Franchise: 2023 Year in Review

Maisa Frank
Jason Johnson
Richard Landon

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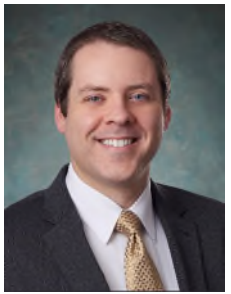
Lathrop GPM

Presenters

Maisa Frank

Partner
Washington, D.C.
Franchise & Distribution



Richard Landon

Partner
Minneapolis, MN
Litigation & Dispute Resolution

Jason Johnson

Associate
Minneapolis, MN
Franchise & Distribution

Legal updates available at:

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Topics Overview

- Antitrust Issues
- Application of State Franchise Laws
- Forum/Venue
- Employment Issues
- Good Faith and Fair Dealing
- Arbitration

Antitrust Liability for Franchisors

- No Poach Agreements
  - Seventh Circuit revives McDonald's class action claims because district court jettisoned per se theory too early
  - District court questions class certification in proposed Papa Johns settlement

- Real Estate Broker Commission litigation
  - Industry disrupting win for home sellers accusing Real Estate Broker Franchisors and National Association of Realtors (NAR) of conspiring to inflate broker commissions
  - Franchisors held liable for requiring franchisees to become members of NAR

No-Poach Agreements

- **Deslandes v. McDonald's USA, LLC** (7th Cir. 2023)
  - Before 2017, McDonald's franchise agreements included no-poach provisions barring franchisees from hiring another franchisee's employees for six months.
  - Two former employees brought class action suit claiming these agreements unreasonably restrained trade in violation of Section 1 of the Sherman Act.
- **July 2021**: Trial court denied class certification, concluding rule of reason analysis, rather than per se, was required.
  - in the context of a franchise system, anti-poaching provisions could be considered ancillary to agreements and serve pro-competitive purposes under full examination.
  - labor markets, particularly for QSR restaurants, are inherently localized. In markets where there were other competitors for labor, a single-system restraint could have little effect.
- **June 2022**: McDonald's granted judgment on the pleadings

Deslandes v. McDonald's USA, LLC . . . *continued*

- **August 2023**: Seventh Circuit rejected ruling that no-poach clauses were “ancillary” to franchise agreements
- More rigorous review of facts necessary before per se standard can be disregarded
- Seventh Circuit proposed various questions courts might consider in determining if a no-poach clause promotes output:
  - e.g., was the restraint protecting the franchise’s investment in training, why did the restrictions have a national scope, why did the restrictions last for six months after employment instead of a period linked to the time it would take to recoup investment, how does the restriction relate to McDonald’s rationale of preventing “free riding.”
  - court remanded to the district court to consider these questions with the benefit of discovery, noting that the classification of a restraint as ancillary is an affirmative defense, not something plaintiffs must anticipate in their complaint

No Poach Agreements

- **In re Papa John's Employee and Franchisee Employment Antitrust Litig.** (D. Ky. Sep. 15, 2023)
- **July 2022**: parties sought judicial approval of $5 million settlement
  - claimed that anti-poaching provisions previously included in franchise agreements had the effect of unlawfully restraining competition among employers for workers and, thus, lowering wages.
  - were nearing the point at which the court would decide on potential class certification
  - settlement would provide approximately $33 to each class member, although less would be due to class members who had entered into arbitration agreements in connection with their employment
- **Sept 2023**: Court refused to rubber stamp settlement in preliminary certification of class
  - raised fundamental questions about the nature of the claim and its fit within established antitrust and economic principles
  - directed the plaintiff to provide additional information to allow proper consideration of the factors specified in Fed. R. Civ. P. 23.

Burnett v. Nat'l Ass'n Of Realtors, (W.D. Mo.)

- Filed in 2019 on behalf of home sellers in Missouri
  - The plaintiffs are a group of individuals who had sold their homes through a Multiple Listing Service (MLS) and who believed that they had paid inflated commissions to their real estate brokers.
- Real Estate agents who use the MLS collect commission from the seller as part of sale price. Brokers who are members of the National Association of Realtors (NAR) are required to use the MLS.
- Plaintiffs allege that having seller pay both agents artificially inflates the commissions and claims that the NAR's MLS requirement is part of a conspiracy between NAR and four broker franchisors to stifle competition in violation of antitrust laws.

Burnett v. Nat'l Ass'n Of Realtors . . . *continued*

- Franchisors and NAR moved for summary judgment, arguing there was insufficient evidence of a conspiracy between them.
  - Allegation was that the association's code of ethics may inflate broker commissions
  - Franchisors did not specifically reference the sharing of commissions, but required participation in NAR or adherence to code of ethics
- **December 2022**: Court denied summary judgment; concluded that requirement to participate in NAR could constitute "direct evidence" that created at least a material dispute of fact regarding conspiracy to maintain cooperative compensation agreement, even if independent business judgment was an alternative explanation for the decision.
- **October 2023**: Jury finds defendants liable and awards $1.8 billion in damages
  - Industry disruptive result, will change how commissions have been structured for over a century if allowed to stand
  - Currently briefing post-trial motions, and likely 8th Cir. appeal to follow

Application of State Franchise/Dealer laws

- **Does the MFA apply to non-Minnesota franchisees?**
  - MFA applies to sales or offers to sell that occur in Minnesota
  - Out of state Franchisees frequently argue the statute applies if the “sale” originated from Minnesota franchisor
- **LG2, LLC v. Am. Dairy Queen Corp.** (D. Minn. Jan. 12, 2023) - District of Minnesota holds assignment of franchise does not constitute a “sale” under the Minnesota Franchise Act
  - LG2 was an Oklahoma Dairy Queen that had acquired a 1962 franchise agreement in 2019, after various assignments over the years
  - LG2 wanted to move the franchise to a new location, but DQ required a new franchise agreement to do that
- LG2 alleged a breach of the original franchise agreement and violation of the MFA
- Court held MFA did not apply because assignment was not a “sale” and Oklahoma franchisee didn’t have other right to invoke the law

Indirect Franchise Fees

- **Cognex Corp. v Air Hydro Power LLC** (D. Mass. Sept. 8, 2023)
  - Distributor alleged violations of Indiana Franchise Act after manufacturer notified it would not renew distribution agreement
  - Court dismissed the claim because distributor wasn't a franchise under the act
  - Purchase of demonstration equipment, payment of software licensing fees, cost to hire and train employees, cost to build demonstration facilities were all sunk costs furthering business goals, not a fee required for right to serve as franchisee

Choice of Forum/Venue

- ***Kava Culture Franchise Grp. v. Dar-Jkta Enters. LLC***, 2023 WL 3568598 (M.D. Fla. May 18, 2023)
  - Franchisor sued in federal court seeking to enforce noncompete covenants in two franchise agreements
  - Forum-selection clause required litigation in Lee County Court in Fort Meyers, Florida
  - District Court sua sponte dismissed the matter for *forum non conveniens*
  - The court recognized there is a "long-approved practice of permitting a court to transfer a case *sua sponte*" under the doctrine so long as the parties are first given the opportunity to present their views on the issue.

Choice of Forum/Venue

- ***Kava Culture Franchise Grp. v. Dar-Jkta Enters. LLC***, (continued)
  - Court provided opportunity for briefing, rejecting arguments against dismissal
  - Defendants argued forum-selection clauses were fraudulently obtained or illegal
    - Defendants later abandoned this argument
    - Even if *Franchise Agreements* were somehow void and unenforceable, that would not impact validity of *forum-selection* clause
  - Plaintiff did not meet its burden to show that any public-interest consideration weighs in favor of retaining the case or that dispute was the exceptional case that should overrule a forum-selection clause
  - One of three Defendants was not a party to the Franchise Agreements
    - Keeping the case against the non-signatory would be "peak of judicial inefficiency and a waste of judicial resources."
    - Franchisor nevertheless permitted leave to file amended complaint against the nonsignatory if it wishes to pursue what may be "financially costly, piecemeal litigation" for the same overarching issue

Choice of Forum/Venue

- ***Singh v. Wireless Vision, LLC*, 2023 WL 2752584 (E.D. Cal. Mar. 31, 2023)**
  - Plaintiff paid $10,000 good faith deposit and signed written T-Mobile Operator Agreement
  - Plaintiff spent more than $160,000 purchasing equipment and building store in California
  - Plaintiff received commissions for sales of T-Mobile service contracts
  - Ameritel assigned Operator Agreement to Wireless Vision
  - Wireless Vision terminated Operator Agreement in 2022 without providing a reason
  - After Plaintiff sued, Defendants removed to federal court and moved to transfer to Eastern District of New York pursuant to forum-selection clause in Operator Agreement

Choice of Forum/Venue

- ***Singh v. Wireless Vision***, (continued)
  - Court noted that "Federal law governs the validity of a forum-selection clause"
  - Plaintiff argued Operator Agreement was a franchise agreement, and forum-selection clause was void under the California Franchise Relations Act (CFRA)
  - Under the CFRA, "[a] provision in a franchise agreement restricting venue to a forum outside this state is void with respect to any claim arising under or relating to a franchise agreement involving a franchise business operating within this state." Cal. Bus. & Prof. Code § 20040.5
  - Court concluded Operator Agreement established a franchise under CFRA
    - Franchisee fee paid (good faith deposit and other payments were unrecoverable investments in the franchisor paid for the right to enter the agreement)
    - Operated business pursuant to franchisor's trademark
    - Granted right to engage in the business of selling goods or services under marketing plan prescribed by franchisor
  - Because the CFRA voids any provision in a franchise agreement restricting venue to a forum outside of California, the court declined to enforce the clause in a motion to transfer under 28 U.S.C. § 1404

Choice of Forum/Venue

- ***Hofbrauhaus of America, LLC v. Oak Tree Mgmt. Servs., Inc.***, 2023 WL 24179 (D. Nev. Jan. 3, 2023)
  - Hofbrauhaus is a Nevada-based franchisor
  - Oak Tree is a Missouri Corporation with a franchised brew pub located in Illinois
  - First Franchise Agreement in December 2014
  - Second Franchise Agreement in February 2017
    - Illinois choice of law and Illinois forum-selection clause
  - Third Franchise Agreement in January 2018
    - Nevada choice of law and Nevada forum-selection clause
  - Oak Tree allegedly defaulted on its obligations by mid-2019

Choice of Forum/Venue

- ***Hofbrauhaus v. Oak Tree Management Servs.***, (continued)
  - In December 2019, upon motion from Oak Tree's lender, court in St. Louis appointed receiver to take over business operations of Oak Tree
  - St. Louis court stayed Hofbrauhaus from terminating Franchise Agreement
  - Hofbrahaus sued in Nevada in March 2022, contending Franchise Agreement expired by its terms
  - Hofbrauhaus asserted claims for:
    - Breach of Contract
    - Trademark Infringement
    - Trade Dress Infringement
    - Copyright Act violations

Choice of Forum/Venue

- ***Hofbrauhaus v. Oak Tree Management Servs.,*** (continued)
  - Oak Tree moved to dismiss for lack of jurisdiction or transfer to Illinois
  - Nevada court rejected jurisdictional arguments
    - Subject matter jurisdiction in light of federal claims
    - Personal jurisdiction over Oak Tree because it had minimum contacts with Nevada
    - Abstention based on state court proceedings inappropriate - copyright claim is exclusive jurisdiction of federal court
  - Nevada court transferred to Southern District of Illinois because brewpub was in Illinois, the likelihood of consumer confusion was in Illinois, and an Illinois court was best positioned to order and enforce injunctive relief if appropriate
  - Court relied on broad "interest of justice" language in 28 U.S.C. 1404(a): "For the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought or to any district or division to which all parties have consented."

Choice of Forum/Venue

- ***Hofbrauhaus v. Oak Tree Management Servs.***, (continued)
  - Court made no determination on validity of forum-selection clause; no choice of law analysis
  - Court referenced Illinois Franchise Disclosure Act, which provides that any provision in a franchise agreement that designates jurisdiction or venue outside of Illinois is void
    - Hofrbrahaus argued IFDA is preempted, but court declined to address the issue
    - Court observed Illinois has a strong interest policy interest in protecting franchisees like Oak Tree
  - No mention by court or parties of Supreme Court decision *Atlantic Marine Constr. Co. v. U.S. Dist. Ct. for W. Dist. Tex.*, 571 U.S. 49 (2013).
    - A valid forum-selection clause will control in all but the most exceptional cases.
    - Valid forum-selection clause changes the 1404 analysis – parties' private interest weigh entirely of preselected forum

Employment – Franchisees Classification

- ***Haitayan v. 7-Eleven, Inc.***, 2022 WL17547805 (9th Cir. Dec. 9, 2022)
  - Four franchisees brought putative class action, alleging 7-Eleven misclassified franchisees as independent contractors
  - In brief opinion, Ninth Circuit affirmed ruling that franchisees are not employees of 7-Eleven
  - District court should have applied the "ABC Test" introduced by California Supreme Court in *Dynamex Operations West v. Superior Court,* 4 Cal.5th 903 (2018).

  - ABC Test codified into law by passage of Assembly Bill 5

  - Under ABC Test, presumption that a worker is an employee, unless an employer can demonstrate:
    A. The worker is free from direction and control in the performance of services; and
    B. The worker is performing work outside the usual course of the business of the hiring company; and
    C. The worker is customarily engaged in an independently established trade, occupation, or business.

Employment – Franchisee Classification

- ***Patel v. 7-Eleven, Inc.***, 81 F.4th 73 (1st Cir. 2023)
  - For second time, First Circuit certifies question to Massachusetts Supreme Court
  - Franchisees filed suit alleging violations of Massachusetts' Independent Contractor Law (ICL), Wage Act, and Minimum Wage Law.
  - After district court ruling in favor of 7-Eleven, First Circuit certified the following question of law to the Massachusetts Supreme Court:
    - Whether the three-pronged test for independent contractor status set forth in the ICL applies to the relationship between a franchisor and its franchisee, where the franchisor must also comply with the FTC Franchise Rule.
  - Massachusetts Supreme Court concluded that the ICL applies to franchisor-franchisee relationships and does not conflict with the FTC's franchise rule.

Employment – Franchisee Classification

- ***Patel v. 7-Eleven, Inc.***, (continued)
  - On remand, district court concluded the three-prong test under the ICL was not met because franchisees did not establish threshold inquiry that they were "performing any services" for 7-Eleven, but instead pay franchise fees in exchange for a variety of services to support the franchisees
  - On appeal, First Circuit certified the following question to the Massachusetts Supreme Court:
    - Do Plaintiffs "perform any service" for 7-Eleven within the meaning of the Massachusetts Independent Contractor Law, where, as here, they perform various contractual obligations under the Franchise Agreement and 7-Eleven receives a percentage of the franchisee's gross profits?
  - Massachusetts Supreme Court has yet to answer the certified question.

Employment – Franchisor as Joint Employer

- ***Fernald v. JFE Franchising, Inc.***, 2023 WL 2938312 (W.D. Tenn. April 13, 2023)
  - Granted motion to dismiss claims that franchisor was liable for workplace mass shooting by franchisee
  - Franchisee operated a Snowfox sushi restaurant inside of grocery store
  - After dispute with grocery store manager, franchisee returned and began indiscriminately shooting persons in the store
  - Under Tennessee Code Section 50-1-208, "[N]either a franchisee nor a franchisee's employee shall be deemed to be an employee of the franchisor for any purpose"
  - No vicarious liability claims were asserted, only claims based on joint employer liability

Employment – Franchisor as Joint Employer

- ***Acuff v. Dy N Fly LLC***, 2023 WL 3293278 (E.D. Mich. May 5, 2023)
  - Court denied franchisor's motion to dismiss claims of sexually-hostile work environment and retaliatory termination at franchised units
  - Applied economic realities test, considering: (1) control, (2) payment of wages, (3) hiring and firing, and (4) responsibility for discipline
  - Allegations created a plausible inference that the franchisor shared or codetermined matters governing terms and conditions of employment
  - Disclaimer in franchise agreement not a decisive factor at the pleading stage, yet the court considered HR policies in the franchise brand manual.

Employment – Franchisor as Joint Employer

- ***Goodwill v. Anywhere Real Estate***, 2023 WL 4034372 (D. Me. June 15, 2023)
  - Court granted franchisor's motion to dismiss claims that franchisor was liable for its franchisee's alleged age discrimination
  - Court considered the "economic reality" and totality of the circumstances
  - Franchisor did not exercise control over hiring, payment, advertising of job opening, or conduct of new employee orientation

Employment – NLRB Joint Employer Rule

- The National Labor Relations Board announced its final rule on October 26, 2023
- New rule replaces regulation requiring companies to have “direct and immediate” control over workers in order to be considered joint employers
- Under new rule, two or more entities may be considered joint employers if they directly or indirectly control—*regardless of whether that direct or indirect control is exercised*—one or more of the employees’ essential terms of employment.
- New rule takes an expansive, non-exhaustive view of “essential” terms, including:
  - (1) wages, benefits, and other compensation; (2) hours of work and scheduling; (3) the assignment of duties to be performed; (4) the supervision of the performance of duties; (5) work rules and directions governing the manner, means, and methods of the performance of duties and the grounds for discipline; (6) the tenure of employment, including hiring and discharge; and (7) working conditions related to the safety and health of employees.
- Rule originally set to take effect in December 2023, but **implementation delayed** until February 26, 2024

Employment – Challenges to NLRB Joint Employer Rule

- Potential Legislative Repeal
  - Under Congressional Review Act, Congress may repeal agency rules through a majority vote in both houses
  - The US House of Representatives, on January 12, 2024, voted 206-177 in favor of a measure to reject the NLRB joint employer rule
  - A simple majority vote in the Senate is required to approve the measure
  - President Biden has signaled he would veto the measure if approved by the Senate

- Litigation Challenges
  - A coalition of major business groups, including the International Franchise Association, have initiated litigation seeking to enjoin the NLRB joint employer rule
  - *Chamber of Commerce of the USA v. NLRB*, 6:23-cv-0053 (E.D. Tex. Nov. 9, 2023)

Good Faith and Fair Dealing

- *Kazi v. KFC US, LLC*, 2023 WL 4983119 (10th Cir. Aug. 4, 2023)
  - Franchisee alleged several claims, including breach of contract and breach of the implied covenant of good faith and fair dealing, arising from alleged encroachment.
  - All claims but the good faith and fair dealing claim were dismissed.
  - A jury found in favor of the franchisee on the good faith and fair dealing claim and awarded a $792,239 verdict.
  - The 10th circuit reversed. It held that breach of the implied covenant must be based on a specific contract provision. The alleged breach in this case – violation of the impact policy – did not arise from a specific contract provision.

Good Faith and Fair Dealing

- *Pinnacle Foods of Cal. v. Popeyes La. Kitchen*, 2022 WL 17736190 (S.D. Fla. Dec. 16, 2022)
  - Franchisee alleged that Popeye's violated the implied covenant of good faith and fair dealing because it (1) failed to evaluate Pinnacle's proposed new restaurant sites under the same criteria it used in other markets, and (2) terminated Pinnacle's exclusivity provision.
  - The court dismissed both claims finding that the first was duplicative of a breach of contract claim, and the second contained no allegations that Popeye's improperly exercised its discretion.
- *Hyundai Subaru of Nashville v. Hyundai Motor Am., Inc.*, 2023 WL 2201015 (M.D. Tenn. Feb. 24, 2023)
  - The dealer alleged violations of the Automobile Dealer's Day in Court Act and the implied covenant of good faith and fair dealing when Hyundai rejected the dealer's proposed relocation sites and attempted to coerce the dealer into selling its dealership.
  - The court declined to grant Hyundai's motion to dismiss, finding that the dealer sufficiently plead coercion giving rise to a good faith and fair dealing claim.

Arbitration

- *Doe v. Massage Envy Franchising, LLC*, 2022 WL 17984107 (Cal. Ct. App. Dec. 29, 2022)
  - Customer signed Terms of Use agreement at franchised location. The court determined this did not constitute an agreement to arbitrate claims against franchisor.
  - Recent decision out of Sixth District Court of Appeal reached opposite conclusion, finding the Terms of Use were an enforceable clickwrap agreement. *Doe #1 v. Massage Envy Franchising, LLC*, 2023 WL 8801517 (Ca. Ct. App. Dec. 20, 2023).

- *Goergen v. Black Rock Coffee Bar, LLC*, 2023 WL 1777980 (D. Or. Feb. 6, 2023)
  - The court found nonsignatory owners were not subject to an arbitration provision. They were not properly designated as principals bound under the franchise agreement, and the court declined to find they were agents or third-party beneficiaries who could be bound by the agreement to arbitrate in the franchise agreement.

Arbitration

- *Passion for Restaurants, Inc. v. Villa Pizza, LLC*, 2022 WL 18024209 (D.N.J. Dec. 30, 2022)
  - The franchisee filed an arbitration against the franchisor, and the franchisor did not pay its portion of the fees as required by the arbitration agreement.
  - When the franchisee, Passion, declined to pay the franchisor's portion of the arbitration fees, the arbitration was dismissed.
  - Passion then sued Villa Pizza to compel arbitration.
  - The court dismissed the lawsuit finding that the arbitration rules permit the termination of a proceeding if the deposit isn't paid, and determining that procedural matters concerning the nonpayment of arbitration fees fall within the discretion of the arbitrator.

Arbitration

- Two cases held that fraudulent inducement claims can be arbitrated, notwithstanding a Tennessee law stating otherwise:
  - *Lunt v. Frost Shades Franchising, LLC*, 2023 WL 3484202 (M.D. Tenn. May 16, 2023)
  - *B&P Glass Mirror, LLC v. Clozetivity Franchising, LLC*, 2023 WL 3484205 (M.D. Tenn. May 16, 2023)
- Franchise systems owned by same principals who failed to disclose in the FDDs their involvement with certain litigation relating to prior franchise law violations.
- Franchisees argued that their fraudulent inducement claims were not subject to arbitration under Tennessee state law.
- Court held it was "well-established that, '[w]hen state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA.'"

Arbitration

- One case declined to enforce arbitration provision:
  - *Munoz v. Earthgrains Distribution, LLC*, 2023 WL 5986129 (S.D. Cal. Sept. 13, 2023)
    - Court found a dispute resolution provision contained in distribution agreements between a large bakery and independent distributors had no mutual assent and was procedurally and substantively unconscionable.

- One case declined to stay litigation while arbitration was pending:
  - *Breadeaux's Pisa, LLC v. Beckman Bros. Ltd.*, 2023 WL 6801149 (8th Cir. Oct. 16, 2023)
    - Court found the franchisor's claims did not fall within the stay provision in Section 3 of the FAA because Section 3 is generally understood to allow a defendant, not a plaintiff, to stay litigation.
    - Court also found that Breadeaux acted inconsistently with its right to arbitrate, waiving that right, which constituted a default under Section 3 of the FAA.

Questions?

Contact Us

Maisa Frank

202.295.2209
maisa.frank@lathropgpm.com

Richard Landon

612.632.3429
richard.landon@lathropgpm.com

Jason Johnson

612.632.3414
jason.johnson@lathropgpm.com