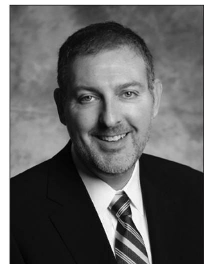
Franchising & Distribution Currents

Kevin Shelley, Briar Siljander & Larry Weinberg

ANTITRUST

Mr. Shelley

Mr. Siljander


Mr. Weinberg

***Turner v. McDonald's USA, LLC*, Bus. Franchise Guide (CCH) ¶ 16,641, 2020 WL 3044086 (N.D. Ill. Apr. 24, 2020)**

The United States District Court for the Northern District of Illinois denied McDonald's' motion to dismiss an antitrust case brought by an employee of a McDonald's franchisee who alleged that McDonald's violated the Sherman Act by agreeing with its franchisees not to hire each other's employees or each other's former employees for a period of six months after employment (so-called "no-hire" clauses). This case is interesting because these no-hire clauses have received substantial public attention and debate recently, leading many franchise systems to discontinue their use.

In this case, the plaintiff, Stephanie Turner, alleged that McDonald's violated the Sherman Act by inserting such no-hire clauses in its McDonald's franchise agreements with its franchisees. Plaintiff alleged that the no-hire clause in her employer's franchise agreement caused her wages to be depressed, such that she was paid less than she would have been paid absent the no-hire clause in the franchise agreements. In its motion to dismiss, McDonald's argued that the plaintiff lacked Article III and antitrust standing and that the plaintiff's claim was barred by the statute of limitations.

Turning to the Article III standing issue, the court noted that the United States Constitution limits a federal court's jurisdiction to cases and controversies, such that a plaintiff must have (1) suffered an injury in fact (2) that is fairly traceable to the challenged conduct of the defendant, and (3) that is likely to be redressed by a favorable judicial decision. Here, the plaintiff alleged that she suffered reduced wages due to the no-hire clause. Specifically, she alleged that the fact that she could not even apply for other positions at other McDonald's restaurants contributed to downward pressure on her wages with her employer, as she could not use a competing offer to negotiate for better wages. She thus

alleged that the restraints constrained competition among McDonald's restaurants and caused her wages to be depressed during her employment.

McDonald's argued that the plaintiff cannot have been injured by the no-hire clause unless she applied for and was rejected on account of the no-hire policy. The court quickly rejected this argument, concluding that the plaintiff's allegation that she suffered depressed wages—that is, the wages that she was actually paid were less than the wages she would have been paid absent the allegedly unlawful no-hire policy—and the loss of those wages was a sufficient injury in fact. Next, McDonald's argued that the depressed wages could not confer standing in this case because such depressed wages are not fairly traceable to the alleged antitrust violation. Again, the court quickly dismissed this argument and concluded that the plaintiff's causation allegations were plausible due to basic principles of economics: if fewer employers compete for the same number of employees, wages will be lower than if a greater number of employers are competing for those employees. The plaintiff's allegation that she suffered injury was, therefore, fairly traceable to McDonald's alleged antitrust violation. Thus, the court concluded that the plaintiff adequately alleged Article III standing by alleging the no-hire agreement depressed her wages.

Turning to the antitrust standing argument, the court noted that a plaintiff asserting an antitrust claim must prove antitrust injury, which is to say injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendant's act unlawful. The injury should reflect an anticompetitive effect either of the violation or of anticompetitive acts made possible by the violation.

Here, the plaintiff alleged injury to competition, namely the injury of depressed prices (wages) to sellers (employees) due to anticompetitive behavior of buyers (employers). In conformity with Seventh Circuit precedent, the court concluded that the plaintiff an alleged antitrust injury in this case. As an aside, the court cited two other federal district courts in Ohio and Kentucky that had recently concluded that a plaintiff had antitrust standing to bring claims arising from similar no-hire or no-poach agreements.

Turning to the statute of limitations issue, the court denied McDonald's motion to dismiss the plaintiff's claim under the applicable four-year statute of limitations set forth in 15 U.S.C. ¶ 15b. The court noted that the period of limitations for antitrust litigation runs from the most recent injury caused by the defendant's activities, rather than from the violation's inception. Thus, each time a plaintiff is injured by an act of the defendant, the cause of action accrues to him to recover the damages caused by that act, and, as to those damages, the statute of limitations runs from the commission of the act. In other words, in this case, each time the plaintiff was paid a depressed wage for her labor, she was injured, and the four-year statute of limitations for that injury began. Failure to comply with the statute of limitations is an affirmative defense, and the court may not dismiss on the basis of an affirmative defense unless the plaintiffs alleges the elements of the affirmative defense.

Because the plaintiff alleged that she was paid a depressed wage for her labor as recently as one year prior to the filing of the complaint in August 2019, plaintiff had not alleged or omitted the ingredients of defendant's statute of limitations affirmative defense, and, as a result, the court denied McDonald's motion to dismiss on statute of limitations grounds.

ARBITRATION

Aguilera v. Matco Tools Corp., Bus. Franchise Guide (CCH) ¶ 16,617, 2020 LEXIS 43283 (S.D. Cal. Mar. 12, 2020)

The U.S. District Court for the Southern District of California issued a preliminary injunction to prevent a franchisor from arbitrating claims against franchisees on the basis that the franchisees were likely to prevail in voiding the arbitration and venue provisions of their franchise agreements.

The dispute began with two franchisees filing a class action in California Superior Court in December 2018, alleging that they and similarly situated franchisees were misclassified by Matco Tools Corporation (Matco) as independent contractors and thus were entitled to expense reimbursements, wage statements, overtime pay, meal and rest breaks, and other wages. The franchisees also alleged that Matco made unlawful deductions from their wages and that Matco engaged in unfair business practices and usury. The franchisees concurrently filed a Notice of Intention to pursue a private attorney general action (PAGA) based on the same misclassification argument. The state court case was removed to the United States District Court for the Northern District of California. Two months later, in March 2019, the parties agreed to dismiss the lawsuit without prejudice after Matco filed a motion seeking to dismiss the lawsuit or transfer it to the Northern District of Ohio, where Matco's principal place of business is located.

While the state court case was pending, on January 29, 2019, a different franchisee (the Fleming Franchisee) filed a putative class action against Matco. *Fleming v. Matco Tools Corp.*, Bus. Franchise Guide (CCH) ¶16,418, 384 F. Supp. 3d 1124 (N.D. Cal. 2019). On May 3, 2019, the court in the *Fleming* case held that the arbitration and forum selection clauses at issue (which were materially equivalent to those in the *Aguilera* case) were unenforceable because the arbitration provision encompassed PAGA claims and contained a non-severability provision which prevented the carving out from arbitration only the PAGA claims. Since the arbitration provision was thus voided by its terms, the *Fleming* court held that the forum selection clause was voided by California law, which was not, in the absence of an enforceable arbitration agreement, superseded by the Federal Arbitration Act. Matco's petition for writ of mandamus with the Ninth Circuit was denied, as was a subsequent petition for rehearing *en banc*. The United States Supreme Court also denied Matco's Petition for a Writ of Certiorari on May 26, 2020.

On March 25, 2019, the day before the California Superior Court entered the stipulated order dismissing the franchisees' complaint, Matco filed a

petition in the Northern District of Ohio, seeking to compel the franchisees to arbitrate any claims arising from their distribution agreements, including those claims that were dismissed by stipulation in the California Superior Court. Then, in June 2019, Matco filed separate claims in arbitration with the American Arbitration Association in Ohio against the same franchisees, alleging that the franchisees failed to pay their promissory notes to Matco. One of the franchisees unsuccessfully contested the validity of the arbitration provisions contained in the distribution agreements in the arbitration and the other franchisee's challenge remained pending.

In August 2019, the franchisees filed their complaint in the United States District Court for the Southern District of California, seeking to enjoin both arbitration proceedings in Ohio and to declare the arbitration and venue provisions in the distribution agreements void and unenforceable. The complaint also alleged that Matco's efforts to enforce the arbitration and venue provisions violated California's unfair competition laws.

Matco filed a motion to dismiss the litigation in October 2019, alleging that (1) its filing of the writ of mandamus to the Ninth Circuit and its filing in the Northern District of Ohio warranted dismissal or stay of the case; (2) based on the distribution agreements, the arbitrator, and not the court, was supposed to decide arbitrability; (3) the franchisees' claims based on the California Unfair Competition Law (UCL) failed for lack of standing; and (4) the doctrine of *forum non conveniens* warranted dismissal or transfer.

In December 2019, the franchisees sought a preliminary injunction and then, in January 2020, a temporary restraining order (TRO) to enjoin Matco from pursing its arbitrations in Ohio. The court issued the TRO in January 2020.

In March 2020, the court issued its order granting in part and denying in part Matco's motion to dismiss the franchisees' claims and granting the franchisees' motion for preliminary injunction, enjoining the franchisor from arbitrating its claims against the franchisees. The court agreed with Matco that the franchisees did not state a claim under the UCL to the extent that the UCL claim related to Matco's filing of the petition to enforce arbitration in the Northern District of Ohio or for restitution (since no funds were received by Matco). The court could find no authority to enjoin the proceedings in the Northern District of Ohio. However, the court denied the balance of Matco's motion to dismiss. Regarding Matco's argument that the case should be dismissed because Matco had first filed the writ of mandamus with the Ninth Circuit and the petition to enforce arbitration in the Northern District of Ohio, the court disregarded application of the first-to-file rule because it found that Matco's petition in the Northern District of Ohio was filed in anticipation of another lawsuit to be filed by the franchisees. As to Matco's argument that the arbitrator should decide whether the agreement to arbitrate was enforceable, the court— noting that the strong federal policy favoring arbitration does not extend to deciding questions of arbitrability—determined that the parties did not clearly agree that issues of arbitrability would be decided by the arbitrator. Despite the fact that the

arbitration provision incorporated the American Arbitration Association's (AAA) rules, which provide for the arbitrator to determine arbitrability, the court noted that the franchisees were not sophisticated and did not, by incorporating the AAA rules, manifest a clear intent to delegate to the arbitrator the question of arbitrability.

Regarding the franchisees' request for a preliminary injunction, the court determined that the franchisees were likely to succeed in voiding the arbitration and venue provisions in the distribution agreements. Because Matco's writ for certiorari to the United States Supreme Court was pending at the time of its order, the court did not base its ruling on collateral estoppel resulting from the decisions in the *Fleming* case. It did, however, find that the Ninth Circuit's ruling on Matco's writ of mandamus was persuasive.

Even if collateral estoppel did not apply, the court noted, the franchisees demonstrated a likelihood of success on the merits. The arbitration provision at issue contained the following "blow-up provision": "If the provision prohibiting classwide or private attorney general arbitration is deemed invalid, then the provision requiring arbitration of breaches between the parties shall be null and void and there shall be no obligation to arbitrate such breaches." The court first cited to well-established Ninth Circuit law for its position that the PAGA waivers in the franchise agreements were invalid and, because they were invalid, the franchise agreement's "blow-up provision" nullified any requirement to arbitrate.

The court also found that the forum selection clause was likely invalid under California Business and Professions Code section 20040.5. Again citing to the *Fleming* case, the court determined that it was likely the forum selection clause requiring litigation outside of California would not be enforced. Notably, as the court in *Fleming* discussed, and the Ninth Circuit affirmed, because the arbitration provision was void and unenforceable, the FAA did not preempt California law invalidating the forum selection clause. The court, with ease, then found that the franchisees would suffer irreparable harm if arbitration were permitted and that the balance of the hardships and consideration of the public interest strongly favored the franchisees. Closing out the matter, the Northern District of Ohio dismissed Matco's petition to compel arbitration for lack of standing. In short, PAGA claims may not be made subject to arbitration, and an arbitration provision that does not permit severability of PAGA claims from its arbitration agreement will result in a franchisor being required to litigate against its franchisees in California.

***Billie v. Coverall North America, Inc.*, Bus. Franchise Guide (CCH) ¶ 16,619, 2020 WL 1185251 (D. Conn. Mar. 12, 2020)**

The United States District Court for the District of Connecticut denied a janitorial service franchisor's motion to dismiss a complaint filed against it by two franchisees on jurisdictional and substantive grounds, but granted the franchisor's motion to stay the action and refer the dispute to arbitration pursuant to arbitration agreements in the franchisees' franchise agreements.

Plaintiffs Caribe Billie and Quincy Reeves commenced an action against Coverall North America, Inc. (CNA), alleging that CNA misclassified them as independent contractors and withheld portions of plaintiffs' wages in violation of Connecticut law. The complaint alleged that CNA employed workers to perform cleaning work for commercial customers and that CNA required its workers to sign janitorial franchise agreements in order to obtain work. Plaintiffs signed franchise agreements with R&B Services, Inc. d/b/a Coverall of Connecticut & Westchester (R&B), a CNA franchisee operating in the Connecticut area. The complaint alleged that, pursuant to these franchise agreements, CNA and R&B exercised considerable control over the plaintiffs' work, including determining what amount to be charged to the customer and the amount paid to the cleaning workers. The complaint further alleged that the plaintiffs were classified as independent contractors and paid sums of money as franchise fees in order to obtain cleaning work and that the plaintiffs were required to pay both initial and ongoing fees to R&B, a portion of which was passed directly to CNA. The complaint alleged that CNA misclassified the plaintiffs as independent contractors and withheld portions of the plaintiffs' wages in violation of section 31-71e of the Connecticut General Statutes. CNA filed a motion to dismiss the action pursuant to Rule 12(b)(2) for lack of personal jurisdiction or Rule 12(b)(6) for failure to state a claim. Alternatively, CNA requested an order staying the action and compelling arbitration.

After reviewing the applicable standards under Rules 12(b)(2) and 12(b)(6), along with the Federal Arbitration Act, the court first addressed CNA's motion to dismiss for lack of personal jurisdiction. The personal jurisdiction question is subject to a two-part inquiry. First, the district court must determine whether the state law permits the court's exercise of jurisdiction over the defendant. Second, the district court must assess whether the court's assertion of jurisdiction under these laws comports with the requirements of due process.

Connecticut's long-arm statute, section 33-929(f) of the Connecticut General Statutes, permits exercise of personal jurisdiction over a foreign corporation in actions arising out of any contract made in Connecticut or to be performed in Connecticut. CNA argued that this prong of the long-arm statute was inapplicable because it is not a party to the franchise agreements at issue. However, the court noted that CNA derives significant benefit from the franchise agreements between plaintiffs and R&B—agreements that CNA itself drafted. Indeed, the court noted that CNA's motion to stay the action and compel arbitration is based upon arbitration provisions in these very same franchise agreements. Thus, based on CNA's significant benefit arising from the franchise agreements that it drafted, plaintiffs made a *prima facie* showing that CNA is subject to the jurisdiction of this court under the Connecticut long-arm statute.

The second part of the inquiry, due process, requires the satisfaction of three conditions for the exercise of specific jurisdiction over a non-resident

defendant. First, the defendant must purposely avail itself of the privilege conducting activities within the forum state or have purposely directed its conduct into the forum state. Second, the plaintiff's claim must arise out of or relate to the defendant's forum conduct. And finally, the exercise of jurisdiction must be reasonable under the circumstances.

The court found that the plaintiffs had plausibly alleged facts sufficient to satisfy these conditions. First, the plaintiffs alleged that CNA had sufficient contacts and that the plaintiffs' claims arose out of CNA's forum conduct. As a result, the court concluded that the assertion of personal jurisdiction was reasonable and comported with fair play and substantial justice such that the due process component of the personal jurisdiction analysis was satisfied. As a result, the court denied CNA's motion to dismiss pursuant to Rule 12(b)(2) for lack of personal jurisdiction.

The court next addressed CNA's motion to dismiss the case for failure to state a claim under Rule 12(b)(6). Specifically, CNA argued that the plaintiffs' claim should be dismissed because CNA had "no connection" to any of the unlawful fees and deductions alleged in the complaint. The court summarily denied this motion, finding that the plaintiffs had plausibly alleged that they were employees of CNA and that, therefore, the deductions and fees allegedly implemented and collected by CNA violated Connecticut wage laws. CNA attempted to avoid liability by noting that CNA was not a party to the franchise agreements and that the plaintiffs' fee obligations were to R&B, not CNA. However, such payments were made pursuant to contract terms drafted by CNA, and CNA's contract with R&B made clear that a portion of the fees paid by the plaintiffs to R&B were passed on directly to CNA. As a result, because the plaintiffs plausibly alleged that they were employees of CNA and that the deductions and fees allegedly implemented and collected by CNA violated Connecticut wage laws, CNA's motion to dismiss for failure to state a claim was denied.

Finally, the court turned to CNA's motion to compel arbitration, based on the arbitration provisions in the plaintiffs' respective franchise agreements entered into with CNA's franchisee R&B. After summarizing applicable provision of the Federal Arbitration Act (FAA), the court noted that, when determining whether to compel arbitration pursuant to the FAA, a court looks to four factors: (1) whether the parties agreed to arbitrate their dispute; (2) whether the asserted claims fall within the scope of the arbitration agreement; (3) whether Congress intended the federal statutory claims asserted by the plaintiff, if any, to be non-arbitrable; and (4) if the court concludes that some, but not all, of the claims in the case are arbitrable, it must then decide whether to stay the remaining claims pending arbitration. Only the first two factors and the defense of unconscionability were in dispute in this case.

As to the first factor, whether the parties agreed to arbitrate, the court applied Connecticut law. Although CNA was not a party to the franchise agreement containing the arbitration provision, the court concluded that,

under Connecticut law, a third party can enforce a contractual right where contractual terms demonstrate that the intent of the parties to the contract was that the promisor should assume a direct obligation to the third party. The court reviewed the language of the arbitration provisions and concluded that the parties agreed to arbitrate this dispute and that the plaintiffs' claims fell within the scope of their arbitration obligations. Specifically, the court concluded that the contractual terms evidenced the parties' intent to include CNA within the scope of the plaintiffs' arbitration obligation.

Second, the court summarily dismissed the plaintiffs' contention that CNA's motion to compel was premature because the issue of class certification had not yet been decided by the court. The court disagreed, finding that because both plaintiffs asserting the claims had signed a contract with an arbitration provision, the motion to compel was not premature. Third, the court addressed the central challenge to the enforceability of the arbitration provisions and specifically the delegation clause (i.e., the provision which provided that the parties agreed to arbitrate "gateway" questions of arbitrability, including whether the arbitration agreement is unconscionable) therein: whether the agreement was unconscionable.

As an initial matter, the court concluded that based on the delegation provision, the plaintiffs cannot challenge the validity of the arbitration provisions as a whole in this action; such challenges were reserved for the arbitrators. However, the court addressed the plaintiffs' unconscionability arguments solely with respect to the delegation clause.

The court began its analysis with a recitation of the law of Connecticut: "The classic definition of an unconscionable contract is one which no man in his senses, not under delusion would make, on the one hand, and which no fair and honest man would accept, on the other." *Smith v. Mitsubishi Motors Credit of America, Inc.*, 721 A.2d 1187, 1190 (Conn. 1998). Substantive unconscionability focuses on the content of the contract, as distinguished from procedural unconscionability, which focuses on the process by which the allegedly unfair terms found their way into the agreement.

As to procedural unconscionability, the plaintiffs contended that the provisions were void because the delegation clause was adhesive, was not explained to the plaintiffs, and was obscure and buried in the franchise agreements. However, the court noted that, as a matter of Connecticut law, the court cannot deem the delegation clause to be unconscionable based solely on the adhesive nature of the contract and the unequal standing of the parties. Thus, the plaintiffs' contention that the delegation clause was the subject of unequal bargaining power or was hidden in the three- or four-page franchise agreements was insufficient. Instead, under Connecticut law, a court cannot find procedural unconscionability unless the party opposing enforcement has introduced some specific evidence of overreaching by the other party in the formation of the agreement. In short, because the plaintiffs' claim that the delegation clauses were buried in the form franchise agreements was not supported by the record and the remaining claims

(relating to the adhesive nature of the contract and the parties' unequal bargaining power) were legally insufficient. As a result, the plaintiffs' claim of procedural unconscionability failed as a matter of law.

Because the court determined that Connecticut law was not clear concerning whether a contract must be both procedurally and substantively unconscionable to be voided, the court considered the plaintiffs' assertions regarding substantive unconscionability of the delegation provisions despite the absence of procedural unconscionability. The plaintiffs argued that the delegation clauses were substantively unconscionable because (1) they contained a cost-splitting provision; (2) they contained a provision requiring the losing party to pay the prevailing party's attorneys fees; and (3) they contained a confidentiality provision. The court initially noted the lack of controlling authority concerning these arguments but that it was nonetheless guided by the well-established rules defining unconscionability in *Smith*.

First, the plaintiffs argued that the cost-splitting provisions rendered the delegation clauses substantively unconscionable. The plaintiffs asserted that the requisite arbitration filing fees would prevent the plaintiffs—janitorial workers of modest means—from vindicating their rights (the so-called "effective vindication" doctrine). However, the court concluded that the effective vindication doctrine did not apply in this context and, in any event, the plaintiffs failed to meet their burden of establishing substantive unconscionability as to the cost-sharing provision because they failed to provide evidence in the record before the court as to the fees likely to be incurred and as to the plaintiffs' financial situations. As a result, the court concluded that, based upon the record before it, any costs beyond the initial filing fee were, at that point, speculative and that the evidence did not otherwise support the conclusion that the cost-sharing provision rendered the delegation clause substantively unconscionable.

Second, the plaintiffs argued that the fee-shifting provision that required the losing party to pay the prevailing party's attorney's fees was substantively unconscionable. Again, faced with the lack of controlling Second Circuit or Connecticut precedent, the court declined to conclude that the fee-shifting provision was substantively unconscionable.

Third, the plaintiffs argued that the confidentiality provision in the franchise agreements were substantively unconscionable. The plaintiffs argued that the confidentiality obligation provided CNA with a "repeat player" advantage where the plaintiffs would be left ignorant of any favorable decisions by other cleaning workers that successfully challenged the validity of the agreement or other threshold issues. However, the court noted that the single case cited by the plaintiffs for this proposition had been overturned, with the appellate court ruling noting that the California Court of Appeals had rejected the policy argument that such confidentiality provisions inhibited employees from discovering evidence from each other. The court further concluded that the policy argument considering confidentiality provision unconscionability was likely foreclosed by the Supreme Court in

AT&T v. Concepcion, 563 U.S. 333 (2011), in which the court stated: "The point of purporting parties' discretion in deciding arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute. It can be specified, for example, that the decision maker be a specialist in the relevant field, or that proceedings be kept confidential to protect trade secrets." *Id.* at 345. The court concluded that the confidentiality clause did not render the agreement substantively unconscionable.

As a result, the court granted CNA's motion to compel arbitration.

ATTORNEYS FEES

Chong v. 7-Eleven, Inc., Bus. Franchise Guide (CCH) ¶ 16,613, 2020 LEXIS 39402 (E.D. Pa. Mar. 4, 2020)

The U.S. District Court for the Eastern District of Pennsylvania granted 7-Eleven, Inc.'s (7-Eleven) motion for summary judgment, dismissing all of the franchisee's claims and awarding damages of nearly $160,000 plus interest and costs for the franchisor's counterclaims.

The franchisee, which operated two stores in the 7-Eleven system for twenty-one years, sued the franchisor after its franchise agreements were terminated for alleged inaccurate transaction reporting. The franchisee claimed that the termination was in bad faith and alleged an assortment of claims, including breach of contract, breach of the covenant of good faith and fair dealing, unconscionability, unjust enrichment, impracticability, conversion, and fraud. The franchisor filed a motion to dismiss and a counterclaim, alleging breach of contract by the franchisee for underreporting merchandise sales. At 7-Eleven's request, the court stayed certain of the franchisee's breach of contract claims, which were required to be arbitrated pursuant to the franchise agreements. The court subsequently dismissed two of the franchisee's breach of contract claims and its claims for impracticability, unconscionability, and fraud. The parties separately stipulated to dismissal of additional breach of contract and conversion claims alleged by the franchisee, leaving only two claims for breach of contract and the claim for breach of the covenant of good faith and fair dealing against the franchisor, as well as 7-Eleven's counterclaim against the franchisee for breach of contract. 7-Eleven moved for summary judgment of the franchisee's remaining claims and its counterclaim.

In the first of the two remaining breach of contract claims, the franchisee alleged 7-Eleven failed to treat it as an independent contractor because 7-Eleven required the franchisee to sell certain products that the franchisee did not order and 7-Eleven interfered with the franchisee's management of its employees by communicating directly with them. The franchisee pointed to language in the franchise agreement wherein the franchisee agreed to "control the manner and means of the operation of the Store" and "to exercise complete control over and responsibility for all labor relations and the conduct of [the franchisee's] agents and employees." The court, however, disagreed, finding that the plain language of the franchise agreement section

cited by the franchisee placed no duties or obligations on 7-Eleven and that the franchisee could not, as it attempted, create an affirmative obligation for 7-Eleven by equitable estoppel. The court further stated that interpreting the independent contractor-related provisions of the franchise agreements in the manner urged by the franchisee would require completely disregarding direct language in the franchise agreements that permitted 7-Eleven to require the franchisee to carry and sell the inventory specified by 7-Eleven. The court also determined that 7-Eleven's employees were not prohibited from talking with the franchisee's employees and the testimony did not otherwise show that 7-Eleven attempted to control the franchisee's employees.

In its second remaining breach of contract claim, the franchisee alleged that the franchisor failed to maintain the franchisee's HVAC equipment despite repeated requests. In dismissing the claim, the court noted that the franchise agreement only required the franchisor to maintain the HVAC equipment when the franchisor determined that it needed to be maintained. Since the court was not convinced that the franchisor subjectively believed maintenance was required, no breach could be sustained. The court's decision may have been aided by evidence that the franchisor had previously replaced and maintained the HVAC system. Nonetheless, responding to the franchisee's claim that the franchisor had an obligation to exercise its discretion in good faith, the court cited prior district court decisions in the Third Circuit refusing to extend the duty of good faith in the franchise context, beyond decisions by a franchisor to terminate a franchisee, and dismissed the claim.

The court next addressed the franchisee's claim that 7-Eleven terminated the franchise agreements in bad faith, violating the covenant of good faith and fair dealing. Reviewing the testimony and evidence, the court found that the franchisee had significantly understated its merchandise sales and therefore underpaid royalties. On this basis, the court determined that 7-Eleven had the right to, and appropriately terminated, the franchise agreements. Based on the same evidence, the court entered judgment in favor of 7-Eleven on its counterclaims against the franchisee and its guaranteeing principal for underpaid royalties of nearly $160,000, with instructions for the parties to submit evidence to support an award for interest and costs, including attorneys fees.

CHOICE OF FORUM

***Aguilera v. Matco Tools Corp.*, Bus. Franchise Guide (CCH) ¶ 16,617, 2020 LEXIS 43283 (S.D. Cal. Mar. 12, 2020)**

This case is discussed under the topic heading "Arbitration."

***CajunLand Pizza v. Marco's Franchising*, Bus. Franchise Guide (CCH) ¶ 16,615, 2020 LEXIS 40944 (E.D. La. Mar. 10, 2020)**

The U.S. District Court for the Eastern District of Louisiana granted the franchisor's motion to transfer a lawsuit filed by an area developer who also operated six franchise locations in Louisiana.

The case stemmed from allegations by the area developer that the franchisor, after approving the sale of the franchise locations, requested that the area developer sell to a different party and, ultimately, revoked its approval of the sale, causing it to fall through.

Opposing the franchisor's motion to transfer the case to the Northern District of Ohio, where the franchisor was based, the area developer argued that, despite a broad and enforceable forum selection clause, its claims against the franchisor were not based on the franchise agreements; rather, the area developer's claims related to its agreement with a third-party purchaser of its franchise locations and the franchisor's tortious interference with that agreement.

The court disagreed, finding that the broad forum selection clause (applying to "any action" between the parties) encompassed the area developer's claims and was valid and enforceable. The court quoted the Supreme Court's decision in *Atlantic Marine Construction Co. v. United States District Court*, 571 U.S. 49, 60 (2013), stating that "a valid forum-selection clause controls the *forum non conveniens* inquiry '[i]n all but the most unusual cases." Noting that the presence of the forum-selection clause precluded consideration of private-interest factors in a U.S.C. § 1404 transfer analysis, the court briefly reviewed the five public-interest factors and determined that only one (the local interest in having localized controversies decided at home) might have weighed in favor of not transferring. It did not create the sort of "extraordinary circumstance" necessary to override the parties' forum-selection clauses.

***Lakeside Surfaces, Inc. v. Cambria Co.*, Bus. Franchise Guide (CCH) ¶ 16,618, 2020 WL 1227047 (W.D. Mich. Mar. 13, 2020)**

This 2020 case from the U.S. District Court for the Western District of Michigan addressed a forum selection clause dispute. The court granted the defendant's motion to dismiss the complaint for failure to state a claim. The court's decision turned on a forum-selection clause agreed to by the parties in their Business Partnership Agreements (BPA). This clause, which also appeared in the credit agreement between the parties, designated Minnesota as the proper forum for any and all claims and disputes arising out of the agreement. The plaintiff wanted the case to be heard in Michigan, thus subjecting the parties to the Michigan Franchise Investment Law (MFIL), which requires good cause before termination of a franchise agreement. However, the plaintiff did not plead any of the necessary considerations to strike a forum-selection clause, and the court dismissed the case on this ground.

The plaintiff, Lakeside Surfaces, Inc. (Lakeside), is a Michigan corporation that sells and fabricates quartz, stone, and other solid-surface countertops. The defendant, Cambria Company, LLC (Cambria) is a Minnesota company that manufactures and sells its own brand of quartz countertops. Cambria approached Lakeside in 2011 to enter into an agreement to make Lakeside one of their "Lexus Partners." This plan required Lakeside to meet several conditions: first, to maintain a broad customer base; second, to have

a sales history averaging two truckloads of Cambria product per month; and third, the ability to fabricate at least 10,000 square feet of Cambria product monthly. Among several other terms in the agreement, Lakeside agreed to maintain eighty percent of its business offering Cambria countertops, to advertise only Cambria on its trucks, to employ at least two full-time Cambria-specific salespeople, to have personnel attend Cambria's training in Minnesota, and to "purchase more than $50,000 in 'Cambria point of sales materials' per year."

The relationship between the parties was lucrative for some time. In 2017, Lakeside constructed a $1,000,000 design gallery with Cambria's branding, and a $6,000,000 facility capable of fabricating 50,000 square feet of Cambria slabs per month. This work was allegedly done with the expectation that Cambria would designate Lakeside as the sole provider of Cambria products in Michigan. However, the relationship disintegrated in January 2018 after Cambria learned of Lakeside offering its customers a new quartz product, Aurea Stone. Cambria effected a unilateral termination of the relationship, telling Lakeside that "supplying other quartz is an immediate termination of our partnership as well understood." Lakeside alleges that this unilateral termination caused significant harm to its reputation because Cambria cancelled orders for 120 slabs of quartz, leaving Lakeside with $500,000 worth of unfulfilled customer orders.

Lakeside's claimed (1) breach of the BPA and its implied covenant of good faith and fair dealing; (2) failure to comply with the MFIL by committing fraud under Michigan Compiled Laws § 445.1505(c) by "deceitfully encourag[ing]" Lakeside to build the new facility; (3) failure to disclose the information required by Mich. Comp. Laws § 445.1508 for the sale of a franchise; (4) breach of good faith and reasonable notice of termination required by *§ 2-309* of the Uniform Commercial Code; and (5) promissory estoppel. Lakeside wanted to have the case decided in Michigan rather than Minnesota because of the protection granted under the MFIL, requiring good cause for termination of a franchise agreement. After a discussion of the applicable dismissal standard, the court explained its reasons for dismissal based on the forum-selection clause.

The basis for Cambria's motion to dismiss was that Lakeside had executed an enforceable forum-selection clause in the BPA. The Credit Agreement between the parties provided that: "This agreement shall be governed by and construed in accordance with the laws of the State of Minnesota. Any proceeding involving this Agreement and/or any claims or disputes relating to the agreements and transactions between the parties shall be in the District Court of Le Sueur County, State of Minnesota." The forum-selection clause is particularly broad and encompassed "all of Lakeside's claims because they all 'relate to' the agreements and transactions between the parties." The court noted that it is also a mandatory, not permissive, clause, meaning the action *must* be brought in the named court. The court rejected Lakeside's argument that the forum-selection clause was invalid under Michigan law based on

two considerations: first, federal law, not state law, "governs the enforceability of a forum-selection clause in these proceedings," and second, the parties contractually agreed to the forum-selection clause. The court concluded that the forum-selection clause was therefore valid and enforceable.

In determining whether the forum selection clause was enforceable under federal procedural law, the court looked at three factors: (1) whether the clause was obtained by fraud, duress, or other unconscionable means; (2) whether the designated forum would ineffectively or unfairly handle the suit; and (3) whether the designated forum would be so seriously inconvenient such that requiring the plaintiff to bring suit there would be unjust. The court noted that none of these factors was addressed in Lakeside's briefs, and therefore Lakeside had not overcome the burden of proving unenforceability of the forum-selection clause.

The court looked at the *Restatement (Second) of Conflict of Laws*, Michigan's authority on choice of law, to decide whether to enforce the forum selection clause. Section 127 (a) of the *Restatement* states that the parties' choice of law will govern unless there is no substantial relationship to the parties and their agreement. The court rejected this outright, because the plaintiff had no problem sending their employees to Minnesota for training.

Section 127 (b) of the *Restatement* says that the chosen forum will govern unless the application of the law would be contrary to a fundamental policy of a state that has a materially greater interest than the chosen state. The court concluded that the MFIL represents the public policy of Michigan, and Michigan has a materially greater interest over protection of its franchisees, but applying Minnesota law would not be contrary to Michigan's fundamental public policy. The plaintiff failed to show that it would suffer from substantial loss of protection by applying Minnesota law instead of Michigan law. The court noted that the only substantial difference between the Minnesota Franchise Act (MFA) and the MFIL is that the MFIL prohibits the use of the forum selection clause—in all other regards, the MFA offers *more* protection.

The plaintiff claimed that being subject to Minnesota law would "deprive it of a meaningful remedy" because the MFA does not apply to out-of-state franchisees. The text of the MFA, however, indicates that that it *does* apply to out of state franchisees, and no Minnesota state court has held the contrary. The court held that only one provision of the MFA (the anti-waiver provision) is expressly limited to franchisees located in Minnesota. Using the plain meaning of the MFA's text, the court concluded that it was not the legislature's intention that it should not apply to out-of-state franchisees.

A final consideration on whether the BPA was governed by Minnesota Law was whether the forum-selection agreement was obtained under unequal bargaining power and, therefore, contrary to Michigan's public policy. The court noted that the parties were similar in bargaining power when the contract was signed—the evidence suggested that Cambria considered

Lakeside a successful business partner. Therefore, no inherent Michigan public policy reason existed to invalidate the forum-selection clause.

Citing *Atlantic Marine Construction Co. v. United States Dist Court*, 571 U.S. 49, 52 (2013), the court held that the proper way to dismiss the case was through the doctrine of forum non-conveniens, since the court was unable to transfer it to another state court. As Lakeside, the party acting in violation of the forum-selection clause, was unable to demonstrate any public interest factors that overwhelmingly disfavor dismissal per *Atlantic Marine*, the claim was dismissed in order to properly enforce the forum-selection clause of the BPA.

The court specifically noted that it made no comment as to whether Lakeside's claim had a reasonable chance of success.

CHOICE OF LAW

***Aguilera v. Matco Tools Corp.*, Bus. Franchise Guide (CCH) ¶ 16,617, 2020 LEXIS 43283 (S.D. Ca. Mar. 12, 2020)**

This case is discussed under the topic heading "Arbitration."

***CajunLand Pizza v. Marco's Franchising*, Bus. Franchise Guide (CCH) ¶ 16,615, 2020 LEXIS 40944 (E.D. La., Mar. 10, 2020)**

This case is discussed under the topic heading "Choice of Forum."

CONTRACT ISSUES

***Chong v. 7-Eleven, Inc.*, Bus. Franchise Guide (CCH) ¶ 16,613, 2020 LEXIS 39402 (E.D. Pa. Mar. 4, 2020)**

This case is discussed under the topic heading "Attorneys Fees."

***Fabius v. Medinexo USA, LLC*, Bus. Franchise Guide (CCH) ¶ 16,629, 2020 LEXIS 59029 (E.D. Mo. Apr. 3, 2020)**

The United States District Court for the Eastern District of Missouri dismissed the majority of claims made by a franchisee of a telehealth franchise system but permitted the franchisee an opportunity to amend the complaint to correct pleading deficiencies.

The franchisee's complaint included claims against the franchisor and its officers for violations of the New York State Franchise Sales Act (NYFSA) and New Jersey Consumer Fraud Act (NJCFA), fraud in the inducement, and breach of contract. The franchisor and its officers filed motions to dismiss, which the court considered concurrently.

The franchisee alleged fraud in the inducement based on statements made by the franchisor at a franchise expo. Applying Missouri law, the court stated that predictions about future profitability and success are not misrepresentations about past or present facts. Therefore, the court ruled that statements by the franchisor's officers that the franchisee would earn approximately $75,000

in the first year and $400,000 in the second year, and would make so much money that it would not want to renew amounted to puffery, not fraudulent misrepresentations, and dismissed that portion of the franchisee's fraud claim.

The franchisee also alleged that it received documents containing specific representations and projections from the franchisor. Because the franchisee's complaint relied on collective, and not specific, allegations, the court dismissed the claim, but granted the franchisee leave to amend the complaint. The franchisor also sought dismissal on grounds that the franchisee in the complaint alleged to have expertise in the industry and conducted extensive due diligence and, as the franchisor argued, therefore could not reasonably rely on the alleged misrepresentations. Although predicting that it might be hard for the franchisee to prove otherwise, the court refused to dismiss the claim because it presented factual issues that were not appropriately decided by a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6).

The court next considered the franchisee's claims for violation of the NYFSA. The court held that whether the NYFSA applied to the franchisee, which was a New York limited-liability company, raised questions of fact that could not be decided at the motion-to-dismiss stage. The court did, however, find that the franchisee did not sufficiently specify how one of the individual officers of the franchisor was implicated, and therefore dismissed the claim as to the officer, granting the franchisee leave to file an amended complaint with allegations particular to the officer. The court also dismissed with leave to amend the franchisee's claim that the franchisor violated New York's franchise registration law's requirements because the franchisee failed to plead how it was damaged.

The court made short work of the franchisee's NJCFA claim, citing to case law stating that it did not apply to franchise sales except for a very narrow exception based on an offering that targeted the general public and required less than a $100 payment. The court dismissed the claim.

Finally, the court dismissed the franchisee's breach of contract claim because the franchisee and its owner did not affirmatively plead, as required by Missouri law, that they had fulfilled their obligations under the franchise agreement. The court, again, granted the franchisee leave to amend its pleadings.

***Real Estate Visionaries v. RE/MAX of New England*, Bus. Franchise Guide (CCH) ¶ 16,642, (Mass. Super. Ct. Apr. 16, 2020)**

This Massachusetts Superior Court case addressed fair dealing and fraudulent inducement. The claims arose in the context of a breakdown of the parties' relationship. The plaintiff franchisee, Real Estate Visionaries, Inc., d/b/a Leading Edge (Leading Edge), operated several Re/Max locations in the Boston area, which were all subject to different expiration dates, per the franchisor's policy. When no contract renewal occurred and the parties were in dispute, the defendant franchisor attempted to recruit agents from some of the franchisee's locations whose franchise agreements had not yet expired. The court found that the defendant franchisor, Re/Max of New England,

Inc. (Re/Max), had breached the parties' franchise agreements and the implied covenant of good faith and fair dealing, as well as having violated the Massachusetts Unfair Trade Practices Act, G.L. c. 93A, §§2 and 11 (Chapter 93A), leading to an award of damages totalling $22,565. The plaintiff's' claims for fraudulent inducement and tortious interference were dismissed, as were the defendant's counterclaim.

The plaintiffs were a franchisee of Re/Max called Leading Edge, and its four owners, Stephen Chuha, Paul Mydelski, Eileen Hamblin, and Linda O'Koniewski. In 2016, they owned nine successful franchised locations in the Boston area, including three "satellite" locations, operated under a total of six franchise agreements per Re/Max's policy to have different agreements govern each location. Each agreement had a term of five years, resulting in staggered expiration dates. At the end of each term, the Franchise Disclosure Document explained that Re/Max may provide for a longer term, or month-to-month renewal. The Re/Max franchise agreements included non-compete clauses: "both (1) an 'in-term' non-compete clause, which barred franchisee/owners from participating in *any* other real estate services, and (2) a 'post-term' non-compete clause, which barred franchisee/owners from participating in any *franchised* real estate brokerage for one year after Re/Max franchise expiration." The post-term non-compete was not included in franchise agreements prior to 2012, and Re/Max had waived this condition several times between 2012 and 2016.

The shift in the business relationship came in 2016, when Leading Edge was considering acquiring several locations affiliated with Hammond realty brokerage. They approached Re/Max to attempt to negotiate a unified termination date for their franchise agreements. Representatives from Leading Edge travelled to Toronto to speak with Re/Max senior representatives regarding the proposed acquisition. They requested a uniform expiration date, removal of the post-term non-compete, and ending the requirement that Leading Edge principals personally guarantee Leading Edge obligations. Despite initially refusing the request, by the meeting's conclusion, Re/Max president Walter Schneider assured Leading Edge that they would "work it out" and to go ahead with their proposed expansion. These requests, however, resulted in mutual hard-bargaining negotiations that lasted from June 2016 to July 2018. Leading Edge tied the renewal of the franchise locations to the request for a unified termination date and the elimination of the post-term non-compete. While Re/Max offered fee reductions and promotional funds to make renewal more attractive, it repeatedly declined to implement a unified termination date and to remove the post-term non-compete. In 2018, after the expiration of the franchise agreements for two Leading Edge franchise locations, Re/Max insisted on its strict contract terms, which prevented Leading Edge from continuing to operate the two expired franchise businesses or opening competing brokerages at these locations while the other franchise locations were still in operation through the in-term non-compete clauses. After a failed attempt at a court injunction, Leading Edge was forced

to cease operations at those locations pending the expiration of the other franchise agreements.

In 2013, Re/Max issued Policy Directive No. 1, which expressly forbade "predatory recruiting activity" between existing Re/Max offices and sales associates. In particular, the Directive discouraged recruiting that "through predatory practices aimed purposefully to induce existing Sales Associates to change their Re/Max office affiliation." On June 26–28, 2018, Re/Max was alleged to have done exactly that: through a mass email and a dinner for other area franchisees that encouraged active recruitment of Leading Edge associates, Re/Max intended to poach as many Leading Edge employees as possible for other Re/Max locations. The court said that since Re/Max's breach was material, Leading Edge's move to terminate performance of the unexpired contracts was within its rights.

The court noted that each independent action by Re/Max would not be actionable, until Re/Max attempted to recruit Leading Edge agents. This illuminated the intent behind the business practices as a whole: Re/Max wanted it to be nearly impossible for former franchisees to conduct business independent of Re/Max. The court noted that, not once during questioning on this point did a Re/Max executive allude to an acceptable scenario where a former Re/Max multi-point franchisee would be able to successfully disengage with Re/Max while still maintaining a lucrative real estate career. The court rightfully surmised that the intent behind the staggered terms and non-compete clauses, then, was to ensure Re/Max's grip over future competition. Taken as a whole, the court found Re/Max's behavior sufficient to warrant an unfair business practice breach under Chapter 93A.

The basis of Leading Edge's claim for fraudulent inducement of the franchise agreements was Item 17(a) of certain Franchise Disclosure Documents, which identified the five-year term and explained that Re/Max *may* provide for an extension. Leading Edge claimed that Re/Max failed to inform Leading Edge that, in reality, Re/Max's position was to deny multi-point franchises longer term franchise agreements or month-to-month extensions. In Massachusetts, to succeed in a claim for fraudulent inducement, the plaintiff must show "misrepresentation of a material fact, made to induce action, and reasonable reliance on the false statement to the detriment of the person relying." Applying this standard to the facts, the court found that Leading Edge's claim did not satisfy the reasonable reliance or causation requirements of fraudulent inducement. This was because the contract term at issue said that Re/Max *may* extend the contract if needed for business expansion purposes, but not that it *must* do so. Because both parties were sophisticated business entities, little evidence suggested that Leading Edge reasonably or in fact relied upon this term. Rather, Leading Edge was aware of the difficulties that the staggered terms and post-term non-compete clauses posed but elected to enter the franchise agreements regardless.

Leading Edge also claimed that Re/Max's failure to consolidate Re/Max promotions with its parent Re/Max in financial statements included in their

Franchise Disclosure Documents constituted fraudulent inducement, with which the court disagreed on the basis that no testimony showed that if the financial statements had been correct, Leading Edge would not have entered into the franchise agreements. Thus, there was no reliance on these terms.

The court then turned to Leading Edge's claims for breach of contract and breach of the implied covenant of good faith and fair dealing. These claims were based on the actions surrounding the four unexpired franchise agreements between June 26–28, 2018. The court agreed with Leading Edge that Re/Max breached the terms of the franchise agreements when it violated its own Policy Directive No. 1 in its efforts to recruit Leading Edge associates to other Re/Max franchised locations. The court noted that there was no dispute that this Policy Directive supplements every franchise agreement and was always intended to constitute a term of contract. The court rejected Re/Max's claim that the Policy Directive does not apply to Re/Max itself, but only to its franchisees, on the basis that it "eviscerates the very protection offered franchisees by the Policy Directive." Re/Max's attempt to point to a contract term that allowed it to contact franchisee agents upon the *termination* of a franchise agreement was likewise rejected, because "termination" and "expiration" of a franchise agreement are treated expressly differently in the contracts themselves. The court concluded that these terms regardless must be interpreted in congruence with Policy Directive No.1 and that any predatory recruiting is therefore prohibited.

The court concluded that Re/Max breached the implied covenant of good faith and fair dealing that exists in each contract, regardless of whether the parties are sophisticated business entities or not. This breach occurred when it recruited Leading Edge sales agents to join other Re/Max franchises, despite the four ongoing franchise agreements between the parties. The court qualified this act as a material breach, thus immediately excusing Leading Edge's continued performance under the remaining franchise agreements. However, the court awarded only limited damages in the amount of $22,565 from losses due to breach of contract and the implied covenant, because the only actual damages caused by the breach were those incurred during a rapid de-identification and rebranding that Leading Edge undertook between June 28 and July 3, 2018. The other costs would have been incurred regardless of whether or not Re/Max committed the material breach.

Next, the court approached the question of tortious interference with contract. Leading Edge claimed that Re/Max's solicitation of its agents constituted tortious interference in its contracts with those agents. To succeed in this claim, the court noted that Leading Edge must prove that (1) they had contracts with a third party; (2) Re/Max knowingly induced Leading Edge agents to break their contracts with Leading Edge; (3) Re/Max's alleged interference, in addition to being intentional, was improper in motive or means; and (4) Leading Edge was harmed by Re/Max's actions. The first and third prongs of this test were met, but the second and fourth were not;

namely, no evidence showed that Re/Max managed to induce any employees to break their contracts with Leading Edge, and the court rejected the inference that the reduction in sales agents was a direct result of their recruitment by Re/Max. Therefore, Leading Edge's claim for tortious interference with contract failed.

Finally, the court undertook an examination of the unfair, deceptive, or anticompetitive conduct claim under Chapter 93(A). The court noted that the statute makes unlawful "unfair methods of competition" and "unfair or deceptive" acts or practices in trade or commerce." This claim was based upon two aspects of Re/Max's conduct: first, that they misrepresented and failed to disclose material facts in their franchise disclosure documents in connection with Leading Edge's franchise agreement renewal; and second, that their contract practices and enforcement towards Leading Edge were in violation of Chapter 93(A). The court disposed of the first claim in the same manner as the fraudulent misrepresentation allegation; there was no proven causation between the loss suffered and Re/Max's conduct. Leading Edge's reliance on the contract term which permitted, but did not oblige, Re/Max to renew franchise agreements was not a sufficient basis for the claim.

However, the court did find that Re/Max's overall course of dealing with their franchisee Leading Edge constituted unfair conduct. The court specifically noted that, taken separately and before the events of late June 2018, no unfair dealing had occurred according to Chapter 93(A). It was not until Re/Max's attempt to solicit Leading Edge's sales agents that their entire business position towards the franchisee was illuminated. The court held that, taken together, the post-term non-compete provision, the staggered franchise agreement expirations, and finally, the attempted poaching of agents, demonstrated Re/Max's practice of making it nearly impossible for a former franchisee to carry on a similarly successful business after ending a relationship with Re/Max. The anti-competitive tactics of Re/Max were found to be unfair commercial conduct in violation of Chapter 93(A). The court attributed the former damages awarded to this claim ($22,565) but also added attorneys' fees for the violation.

The court went on to dismiss Re/Max's counterclaim asking to recover fees and penalties on the basis that Leading Edge breached the franchise agreements and was not entitled to recovery under the unexpired agreements. The court elected not to comment on whether the non-compete agreements were invalid overall because the parties were no longer bound by them.

DAMAGES

***Chong v. 7-Eleven, Inc.*, Bus. Franchise Guide (CCH) ¶ 16,613, 2020 LEXIS 39402 (E.D. Pa. Mar. 4, 2020)**

This case is discussed under the topic heading "Attorneys Fees."

***Fabius v. Medinexo USA, LLC*, Bus. Franchise Guide (CCH) ¶ 16,629, 2020 LEXIS 59029 (E.D. Mo. Apr. 3, 2020)**
This case is discussed under the topic heading “Contract Issues.”

***Orange Rabbit, Inc. v. Franchoice, Inc.*, Bus. Franchise Guide (CCH) ¶ 16,650, 2020 WL 2191947 (D. Minn. May 6, 2020)**
The United States District Court for the District of Minnesota granted a kickboxing business franchisee and its owner leave to amend their complaint to assert a claim for punitive damages against the defendant franchise consultant under Minn. Stat. ¶ 549 based upon the defendant’s specific representations about the franchisor made without investigating or verifying them, when such representations were false and were known or should have been known to the defendant to be false. However, the court denied the franchisee’s motion to the extent that it sought to assert a claim for punitive damages arising from other allegations, which the court deemed insufficient to state a claim for punitive damages under the statute.

In this case, the franchisee alleged fraud and sought punitive damages, not against the franchisor, but against a franchise consultant who the franchisee alleged committed fraud by knowingly making false representations to the franchisee for the purpose of inducing it to purchase an “I Love Kickboxing” (ILKB) kickboxing franchise. The franchisee alleged that the representations proved to be untrue; that the franchisee reasonably relied on the information in deciding to purchase an ILKB franchise, and that as a result, the franchisee and its owner suffered damages in excess of $500,000.

In the proposed second amended complaint, the franchisee alleged that the defendant failed to perform any systematic or professional due diligence upon ILKB but, instead, merely accepted ILKB’s representations as true and passed them along to the franchisee. The second amended complaint also alleged that the defendant made affirmative misrepresentations about ILKB without investigating or verifying them, when such representations were false and were known or should have been known to defendant as false.

Under Rule 15, leave to amend “shall be freely given when justice so requires.” In the Eighth Circuit, amendment of a pleading is allowed liberally to ensure that a case is decided on the merits, but no absolute right to amend exists. Denial of leave to amend may be justified by, *inter alia*, futility of the amendment or unfair prejudice to the opposing party. In this case, the defendants argued that the motion should be denied because it is futile. Thus, the question presented to the court was whether the proposed second amended complaint plausibly alleged facts showing that the acts of the defendants showed deliberate disregard for the rights or safety of others as defined in Minn. Stat. ¶ 549.20.

Under the criteria set forth in sec 549.20, a defendant operates with “deliberate disregard” by acting with intent or indifference to threaten the rights or safety of others. As such, the mere existence of negligence or gross

negligence does not rise to the level required so as to warrant a claim for punitive damages. Further, a plaintiff must allege that defendant was aware of a high probability that its conduct would cause injury to the plaintiff. Put another way, the court looks to whether the allegations in the proposed complaint plausibly allege that a defendant knew of facts, or intentionally disregarded facts, that created a high probability that the defendant's actions would harm the rights or safety of the plaintiff.

Applying this standard, the court found that the plaintiffs' general allegations of misconduct in connection with the sale of the franchise failed to plausibly allege misconduct in violation of the Minnesota statute. However, the court determined that the plaintiffs' allegations that the defendant made specific representations about ILKB without investigating or verifying them, when such representations were false and were known or should have been known to the defendant as false, did meet the strict standards in the Minnesota statute. These allegations of specific misrepresentations set forth a plausible claim that the defendant knowingly, or with indifference, provided the plaintiffs with inaccurate information about ILKB to entice them to invest in an ILKB franchise, thereby creating a high probability that the defendant's actions would harm the plaintiffs. As a result, the court granted the plaintiffs' motion to amend only to the extent that it sought to add a claim for punitive damages in relation to the specifically alleged fraudulent misrepresentation made by the defendant to the plaintiffs, which the court set forth in detail in its opinion.

And, finally, the court concluded its analysis by reminding the plaintiffs that the analysis was conducted under the liberal pleading standard of Rule 15 and that the court granted them leave to amend did not imply that they are likely to succeed with their claims for punitive damages.

DEFINITION OF FRANCHISE

Trade Links, LLC v. BI-QEM SA de CV, Bus. Franchise Guide (CCH) ¶ 16,664, 2020 WL 1335688 (D. Conn. Mar. 23, 2020)

This case is discussed under the topic heading "Jurisdiction."

DISCRIMINATION

Chavez v. McDonald's Corp., Bus. Franchise Guide (CCH) ¶ 16,623, 2020 WL 1322864 (D. Colo. Mar. 20, 2020)

In this United States District Court for the District of Colorado decision, the court granted the defendants' motion to dismiss a U.S.C. *§ 1981* equal rights claim for racial discrimination. The plaintiffs were Theresa and Natalie Chavez, a mother and daughter, who visited a McDonald's franchised location, operated by the franchisee Ultra Mac, on April 26, 2018. While at the location, the store manager Ms. Juarez-Batista allegedly engaged with them in an altercation that was discriminatory in nature. After Natalie Chavez

requested fries without salt, Ms. Juarez-Batista allegedly swore at the women, asking them whether they spoke English before throwing their bag of food in the garbage near the women, resulting in a laceration to Theresa Chavez's chest. The police were called, and Ms. Juarez-Batista ultimately pled guilty to a charge of disorderly conduct. Theresa Chavez later called a complaints hotline at the restaurant, which connected her to the McDonald's Corporation. As a result of this incident, the plaintiffs brought a claim under § 1981 against the franchisee, Ultra Mac, as well as the franchisor. The franchisor's motion to dismiss the action against the franchisor was granted.

After a discussion of the legal standard for dismissal of a claim, the court launched into its analysis of the defendants' liability under § 1981. The court initially dismissed the claim because other courts have held that, to be liable for a discriminatory action, the employer must have been directly involved in the event. The plaintiffs did not allege that the defendants had any direct involvement in the discriminatory events, so the claim failed on this ground. However, because the Tenth Circuit had never addressed the issue directly, the court went on to dismiss the claim in the alternative based on the definition of *employer*.

This question turned on whether the defendant entities were "considered an 'employer' of that employee and thus could be held liable for the actions of that employee." The court noted that the parties placed incorrect emphasis on the question of whether the franchisor was in an agency relationship with the employee, which is not the correct test. Rather, the court employed the "joint employer" test because the defendants and Ultra Mac are separate entities, rather than hybrid entities or a single employer. Citing *Bristol v. Board of County Commissioners*, 312 F.3d 1213, 1219 (10th Cir. 2002), the court explained that two entities are joint employers "if they share or co-determine those matters governing the essential terms and conditions of employment. Both entities are employers if they both exercise significant control over the same employees." The three factors for this analysis are (1) whether the entity has the right to terminate; (2) whether the entity has control of records, including payroll, insurances, taxes and the like; and (3) whether the entity maintains day-to-day supervision, including employee discipline.

Regarding the first factor, the plaintiffs claimed that the franchisor "operate[s] or significantly control[s]" the Ultra Mac franchise. They also claimed that the defendants controlled the day-to-day business operations over the franchise. However, they offered no details to support these claims, so they were dismissed. The plaintiffs made no mention of control over termination, which is the most important factor in the analysis. This gap weighed greatly in the defendants' favor. The plaintiffs made no allegations that the franchisor maintained control over Ultra Mac records, so the second factor failed. Regarding the third factor, the plaintiffs claimed that uniformity in branding supported a conclusion that the franchisor has control of the franchisee. The court noted that this argument was dispelled by *McKinnon v. YUM! Brands, Inc.*, 2017 WL 3659166, at *9 (D. Idaho Aug. 24, 2017). The plaintiffs also alleged that the complaint hotline is evidence of employee control, but the court did

not find this argument persuasive due to the holding in *Allen v. Greenville Hotel Partners, Inc.*, 2006 U.S. Dist. LEXIS 33771, 2006 WL 1389812, at *2 (D.S.C. May 17, 2006), which found a complaint hotline was insufficient evidence to indicate control. Thus, the court found that the franchisor was not a joint employer with the Ultra Mac franchisee, and the claims against the franchisor were dismissed. The court further dismissed the state law claims based on 28 U.S.C. § 1367(c)(3), which entitles a district court to decline to exercise supplemental jurisdiction over a claim if the district court has dismissed all claims over which it has original jurisdiction. Because the plaintiffs did not argue that the court should retain jurisdiction, this claim was also dismissed.

EARNINGS CLAIMS

***Fabius v. Medinexo USA, LLC*, Bus. Franchise Guide (CCH) ¶ 16,629, 2020 LEXIS 59029 (E.D. Mo. Apr. 3, 2020)**
This case is discussed under the topic heading "Contract Issues."

FRAUD

***Fabius v. Medinexo USA, LLC*, Bus. Franchise Guide (CCH) ¶ 16,629, 2020 LEXIS 59029 (E.D. Mo. Apr. 3, 2020)**
This case is discussed under the topic heading "Contract Issues."

***Real Estate Visionaries v. RE/MAX of New England*, Bus. Franchise Guide (CCH) ¶ 16,642, (Mass. Super. Ct. Apr. 16, 2020)**
This case is discussed under the topic heading "Contract Issues."

***The Orange Rabbit, Inc. v. Franchoice, Inc.*, Bus. Franchise Guide (CCH) ¶ 16,650, 2020 WL 2191947 (D. Minn. May 6, 2020)**
This case is discussed under the topic heading "Damages."

GOOD FAITH AND FAIR DEALING

***Chong v. 7-Eleven, Inc.*, Bus. Franchise Guide (CCH) ¶ 16,613, 2020 LEXIS 39402 (E.D. Pa. Mar. 4, 2020)**
This case is discussed under the topic heading "Attorneys Fees."

***Real Estate Visionaries v. RE/MAX of New England*, Bus. Franchise Guide (CCH) ¶ 16,642, (Mass. Super. Ct. Apr. 16, 2020)**
This case is discussed under the topic heading "Contract Issues."

INJUNCTIVE RELIEF

***Aguilera v. Matco Tools Corp.*, Bus. Franchise Guide (CCH) ¶ 16,617, 2020 LEXIS 43283 (S.D. Cal. Mar. 12, 2020)**
This case is discussed under the topic heading "Arbitration."

***JTH Tax LLC v. McHugh*, Bus. Franchise Guide (CCH) ¶ 16,631, 2020 WL 1689731 (W.D. Wash. Apr 7, 2020)**

The U.S. District Court for the Western District of Washington granted the plaintiff franchisor a preliminary injunction against a former franchisee who, after allegedly abandoning her franchise in 2019, opened a new tax business within twenty-five miles, allegedly violating the noncompete clause of their franchise agreements.

The plaintiffs, Liberty Tax Service and SiempreTax+ (JTH Tax) are a tax preparation franchisor with thousands of locations nationally. One such franchise was operated by defendants Lorraine McHugh and Richard O'Brien. The parties entered into a Franchise Agreement in 2015, which granted McHugh a territory near Federal Way, Washington, and restricted use of the "confidential and proprietary business information that would be provided to her as a franchisee." The non-compete clause included in the Franchise Agreements stated that, for two years after termination of the Agreement, the defendants would not prepare or file income tax returns for a charge within twenty-five miles of the boundaries of the franchisee's territory. In addition, non-solicit and non-disclosure clauses contained in the Franchise Agreements allowed the plaintiffs to request a temporary restraining order, or a preliminary or permanent injunction for the breach of these duties. The plaintiffs alleged that, in 2019, McHugh effectively abandoned the franchise, which prompted them to send her a termination letter on August 2, 2019. In this letter the plaintiffs offered evidence that the defendant owed them thousands of dollars. Following the termination, McHugh opened her own tax preparation business, KVC Tax Services (KVC), less than ten miles away from her territory. The plaintiffs claim that several of KVC's clients were solicited by McHugh from her former JTH Tax franchise location. According to JTH Tax, these actions were a knowing and intentional breach of the parties' franchise agreements.

JTH Tax sought to enjoin the defendants from holding themselves out as being associated with the plaintiffs, owning, maintaining, engaging in, or having any interest in any other business that sells similar products and services within twenty-five miles of the former franchise for two years, employing or seeking to employ any person employed by the plaintiffs or any of their franchisees, using any confidential information provided by the plaintiffs, and diverting or attempting to divert any customer or business from the plaintiffs or attempting to solicit the business of any person who has been a customer of JTH Tax. The court applied the test for preliminary injunction as stated in *Winter v. NRDC, Inc.*, 555 U.S. 7 (2008). According to the *Winter* test, the moving party must show that (1) it is likely to succeed on the merits; (2) it is likely to suffer irreparable harm in the absence of preliminary relief; (3) the balance of equities tips in its favor; and (4) an injunction is in the public interest. Applying the first factor, the court found that the plaintiff's pleadings sufficiently indicated that the defendants likely breached or may intend to breach the noncompetition, nonsolicitation, and nondisclosure clauses. The court had earlier granted a temporary restraining order against the defendant

and built from this ruling to find that JTH Tax was likely to suffer irreparable harm from loss of customer goodwill and damage to the franchise system. The court held that the balance of equities favored the defendant and that a preliminary injunction "is in the public interest as it could prevent customer confusion." Therefore, the test for a preliminary injunction was met.

The defendants attempted to argue that the noncompetition clause was void and unenforceable under the Revised Code of Washington § 49.62 (Act), Washington State's new anti-noncompete law, which went into effect January 1, 2020. The court concluded that the non-compete clause in the Franchise Agreement was not subject to this law because the parties are not independent contractors to each other (despite the wording of their franchise agreement), but franchisee and franchisor, which is expressly excluded by the Act. The court granted a preliminary injunction against the former franchisee in this case.

***New Jersey Coalition v. Mazda Motor of America*, Bus. Franchise Guide ¶ 16,643, 957 F.3d 390 (3d Cir. Apr. 28, 2020)**
This case is discussed under the topic heading "Statutory Claims."

JURISDICTION

***Billie v. Coverall North America, Inc.*, Bus. Franchise Guide (CCH) ¶ 16,619, 2020 WL 1185251 (D. Conn. Mar. 12, 2020)**
This case is discussed under the topic heading "Arbitration."

***Fidrych v. Marriott International, Inc.*, Bus. Franchise Guide (CCH) ¶ 16, 610, 952 F.3d 124 (4th Cir. 2020)**
In an action brought by South Carolina residents in federal district court in South Carolina against Marriott International, Inc. (Marriott) after one of the plaintiffs was injured at the Boscolo Milano, a Marriott-affiliated hotel in Milan, Italy, the Fourth Circuit affirmed the district court's dismissal of the action against Marriott for lack of personal jurisdiction, but vacated the district court's denial of sanctions against Marriott and remanded that issue for reconsideration.

During a stay at the Boscolo, plaintiff Bud Fidrych (Fidrych) was injured when a glass shower door shattered in his hand, severing a tendon in his thumb. Fidrych and his wife subsequently filed suit against Marriott in federal district court in South Carolina, where they reside.

Marriott is incorporated in Delaware, with its principal place of business in Maryland. Of the 6,200 hotels in the Marriott system, ninety (1.54%) are in South Carolina. Marriott does not own any of those ninety hotels; sixty-three are franchises, and the remaining twenty-seven are licensed or managed by Marriott. Marriott has a Certificate of Authority issued by the South Carolina secretary of state, as is required of all foreign corporations transacting business in the state. Marriott's website permits online booking and is accessible in South Carolina. The Boscolo is not owned or managed

by Marriott, but is part of Marriott's "Autograph Collection" of hotels. The operation of the Boscolo is governed by a franchise agreement to which Marriott is not a party.

After Marriott was served with the complaint, it tendered defense of the action to the management of the Boscolo, in light of the Boscolo's contractual indemnification obligations. Boscolo failed to take appropriate action, and no answer was filed. At the plaintiffs' request, the district court clerk made an entry of default, and the district court subsequently granted the Fidrychs' motion for default judgment and set a date for damages hearing. The district court sent Marriott notice of the default and the hearing and, within a few days, Marriott filed a motion to set aside the default in which it asserted good cause to be relieved of the default and argued that the district court lacked personal jurisdiction over it.

The district court granted the motion to set aside the default under the standard set out in Rule 55 of the Federal Rules of Civil Procedure, and, in that order, the court invited the plaintiffs to file a motion for sanctions against Marriot as a result of the default. After the default was set aside, Marriott filed a motion to dismiss for lack of personal jurisdiction, and plaintiffs filed a motion seeking sanction of more than $86,000 in attorneys fees and expenses. The district court granted Marriott's motion to dismiss and denied plaintiffs' motion for sanctions, and an appeal to the Fourth Circuit followed.

On appeal, the court first examined whether the district court correctly proceeded under Rule 55, rather than Rule 60, when granting Marriott's motion to set aside the default. The court reviewed the language of Rule 55, which incorporates a good-cause standard, and Rule 60(b), which incorporates an excusable-neglect standard, and distinguished the two based upon Rule 60's application only to final judgments. Applying that distinction, the court concluded that because no damages were awarded in the district court's "default judgment," the order operated as nothing more than an entry of default, albeit one made by the court rather than the clerk, and was therefore not a "final judgment" for purposes of Rule 60(b). As a result, the court concluded that because no final judgment of default had been entered, Rule 60 was inapplicable, and the district court properly applied Rule 55's good-cause standard when considering Marriott's motion to set aside the default. The court therefore affirmed the district court's decision to set aside the default.

Turning to the central jurisdictional issue, the court discussed, at some length, controlling principles of general and specific jurisdiction under federal law guided by two relatively recent decisions from the U.S. Supreme Court—*Daimler AG v. Bauman*, 571 U.S. 117 (2014) and *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915 (2011).

Broadly speaking, the validity of an order of the federal court depends upon that court's having jurisdiction over both the subject matter and the parties. Subject matter jurisdiction—an Article III requirement—functions as a restriction on a federal power and cannot be conferred on the court

by the actions of the parties. The requirement that the court have personal jurisdiction, however, springs not from Article III of the Constitution, but from the Due Process clause. Because the personal jurisdiction requirement recognizes and protects an individual liberty interest, the requirement may be waived by defendant's express or implied consent to the personal jurisdiction of the court.

Absent consent, the exercise of personal jurisdiction must comport with the requirements of the Due Process clause: valid service of process, "as well as . . . 'minimum contacts' with the forum so that the exercise of jurisdiction 'does not offend traditional notions of fair play and substantial justice.'"

The nature and quality of forum-state contacts required depends on whether the case involves the exercise of "specific" or "general" jurisdiction. General jurisdiction permits the court to hear any and all claims against the defendant, regardless of where the claims arose or the plaintiffs' citizenship. General jurisdiction may be exercised when the defendant has contacts with the forum jurisdiction that are "so constant and pervasive as to render it essentially at home in the forum State." *Daimler AG*, 571 U.S. at 122. If the defendant does not have sufficient contacts to be at home in the forum, the court may exercise specific jurisdiction if the defendant has continuous and systematic contacts with the forum state and the claims at issue arise from those contacts with the forum state. *Id.* at 126–27. The plaintiffs contended that both specific and general jurisdiction were present in this case.

Turning first to plaintiffs' claim that Marriott had sufficient contacts with South Carolina to subject it to general jurisdiction, the court began with a detailed discussion of the *Daimler* and *Goodyear* cases cited above. After summarizing the jurisdictional principles set out in *Goodyear* and *Daimler*, the court had no difficulty concluding that Marriott's contact with South Carolina were insufficient to make it "at home" in South Carolina, as is required for the exercise of general jurisdiction. Marriott's contacts with South Carolina were generally limited to its filing of a Certificate of Authority; its affiliation with ninety hotels in South Carolina, none of which it owned; and, its maintenance of an interactive website accessible in South Carolina. The court held that while these contacts certainly qualify as systematic and continuous, they are not substantial enough to "render [Marriott] essentially at home in the forum State" as required by *Daimler*. Because there is nothing that would distinguish Marriott's relationship with South Carolina from its relationship with any other of the states where it does business but where it is not incorporated or headquartered, this is not the exceptional case for general jurisdiction contemplated by the *Daimler* Court. Indeed, the court noted that accepting the plaintiffs' jurisdictional arguments in this case would mean that Marriott would be subject to general jurisdiction in every state where its hotels, whether owned, franchised, or managed, are located. As the Supreme Court explained, "[a] corporation that operates in many places can scarcely be deemed at home in all of them." *Daimler*, 571 U.S. at 139 n.20. The court therefore concluded that because Marriott's contacts

with South Carolina are not sufficient to render it "at home" in South Carolina, the requirements for the exercise of contact-based general jurisdiction were not satisfied.

However, plaintiffs also contended that, even if Marriott's contacts were insufficient to support the exercise of general jurisdiction, Marriott consented to general jurisdiction in South Carolina when it obtained Certificate of Authority to conduct business in the state. After considering older precedent on this issue in light of *Daimler*, the court concluded that a Certificate of Authority does not automatically subject a foreign corporation to jurisdiction in South Carolina courts and that jurisdiction instead depends on sufficient South Carolina contacts by the foreign corporation. As a result, the court held that the district court properly concluded that Marriott did not consent to the exercise of general jurisdiction by obtaining the Certificate of Authority.

Turning to plaintiffs' claim that South Carolina may properly exercise specific jurisdiction, the court noted that the Due Process clause permits the exercise of specific jurisdiction over a defendant if "the defendant [has] purposefully established minimum contacts in the forum State such that it should reasonably anticipate being hailed into court there." These requirements are met, and specific jurisdiction may be exercised, if the defendant has purposefully directed his activities at residents of the forum, and the litigation results from alleged injuries that arise out of relate to those activities. When determining whether specific jurisdiction exists, the court shall consider (1) the extent to which the defendant purposefully availed itself of the privilege of conducting business in the State; (2) whether the plaintiffs' claims arise out of those activities directed at the State; and, (3) whether the exercise of personal jurisdiction would be constitutionally reasonable.

Addressing these factors, the court first discussed whether the litigation arose out of Marriott's contacts with South Carolina. For a state court to exercise specific jurisdiction, the action must arise out of or relate to the defendant's contacts with the forum. When no such connection exists, specific jurisdiction is lacking, regardless of the extent of a defendant's unconnected activities within the state. The only action by Marriott arguably relevant to the claims asserted was the operation of its website. Although Fidrych did not make his own reservation, his Complaint alleges that a travel agent used by his employer did use Marriott's website to make his reservation at the Boscolo. The court concluded that whether the use of the website to make the reservations means that Fidrych's personal injury claims arise from or relate to Marriott's operation of the website is a difficult question, which the court need not definitively resolve because Marriott's operation of a website accessible in South Carolina is insufficient to satisfy the minimum-contacts requirement of personal jurisdictional inquiry, discussed immediately below. The purposeful-availment requirement ensures that a defendant will not be hailed into a jurisdiction solely as a result of random, fortuitous, or attenuated contacts, or of the unilateral activity of another party or third person. In this case, none of the wrong that Marriott

is alleged to have committed took place in South Carolina, and, accordingly, the court was again left with Marriott's operation of its website as the only arguable jurisdictional hook connecting this case to South Carolina. The question, then, was whether Marriott's operation of the website amounts to activity purposefully directed at South Carolina residents. After reviewing the jurisdictional analysis of Internet usage, the Court concluded that the Marriott website, although interactive, is not used to target South Carolina residents in particular. As a result, the court concluded that Marriott's case-related contacts with South Carolina are too tenuous and too insubstantial to constitutionally permit the exercise of specific jurisdiction over Marriott. Because neither general nor specific jurisdiction may be exercised in the case, the district court properly granted Marriott's motion to dismiss for lack of personal jurisdiction.

Finally, the court addressed plaintiffs' claim that the district court erred by denying their motion for sanctions as a result of Marriott's failure to file a timely answer. In its order setting aside Marriott's default, the district judge noted the possibility of awarding sanctions to compensate the plaintiffs for costs incurred as a result of Marriott's failure to answer. Plaintiffs subsequently filed a motion seeking more than $86,000 in attorney's fees and costs. After the motion was filed, the case was transferred to a different district judge, who denied plaintiffs' motion for sanctions, concluding that the requested amount was excessive and that plaintiffs failed to show an adequate causal link between the default judgment and the total requested fees.

The court first dismissed Marriott's argument that the lack of personal jurisdiction precluded the court from entering any sanctions order. Instead, the court held that even if a judgment on the merits of plaintiffs' claims would be void for lack of personal jurisdiction, that does mean that the district court lacks jurisdiction to impose sanctions.

Turning to the merits of the denial of the request for sanctions, the court concluded that the district court's explanation of its discretionary ruling was insufficient to permit meaningful appellate review and therefore vacated the district court's denial of sanctions and remanded that issue for reconsideration by the district court.

***New Jersey Coalition v. Mazda Motor of America*, Bus. Franchise Guide ¶ 16,643, 957 F.3d 390 (3d Cir. Apr. 28, 2020)**

This case is discussed under the topic heading "Statutory Claims."

***Trade Links, LLC v. BI-QEM SA de CV*, Bus. Franchise Guide (CCH) ¶ 16,664, 2020 WL 1335688 (D. Conn. Mar. 23, 2020)**

The United States District Court in the District of Connecticut denied a foreign manufacturer's motion to dismiss a complaint brought by its longtime distributor on jurisdictional grounds, but granted the manufacturer's motion to dismiss a claim under the Connecticut Franchise Act because the parties' contractual relationship did not constitute a franchise under the

statute. The court also denied the manufacturer's motion to dismiss various additional statutory and common law claims.

Trade Links is a Connecticut limited-liability company owned and operated by a Connecticut resident. On November 9, 1999, Trade Links executed a sales representative agreement (SRA) with defendant BI-QEM SA de CV (BI-QEM), pursuant to which BI-QEM appointed Trade Links as the "sole and exclusive representative to develop business, in, sale and promote" the covered products of BI-QEM and its affiliates in the United States, Puerto Rico, and Canada. The initial term of the SRA was for three years, and, thereafter, it renewed on an annual basis automatically so long as Trade Links exceeded the minimum sales requirement set forth in the SRA for the preceding twelve-month period and Trade Links was not in default of the performance of any of its obligations under the SRA.

In 2017, the parties' relationship began to deteriorate, culminating in BI-QEM's issuance of a notice of termination, the effectiveness of which was contested by Trade Links. Trade Links filed a demand for arbitration with the American Arbitration Association to address BI-QEM's interference with Trade Links' rights under the SRA. In response, BI-QEM filed petitions to stay the arbitration in the New York and Massachusetts state courts. BI-QEM was unsuccessful in securing a stay in either forum. The AAA panel similarly rejected BI-QEM's efforts to stay the arbitration and held hearings in October 2018. On October 30, 2018, the day after Trade Links testified before the arbitration panel, BI-QEM sent a letter withdrawing the notice of termination. Thereafter, the parties reached a resolution whereby the arbitration and stay actions were dismissed. Unfortunately, the parties' efforts to reach a global settlement of their differences were ultimately unsuccessful. In March 2019, Trade Links commenced an action in the United States District Court for the District of Connecticut asserting claims for breach of contract; violation of the Connecticut Unfair Trade Practices Act (CUTPA); violation of the Connecticut Franchise Act; breach of the implied covenant of good faith and fair dealing; interference with business expectancy; violation of the Connecticut Sales Representatives Commission statute; violation of the Massachusetts Unfair Trade Practices Act; and vexatious litigation in violation of Connecticut law. BI-QEM moved to dismiss the complaint for lack of personal jurisdiction pursuant to Federal Rule of Civil Procedure 12(b)(2) and moved to dismiss various claims for failure to state a claim pursuant to Rule 12(b)(6).

Turning to the jurisdictional issue, the court noted that the plaintiff bears the burden of showing that the court has jurisdiction over the defendants and that the court conducts a two-part analysis to determine whether specific personal jurisdiction exists in a diversity case: first, it must look to the state's long-arm statute and then analyze whether jurisdiction comports with federal due process.

Connecticut's long-arm statute set forth four situations in which foreign corporations can be hailed into a Connecticut court. As relevant here,

section 33-929(f)(1) of the long-arm statute states that foreign corporations are subject to suit in Connecticut "on any cause of action arising . . . out of any contract . . . to be performed in this state." Whether a contract contemplates performance in Connecticut turns on its totality of contacts that a party to the contract obligates itself to have, or contemplates that it will have, in Connecticut on the basis of the agreed-upon performance in the contract. This determination requires a fact-specific, case-by-case examination of the obligations that the contract contemplates. The court concluded that the SRA contemplated that performance would occur in Connecticut, based on, *inter alia*, the presence of Trade Links' customers in Connecticut, Trade Links' offices and employees in Connecticut, and the Connecticut choice-of-law provision. As a result, the court concluded that Trade Links met its burden of establishing that the court's exercise of personal jurisdiction over the defendants was proper under Connecticut's long-arm statute.

The court then considered whether the exercise of personal jurisdiction over the defendants comported with due process. Summarizing well-settled law, the court noted that due process requires that a defendant be haled into court in a forum state based on his own affiliation with the state, not based on the random, fortuitous, or attenuated contacts that he makes by interacting with other person affiliated with that state. The due-process analysis proceeds in two steps. First, courts evaluate the quality and nature of the defendant's contacts with the forum state under the totality of the circumstances test. Where the claim arises out of, or relates to, the defendant's contacts within the forum—that is, specific jurisdiction is asserted—minimum contacts to support such jurisdiction exist where the defendant purposely availed itself of the privilege of doing business in the forum and could foresee being haled into court there. Second, once minimum contacts are established, a court considers those contacts in light of other factors to determine whether the assertion of personal jurisdiction would comport with fair play and substantial justice. Finally, a commercial actor need not have a physical presence in a state to establish the necessary minimum contacts, so long as the defendant's own actions have created a substantial connection with the forum state—for example, by deliberately engaging in significant activities within the forum state or creating continuing obligations between himself and a resident of the forum state.

The court concluded that the defendants had purposely availed themselves of the benefit of doing business in Connecticut in a variety of ways, including entering into the SRA and selling its products in Connecticut through Trade Links. The court was also persuaded that its exercise of personal jurisdiction over the defendants would not offend traditional notions of fair play and substantial justice. First, Connecticut is a neighboring state of Massachusetts, where the defendants were located. Second, the court was not persuaded that litigating in Connecticut would be unduly burdensome to the defendants, who have an international reach and anticipated doing business in Connecticut. Third, Connecticut had a strong interest in adjudicating this case since plaintiff was a Connecticut resident. And, finally, the

convenience of the plaintiff and the witnesses favored exercise of jurisdiction in Connecticut. As a result, the court denied the defendants' motion to dismiss for lack of personal jurisdiction.

Turning to the various motions to dismiss for failure to state a claim under Rule 12(b)(6), the court noted that in order to survive a motion under this rule, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its fact.

The defendants moved to dismiss Trade Links' claim under the Connecticut Franchise Act, Con. Gen. Stat. ¶ 42-133e (Franchise Act) on the grounds that the SRA did not constitute a franchise as defined in the Franchise Act. Under the Franchise Act, a franchise is

> a written agreement . . . in which (i) a franchisee is granted the right to engage in the business of offering, selling or distributing goods . . . under a marketing plan or system prescribes in substantial part by a franchisor . . . and (ii) the operation of the franchisee's business pursuant to such plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logo type, advertising or other commercial symbol designating the franchisor or its affiliate. . . .

Conn. Gen. Stat. ¶ 42-1333(b). The court noted that this definition requires a two-step inquiry. First, the franchisee must have the right to offer, sell or distribute goods or services and, second, the franchisor must substantially prescribe a marketing plan for the offering, selling, or distributing of goods or services.

The court began its analysis by noting that the purpose of the Franchise Act is to protect independent businesspersons who have assumed an entrepreneurial role and who face the risk of the market. Thus, one who acts an agent for another in selling a product does not ordinarily qualify as a franchisee. Reviewing the parties' relationship and the SRA, the court concluded that, even construing the allegations liberally and in the plaintiff's favor, Trade Links had not plausibly alleged that its relationship with BI-QEM was one of franchisor-franchisee. Indeed, the SRA itself contradicted any such claim. Trade Links was not in the business of offering or selling goods, within the meaning of the Franchise Act, since Trade Links did not purchase BI-QEM's products and resell them to consumers. Rather, it merely served as BI-QEM's agent. BI-QEM had the sole discretion to accept and fulfill orders obtained by Trade Links, and BI-QEM had the exclusive right to set the price and terms for sale of its products. The court concluded that the parties' relationship was not a franchise and, as a result, dismissed Trade Links' claim under the Franchise Act.

The defendants also moved to dismiss the claims under the Connecticut Unfair Trade Practices |Act (CUTPA), Conn. Gen. Stat. ¶ 42-110a, and the Massachusetts Unfair Trade Practices Act (Chapter 93A), Mass. Gen. Laws. Ch. 93A, § 1 *et seq*. To successfully state a claim for a CUTPA violation, a plaintiff must allege that he (1) suffered an ascertainable loss of money or property, (2) that was caused by an unfair method of competition or an

unfair or deceptive act, and (3) that occurred in the conduct of trade or commerce. After discussing the factors to be considered to determine whether an "ascertainable loss" has been suffered and whether a practice is unfair, the court concluded that Trade Links pleaded a plausible CUTPA violation. The amended complaint outlined in detail how BI-QEM sought to marginalize Trade Links from their business arrangement in an effort to coerce Trade Links into renegotiating or terminating the SRA. BI-QEM is alleged to have issued a notice of termination to bolster its negotiating position with Trade Links and will full knowledge that such termination was not permitted under the SRA. When Trade Links attempted to arbitrate the dispute, BI-QEM filed petitions to stay both in New York and Massachusetts and was accused of knowingly submitting false affidavits in support of the Massachusetts stay action. Only after the arbitration proceeded to a hearing did BI-QEM withdraw the notice of termination and yet, thereafter, it increased its efforts to marginalize Trade Links. The court concluded that these allegations were more than sufficient to state a claim under CUTPA.

Similarly, the court denied the defendants' motion to dismiss the Chapter 93A claim. To state a cause of action under Chapter 93A, plaintiff must allege that he (i) suffered a loss of money or property (ii) as a result of an unfair method of competition or an unfair or deceptive act (iii) that was used or employed by someone who engages in trader commerce. Further, a plaintiff must establish that the actions or transactions constituting an alleged unfair method of competition or unfair deceptive act or practice occurred primarily and substantially within Massachusetts. BI-QEM first asserted that only competitors can assert claims under Chapter 93A, an argument that the court quickly dismissed based on the plain language of Chapter 93A and Massachusetts precedent. The defendants next argued that Trade Links did not allege that the unfair acts occurred principally or substantially in Massachusetts. However, the allegations in the amended complaint included a number of events and conduct on the part of BI-QEM which were alleged to have occurred, expressly or by implication, in Massachusetts. As a result, the court concluded that the amended complaint sufficiently plead a Chapter 93A claim.

BI-QEM next argued that Trade Links did not assert a claim for tortious interference with business expectancy based on its relationship with BI-QEM's customers. The court began its analysis by noting that in order to recover for a claim of tortious interference with business expectancies, the claimant must plead and prove that: (1) a business relationship existed between the plaintiff and another party; (2) the defendant intentionally interfered with the business relationship while knowing of the relationship; and (3) as a result of the interference, the plaintiff suffered actual loss. BI-QEM's sole argument was that Trade Links' business relationship with BI-QEM's customers cannot satisfy the first element—a business relationship between plaintiff and third party—as a matter of law. However, BI-QEM relied on a single precedent, which the court found inapplicable, and, absent controlling precedent that a sales representative cannot assert a claim for tortious

interference under Connecticut law based on its relationship with its principal's customers, the court was compelled to deny the motion on this ground.

Finally, the court denied the defendants' motion to dismiss the breach of the covenant of good faith and fair dealing, the Connecticut Commissions statute, and the Connecticut vexatious litigation statute in summary fashion.

In short, although the court concluded that the distribution relationship did not constitute a franchise, the plaintiff/representative had pleaded statutory and common-law claims sufficient to survive the motion to dismiss.

LABOR AND EMPLOYMENT

***Aguilera v. Matco Tools Corp.*, Bus. Franchise Guide (CCH) ¶ 16,617, 2020 LEXIS 43283 (S.D. Cal. Mar. 12, 2020)**
This case is discussed under the topic heading "Arbitration."

***Billie v. Coverall North America, Inc.*, Bus. Franchise Guide (CCH) ¶ 16,619, 2020 WL 1185251 (D. Conn. Mar. 12, 2020)**
This case is discussed under the topic heading "Arbitration."

***Chavez v. McDonald's Corp.*, Bus. Franchise Guide (CCH) ¶ 16,623, 2020 WL 1322864 (D. Colo. Mar. 20, 2020)**
This case is discussed under the topic heading "Discrimination."

***JTH Tax LLC v. McHugh*, Bus. Franchise Guide (CCH) ¶ 16,631, 2020 WL 1689731 (W.D. Wash. Apr 7, 2020)**
This case is discussed under the topic heading "Injunctive Relief."

***Turner v. McDonald's USA, LLC*, Bus. Franchise Guide (CCH) ¶ 16,641, 2020 WL 3044086 (N.D. Ill. Apr. 24, 2020)**
This case is discussed under the topic heading "Antitrust."

NON-COMPETE AGREEMENTS

***Real Estate Visionaries v. RE/MAX of New England*, Bus. Franchise Guide (CCH) ¶ 16,642, (Mass. Super. Ct. Apr. 16, 2020)**
This case is discussed under the topic heading "Contract Issues."

***Turner v. McDonald's USA, LLC*, Bus. Franchise Guide (CCH) ¶ 1,641, 2020 WL 3044086 (N.D. Ill. Apr. 24, 2020)**
This case is discussed under the topic heading "Antitrust."

RELEASES

***Aguilera v. Matco Tools Corp.*, Bus. Franchise Guide (CCH) ¶ 16,617, 2020 LEXIS 43283 (S.D. Cal. Mar. 12, 2020)**
This case is discussed under the topic heading "Arbitration."

STATE DISCLOSURE/REGISTRATION LAWS

***Fabius v. Medinexo USA, LLC*, Bus. Franchise Guide (CCH) ¶ 16,629, 2020 LEXIS 59029 (E.D. Mo. Apr. 3, 2020)**
This case is discussed under the topic heading "Contract Issues."

STATUTORY CLAIMS

***Aguilera v. Matco Tools Corp.*, Bus. Franchise Guide (CCH) ¶ 16,617, 2020 LEXIS 43283 (S.D. Cal. Mar. 12, 2020)**
This case is discussed under the topic heading "Arbitration."

***Fabius v. Medinexo USA, LLC*, Bus. Franchise Guide (CCH) ¶ 16,629, 2020 LEXIS 59029 (E.D. Mo. Apr. 3, 2020)**
This case is discussed under the topic heading "Contract Issues."

***N.J. Coalition v. Mazda Motor of America*, Bus. Franchise Guide ¶ 16,643, 957 F.3d 390 (3d Cir. Apr. 28, 2020)**
The Third Circuit Court of Appeals reversed the U.S. District Court for the District of New Jersey's dismissal of a complaint by an automobile dealers' association for lack of standing because it found that the district court construed the association's complaint too narrowly.

The New Jersey Coalition of Automobile Retailers (Association) filed a complaint against Mazda Motor of America, Inc. (Mazda) seeking to enjoin Mazda from an incentive program that the Association alleged violated the New Jersey Franchise Practices Act by creating unfair competitive advantages for dealers who qualified for incentives under the program. The district court applied the three-prong test established by the Supreme Court in *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333, 343, (1977), which provides that an association has standing if "(a) its members would otherwise have standing to sue in their own right; (b) the interests it seeks to protect are germane to the organization's purpose; and (c) neither the claim asserted nor the relief requested requires the participation of individual members in the lawsuit." The district court dismissed the complaint for lack of standing after it determined that it did not seek to protect the interests of the Association's members because only five of the sixteen members who were Mazda dealers would benefit from the lawsuit.

Reversing the decision, the Third Circuit first noted that the complaint must be construed in favor of the complaining party. The court noted that the district court improperly confined the Association's complaint to a single zero-sum theory that could only favor the five dealers that did not qualify for the incentive program. The Third Circuit noted several reasons why the lawsuit might benefit more than just those dealers who did not qualify for incentives and ultimately determined that Mazda failed to show that any more than five dealers opposed filing the lawsuit. The court refused to infer

that other dealers who participated in the incentive program opposed the lawsuit because doing so would not be viewing the complaint in the light most favorable to the complainant. The Third Circuit did make clear, however, that it took no position on whether the complaint adequately pled a claim under the New Jersey Franchise Practices Act. Dismissal was reversed, and the case was remanded for further proceedings in the district court.

***Trade Links, LLC v. BI-QEM SA de CV*, Bus. Franchise Guide (CCH) ¶ 16,664, 2020 WL 1335688 (D. Conn. Mar. 23, 2020)**
This case is discussed under the topic heading "Jurisdiction."

TERMINATION AND NONRENEWAL

***Chong v. 7-Eleven, Inc.*, Bus. Franchise Guide (CCH) ¶ 16,613, 2020 LEXIS 39402 (E.D. Pa. Mar. 4, 2020)**
This case is discussed under the topic heading "Attorneys Fees."

***Real Estate Visionaries v. RE/MAX of New England*, Bus. Franchise Guide (CCH) ¶ 16,642, Superior Court, Mass. (Apr. 16, 2020)**
This case is discussed under the topic heading "Contract Issues."

TORTIOUS INTERFERENCE

***Real Estate Visionaries v. RE/MAX of New England*, Bus. Franchise Guide (CCH) ¶ 16,642, Superior Court, Mass. (Apr. 16, 2020)**
This case is discussed under the topic heading "Contract Issues."

UNFAIR COMPETITION/UNFAIR AND DECEPTIVE PRACTICES

***Real Estate Visionaries v. RE/MAX of New England*, Bus. Franchise Guide (CCH) ¶ 16,642, Superior Court, Mass. (Apr. 16 ,2020)**
This case is discussed under the topic heading "Contract Issues."

VICARIOUS LIABILITY

***A.B. v. Marriott International, Inc.*, Bus. Franchise Guide (CCH) ¶ 16,640, 2020 WL 1939678 (E.D. Pa. Apr. 22, 2020)**
This United States District Court for the Eastern District of Pennsylvania case deals with claims of a hotel franchisor's vicarious liability for sex trafficking. The defendant Marriott International (Marriott) is a franchisor of three Philadelphia airport hotels where plaintiff A.B. alleged she was sex trafficked between 2009 and 2014. As the Court stated, Marriott "sells its brand name and marketing power to third-party owners for use for building and operations run by a franchisee or third-party management company under Marriott's control." It is not expressly stated in the Court decision whether

the hotels in question were run by a franchisee or owned by a franchisee and run by a third-party management company under Marriott's control.

The plaintiff, A.B., structured her claim around Marriott's knowledge, through an actual agency relationship with the hotel franchisees, that they were benefitting from the proceeds of sex trafficking, thus entitling A.B. to a remedy under section 1595 of the William Wilberforce Trafficking Victims Protection Reauthorization Act of 2008, 18 U.S.C. § 1595 (Act). The plaintiff claimed that Marriott should have known she was being trafficked due to several obvious signs present over the course of her five-year ordeal. She claimed that her traffickers paid for rooms weeks in advance with prepaid credit cards; she never had a phone, identification, or personal possessions with her; she often had visible signs of abuse such as bruising; and there was significant foot traffic to and from the rooms and sex paraphernalia in the rooms where men were allegedly purchasing sex. A.B. further pleaded that Marriott "failed to adopt and enforce anti-trafficking policies from the corporate level," failed to establish effective reporting mechanisms at the hotels, and failed to take measures to prevent sex trafficking. Marriott has control over the three franchises through their brand name, marketing, and property maintenance and inspection. Marriott receives ten percent of each franchisee's total revenue.

Marriott brought a motion to dismiss, which was granted in part. However, the court found that A.B. adequately pleaded a claim under the Act, which entitles trafficking victims to a civil remedy against their traffickers and "whoever" knowingly profited from the trafficking. The court determined that A.B. plausibly alleged actual or constructive knowledge on the part of Marriott and an agency relationship between Marriott and the hotels. A.B.'s apparent agency claim was dismissed, as were the time-barred Pennsylvania human-trafficking statute claims.

The Act entitles a victim of sex trafficking to receive civil damages from both the trafficker and anyone who benefited from the trafficking. The elements of the civil remedy require A.B. to plead facts beyond mere conclusions, allowing the plausible inference that Marriott (1) knowingly benefitted financially or by receiving anything of value, (2) from participation in a venture, (3) it knew or should have known has engaged in sex trafficking under § 1591. Marriott sought to dismiss because it interpreted the legislation as requiring a "joint venture" between Marriott and the traffickers, which A.B. did not plead. However, the court disagreed with Marriott's interpretation and agreed with A.B. that the remedy Congress intended to give to victims of trafficking is against "whoever knowingly benefits" from participation in a venture that the person "knew or should have known engaged" in a violation of the Act. This does not impose any positive duties on hotels to end trafficking; rather, it allows victims to obtain a remedy from those parties who benefited financially from their trafficking. The court found that A.B. had sufficiently pleaded these facts and her claim for the remedy under the Act was permitted to move forward.

The court then analyzed each element of § 1595: "knowingly benefits financially," "participation in a venture," and "knew or should have known" of a sex trafficking venture. Regarding the first element, the allegations at this stage adequately suggested Marriott benefitted financially from the renting of the rooms through the ten percent paid to the company by each franchisee. The court also found that A.B.'s pleadings that Marriott "participated in a venture" were sufficient. Regarding the third element, Marriott argued that A.B.'s pleadings as to whether Marriott "knew or should have known" of a sex trafficking venture were too broad and relate to the hospitality industry generally and not their three franchises specifically. The court disagreed with this analysis, as A.B.'s pleadings pointed to several specificities, like loud altercations overhead by patrons and employees, and the constant stream of men coming and going from the rooms rented by the traffickers. The elements of § 1595 were sufficiently pleaded, and this portion of the claim was not dismissed.

Next, the court turned to the principal-agent relationship between the three franchised hotels and Marriott. Marriott's response was that Pennsylvania law does not necessarily imply a principal-agent relationship between franchisee and franchisor. Rather, the court noted, A.B. must sufficiently apply the facts to a test set by the Pennsylvania Supreme Court to determine the existence of a master-servant relationship: "whether such person is subject to the alleged employer's control or right to control with respect to his physical conduct in the performance of the services for which he was engaged. . . . The hallmark of an employee-employer relationship is that the employer not only controls the result of the work but has the right to direct the manner in which the work shall be accomplished; the hallmark of an independent contractee-contractor relationship is that the person engaged in the work has the exclusive control of the manner of performing it, being responsible only for the result." Marriott relied on *Myszkowski v. Penn Stroud Hotel, Inc.*, 634 A.2d 622, 625 (Pa. Super. 1993), a case where the Pennsylvania Superior Court decided that the franchisor did not have an agency relationship with the franchisee due to lack of sufficient day-to-day control. The court distinguished that case and found that A.B. properly pled Marriott's "ongoing and systematic right of control over its franchisee hotels." The following factors were cited by A.B. in determining an agency relationship: "hosting online bookings on Marriott's domain; requiring the three hotels to use Marriott's customer rewards program; setting employee wages; making employment decisions and advertising for employment; sharing profits; standardizing employee training; building and maintaining the facility as specified by Marriott; standardized rules of operation; regulation site inspections; fixing pricings, and other actions depriving the three hotels from any independence in their business operations." Ultimately, the court found A.B.'s pleadings regarding principal-agent liability sufficient.

However, the court granted Marriott's motion to dismiss A.B.'s apparent agency theory because A.B. was unable to show the necessary elements of a representation of agency and reliance by the plaintiff on that agency. The court also dismissed A.B.'s Pennsylvania claim, as it was time-barred and failed to state a claim.

***Chavez v. McDonald's Corp.*, Bus. Franchise Guide (CCH) ¶ 16,623, 2020 WL 1322864 (D. Colo. Mar. 20, 2020)**
This case is discussed under the topic heading "Discrimination."