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State Franchise and Dealer Laws

California Court Dismisses or Stays Franchisee's Claims Arising Out of Same Facts as in Pre-Existing Colorado Case

In *SDMS, Inc. v. Rocky Mountain Chocolate Factory Inc.*, 2008 WL 4838557 (S.D. Cal. Nov. 6, 2008), the United States District Court for the Southern District of California considered claims brought by terminated franchisees under the California Unfair Business Practices and Unfair Competition Acts. The franchisees alleged that the sale of products by Rocky Mountain to discount retail outlets such as Costco.com, without disclosure to the franchisees prior to execution of the franchise agreement, violated their rights under the California statutes. At the outset the court acknowledged that a similar case involving the same parties was pending in the United States District Court for Colorado. The court ruled that if Colorado law governed the allegations in the franchisees' California-law claims, those claims must be dismissed. The court also determined that several of the franchisees' claims in the California case were precluded because they involved facts and issues addressed in the Colorado case. Additionally, to the extent that issues raised in the California case should have been asserted as compulsory counterclaims in Colorado, the California court stayed consideration of those claims the Colorado case has ended. Nevertheless, the court evaluated whether the franchisees had failed to state valid California-law claims and concluded that a claim requesting disgorgement and restitution under the California Unfair Competition Act would survive a motion to dismiss, provided that it is not ultimately required to be dismissed as a claim which should have been brought in the Colorado case.

The parties' franchise agreement contained a Colorado choice of law clause, but the Rocky Mountain UFOC stated that this clause "may not be enforceable under California law." The California court held that even if this UFOC language created an unenforceable choice of law clause for lack of a "meeting of the minds," application of California law would not be automatic. The franchisor had filed a claim for damages against the franchisees in Colorado. In the absence of a valid choice of law clause in a diversity case, a court could base the applicable law on the forum state's choice of law rules. Although Colorado and California followed the same conflict of law principles in this regard, the court stayed the resolution of the choice of law issue pending the outcome in Colorado.