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The GPMemorandum

TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS

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

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CASE SUMMARIES

Below are summaries of recent case decisions of interest to franchisors.

DAMAGES TO FRANCHISEE

NINTH CIRCUIT ONCE AGAIN AFFIRMS $16 MILLION VERDICT IN FAVOR OF LICENSEE

The United States Court of Appeals for the Ninth Circuit has amended a recent opinion and voted to deny rehearing en banc in *Alaska Rent-A-Car, Inc. v. Avis Budget Group, Inc.*, 2013 U.S. App. LEXIS 12709 (9th Cir. June 19, 2013). We previously reported on the case in Issue 165 of *The GPMemorandum.* In its most recent opinion, the court of appeals upheld the plaintiff licensee's $16 million jury verdict for lost profits and lost future profits stemming from Avis's purchase of Budget Rent-A-Car out of bankruptcy. Alaska Rent-A-Car successfully argued that Avis's ownership and operation of Budget violated a settlement agreement regarding its exclusive territory and reduced the profits it could have expected without the competition from Budget. On appeal, Avis challenged the damages award based on the method with which Alaska Rent-A-Car's expert calculated lost profits and the degree of certainty to which Alaska Rent-A-Car proved those damages. Avis also challenged the award of attorneys' fees, which were assessed because the common law in Alaska always permits the prevailing party to recover a portion of its attorneys' fees from the other party, regardless of whether it was provided for by contract or statute.

The Ninth Circuit rejected the challenges to the award, noting that Avis's arguments about the method used to calculate lost profits and the certainty with which they were proved went only to the weight and credibility of the evidence, not to its admissibility. The appellate court had to view the evidence in a light most favorable to the jury's verdict, and the Ninth Circuit concluded that Avis had failed to demonstrate that the only reasonable conclusion was contrary to that of the jury. The court also ruled that, although Alaska's rule on attorneys' fees was unique, it still applied to a diversity action brought in Alaska even though the substantive law of another state governed the parties' relationship. The Ninth Circuit affirmed the verdict in its entirety; however, it remanded the case in order to reduce the amount of prejudgment interest, which both parties agreed had been calculated in error.

STATE FRANCHISE LAWS

SECOND CIRCUIT FINDS INSURANCE AGENT IS NOT A FRANCHISEE

Applying Connecticut law, the United States Court of Appeals for the Second Circuit held last month that an insurance agent is not protected by the state's franchise relationship law. *Garbinski v. Nationwide Mut. Ins. Co.*, 2013 U.S. App LEXIS 12856 (2d Cir. June 24, 2013). In this decision, the Second Circuit reviewed and affirmed the district court's dismissal order that we reported in Issue 159 of *The GPMemorandum*. Readers may recall that Nationwide, the insurance company, terminated its contract with Garbinski, who sold Nationwide insurance policies, after local media stories reported that Garbinski domestically assaulted his wife, thereby violating the "public image" provision of his contract. Garbinski sued Nationwide for violating the Connecticut statute for terminating his "franchise" without the 60-day notice required by the franchise statute. The courts have focused on whether the parties were in a franchisor-franchisee relationship governed by the Connecticut Franchise Act.

The court of appeals found no franchise relationship existed, and affirmed the district court's dismissal of Garbinski's claims. The Second Circuit applied a two-step test, analyzing whether the alleged franchisee had the right to offer, sell, or distribute goods or services; and whether the alleged franchisor substantially prescribed a marketing plan for the franchisee to offer, sell, or distribute the goods or services. First, the court found that Garbinski was merely a sales representative because he never purchased anything from Nationwide to resell and never actually owned the goods he sold, unlike a typical franchisee. Second, according to the court, Nationwide did not instruct Garbinksi on how to sell or market the insurance plans, and required no quota from him, so it did not substantially prescribe Garbinski's marketing plan. On these two issues, the appellate court concluded a reasonable jury could not find that a franchise relationship existed between Nationwide and Garbinski, and Garbinski's claim for improper termination under the Connecticut Franchise Act failed as a matter of law.

FRAUD

COURT DISMISSES LICENSEE'S FRAUD CLAIM BASED ON PAROL EVIDENCE RULE

In *Palermo Gelato, LLC v. Pino Gelato, Inc.*, 2013 U.S. Dist. LEXIS 85925 (W.D. Pa. June 19, 2013), a federal court in Pennsylvania revisited its decision to dismiss the case for lack of subject matter jurisdiction. As reported in Issue 164 of *The GPMemorandum*, Palermo, a licensee of Pino, brought suit after discovering that Pino allegedly had misrepresented the origins of the gelato product it supplied. Palermo claimed that it was led to believe it was purchasing Pino's own exclusive recipe gelato when in fact the gelato was manufactured in bulk by a wholesaler. Palermo further asserted that the agreement amounted to a franchise relationship and that Pino had failed to comply with disclosure laws that would have required it to reveal the source of its gelato. Pino moved to dismiss on the grounds that the parol evidence rule precludes any evidence that would support Palermo's fraud claim, and that the absence of any basis to invalidate the agreement barred Palermo's claim for unjust enrichment.

In granting Pino's motion, the court held that parol evidence was inadmissible because the parties' agreement contained terms that directly addressed the subject matter of the alleged misrepresentations. The agreement discussed topics relating to the gelato recipe and specifically stated that the parties did not intend to enter into a franchise relationship. The agreement also contained an integration clause in which Palermo acknowledged that the contract superseded any prior understandings between the parties and that it encompassed the entirety of matters concerning the gelato license. Relying on several recent decisions by the Pennsylvania Supreme Court, the federal court determined that the combination of these factors was sufficient to prohibit evidence of any prior misrepresentations that may have induced the licensee to enter into the contract. The court therefore dismissed the cause of action for fraud in the inducement, reasoning that Palermo could not state a viable claim without such evidence. Because Palermo could not demonstrate the invalidity of the agreement, its claim for unjust enrichment also failed.

TERMINATIONS

COURT DENIES FRANCHISEE'S MOTION FOR INJUCTION AGAINST TERMINATION

The United States District Court for the District of Maryland has denied a franchisee's motion for preliminary injunctive relief to prohibit the termination of its franchise agreement. *Noya v. Frontier Adjusters, Inc.,* 2013 U.S. Dist. LEXIS 80672 (N.D. Md. June 7, 2013). Frontier Adjusters, Inc., and Noya were parties to several franchise agreements under which the franchisees operated insurance adjustment businesses, including one agreement that expired on June 9, 2013. Franchisee Noya had expressed its desire to enter into a new franchise agreement for the locations with the expiring

agreement. After trying unsuccessfully to resolve a dispute related to Frontier's new national accounts program, Noya brought suit against Frontier for breach of the franchise agreement and other claims.

The court denied the motion for two reasons. First, Noya was unlikely to succeed on the merits of his claims because Frontier had not terminated the franchise agreement. Rather, the agreement expired under its own terms, and not because of Frontier's action. Second, the court determined that Noya would not suffer irreparable harm if the franchise agreement expired because there was no threat of imminent financial ruin. Noya operated additional businesses under franchise agreements with Frontier and Frontier had consented to the sale of the business at issue to another franchisee that was ready to immediately move forward with the sale.

JURISDICTION

KENTUCKY DISTRICT COURT CONCLUDES IT LACKS PERSONAL JURISDICTION OVER GUARANTORS TO FRANCHISEES' PROMISSORY NOTES

In *KFC Corp. v. Wagstaff*, 2013 U.S. Dist. LEXIS 86758 (W.D. Ky. June 19, 2013), a district court in Kentucky held that neither the forum selection clauses in agreements underlying a personal guarantee nor Kentucky's long-arm statute conferred personal jurisdiction over the defendant guarantors. The defendants owned or operated KFC franchises. After KFC terminated the franchises for failing to pay fees due, the parties executed, among other things, a prenegotiation agreement under which KFC would forgo suit, promissory notes under which the franchisee corporations agreed to repay outstanding debts, and guarantees of the notes by Wagstaff. When KFC brought suit to enforce the guarantees, Wagstaff moved to dismiss for lack of jurisdiction or transfer.

KFC contended Wagstaff was bound by the forum selection clauses in the prenegotiation agreement and the promissory notes that identified Kentucky as a permissible forum. The court held that KFC's action to enforce the guarantees did not "arise under" the prenegotiation agreement because it was executed earlier in time and dealt with a different subject matter. The court also rejected KFC's argument that the promissory notes' forum selection clause bound Wagstaff even though the notes stated, "Guarantors and sureties hereby consent and voluntarily submit to personal jurisdiction in the Commonwealth of Kentucky . . . under this Note or any related Guaranty." The court pointed out that Wagstaff did not sign the notes, and the guarantees were limited to the notes' repayment obligations. KFC could have included a forum selection clause in the guarantees or broadened them to encompass "all of the agreements in the Notes," the court concluded. Lastly, the court found no jurisdiction under Kentucky's long-arm statute because an action on the guarantees did not "arise from" Wagstaff's business transactions in Kentucky. Simply entering into the guarantees with a Kentucky corporation, did not create jurisdiction, so the court transferred the case.

CONTRACTS

"UNCLEAN HANDS" DEFENSE DOES NOT HELP FRANCHISEE WHO CONTINUED TO ACCEPT BENEFITS UNDER ITS FRANCHISE AGREEMENT

A federal district court in New Jersey granted summary judgment to Ramada Worldwide on several counts of a breach of contract claim against a franchisee, despite the franchisee's equitable challenge to enforcement of the parties' franchise agreement. *Ramada Worldwide Inc. v. Southport, LLC*, 2013 U.S. Dist. LEXIS 91719 (D.N.J. June 27, 2013). Ramada brought a claim against Southport and other individuals for breach of a license agreement, development incentive note, and guaranty, because Southport had failed to make periodic payments required by the agreements. Ramada sought, and the court granted, summary judgment for outstanding recurring fees, interest, liquidated damages, unpaid principal, and attorneys' fees in connection with the breach.

Southport took an unusual approach to defending the case: it did not dispute the validity of any of the contractual provisions, but claimed that the equitable doctrine of unclean hands applied. "Unclean hands" is a defense to breach of contract when there is inequitable conduct such as fraud, unconscionability, or bad faith on the part of the plaintiff. The court, however, found that nothing in the record supported Southport's allegations. Further, even if the defense applied, the court determined that it would not excuse the breaches because unclean hands cannot be invoked by a party that stops performance but continues to take advantage of the contract's benefits. Because Southport failed to make payments while continuing to operate under the contract, the doctrine did not preclude summary judgment for Ramada.

CHOICE OF FORUM

FEDERAL COURT UPHOLDS FRANCHISE AGREEMENT FORUM SELECTION CLAUSE

The United States District Court for the Eastern District of Pennsylvania has denied a motion to transfer filed by California franchisee defendants, finding the forum selection clause in their franchise agreement valid and enforceable and concluding that the defendants failed to demonstrate that the action should be moved to the Northern District of California. *Maaco Franchising, Inc. v. Tainter*, 2012 U.S. Dist. LEXIS 80790 (E.D. Pa. June 6, 2013). Franchisor Maaco filed the action asserting breaches of the franchise agreement. The agreement contained a choice-of-law provision requiring it to be interpreted and construed under the laws of Pennsylvania, and a forum selection clause providing that any action arising out of or relating to the agreement must be brought and litigated in a state or federal court of general jurisdiction in Pennsylvania.

In reaching its decision, the court began by weighing party-specific factors, most notably their agreement as to the forum, which choice was entitled to substantial consideration but was not dispositive. The court found Tainter's preference to defend the action in California to be insignificant because the purpose of a transfer is not to shift the inconvenience from one party to another. Further, witnesses and documents were located in Pennsylvania, where Maaco conducts substantial business. Public factors also supported denial of transfer. Though a judgment would need to be enforced in California, there was little significance in enforcing it in one federal forum over another. Further, the court found that cases are resolved more quickly in the Eastern District of Pennsylvania than in the Northern District of California. Finally, Pennsylvania courts have an equal interest in deciding a controversy involving an agreement governed by Pennsylvania law, and Pennsylvania had a significant public policy interest in enforcing forum selection clauses consistent with Pennsylvania public policy.

CLASS ACTIONS

CLASS ACTION LAWSUITS AGAINST SUBWAY FOR MISLEADING ADVERTISING ARE CENTRALIZED BY JUDICIAL PANEL FOR MULTIDISTRICT LITIGATION

Seven putative class action cases against Subway Sandwich Shops, Inc. for engaging in a false or misleading advertising campaign will be centralized in the Eastern District of Wisconsin, according to a transfer order by the Judicial Panel on Multidistrict Litigation. *In re: Subway Footlong Sandwich Mktg. & Sales Practices Litig.*, 2013 U.S. Dist. LEXIS 81639 (E.D. Wis. June 10, 2013). The plaintiffs allege that Subway's advertising misled them regarding the size of the Subway footlong sandwich. Specifically, they complained that Subway's uniform standards and practices with respect to the manufacturing process and franchisee training result in a sandwich that is materially shorter than the foot that is advertised, in violation of state consumer protection laws.

VICARIOUS LIABILITY

MASSACHUSETTS SUPREME COURT RULES MODIFIED "RIGHT OF CONTROL" TEST APPLIES TO VICARIOUS LIABILITY CLAIMS AGAINST FRANCHISOR

In *Depianti v. Jan-Pro Franchising International, Inc.,* 2013 Mass. Lexis 472 (Mass. June 17, 2013), the Supreme Judicial Court of Massachusetts ruled that in analyzing vicarious liability claims against a franchisor, a modified right of control test should be applied. In addition, the court held that a franchisor can be sued by a franchisee for alleged worker misclassification even if there is no written contract between the franchisor and the franchisee. Jan-Pro operates a multi-tier janitorial services franchise system, in which it enters into agreements with master franchisees who then sell single-unit franchises within their regions. A putative class of unit franchisees sued Jan-Pro, alleging that it was vicariously liable for unfair trade practices by a master franchisee

and that they were misclassified as franchisees when they were employees. In reviewing summary judgment motions, the federal district court in Massachusetts had certified to the state's high court the questions whether a "right of control" test applied to the vicarious liability claims and whether Jan-Pro could be liable for misclassification.

On the first question, the court ruled that the unit franchisees' claims were subject to a modified right of control test. It observed that vicarious liability is typically imposed when the master has the right to control the agent's actions, even if actual control is not exercised. The court decided that this test could not be applied strictly in the franchise context, because franchisors must exercise some supervision and control over their franchisees to preserve their trademark rights under the federal Lanham Act. Thus, the court held that a modified "right of control" test applies to franchise relationships and that, under this test, a franchisor may be vicariously liable for a franchisee's acts only if the franchisor controls or has the right to control the daily conduct or operations of the particular aspect of the franchise's business relationship that caused the plaintiff's harm. On the worker misclassification claims, the court held, without ruling on the merits, that the absence of a contract between Jan-Pro and the unit franchisees did not preclude the misclassification claim. It decided that Jan-Pro could not avoid potential liability by establishing a franchise system that potentially misclassified unit franchisees and by causing its master franchisees to contract directly with the unit franchisees.

HOTEL FRANCHISOR MUST STAND TRIAL AFTER SICKNESS AT FRANCHISED UNIT

A federal district court in Utah last week denied summary judgment for the defendant franchisor in a case involving a Legionnaires' disease outbreak at a franchised hotel. *Licari v. Best Western International, Inc., et al.*, 2013 U.S. Dist. LEXIS 97725 (D. Utah July 12, 2013). The court found that the plaintiff, who became ill after staying at the hotel, could proceed against the franchisor on two agency-based liability theories. First, the court found enough evidence to suggest that the franchisee was an "actual agent" of the franchisor. The most significant evidence in that regard was the "detailed requirements for the day-to-day maintenance and operation of the hotel," including how the buildings, grounds, and public areas should be kept, the housekeeping department, and how guest rooms and bathrooms should be maintained. The franchisor's right to conduct inspections also was cited. These facts were enough to support a potential jury finding of "control" in the court's view. The court also denied summary judgment on the theory of apparent authority. To support this claim, the plaintiff had alleged that a road sign with the franchisor's brand had been instrumental in her decision to spend the night at that particular hotel, and that the road sign did not contain any statement that the unit was independently owned and operated.

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