Franchise: 2024 Year in Review

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Lathrop GPM

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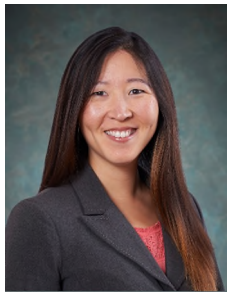

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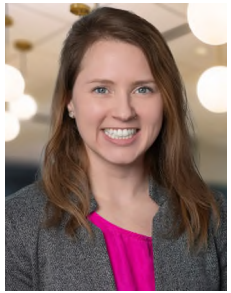

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Topics Overview

- Arbitration
- Enforcement of Noncompetes
- Antitrust Issues
- Application of State Franchise Laws
- Human Trafficking Cases
- Bankruptcy Issues

Arbitration

2024 in Franchising & Arbitration

- Two SCOTUS opinions
  - Stays in court when arbitration is ordered
  - The “transportation worker” exception to the Federal Arbitration Act.

- Notable district court decision – what arbitration awards may courts review?

Stays Pending Arbitration

- *Smith v. Spizzirri*, 144 S. Ct. 1173 (2024).
- SCOTUS: When the FAA says “shall stay,” it means “shall stay.”
- Unanimous opinion overturning Circuit precedent permitting district courts to dismiss rather than stay a suit after determining all claims are subject to arbitration.

Stays Pending Arbitration – ctd.

- Section 3 of the FAA: when a dispute is subject to arbitration, a district court **"shall on application of one of the parties stay the trial of the action** until [the] arbitration has been had."

- “[T]he use of the word 'shall' 'creates an obligation impervious to judicial discretion.’”

- Dismissal without prejudice is not a "stay."

- The FAA anticipates that the parties can return to federal court if the arbitration breaks down- a stay aligns with this statutory language, dismissal does not.

“Transportation Worker” FAA Exception

- *Bissonnette v. LePage Bakeries Park St., LLC*, 601 U.S. 246 (2024).
- Plaintiff franchisees filed putative misclassification class action in federal court.
- Defendants moved to compel arbitration pursuant to Plaintiffs’ distributor agreements.
- District Court compelled arbitration, concluding Plaintiffs were not included in the “transportation worker” exception to the FAA.

“Transportation Worker” FAA Exception – ctd.

- Second Circuit agreed – twice.

- *Southwest Airlines Co. v. Saxon*, 596 U.S. 450 (2022).
  - The "transportation worker" exception hinged not on the employer's industry, but the work performed by the worker.

- SCOTUS: we meant what we said in *Saxon*.
  - Held: a transportation worker need not work in the transportation industry to fall within the "transportation worker" exemption. The question is whether a worker plays a "direct and necessary role in the free flow of goods across borders."

What is a “final award” per the FAA?

- *Subway Franchise Sys. of Canada, ULC v. Subway Devs. 2000, Inc.*, 2024 WL 3090480 (S.D.N.Y. June 21, 2024).
- FAA & the New York Convention.
- 50% interim payments.
- Arbitrator ordered Subway to make the payments, Subway refused.
- Arbitrator’s order was a “final” order capable of review.
- Order “finally and conclusively disposed of a separate and independent claim.” Specifically, that claim was "who would possess certain money during the pendency of the arbitration."

Non-competes

2024 in Franchising & Non-competes

- The FTC crackdown on non-competes

- Circuit & district court approaches to non-competes

The Attempted FTC Crackdown on Non-competes

- April 2024 – final rule passed.
- Slated to go into effect in fall 2024.
- Would bar non-competes for all workers except “senior executives.”
- Would not apply to non-competes between franchisors and franchisees, nor to non-competes associated with the sale of a business.

The Attempted FTC Crackdown on Non-competes – ctd.

- *Ryan, LLC v. Fed. Trade Comm'n*, 2024 WL 3879954 (N.D. Tex. Aug. 20, 2024).
- APA action.
- Rule prohibited from going into effect nationwide.
  - No statutory authority for substantive rule.
  - Issuance of rule was “arbitrary and capricious.”
- What now?
  - Fifth Circuit Appeal.
  - New FTC composition.

Non-competes in Court in 2024

- Overall, alive and well.
- Trend: blue-penciling the geographic scope of non-competes.
- *Baldwin v. Express Oil Change, LLC*, 87 F.4th 1292 (11th Cir. 2023).
  - Georgia Restrictive Covenants Act
  - Blue-penciled the restrictive covenant for a former franchisee employee
  - Original: no involvement in automotive service businesses in the entire state of Georgia and Alabama, or a five-mile radius of any of the 1,100 automotive repair or service facility business operated by franchisor.
  - Court's reworked covenant: only prohibited involvement in automotive service businesses within five mile radius of stores former employee had previously overseen.

Non-competes in Court in 2024 – ctd.

- *GPI, LLC v. Patriot Goose Control Inc.*, 2024 WL 1704731 (D.N.J. Apr. 18, 2024).
  - Original: prohibited franchisee from engaging in any post-termination business involving waterfowl control within 150 miles of franchisee's former territory or any other franchisee's territory for two years.
  - As agreed: prohibited franchisee from engaging in any border-collie facilitated goose control business within 50 miles of franchisee's territory for two years.

- *LeTip World Franchise, LLC v. Long Island Social Media Group LLC*, WL 380985 (D. Ariz. Feb. 1, 2024).
  - Original: No involvement in similar businesses in franchisee's former territory or any territory of any other franchisee for two years.
  - As reworked: No involvement in similar businesses in franchisee's former territory for two years.

Antitrust

Antirust – Tying Arrangements

- ***In re Harley-Davidson Aftermarket Parts Marketing, Sales Practices, and Antitrust Litig.***, No. 23-MD-3064, 2024 WL 2846349 (E.D. Wis. June 5, 2024)
  - Motorcycle Purchasers alleged antitrust tying violations based on Harley-Davidson's bundle of motorcycle with 24-month limited warranty
    - No Magnuson-Moss Warranty Act violation because HD said use of non-authorized parts *may* void warranty, but did not say it *will* void warranty
    - No Sherman Act violation because HD has not tied the sale of motorcycles to parts
      - Warranties are not sold as a separate product and don't constitute type of economic coercion that constitutes a tie

Antirust – Tying Arrangements, Boycotts

- ***Tiz, Inc. v. Southern Glazer's Wine and Spirits LLC.***, No. 23-CV-1648, 2024 WL 2785142 (N.D. Ill. May 30, 2024)
  - Online platform helped retailers communicate orders to alcohol distributors for fulfillment
  - Defendants are large wine and distilled spirit distributors that stopped accepting orders placed through plaintiff's platform
  - Complaint alleged (1) Monopolization, (2) Horizontal and Vertical Conspiracy, and (3) Tying
    - Monopolization plausibly alleged in relevant markets, exclusive dealing was sufficiently exclusionary
    - Horizontal conspiracy plausibly alleged because of parallel conduct and plus factors (refused Provi orders against self interest, opportunity to conspire in concentrated market, departure from established practice of accepting Provi orders)
    - Vertical conspiracy plausibly alleged because allegations stated retailers were coerced to forgo Provi orders
    - Tying plausibly alleged because Defendants had power with exclusive rights to certain brands to coerce retailers to use second product, e-commerce services

State Franchise Laws

State Franchise Laws – Unfair Competition/Deceptive Practices

- **Washington v. National Maintenance Contractors, LLC**, No. 21-2-04554-1 (Wash. Sup. Ct. Nov. 1, 2024)
  - Washington Attorney General brought claims against franchisor of janitorial services in connection with the marketing, sale, and operation of franchises within Washington
  - Washington Consumer Protection Act claims dismissed
    - Meant to target conduct that has capacity to deceive a substantial portion of the public, but franchisor/franchisee communications were not public advertisements with a capacity to deceive a substantial portion of the public
    - Requires conduct that has an impact on public interest, but this dispute was characterized as a private matter involving a limited group of people: NMC franchisees.
  - Franchise Investment Protection Act claims dismissed
    - No genuine fact issues regarding untrue statements of material fact or omissions

State Franchise Laws – No Private Right of Action

- ***Benjamin Franklin Franchising SPE LLC v. David Michael Plumbing Inc.***, No. 2:24-cv-10286, 2024 WL 3997056 (E.D. Mich. Aug. 29, 2024)
  - Franchisee alleged violation of MFIL § 445.1527(c), which voids any franchise agreement "provision that permits a franchisor to terminate a franchise prior to the expiration of its term except for good cause."
  - Claim ultimately dismissed because MFIL § 445.1534 foreclosed any implied right of action: "Except as explicitly provided in this act, civil liability in favor of any private party shall not arise against a person by implication from or as a result of the violation of a provision of this act or a rule or order hereunder."
    - 1990 Sixth Circuit precedent made an "*Erie* guess" that Michigan courts would imply a private right of action.
    - 1997 Michigan court of appeals concluded that legislature expressed its clear intent in MFIL § 445.1534, which was not considered by Sixth Circuit

State Franchise Laws – Application to Foreign Franchises

- ***Cambria Co. v. M&M Creative Laminants, Inc.***, 11 N.W.3d 318 (Minn. 2024)
  - M&M counterclaim alleged Cambria unlawfully terminated franchise agreement under Minnesota Franchise Act
    - First question was whether the MFA applied to out-of-state company alleging franchise relationship
      - Some provisions of MFA contain an explicit territorial limitation
      - Nothing in MFA § 80C.14 indicated intent by legislature to only let Minnesota franchisees enforce protection
    - Ultimately, no franchise relationship existed between Cambria and M&M because no franchise fee was paid
      - A business relationship is a “franchise” if
        - (1) the parties had an agreement by which the franchisee has the right to sell the goods or services of the franchisor using the franchisor's name or trademark;
        - (2) the franchisor and franchisee had “a community of interest” in marketing the goods or services, and
        - (3) the franchisee paid, “directly or indirectly,” a “franchise fee.”
      - Required fabrication services fell under exclusion for purchase of goods at a bona fide wholesale price

State Franchise Laws – Other Cases

- ***Scion Hotels LLC v. Holiday Hospitality Franchising LLC***, 2024 WL 4224580 (D.N.J. Sept. 18, 2024)
  - Allegations that franchisor violated New Jersey Franchise Practices Act barred by franchisee's execution of a franchise agreement with a competitor after entering but before concluding its license agreement

- ***Brava Salon Specialists, LLC v. REF N. Am., Inc.***, 2024 WL 3443799 (W.D. Wis. July 16, 2024)
  - WFDL claims did not extend to sales in Florida
  - Dispute of material fact precluded resolution of claim that new requirements for dealers were a substantial change to competitive circumstances

Human Trafficking Cases

Trafficking Victims Protection Reauthorization Act

- Amended in 2008 to add civil liability for those who knowingly “benefit, financially or by receiving anything of value, from participation in a venture . . .” that involves the use of force, fraud, or coercion to cause a person to engage in a commercial sex act.
  - Receiving revenue from the rental of hotel rooms is understood to amount to receiving a financial benefit.
- Many cases have been filed against hotel franchisees and franchisors relating to hotels at which individuals allege they were trafficked.
- Legal precedent for franchisor liability is still very much developing.

Human Trafficking Cases – Motion to Dismiss

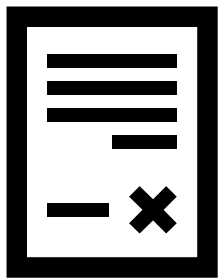
- *Doe (K.B.) v. G6 Hosp., LLC*, 2023 WL 8650785 (N.D. Ga. Dec. 14, 2023)
  - Plaintiff claimed she was trafficked at a hotel owned by a Motel 6 franchisee.
  - Court dismissed claims against Motel 6, plaintiff failed to allege a venture between franchisor and the traffickers, and franchisor didn't have knowledge of the alleged trafficking.
  - Court also found franchisor did not exercise sufficient control to be vicariously liable for franchisee's actions.
  - Claims against the franchisee under the TVPRA went forward.

Human Trafficking Cases – Summary Judgment

- *J.M. v. Red Roof Inns, Inc.*, 2024 WL 4534479 (E.D. Cal. Oct. 21, 2024)
  - Plaintiff brought claims against franchisor of Red Roof Inns hotel under theories of perpetrator liability, beneficiary liability, and vicarious liability.
  - On summary judgment, court dismissed all claims.
    - Insufficient evidence that hotel employees knew about trafficking and reported it to franchisor.
    - No evidence franchisee informed the franchisor about the trafficking.
    - No agency relationship or control over day-to-day operations for vicarious liability.
- *S.C. v. Wyndham Hotels & Resorts, Inc.*, 2024 WL 1429114 (N.D. Ohio Apr. 2, 2024)
  - Plaintiff brought claims against franchisor under beneficiary liability and vicarious liability theories.
  - Court granted summary judgment to franchisor on all claims.
    - No evidence of franchisor participation in a sex trafficking venture. Franchisor never interacted with the trafficker and franchisors were removed from hotel operations.
    - No franchisor control over the daily operations of the hotel.s

Human Trafficking Cases - Indemnification

- *A.S. v. Red Roof Inns, Inc.*, 2024 WL 5245123 (S.D. Ohio Dec. 30, 2024)
  - Plaintiff brought sex-trafficking claims against franchisor Red Roof Inns.
  - Franchisor, Red Roof Inns, filed third party complaint against franchisee asserting various claims for indemnification and contribution under the franchise agreement and the common law.
  - Plaintiff moved to strike the common law claims and sever and stay the remaining claims.
  - Court held the TVPRA does not "expressly provide a cause of action for contribution or indemnification," and it granted motion to strike the federal common law contribution and indemnification claims.
  - Court declined to stay state law claims, as they had sufficient overlap with plaintiff's claims.



Bankruptcy

Bankruptcy Issues

- *In re: Empower Cent. Michigan, Inc.*, 2024 WL 1848504 (Bankr. E.D. Mich. Apr. 26, 2024)
  - Franchisee of Auto Lab Complete Care Care Center, filed Chapter 11 bankruptcy petition and stated intent to reaffirm its franchise agreement.
  - Later tried to reject agreement but continue to operate as independent auto repair shop.
  - Franchisor objected and argued that the non-compete and confidentiality agreements were non-executory, and so could not be rejected.
  - The court agreed as to both.

Bankruptcy Issues, ctd.

- *In re Pinnacle Foods of California LLC*, 2024 WL 4481070 (Bankr. E.D. Cal. Oct. 10, 2024)
  - Franchisee of six Popeyes Louisiana Kitchen franchise agreements sought to assume the agreements as part of plan of reorganization.
  - Popeyes opposed the motion.
  - Court applied hypothetical test under Ninth Circuit law and determined that the Lanham Act and California Franchise Relations Act were both applicable laws that would excuse Popeyes from accepting performance from certain third parties under certain situations.
  - Thus, the franchisee could not assume the franchise agreements without Popeyes' consent.

Bankruptcy Issues, ctd.

- *JTH Tax LLC, d/b/a Liberty Tax Service v. Lowensky Cortorreal*, 2024 WL 3928884 (E.D. Va. Aug. 23, 2024)
  - Franchisor filed complaint against former frasnchisees alleging unlawful competition, including under the Defend Trade Secrets Act.
  - Franchisees moved to dismiss claiming actions were stayed by Canadian bankruptcy proceeding involving JTH Tax.
  - Virginia court concluded stay only applied to actions against JTH Tax, and did not prevent it from asserting claims against other parties.

Questions?

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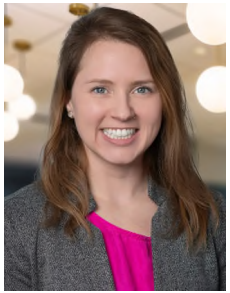

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