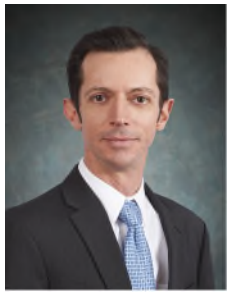
Franchise: 2021 Year in Review

Maisa Frank
Richard Landon
Samuel Butler

January 13, 2022

Lathrop GPM

Presenters

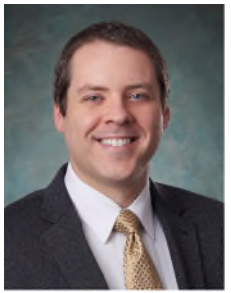


Samuel Butler

Associate
Washington, D.C.
Franchise & Distribution

Maisa Frank

Partner
Washington, D.C.
Franchise & Distribution



Richard Landon

Partner
Minneapolis, MN
Litigation & Dispute Resolution

Legal updates now available at:

www.lathropgpm.com/TheFranchiseMemorandum

Topics Overview

- Employer Standards
- Anti-Poaching Agreements
- Standing to Sue
- Injunctions
- Misrepresentation in Franchise Sales
- Choice of Law

Employer Standards—ABC Test—*Vazquez*

***Vazquez v. Jan-Pro Franchising Int'l, Inc.*, 10 Cal. 5th 944, 478 P.3d 1207 (2021)**

- Franchisees alleged entitlement to minimum wages and overtime
- Summary judgment vacated by 9th Circuit in 2019, holding that California courts would apply *Dynamex* "ABC test" retroactively

- Question of retroactive application certified to California Supreme Court, which agreed with the 9th Circuit:
  - Retroactive application favored because the ABC elements were included in the broader test applied in *Borello*
  - Unfairness to employees deprived of protection outweighed unfairness to employer
- Supreme Court declined to address the applicability of *Dynamex* to franchise relationships, even though *Vazquez* involved franchisees

Employer Standards—Additional Cases

***Mujo v. Jani-King Int'l, Inc.*, 13 F.4th 204 (2d Cir. 2021)**

- Franchisees argued franchise fees were improper wage deductions
- Even if franchisees were employees, they agreed to the franchise fees

***Haitayan v. 7-Eleven, Inc.*, 2021 WL 4078727 (C.D. Cal. Sept. 8, 2021)**

- Franchisees brought wage and hour claims
- Franchisees controlled product selection, pricing, employee management and compensation
- Appeal filed Oct. 19, 2021

Employer Standards—ABC Test—DOL Rule

DOL Withdrawal of Independent Contractor Rule

- Rule: 86 Fed. Reg. 1168 (Jan. 7, 2021) (to take effect March 8, 2021)
- Delayed: 86 Fed. Reg. 12,535 (Mar. 4, 2021) (delayed until May 7, 2021)
- Withdrawal: 86 Fed. Reg. 24,303 (May 6, 2021)

- Rule's test:
  - Nature and degree of the worker's control over the work
  - Worker's opportunity for profit or loss
- The Protecting the Right to Organize (PRO) Act of 2021
  - Would institute the ABC Test at the federal level
  - Passed by House in March; stalled in Senate committee since

Employer Standards—Training

***Johnson v. McDonald's Corp.*, --- F. Supp.3d ----, 2021 WL 2255000 (E.D. Mo. June 3, 2021)**

- Employee quit shortly after being hired; alleged she was sexually harassed and assaulted

- Court denied motion to dismiss in a "close case"
  - Extremely brief decision
  - Apparently based on typical franchisor controls, in addition to a requirement of sexual harassment prevention and reporting training
  - Case settled in October

- *Johnson* distinguished by *Ries v. McDonald's USA, LLC*, No. 1:20-CV-2, 2021 WL 5768436 (W.D. Mich. Dec. 6, 2021) (motion for summary judgment)

Employer Standards—Training

***Rivers v. Int'l House of Pancakes*, 2021 WL 860590 (S.D.N.Y. Mar. 8, 2021)**

- Employee sued for pregnancy discrimination
- No franchisor role in hiring, scheduling, compensation, or work conditions (beyond semiannual inspections)

Anti-Poaching Agreements

- ***Conrad v. Jimmy John's Franchise, LLC*, (S.D. Ill. 2021)**

- ***Deslandes v. McDonald's USA,* LLC, (N.D. Ill. 2021)**

Conrad v. Jimmy John's Franchise

- Antitrust case brought by a putative class of current and former Jimmy John's employees, including managers and nonsupervisory employees
  - Alleged that a "No-Poach Provision" in Jimmy John's Franchise Agreement effectively prohibited employees from switching between locations with different owners
  - Argued this stifled competition in the labor market through an unlawful exercise of monopsony power under Section 1 of the Sherman Act
- After extensive discovery, plaintiffs filed for class certification, and both parties submitted expert testimony about whether damages in the form of allegedly suppressed wages could be proven on a class-wide basis
  - In February, the Court excluded plaintiff's expert for failing to adopt a reliable method for establishing damages were susceptible to proof on a class wide basis
  - Concluded the expert's methodology improperly treated all wages as hourly, even though many managers were compensated on a per-shift basis, which inflated estimates of impact

Conrad v. Jimmy John's Franchise

- In July, the Court denied class certification
  - Employees within the class had conflicting roles—managers vs. non-managers
  - Putative class representative admitted that he had never sought employment at another Jimmy Johns restaurant; thus, he was never prevented from changing jobs by the provision at issue
  - Terms of provision also changed over time, and enforcement was spotty at best and varied locally

- Court ultimately determined that allegations would be governed by rule of reason, and did not establish per se illegality
  - Would lead to additional issues that could not be determined on a class-wide basis
  - Court noted that the plaintiffs' attempt to define a single-system labor market was refuted by evidence that Jimmy John's restaurants competed for labor with other QSR restaurants as well as other local employers

Deslandes v. McDonald's

- Plaintiffs sought to represent nationwide class in claim that no-poach in Franchise Agreement from 1973 to 2017 violated Sherman Act and suppressed wages

- Also denied class certification, and also concluded that rule of reason would apply
  - Court noted that, in the context of a franchise system, anti-poaching provisions could serve pro-competitive purposes that should not be condemned with full examination
  - Focused on the fact that labor markets, particularly for QSR restaurants, are inherently localized
    - Hundreds or potentially thousands of relevant markets in which the effects, if any, of the anti-poaching provision would need to be evaluated
    - In markets where there were other competitors for labor, a single-system restraint could have little effect

No Poach Takeaways

- Two different routes to denying predominance
- Both courts concluded rule of reason would be the appropriate standard given defendants' evidence of procompetitive benefits (i.e., encouraged franchisees to invest in training and promoted cooperation between franchisees)
- Significant hurdle for treatment of no poach clauses on a class-wide basis
- Demonstrate limitations in private enforcement, but remains to be seen whether increased attention from FTC leads to more pressure from the regulator

Standing to Sue

APFA Inc. v. UATP Mgmt., LLC (N.D. Tex. May 6, 2021)

- Franchisor of 200 indoor trampoline parks implemented various changes to the franchise system, including an increased royalty fee, removal of the development fund fee, and the addition of a membership program and new fees
- Adventure Park Franchisee Association (APFA) represents more than 50 Urban Air franchisees
  - Franchise Association brought suit in New Jersey alleging franchisor unlawfully identified new designated vendors, received rebates from those vendors, and engaged in financing that was not properly disclosed in the FDD
  - Transferred to Texas because of forum selection clause

- Dismissed for lack of standing
  - Franchise Association could show (1) members had standing to sue in their own right, and (2) interests association is trying to protect are part of its mission
  - But could not show (3) lawsuit would not require participation of individual members
    - Association not in the best position to present the subtleties of its members' contract and tort claims would require fact intensive inquiry

Post-termination noncompete Injunctions

- ***Jackson Hewitt Inc. v. Njoku***, 2021 WL 1827277 (D.N.J. May 6, 2021)
  - Injunction granted against terminated franchisee for failing to adhere to post termination non-compete and non-solicitation provisions. One-year delay was justified by franchisor's belief that defendant was complying with provisions.
- ***Bambu Franchising, LLC v. Nguyen***, 2021 WL 1839664 (N.D. Cal. May 7, 2021)
  - Injunction granted against former franchisee for operating competing restaurant in violation of noncompetition provision
- ***Core Progression Franchise, LLC, v. O'Hare***, 2021 WL 2566890 (D. Colo. June 23, 2021)
  - Injunction granted against terminated franchisee for operating competing business in same location; awarded attorneys fees as a sanction for continued violations after issuance of injunction.
- ***JTH Tax, LLC v. Johnson***, 2021 WL 2379541 (E.D. La. June 10, 2021)
  - Injunction granted against terminated franchisee for failing to adhere to post termination non-compete and non-solicitation provisions; equitably extended the length of non-compete provisions from the date that the injunction began.
- ***Steak N Shake Enters. v. iFood, Inc***., 2021 WL 3772012 (S.D. Ind. Aug. 25, 2021)
  - Injunction granted against terminated franchisee for operating a competing business in same location, even though franchisee eventually ceased violation of franchisor's trademark.
- ***Stone Strong, LLC v. Stone Strong of Texas, LLC***, 2021 WL 4710449 (D. Neb. Oct. 28, 2021).
  - Injunction **denied** against terminated licensee despite likelihood of prevailing on breach of contract and trademark claims, because any concern about the harm and customer confusion caused by continued use of the marks was negated by 10-month delay in bringing suit

Misrepresentation in Franchise Sales

Mount Holly Kickboxing, LLC v. FranChoice, Inc., 2021 WL 117968 (D. Minn. Mar. 24, 2021)

- One of several cases against FranChoice related to the sale of iLoveKickboxing.com units
- Alleged franchise sales brokers made misrepresentations in sale of franchises, in violation of state franchise laws and common law
  - Cases targeted franchise brokers rather than franchisors. Court did hold that brokers could be sued for false or misleading statements
- However, this decision found no evidence of fraud or misrepresentation, and dismissed all claims.
  - All statements but one were not false, were statements about future events, or were puffery and were not actionable as fraud. E.g.:
    - ILKB was suitable for absentee ownership – prediction of future event
    - Maximum cost to franchisee was $275,000 – prediction of future event
    - ILKB “works well” with franchisees and is “very responsive” – puffery
  - For the one remaining statement, there was no reasonable reliance
    - Statement that no ILKB franchises had ever closed was directly contradicted by the FDD; franchisee was experienced businessperson who should not have relied on the statement

Choice of Law

Lakeside Surfaces, Inc. v. Cambria Co., LLC, 16 F.4th 209 (6th Cir. 2021)

- Franchisor was located in Minnesota; franchisee was located in Michigan
- Contract contained Minnesota forum selection and choice of law clauses
  - District court concluded that Minnesota law would apply and dismissed the case in favor of a Minnesota forum
- Sixth circuit reversed and held that the Minnesota choice of law provision did not make the Michigan Franchise Investment Law and its prohibition on out-of-state forum selection clauses inapplicable

Purugganan v. AFC Franchising, LLC, 2021 WL 723916 (D. Conn. Feb. 24, 2021)

- Franchisor was located in Alabama; franchisee managed franchises in New York and Connecticut
- Contract chose Maryland law – the state where the predecessor franchisor was located
- Franchisee argued that Maryland law could not apply because neither party had any relationship with Maryland
- Court held that the successor franchisor's location in Maryland at time of contract formation was sufficient to establish a substantial relationship between Maryland and the franchisee, and between Maryland and the underlying transaction

Choice of Law

Jack in the Box Inc. v. San-Tex Restaurants, Inc., 2021 WL 148058 (W.D. Tex. Jan. 14, 2021)

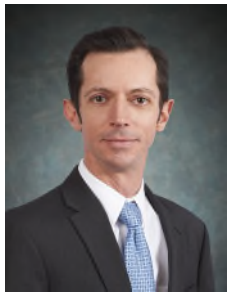
- Franchisee of restaurants in Texas brought claims under California state law
- Contract had a California choice of law provision, and the franchisor was located in California
- Court dismissed the California Franchise Relations Act claim, which only applies to franchisees domiciled, or franchised businesses operating, in California
- However, the California Unfair Practices Act claim did not contain a similar territorial requirement

Universal Property Services Inc. v. Lehigh Gas Wholesale Services, Inc., 2021 WL 118940 (D.N.J. Jan. 13, 2021)

- Lease and supply agreement choice of law provisions did not cover noncontractual claims
  - It read: "This Contract shall be governed by and construed in accordance with the laws of . . ."
- Choice of law provision in franchise agreement did apply to noncontractual tort claims
  - It applied to "this Agreement and the relationship between Franchisor and Franchisee"

Questions?

Contact Us



Samuel Butler

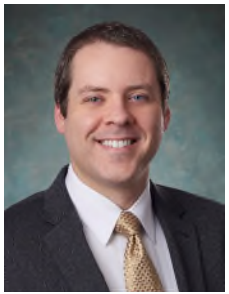
202.295.2246

Samuel.butler@lathropgpm.com

Maisa Frank

202.295.2209

maisa.frank@lathropgpm.com



Richard Landon

612.632.3429

richard.landon@lathropgpm.com