's dismissal of a counterclaim brought by a California franchisee under the California Franchise Investment Law (CFIL) and enforced a covenant not to compete despite the fact that California law disfavors such provisions. *Paul Green School of Rock Music Franchising, LLC v. Smith*, 2009 WL 426175 (E.D. Pa. Feb. 17, 2009). The franchisee in this case had operated a music lesson franchise in California under an agreement that contained Pennsylvania choice of law and venue provisions. The franchisor began the case by filing an arbitration in Philadelphia, which sought an injunction, damages, and attorneys' fees. The franchisee filed an objection and a counterclaim under the CFIL. In addition, he sued in California federal court to compel arbitration there. In denying the franchisee's motion to compel, a California federal court had held that the Pennsylvania venue and choice of law provisions would apply, but only if the arbitrator in Philadelphia also heard the CFIL claim. After a full hearing, the Philadelphia arbitrator ultimately dismissed the CFIL claim, enjoined the franchisee from violating a two-year covenant not to compete, and awarded the franchisor over $400,000 in damages and expenses.

In granting the franchisor's motion to confirm the arbitration award, the Pennsylvania federal court explained that under the Federal Arbitration Act it could vacate an award only in what it called "exceedingly narrow circumstances." Such an action could be taken only when an arbitrator displayed a "manifest disregard" of the law or when the award was "completely irrational" or had "no support at all in the record." With respect to the dismissal of the CFIL counterclaim, the court upheld the decision despite the California court's earlier ruling that the arbitration being in Pennsylvania was specifically contingent on the arbitrator hearing the California statutory claim. The Pennsylvania court noted that parties fully briefed the legal and factual issues with respect to the claim and thus the arbitrator was "aware" of the CFIL. Therefore, the arbitrator did not exceed his authority when he dismissed the counterclaim rather than ruling on the merits of the claim.

The Pennsylvania court also enforced the covenant not to compete. The franchisee pointed out that a specific California statute (Business & Professions Code § 16600) barred the enforcement of noncompete provisions and that the California court had required the arbitrator to apply California law at least with respect to the CFIL claim. However, the court held that the choice of law provision in the franchise agreement applying Pennsylvania law was valid and enforceable and, furthermore, that it would "not independently presume that the California Business & Professions Code should have been applied by the arbitrator." Finally, even if section 16600 applied, the court concluded that the arbitrator's decision would be upheld since the statute contains an exception for the protection of trade secrets, which the franchisee was accused of usurping.

## TERMINATIONS

### FRANCHISOR'S CLAIM FOR FUTURE ROYALTIES DENIED BY COLORADO FEDERAL COURT

In *Rocky Mountain Chocolate Factory, Inc. v. SDMS, Inc.*, 2009 WL 579516 (D. Col. Mar. 4, 2009), a Colorado federal court this month denied a franchisor's claim for future royalties after termination of the franchise. This case shows that, although future royalties may be claimed under certain states' laws, a franchisor must still prove that they are certain. The parties in this case entered into a franchise agreement for a franchise in San Diego. From the beginning, the franchisees operated at a loss. They were defaulted several times for failure to comply with the franchisor's standards and selling unapproved products. Then, after terminating, the franchisor sued for non-payment and sought damages at trial, including future royalties in the amount of $201,708.

Under Colorado law, which governed the interpretation of the franchise agreement, a franchisor may claim future royalties if they are certain. The court held, however, that the franchisor failed to show the operating expenses attributable to doing business with the defendants and therefore had failed to prove its claim for future royalties. Under Colorado law, a franchisor also must show that, but for the breach, the franchise would have enjoyed success. In this case, there was substantial doubt about the continued success of the business because of the franchisees' financial problems. The court found in favor of the franchisor but granted it damages of just $33,000 plus attorneys' fees.

## CONNECTICUT FEDERAL COURT ALLOWS STATE FRANCHISE ACT AND TORTIOUS INTERFERENCE CLAIMS AGAINST FRANCHISOR

In *Sherman Street Associates, LLC v. JTH Tax, Inc.*, 2009 WL 426469 (D. Conn. Feb. 20, 2009), a Connecticut federal court considered dueling summary judgment motions from the terminated former franchisee-plaintiff and franchisor-defendant, JTH Tax, Inc. (doing business as Liberty Tax Service). The case came about after the franchisor terminated the franchise agreement for underpayment of fees and failure to pay on a promissory note, among other alleged violations. The franchisee's lawsuit claimed wrongful termination in violation of the Connecticut Franchise Act (CFA) and the Connecticut Unfair Trade Practices Act (CUTPA), as well as tort claims.

The court granted the franchisor's motion on the CUTPA claim, finding that although Connecticut law governed the CFA claim, Virginia law, where the franchisor is headquartered, governed the CUTPA claim and barred it. The court also granted summary judgment in favor of the franchisor on the franchisee's breach of the covenant of good faith and fair dealing claim, finding that it could not succeed as a matter of law without a corresponding breach of contract claim. The CFA and tortious interference (Virginia law) claims were allowed to proceed, however, as the court determined there were sufficient factual issues, regarding whether the franchisor had good cause to terminate and provided proper notice, for each to survive summary judgment.

## CLASS ACTIONS

### CALIFORNIA FEDERAL COURT GRANTS REMAND TO STATE COURT

In *Ganezer, et al. v. DirectBuy, Inc, et al.*, 2009 WL 363908 (C.D. Cal. Feb. 11, 2009), a California federal court granted the plaintiffs' motion to remand the case back to state court. The plaintiffs had filed a class action suit in California state court against DirectBuy, a franchisor of outlets marketing a direct-buying service to the public through club membership programs. DirectBuy removed the action to federal court under the provisions of the Class Action Fairness Act (CAFA). The plaintiffs moved to remand to state court claiming that the CAFA amount in controversy and minimal diversity requirements had not been met.

CAFA provides that the federal district courts have original jurisdiction of a civil action in which the amount in controversy exceeds $5,000,000 and is a class action in which any member of a class of plaintiffs is a citizen of a state different from any defendant. According to the court, because the burden was on DirectBuy to establish federal jurisdiction, it had the burden of proving that its "place of operations"—the state in which it conducts a substantial predominance of its business—was in a state other than California. While DirectBuy argued that it had no other place of business outside of Indiana, its state of incorporation, the court found that DirectBuy ignored the operation of its franchise locations and failed to provide the court with information to compare its business activity in California to its business activity in other states.

## DISCRIMINATION

### COURT REJECTS PROSPECTIVE FRANCHISEE'S DISCRIMINATION CLAIM

In *Elbanna v. Captain D's, LLC*, 2009 WL 435051 (M.D. Fla. Feb. 17, 2009), a prospective franchisee brought suit against a franchisor, alleging he was rejected from the system because he was Arab, and also claiming Captain D's defamed him throughout the application process. Elbanna had been operating several Shoney's franchises when he approached Captain D's about opening one of its restaurants. Although his application was initially approved, the parties were unable to agree on a location. Two years later, Elbanna again approached Captain D's about buying several franchises from an existing franchisee. After reviewing his updated application and financial capital, as well as visiting his Shoney's restaurants (which Captain D's judged to be unclean and empty over the lunch hour), Captain D's rejected the proposed transfer. Elbanna alleged the reasons set forth in the rejection letter were pretextual, and that it actually denied his application because of his Middle Eastern descent.

The court rejected Elbanna's arguments and granted summary judgment to Captain D's, pointing out that "[t]his is not the forum to litigate whether or not Elbanna was in fact a good restaurateur. Where pretext is an issue, the question the factfinder must answer is whether defendant's proffered reasons were a cover-up for a discriminatory decision." The court found they were not. The court also noted that Elbanna did not produce any evidence that statements made by Captain D's were, in fact, false, and therefore he could not sustain a claim for defamation either.

## TRADEMARKS

### COURT GRANTS PARTIAL SUMMARY JUDGMENT ON FRANCHISOR'S CLAIM OF TRADEMARK INFRINGEMENT

In *Homes & Land Affiliates, LLC v. Homes & Loans Magazine*, LLC, 2009 WL 260992 (M.D. Fla. Feb. 4, 2009), the court granted a franchisor partial summary judgment against one of its competitors on claims of trademark infringement. In this case, the franchisor published *Homes & Land*, a free magazine containing real estate advertisements found in display racks, which the franchisor licensed to franchisees in several markets across the country. The franchisor owned a federal registration of its mark HOMES & LAND®, which it first used in commerce in 1973, and also owned a domain name registration for its service mark HOMESANDLAND.COM.

The court examined whether there was a likelihood of confusion between the franchisor's marks and the defendant's HOMES & LOANS MAGAZINE and HOMESANDLOANSMAG.COM marks. The court found that the franchisor's marks were descriptive because they describe the products being offered but that the franchisor's promotion of the marks over the years had strengthened the otherwise weak marks. Further, the court found the mark HOMES & LAND® was incontestable under the Lanham Act but that HOMESANDLAND.COM did not share this presumption of strength. Citing widespread third-party use of the word "Homes" in real estate listing magazines and Web sites, the court noted the franchisor's marks were not particularly strong and found that the service mark HOMESANDLAND.COM was weak. The court did hold that the overall impression created by the marks was likely to cause confusion among consumers. In addition, both the identical nature of the products and the similar manner in which both parties sell advertisements contributed toward a finding of a likelihood of confusion. While the court could not find that the defendant adopted the franchisor's mark with the intention of deriving improper benefit, the court did rely on several instances of actual confusion to find a likelihood of confusion.

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