The GPMemorandum

TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS

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

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

CLASS ACTION

NINTH CIRCUIT AGREES THAT MCDONALD’S IS NOT A JOINT EMPLOYER

In a closely watched case, the United States Court of Appeals for the Ninth Circuit has affirmed a ruling that McDonald’s is not a joint-employer of its California franchisee’s employees. Salazar v. McDonald’s Corp., 2019 WL 4782760 (9th Cir. Oct. 1, 2019). Guadalupe Salazar and other employees of a McDonald’s franchisee in California filed a class action suit against both the franchisee and McDonald’s alleging that defendants, as joint employers, violated various wage-and-hour statutes. After Salazar entered into a settlement agreement with the franchisee, McDonald’s successfully dismissed the suit at summary judgment on the grounds that it was not a joint employer and did not owe Salazar a duty of care. Salazar appealed and the matter was heard by a three-judge panel on the Ninth Circuit.

The Ninth Circuit affirmed the lower court’s ruling, concluding that under California law McDonald’s did not exercise requisite levels of control over the franchisee’s workers, such as control over the wages, hours, or working conditions, and that the franchisor did not meet the “suffer or permit” element of the applicable definition of an employer. Salazar argued that McDonald’s should be liable as a joint employer because it knew that the franchisee was violating wage-and-hour laws since the franchisee was using software recommended and provided by McDonald’s that did not comply with such laws. The Ninth Circuit noted that the proper inquiry in
analyzing joint-employer status is whether McDonald’s is Salazar’s employer, not whether McDonald’s caused the franchisee to violate the law or gave the franchisee bad tools or advice. Because McDonald’s did not have the requisite level of control over Salazar’s employment, the court concluded that the franchisor was not a joint employer of Salazar. Additionally, the court rejected Salazar’s argument that McDonald’s was liable under an ostensible-agency theory because McDonald’s did not actually employ Salazar and did not actually exercise control over Salazar’s wages, hours, or working conditions. This case is a significant victory for franchisors in the ever-changing landscape of joint-employer liability.

ARBITRATION

SECOND CIRCUIT UPHOLDS ARBITRATION AGREEMENT IN PROSPECTIVE FRANCISEE’S APPLICATION

The United States Court of Appeals for the Second Circuit has upheld an arbitration agreement between Doctor’s Associates, Inc. (“DAI”), the franchisor of Subway restaurants, and a prospective franchisee, finding that it was supported by sufficient consideration during the application process. Doctor’s Associates, Inc. v. Alemayehu, 934 F.3d 245 (2d Cir. 2019). In 2016, Alemayehu sought to purchase an existing Subway franchise in Colorado. As part of the application process, Alemayehu checked a box on an online form agreeing to submit any claims arising from the application process to arbitration venued in Bridgeport, CT. When DAI denied Alemayehu’s application he filed a lawsuit alleging racial discrimination. DAI responded by bringing an action in a Connecticut federal court seeking to compel the arbitration of Alemayehu’s claims. The district court denied DAI’s motion, finding that the putative arbitration agreement lacked consideration because it contained only unilateral promises made by Alemayehu and failed to require anything of DAI.

The Second Circuit determined that the district court erred in its conclusion on the consideration issue. The Second Circuit agreed that, under the Federal Arbitration Act, the threshold issue of whether the arbitration agreement was supported by consideration should be resolved by the court rather than the arbitrator. But the appellate court went on to note that a fundamental tenet of the law of consideration is that consideration may consist of a performance or a return promise, and that any performance which is bargained for is consideration. Here, Alemayehu received a bargained-for performance in exchange for his agreement to arbitrate. DAI was under no obligation to entertain an application from any prospective franchisee who did not agree to DAI’s preconditions. By completing and submitting his application, Alemayehu offered his promise to arbitrate in exchange for DAI’s subsequent review of his application. As a result, the Second Circuit vacated the judgment of the district court and remanded the case for further proceedings consistent with its opinion.
In another appellate decision interpreting arbitration provisions, the United States Court of Appeals for the Tenth Circuit affirmed the denial of a franchisor’s motion to compel arbitration, finding that the parties had not entered into a “written” agreement to arbitrate the claims at issue as required by the Federal Arbitration Act. *Campbell Invs., LLC v. Dickey's Barbecue Rests., Inc.*, 2019 WL 4235345 (10th Cir. Sept. 6, 2019). Campbell Investments initially signed a Dickey’s development agreement and franchise agreement for a restaurant in Ogden, Utah. Both agreements had arbitration provisions, but Campbell never opened the Ogden restaurant. Instead, Campbell purchased an existing franchised restaurant in South Jordan, which Campbell operated for two years in compliance with the terms of the prior franchisee’s agreement. Campbell never entered a written assumption of the prior franchise agreement, and did not enter a new agreement with Dickey’s for the South Jordan restaurant. When a dispute later arose between the parties, Campbell filed a lawsuit and Dickey’s sought to compel arbitration, arguing that the terms of the parties’ agreements required arbitration. The district court denied the motion reasoning that, even if Campbell impliedly assumed other terms of the South Jordan agreement by operating in compliance with those terms, Campbell had not agreed in writing to arbitrate claims relating to the South Jordan franchise.

The Tenth Circuit agreed with the district court’s analysis. It found that an integration clause in Campbell’s asset purchase agreement with the former franchisee — as well as Dickey’s failure to approve a transfer of the South Jordan franchise agreement to Campbell in writing — foreclosed the argument that Campbell had assumed the franchise agreement’s arbitration provision. The court also rejected Dickey’s argument that the lawsuit fell within the scope of the development agreement’s arbitration clause, since that agreement did not relate to the South Jordan franchise. Finally, the court found that Campbell’s knowledge of arbitration clauses in the South Jordan and other agreements was insufficient to create a “written” agreement by Campbell to arbitrate its claims arising out of the South Jordan franchise.

**CONTRACTS**

**ELEVENTH CIRCUIT ENFORCES INDEMNIFICATION PROVISION AGAINST FRANCHISEE**

The United States Court of Appeals for the Eleventh Circuit has held that a franchisee is required to indemnify a franchisor for its litigation defense costs, vacating a district court’s orders of summary judgment in favor of the franchisee. *Aaron’s Inc. v. MKW Invs., Inc.*, 2019 WL 4200260 (11th Cir. Sept. 5, 2019). Aaron’s Inc., a home furnishings retailer and franchisor, entered into a franchise agreement with MKW Investments under which MKW agreed to indemnify Aaron’s for certain expenses incurred as a result of certain conduct by MKW. After a former MKW employee sued both MKW and Aaron’s for wrongful termination, Aaron’s sought
to enforce the indemnification provision and recover its costs in defending against the former employee’s claims. The district court denied Aaron’s claims, and Aaron’s appealed.

MKW successfully argued to the district court that its obligation to indemnify Aaron’s was extinguished after Aaron’s terminated MKW’s chosen counsel and hired its own attorney. The franchise agreement provided that Aaron’s “shall have the option, in its sole discretion, to defend any action or to allow Franchisee to defend such action with counsel satisfactory to Franchisor.” According to MKW, Aaron’s decision to replace MKW’s counsel with its own attorney operated as a condition subsequent terminating the duty to indemnify. The Eleventh Circuit disagreed, finding no language in the agreement that supported MKW’s interpretation. Instead, the indemnification provision unambiguously required MKW to indemnify Aaron’s, regardless of Aaron’s replacement of MKW’s chosen counsel with one of its own choosing.

PRELIMINARY INJUNCTIONS

COURT DENIES FRANCHISEE’S MOTION TO STAY ENFORCEMENT OF PRELIMINARY INJUNCTION PENDING INTERLOCUTORY APPEAL

In the continuation of a case that appeared in Issue 244 of the GPMemorandum, a federal court in Michigan denied the motion of former Little Caesar’s franchisees to stay the enforcement of a preliminary injunction order pending their appeal of the order to the United States Court of Appeals for the Sixth Circuit. Little Caesar Enters., Inc. v. Miramar Quick Serv. Rest. Corp., 2019 WL 3997161 (E.D. Mich. Aug. 23, 2019). As previously reported, in July 2019, the court granted Little Caesar’s motion for a preliminary injunction enforcing its termination of the franchisees’ franchise agreements.

The district court considered the franchisees’ request to stay enforcement of its injunction under Fed. R. Civ. P. 62(d), considering the same factors in assessing whether to grant the stay as in deciding whether to issue an injunction. First, the court found that the franchisees were unlikely to succeed on the merits of their appeal because they failed to advance any new factual or legal arguments to alter the court’s original conclusion that Little Caesar was likely to succeed on the merits of its claim that it had good cause to terminate the franchise agreements. Second, the court found that any injury the franchisees suffered from the loss of their businesses, absent a stay, was compensable with monetary damages and, therefore, not irreparable. Third, and on the other hand, the court found that Little Caesar did stand to suffer irreparable harm from a stay, in the form of customer confusion and reputational damage arising from the franchisees’ unauthorized use of Little Caesar’s trademarks. Finally, the court determined that it was in the public’s interest to deny the requested stay in order to protect the rights of a trademark holder and prevent customer confusion. Because all factors weighed against the defendants, the court denied the motion to stay the injunction pending appeal. Little Caesar was represented by Gray Plant Mooty in this action.
ANTITRUST

JERSEY MIKE’S SETTLES WASHINGTON ANTIPOACHING CASE; AGREES TO REMOVE ANTIPOACHING PROVISIONS NATIONWIDE AND PAY $150K

Since early 2018, the Washington Attorney General’s Office has been carrying out a campaign to remove antipoaching provisions from franchise agreements nationwide, reaching agreements with 93 franchisors to remove such provisions. When Jersey Mike’s was served with a Civil Investigative Demand from the Attorney General, Jersey Mike’s responded that it did not enforce the provisions and had removed the provision from its standard form franchise agreements. The primary obstacle to resolution between Jersey Mike’s and the Attorney General, however, was the latter’s insistence that the provisions be removed from existing franchise agreements nationwide, a demand Jersey Mike’s suggested ought to be limited to Washington franchisees. When the two sides could not reach agreement, Washington brought suit against Jersey Mike’s and 22 of its Washington-based franchisees. Washington v. Jersey Mike’s Franchise Sys., No. 18-2-25822-7 SEA (Wash. Super. Ct. 2018).

Jersey Mike’s moved to dismiss the case, which was denied in a single-page order entered January 25, 2019. The parties engaged in discovery over the next several months, while Jersey Mike’s began the process of amending its 1,400 existing franchise agreements nationwide to remove the antipoaching provision — obtaining consent to amend all but one agreement. With a November trial date looming, the parties reached a settlement that included the standard commitments not to enforce the antipoaching provision in the single agreement that still contained it and not to include antipoaching provisions in future franchise agreements. Jersey Mike’s also agreed to pay $150,000 to the Attorney General for costs and attorneys’ fees.

VICARIOUS LIABILITY

FRANCHISOR GRANTED SUMMARY JUDGMENT IN SLIP AND FALL CASE

Burger King has prevailed on its motion for summary judgment in a lawsuit related to a slip and fall incident that occurred at a franchised restaurant. Cram v. Burger King Corp., 2019 WL 4095570 (D.N.H. Aug. 29, 2019). The incident occurred when plaintiff Elizabeth Cram’s foot got caught in a child’s highchair improperly placed next to the restroom entrance, causing her to fall and tear her Achilles tendon. Plaintiffs asserted negligence and vicarious liability claims against Burger King because it was the owner and lessor of the restaurant at issue. Burger King filed a motion for summary judgment, arguing that it did not breach any duty owed to the customer.

In its examination of the plaintiffs’ negligence claim, the court concluded that New Hampshire law does not impose an absolute duty on landowners and landlords, particularly where the
premises are controlled by another party. Instead, the court noted that landlords must exercise reasonable care not to subject others to an unreasonable risk of harm. In this case, Burger King leased the premises to its franchisee, which assumed the primary duty to maintain the restaurant in good order and to take reasonable precautions to prevent injury. The court found no evidence that Burger King was involved in the restaurant’s maintenance or controlled the placement of the highchairs. The court’s analysis of the vicarious liability claim was nearly identical. The plaintiffs again argued that Burger King owed them a nondelegable duty to maintain a safe premises, but Burger King did not retain possession or control of the restaurant and did not exercise control over the location and placement of the highchairs in the restaurant. As a result, the court granted summary judgment in favor of Burger King.

STATE FRANCHISE LAWS

WASHINGTON STATE SUPREME COURT PROVIDES GUIDANCE AS TO WHAT “FAIR AND REASONABLE PRICE” MEANS UNDER THE FRANCHISE INVESTMENT PROTECTION ACT

The Washington Supreme Court has answered two certified questions from a federal district court regarding the meaning of the phrase “fair and reasonable price” under Washington’s Franchise Investment Protection Act (“FIPA”). *Money Mailer, LLC v. Brewer*, 2019 WL 4508353 (Wash. Sept. 19, 2019). FIPA prohibits franchisors from selling to a franchisee any product or service “for more than a fair and reasonable price.” A federal district court certified two questions regarding that prohibition: (1) whether a franchisee may rely on the price at which the franchisor is able to obtain the product or service in the absence of evidence indicating that the price was not a true market price; and (2) whether a franchisor violates the prohibition as a matter of law when it charges the franchisee twice what it pays for a product or service.

Based on the plain meaning of the statutory language and its legislative history, the court held that what is a “fair and reasonable price,” is a question of fact that should take into account the following factors: (a) the price at which the franchisor acquired the products or services; (b) statements about profit margin made by the franchisor; (c) the franchisor’s charges to other franchisees for the same or similar products or services; (d) what other similarly situated franchisors charge similarly situated franchisees for the same or similar products or services; (e) business and industry practices; (f) the price the franchisor pays for the products or services; (g) the price at which the franchisee could obtain the same or equivalent products or services elsewhere, including in an arm’s-length deal on the open market; (h) the value that the franchisor adds to the product or service; and (i) any other unspecified market forces at issue in any given case. The court noted that this list of factors was not exhaustive, exclusive, or mandatory and “not every factor need be referenced or used.” Given these factors, the court held that (1) a fair and reasonable price is not inherently established by the price at which the franchisor obtains the product or service; and (2) a franchisor does not violate FIPA as a matter of law by selling a product or service for twice the price at which the franchisor obtained it.
CALIFORNIA LEGISLATURE PASSES AB-5

Making major changes to employment law in California, AB-5 codifies the holding in *Dynamex Operations West, Inc. v. Superior Court*, which established the so-called “ABC test” for determining whether a worker is an “employee” or an “independent contractor” in California. The ABC test creates a rebuttable presumption that a worker who performs services for hire in exchange for remuneration is an employee, unless the hiring entity can demonstrate that: (a) the individual is free from the control and direction of the hiring entity in connection with the performance of the work, both in practice and on paper; (b) the individual performs work that is outside the usual course of the hiring entity’s business; and (c) the individual is customarily engaged in an independently established trade, occupation, or business. If an individual is determined to be an “employee” under AB-5, then the California Labor Code, Unemployment Insurance Code, and California Industrial Welfare Commission Wage Orders apply to that individual. California AB-5 will take effect on January 1, 2020.

AB-5 ostensibly applies to companies like Uber, Lyft, and other businesses engaged in the “gig economy,” not franchising. However, the passage of AB-5 is particularly concerning to franchisors because in May 2019 one California court used the ABC test to come very close to concluding that a franchisor was the employer of its franchisees in *Vazquez v. Jan-Pro Franchising International, Inc.* The outcome in *Vazquez* may ultimately be a result of the structure of the Jan-Pro system, where most franchisees are individual owner-operators performing janitorial services contracts executed between a master franchisee and the client, rather than between the franchisee and the client.

Regardless, all three prongs of the ABC test could be problematic for most franchise structures. As for the first prong, the franchisor’s obligation to protect its trademarks in the form of operating procedures and brand standards could be cited as evidence of control over the performance of a franchisee’s work. With regard to the second prong, the franchisor’s advertising and uniform promotion of the brand and marks could be viewed as evidence that the franchisor and its franchisees are engaged in the same type of business. Further, franchisors with company-owned units will have difficulty satisfying the second prong because the company-owned units engage in the exact same business as the franchised units. A franchisor must satisfy all three prongs to avoid having its franchisees classified as employees. However, the ABC test is not new and has been used in the context of different employment law regulatory schemes in several states — including Massachusetts, Connecticut, and New Jersey — where franchising continues to thrive.
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