The GPMemorandum

TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS
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Here are some of the most recent legal developments of interest to franchisors. If you wish to discuss any of these cases further, please call any of the attorneys listed on the back page of this memorandum.

TRADEMARK INFRINGEMENT

COURT GRANTS PRELIMINARY INJUNCTION AGAINST FRANCHISEE FOR HEALTH/FOOD SAFETY VIOLATIONS BASED PRIMARILY ON TRADEMARK INFRINGEMENT INSTEAD OF CONTRACT CLAIMS

The United States District Court for the Western District of Missouri recently granted a preliminary injunction against a franchisee and ordered the franchisee to cease using the franchisor’s trademarks due to the poor condition of the franchisee’s store. The case is American Dairy Queen Corp. v. McMurray, No. 11-00859-CV-W-GAF (W.D. Mo. Sept. 2, 2011). Gray Plant Mooty represented American Dairy Queen (ADQ) in the action.

ADQ brought the action after store inspections revealed health and food safety violations at the store. The decades-old contract between the parties did not have a provision specific to maintaining health and food safety standards. Therefore, ADQ based its complaint on the trademark infringement inherent in a franchisee’s failure to meet system-wide standards and the dilution of the mark that naturally occurs in such situations. ADQ argued that the condition of the store was so far below the standards associated with Dairy Queen® stores that it constituted trademark infringement. The court agreed, granting
ADQ an injunction before the parties had even briefed a preliminary injunction motion. The court held that “[t]he lack of food safety and cleanliness at the Store threatens to irreparably harm Plaintiff’s national reputation of providing quality food products and services in a safe and sanitary manner” and noted that it would also likely cause consumer confusion.

DEFAMATION

COURT HOLDS THAT FRANCHISEES CAN PROCEED WITH ACTION FOR DEFAMATION BASED ON STATEMENTS APPEARING ON FRANCHISOR’S WEBSITE

In reinstating franchisees’ claims for defamation, the Florida Court of Appeals recently held that statements made by a franchisor on its website are not protected by the “litigation privilege.” Ball v. D’Lites Enterprises, Inc., 65 So. 3d 637 (Fla. Ct. App. July 27, 2011). When the franchisees sued their franchisor regarding representations as to the nutritional content of its products, the franchisor placed a statement on its website stating that the products sold by the franchisees under the franchisor’s trademarks were unauthorized and constituted a “hoax” on the public. The franchisees then amended their complaint to allege claims for defamation. The franchisor moved to dismiss, arguing that its website statements were protected by the “litigation privilege.”

The court of appeals held that the claims could go forward. Although statements made in the course of, or ancillary to, a judicial proceeding are privileged, the court found that statements made on a commercial website did not fall into that category. Rather, statements on a website were found to be analogous to statements made in press conferences and press releases, which are not protected.

EMPLOYMENT

MASSACHUSETTS SUPREME COURT ISSUES DAMAGES RULING IN AWUAH

Last year, we reported on a ruling that shocked the franchise community when a Massachusetts district judge compared a franchise to a modified Ponzi scheme and held, in a putative class action case, that a commercial janitorial services franchisor had misclassified its franchisees as independent contractors when they were employees. Awuaah v. Coverall North America, Inc., 707 F. Supp. 2d 80 (D. Mass. 2010). We subsequently reported on a later damages ruling in which the district court appeared to favor Coverall’s arguments, but ultimately certified various damages questions to the Massachusetts Supreme Judicial Court. Awuaah, 740 F. Supp. 2d 240 (D. Mass. 2010). Two weeks ago, the Massachusetts high court ruled on the certified questions, holding that Coverall had violated Massachusetts state wage law in its method of payment to the plaintiff in question Graffeo and in charging him various insurance-related and

The certified damages questions involved the Massachusetts Wage Act, which requires that employees be paid all earned wages on a weekly or biweekly basis and prohibits any “special contract” to exempt the employer from these requirements:

- The court considered two questions related to Coverall’s method of paying Gaffeo: (1) whether Coverall could lawfully use customer accounts receivable financing to pay Gaffeo; and (2) whether Coverall could withhold wages based on an agreement with Gaffeo that wages weren’t earned until the customer remitted payment. The court held that the answer to both of these questions was “no.” The court rejected Coverall’s comparison of its payment method to a commission system and its arguments that no wages were due until all contingencies, including customer payment, were satisfied. The court ruled that Coverall’s method improperly deferred payment of Gaffeo’s wages, which were earned when he completed performing his services. The court also held that Coverall’s system violated the “no special contracts” language of the Wage Act and that the charge-backs to Gaffeo were improper wage deductions.

- The court also considered two questions related to charges imposed on Gaffeo for costs such as bonding, worker’s compensation, and unemployment insurance: (1) whether Gaffeo could recover such costs as damages; and (2) whether an employee can lawfully agree to pay some or all of an employer’s costs for statutorily mandated insurance coverage or other items designed to alleviate the employer’s liability. On these questions, the court held that Coverall could not pass on the cost of statutorily mandated insurance coverage, such as worker’s compensation or unemployment insurance. The court found that costs for bonding or insurance designed to alleviate an employer’s risks are incidental to doing business and cannot be unilaterally passed on to an employee.

The court also accepted the district court’s invitation to provide guidance on whether Gaffeo could recover franchise fees paid to Coverall. Specifically, the court addressed the initial and additional royalty fees that Gaffeo paid for the franchise relationship, which the court viewed as a direct employment relationship. The court stated that such fees were impermissible as a matter of public policy because they required employees to buy their jobs, and employees cannot be required to pay for the privilege of working.

The *Awuah* ruling provides an important reminder that franchisors must be careful to structure relationships to ensure that franchisees are truly independent contractors, and of the significant monetary costs of misclassifying franchisees. Importantly, in issuing its ruling, the Massachusetts Supreme Judicial Court was careful to point out that its
damages rulings have no application to properly classified independent contractors operating under franchise agreements.

**COURT GRANTS SUMMARY JUDGMENT TO FRANCHISOR ON CLAIM BY FRANCHISEE’S EMPLOYEE**

In *Howell v. Papa John’s Int’l*, 2011 U.S. Dist. LEXIS 90972 (N.D. Ohio Aug. 16, 2011), the plaintiff alleged that his employment with a Papa John’s franchisee was terminated improperly in violation of the Americans with Disabilities Act. The plaintiff sued Papa John’s, claiming it was responsible for its franchisee’s employment decision. Papa John’s moved for summary judgment on the grounds that it had never employed the plaintiff and was not responsible for its franchisee’s conduct. The court agreed, finding that the plaintiff had failed to present any evidence to suggest that Papa John’s and its franchisee were anything other than wholly distinct entities. Papa John’s did not own the premises at which the plaintiff was employed and did not exercise any day-to-day control over its franchisee’s business operations. The court also noted that Papa John’s played no role in the hiring, discipline, or discharge of the franchisee’s employees. Because of that lack of control, the court granted summary judgment to Papa John’s.

**VICARIOUS LIABILITY**

**NEW YORK STATE COURT DENIES MCDONALD’S MOTION FOR SUMMARY JUDGMENT ON VICARIOUS LIABILITY CLAIM**

In *Solis v. McDonald’s Corp.*, 2011 N.Y. Misc. LEXIS 3366 (N.Y. Sup. Ct. July 11, 2011), a New York state court denied McDonald’s summary judgment on a vicarious liability claim, concluding that there was a question of fact regarding whether the franchisor exercised sufficient control over its franchisee’s day-to-day operations to be held liable for the franchisee’s negligent acts. The case arose out of injuries suffered by the plaintiff when he fell on a staircase inside a McDonald’s restaurant entrance. The plaintiff sued the franchisee and McDonald’s, seeking damages for negligence because the stairs allegedly were improperly maintained and defective.

The court agreed with McDonald’s that the mere existence of a franchise agreement was insufficient to impose vicarious liability for its franchisee’s acts. In denying summary judgment to McDonald’s, the court focused on the language of the franchise agreement, analyzing various provisions to determine whether McDonald’s exercised control over the day-to-day operations of its franchisee. The court focused on the fact that McDonald’s established requirements relating to its operational standards and policies, advised the franchisee about operational issues and improvements, and issued a manual to the franchisee that “set forth guidelines for maintaining a safe operation” of the restaurant. The court also placed great weight on the fact that the franchise agreement gave McDonald’s the right to inspect the premises at all times to ensure
compliance with its standards and policies, and noted that a McDonald’s operations consultant had performed multiple inspections of the premises. A critical fact in this case was that McDonald’s owned the property and had leased it to the franchisee; the franchisee had no right to alter the premises without obtaining the franchisor’s prior written approval. The court concluded that the plaintiff “amply” demonstrated that McDonald’s “owned the subject premises and maintained substantial control and dominion over the operations of the restaurant.” At the very least, the court held, there was a triable issue of fact about whether McDonald’s exercised control over the franchisee’s day-to-day operations.

NEW YORK FEDERAL COURT FINDS FRANCHISOR NOT VICARIOUSLY LIABLE FOR THE UNPAID DEBTS OF ITS FRANCHISEE

In Ammirato v. Duraclean Int’l., Inc., 2011 U.S. Dist. LEXIS 75305 (E.D.N.Y. July 13, 2011), the United States District Court for the Eastern District of New York held that a franchisor was not vicariously liable for a franchisee’s default on loans. A Duraclean franchisee (not a party to this case) obtained a series of loans from plaintiffs to finance cleaning projects by the Duraclean “National Team,” a marketing program whereby the franchisee would obtain large national accounts. When the franchisee failed to repay the loans, plaintiffs sued Duraclean International, Inc., the franchisor, for breach of contract, alleging that Duraclean was an ultimate beneficiary of the loans and was liable for the debt incurred by its franchisee as a joint venture partner, an entity with control over the borrower, or a principal whose agent had apparent authority to bind it.

After an eight-day bench trial, the court concluded that Duraclean was not liable for its franchisee’s unpaid loans. The court found that there was no joint venture between franchisor and franchisee resulting from the formation of the National Team. Specifically, the court found that plaintiffs were unable to prove the essential elements of a joint venture: (1) an agreement to share in the potential profits of the National Team; (2) an agreement to share the losses of the National Team; and (3) joint proprietorship or control over the National Team. The court further found that Duraclean could not be held vicariously liable for its franchisee’s unpaid debt because Duraclean did not exercise the requisite control over its franchisee. Finally, the court found the franchisee did not have apparent authority as an agent to bind Duraclean.

Franchisors need to be cognizant of the legal criteria for joint venture and similar business arrangements, and then make sure to craft relationships with franchisees that do not subject the franchisor to vicarious liability for a franchisee’s debts or other liabilities. This decision provides important guidance in that area.
FRANCHISE SALES

COURT FINDS IN FAVOR OF FRANCHISOR ON REGISTRATION AND EARNINGS CLAIMS

A Minnesota federal court recently granted a franchisor’s motion for summary judgment on certain claims pertaining to the franchisor’s alleged violations of the Minnesota Franchise Act. In Ellering v. Sellstate Realty Sys. Network, Inc., 2011 U.S. Dist. LEXIS 75852 (D. Minn. July 13, 2011), the issue presented was whether the franchisor was registered to sell franchises in Minnesota and whether the franchisor had misrepresented the potential earnings of the area franchise agreement. The plaintiff-franchisees claimed that the franchisor was not registered when it sold the franchise and thus had violated the Franchise Act. The franchisor filed for summary judgment on this claim contending that, even if true, the claim was time-barred under the Franchise Act’s three-year statute of limitations. The franchisees contended that the claim was not barred because they allegedly “discovered” the claim during the course of discovery. The court sided with the franchisor, stating that the discovery rule ordinarily applies to fraud-based actions and that failing to register is not fraudulent conduct. Even if the discovery rule were applicable, the court held that the franchisees could have discovered this claim well before the expiration of the limitations period. The court cited to the Minnesota Department of Commerce’s website, which provides a list of registered franchisors, and noted that it is a matter of public record whether a franchisor is or is not registered with the state.

As to the earnings claim, the court stated that it failed for a different reason. Although the claim was timely, the court concluded that the franchisees could not have reasonably relied on the alleged representations given the explicit language in the Uniform Franchise Offering Circular and area franchise agreement. The UFOC should have “planted seeds of doubt” with the franchisees given the disclaimer language pertaining to any earnings claims. Moreover, the franchisees had expressly acknowledged in signing the area franchise agreement that they did not rely on any forecast or earnings claim. Given these facts, the franchisees could not have reasonably relied on the alleged misrepresentations of the franchisor.

TERMINATION

COURT UPHOLDS TERMINATION BASED ON FRANCHISEE’S FAILURE TO PAY

In a case we have been tracking in The GP Memorandum, income tax preparation franchisor Liberty Tax Service achieved a victory in a dispute concerning whether it properly terminated a former franchisee under Connecticut law on non-payment grounds. The court in Sherman St. Assocs., LLC v. JTH Tax, Inc., 2011 U.S. Dist. LEXIS 97073 (D. Conn. Aug. 30, 2011), found in Liberty’s favor on its counterclaims against
franchisee Sherman Street Associates for breach of the parties’ franchise agreements, a promissory note, and a personal guaranty. The court held that Sherman Street’s failure to pay amounts owed to Liberty constituted “good cause” under the Connecticut Franchise Act (CFA) for terminating the franchise agreements even though the decision to terminate was motivated in part by negative comments about Liberty made by one of Sherman Street’s principals to a franchise prospect. The court commented that regardless of the franchisor’s motive for terminating, its only task was to “decide whether Liberty’s stated reasons objectively satisfy the ‘good cause’ standard” and held that Sherman Street’s failure to make payments easily met that standard. The court also rejected the franchisee’s contention that it was confused about the precise amounts that it owed, holding that “whatever confusion Sherman Street may have had . . . did not excuse [it] from its obligations to pay.”

The court did find, however, that Liberty violated the CFA by issuing a termination notice that was effective “immediately,” instead of giving the franchisee 60 days notice of the termination as required under the statute. The court noted, though, that the only remedy provided by the CFA for this violation was the recovery of lost profits for the period in which the termination was in effect without the requisite notice. No such recovery was possible in this case because Sherman Street had failed to show that it would have made any profit during this period, which was not during the tax season. Indeed, the evidence showed that Sherman Street lost money. Finally, the court rejected the franchisee’s claim for tortious interference with business expectancy based on a failed attempt to assign one of its franchised locations to a third party. The court found that Liberty would have been a party to the contract and, as a matter of law, a defendant cannot tortiously interfere with a business relationship to which it is a party.

ARBITRATION

EIGHTH CIRCUIT APPLIES RECENT SUPREME COURT RULING TO REQUIRE ARBITRATION IN FRANCHISE CASE

The United States Supreme Court’s arbitration-friendly decision in AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740 (U.S. 2011), was extended this month to a group of “franchisees” who sought to claim they were really employees. Green v. SuperShuttle International, Inc., 2011 U.S. App. LEXIS 18483 (8th Cir. Sept. 6, 2011). The franchisees in this case are current and former shuttle drivers who alleged (on a class basis) violations of the Minnesota Fair Labor Standards Act. As reported in Issue 135 of The GPMemorandum, the federal district court compelled arbitration on an individual basis pursuant to franchise agreements the drivers had signed. On appeal, applying the AT&T Mobility decision, the Eighth Circuit held that the FAA preempts any state-law challenge to arbitration agreements, including the class action waiver provision in the
SuperShuttle agreements. Accordingly, the district court correctly granted the motion to compel arbitration and enforced the class action waivers, the Eighth Circuit ruled.

COURT ENFORCES ARBITRATION CLAUSE WHILE ISSUING INJUNCTION

A federal court in Pennsylvania recently granted a franchisee’s motion to compel arbitration, while simultaneously granting the franchisor’s motion for a preliminary injunction. *AAMCO Transmissions, Inc. v. Dunlap*, 2011 U.S. Dist. LEXIS 91130 (E.D. Pa. Aug. 16, 2011), involved a lengthy dispute over the franchisor’s termination of the franchise agreement. In 2007, AAMCO sued to enforce termination, which resulted in a settlement agreement allowing Dunlap to operate the franchises for their remaining terms for the limited purpose of giving him an opportunity to sell his AAMCO centers to third party purchasers. When Dunlap failed to meet the terms of the settlement agreement, AAMCO initiated the current lawsuit and moved for a preliminary injunction to require him to cease operating the remaining terminated franchise location. Dunlap moved to dismiss the lawsuit and to compel arbitration pursuant to a broad arbitration clause contained in the franchise agreement.

AAMCO opposed Dunlap’s motion, arguing that he had waived his right to arbitrate because he had never attempted to enforce the arbitration clause during the 2007 lawsuit. The court found, however, that Dunlap had not waived his right to arbitrate—even though he fully litigated the 2007 lawsuit—because the 2007 action was separate from the current lawsuit. It noted that AAMCO filed a new lawsuit and never contended that this lawsuit was a continuation of the 2007 action and that Dunlap moved to compel arbitration early in the second suit. The court also found that granting one party’s motion to compel did not prevent it from granting the opposing party’s motion for a preliminary injunction, even if the injunction would not merely preserve the status quo. The court determined that because it granted AAMCO’s motion for a preliminary injunction, forcing Dunlap to cease operating his remaining AAMCO center, AAMCO would suffer no prejudice by arbitrating the remaining issues.

FRAUD

SUMMARY JUDGMENT GRANTED ON NEARLY ALL CLAIMS
BY THREE CLEANING FRANCHISEES

A Minnesota federal district court has dismissed nearly all claims in *Moua v. Jani-King of Minnesota, Inc.*, 2011 U.S. Dist. LEXIS 98455 (D. Minn. Aug. 30, 2011). This case originally was brought as a class action by a group of individuals who provide cleaning services or janitorial work at client accounts. After class certification was denied (see Issue 130 of The GP Memorandum), the parties apparently agreed that the defendant franchisor would move for summary judgment as to three of the individual plaintiffs
before further summary judgment motions were filed. The plaintiffs alleged that they had been induced to enter into contracts in violation of the Minnesota Franchise Act.

After a careful review of the evidence, the court found no violation. First, statements by the franchisor that the franchise would be a “good business” and would continue for “a long time” were deemed mere puffery and not actionable. In addition, the court held that “[i]migrants, even those with limited English skills and no business experience, are not a group so gullible that they cannot recognize obvious puffery.” Disclaimers and other provisions in the written documents signed by the plaintiffs also were enforced by the court. After this summary judgment ruling, only contract-based claims by one plaintiff as to one specific cleaning account survived for further proceedings, along with one plaintiff’s claim related to an alleged “fraud by omission,” which was held in abeyance until the court received a copy of the correct UFOC at issue. All other fraud, good faith and fair dealing, and franchise claims were dismissed with prejudice.

FRANCHISE CONTRACTS

STATUTE OF FRAUDS SATISFIED DESPITE NO SIGNATURE FROM THE FRANCHISEE

In Good Feet Worldwide, LLC v. Larry Schneider, 2011 U.S. Dist. LEXIS 83865 (S.D. Cal. August 1, 2011), the court held that the statute of frauds was satisfied even though the franchisee did not sign a franchise agreement. A dispute arose between the franchisor and franchisee that eventually required a determination of whether the forum selection clause was enforceable because the entire franchise agreement itself was not signed by the franchisee. The franchisor argued that the statute of frauds was satisfied because the specific franchisee in question had “signed documents that relate to, refer to, and/or comprise important Exhibits and Addenda to the Franchise Agreement that clearly evidence his intent to be bound by the Franchise Agreement.”

The rule of law applied by the court was that “a memorandum satisfies the statute of frauds if it identifies the subject of the parties’ agreement, shows that they made a contract, and states the essential contract terms with reasonable certainty.” The court found that four signed “Territory and Location Exhibits” to the franchise agreement constituted adequate documentation of the underlying franchise agreement. The Territory and Location Exhibits contained a description of the territory in which the franchisee was to operate and identified the existence of a franchise agreement, which was a defined term in the Territory and Location Exhibit. The court noted that the statute of frauds only requires a signature by the party against whom the contract is to be enforced.
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