Franchise Law Journal (ISSN: 8756-7962) is published quarterly, by season, by the American Bar Association Forum on Franchising, 321 North Clark Street, Chicago, Illinois 60654-7598. Franchise Law Journal seeks to inform and educate members of the bar by publishing articles, columns, and reviews concerning legal developments relevant to franchising as a method of distributing products and services. Franchise Law Journal is indexed in the Current Law Index under the citation FRANCHISING.

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# Franchise Law Journal

**Volume 37, Number 3**  
**Winter 2018**

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From the Editor-In-Chief

Gary R. Batenhorst

Welcome to the first issue of the *Franchise Law Journal* for 2018. I hope that 2018 has gotten off to a good start for you, your families, and your colleagues. We start this year off with a good variety of articles for your review.

Leading off this issue is *Effectiveness of the Legislative Response to Joint Employer Liability* by Allison R. Grow and Adrienne L. Saltz. This article provides a comprehensive analysis of how state legislatures have responded to the joint employer issues that have been so prominent in franchising the past few years. Although recent developments at the U.S. Department of Labor and the National Labor Relations Board have altered the federal government’s response to this issue, the state law responses will remain an important part of joint employer jurisprudence. This article provides an excellent summary of where things stand in the states.

We follow that article with *Is It Possible to Fully Insulate Yourself from Personal Liability* by Megan Center. The possibility of personal liability for violations of franchise laws is a risk that executives and certain other employees of franchisors need to consider. This article provides a very helpful overview of the issues and scenarios that can lead to personal liability.

Next we have *The Unwelcome Phone Call—Responding to Regulatory Audits and Investigations* by Eric L. Yaffe and Christopher A. Nowak. This article is based on a presentation Eric and Chris made at the 2017 Forum on Franchising, and it was my privilege to be their program director. Because this article provides a very useful introduction to the issues that can face franchisors and franchisees when government officials investigate their businesses, we wanted to give it a wider audience by publishing it in the *Journal*.

We follow our look at regulatory audits and investigations by looking at franchise resales in *Resale Programs for Franchise Systems: A Different Perspective on Franchisees Exiting the System* by Sarah Walters and Noah Leszcz. Sarah

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Gary R. Batenhorst (gbatenhorst@clinewilliams.com) is a partner in the Omaha office of Cline Williams Wright Johnson & Oldfather, L.L.P, where he focuses on franchising and distribution, business organization, and mergers and acquisitions. He welcomes comments from readers.
and Noah provide an interesting and informative view on these issues for both Canadian and U.S. franchise systems.

We finish the articles section of this issue with Enforceability of Choice of Law Clauses in Arbitration When Such Clauses Are Contrary to the Public Policy of the Puerto Rico Relationship Statutes by Rossell Barrios. Rossell provides us with some valuable insights at the point where choice of law provisions in franchise or distribution agreements conflict with the public policy of a jurisdiction. Our thoughts are with our Forum on Franchising colleagues in Puerto Rico and their fellow Puerto Ricans as they work to rebuild their beautiful island after last year’s devastating hurricane.

We conclude with the always popular Franchise (& Distribution) Currents. Thank you to lead editor Kevin Shelley, Larry Weinberg, and Bill Bryner for their good work in preparing these Currents. Special thanks also to Marlen Cortez-Morris for all of her good work in editing the legislative response to joint employment issues article.

If you appreciate the time and effort our authors spend in preparing their articles, you should consider joining them by writing for the Franchise Law Journal. Writing for the Journal gives you an opportunity to contribute to the excellent scholarship that is a hallmark of the Forum and serves as a pathway toward greater involvement and leadership in the Forum. Please email me for a list of our open topics, or better yet come up with a topic of your own that interests you.

I also want to remind newer members of the Forum about the Edward Wood Dunham Rising Scholar Award, a writing competition for lawyers who are 0-7 years out of law school. Participants write articles on a franchise or distribution law topic utilizing our existing author guidelines. Entrants can select a topic from our open topics list, but we prefer that authors select their own topics. The deadline for submitting articles for this award is July 16, 2018, and the winning article will be considered for publication in the Franchise Law Journal. The author will be recognized at the Annual Forum on Franchising, will receive reimbursement for partial expenses for traveling to the Forum, and the author’s registration fee for attending the Forum will be waived. It is a great way for our newer colleagues to launch their careers as franchise lawyers.
Deadline for 2018 Edward Wood Dunham Rising Scholar Award Announced

The deadline for the 2018 Rising Scholar Award will be Monday, July 16, 2018. To be eligible, entrants must be members of the ABA Forum on Franchising and zero to seven years out of law school. Qualified participants should prepare articles according to the *Franchise Law Journal*’s author guidelines. The submissions will be judged by current and former members of the *Franchise Law Journal* and the *Franchise Lawyer* editorial boards. The current Forum chair will also be consulted and provide input on the selection of the winning article.

The author of the winning article will receive the following: (1) the article will be considered for publication in a future edition of *Franchise Law Journal*; (2) the author will be recognized and presented with a plaque at the Annual Forum on Franchising; (3) the author will receive a small financial award to reimburse in part expenses for traveling to the Annual Forum for the award presentation; and (4) the author’s registration fee for attending the Annual Forum will be waived.

Articles must be submitted to Gary R. Batenhorst, the editor-in-chief of the *Franchise Law Journal*, no later than Monday, July 16, 2018, to be considered in this year’s competition. All inquiries should be directed to: gbatenhorst@clinewilliams.com.

We look forward to receiving the submissions!
Save the Date!

Mark your calendars for the
41st Annual Forum on Franchising
Nashville, TN
October 10-13, 2018
The franchise industry occupies a unique space in the larger employment and workplace debates occurring across the country. Thousands of people work for franchised businesses in the United States—often small businesses—which are independently owned and operated. The franchisees are responsible for employing their workforce and paying their own labor costs. But their employees carry the mantle of large national brands, not mom-and-pop shops. Their uniforms and work spaces bear recognizable trademarks, and they follow detailed systems for selling specific products and services that the consuming public expects to be produced consistently across the country. Therein lies the rub. In a business model built on control, how much control is too much? And what forms can (or should) a franchisor’s control take?

Franchise lawyers and business people have been grappling with these questions for years, long before “joint employer liability” became the term du jour. For decades, franchisors could be held liable under a theory of vicarious liability if they exercised direct and immediate control over day-to-day employment matters related to the franchisees’ employees—that is, if the franchisor disciplined, hired, fired, or supervised these employees. And the U.S. Supreme Court repeatedly considered whether or not an employment relationship existed under common law agency principles.¹

¹ See, e.g., Cmty. for Creative Non Violence v. Reid, 490 U.S. 730, 751–52 (1989) (“In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party’s right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party’s discretion over when and how long to work; the method of payment; the hired party’s role in hiring and paying assistants; whether the work is
The National Labor Relations Board (NLRB) and the U.S. Department of Labor (DOL) turned that established standard on its head in recent years. In the 2015 *Browning-Ferris* decision, the NLRB greatly expanded the joint employer standard under the National Labor Relations Act (NLRA)\(^2\) to include “indirect control.”\(^3\) Likewise, the DOL issued guidance that expanded the joint employer standard under the Fair Labor Standards Act of 1938 (FLSA)\(^4\) and the Migrant and Seasonal Agricultural Worker Protection Act\(^5\) for violations by staffing agencies, contractors, and franchisees (and others) on January 20, 2016.\(^6\) These developments created considerable uncertainty, which was later compounded by litigation at the state and federal level filed by franchisees, employees, and others seeking to hold franchisors responsible for everything from state wage and hour violations to discrimination and sexual harassment. All told, what controls a franchisor could exercise without exposing itself to joint employer liability were in doubt.

Rather than wait for clarity from the courts or administrative agencies, state and federal legislators considered and passed laws addressing joint employer liability in franchising. At this time about forty percent of the states have passed some law addressing the issue. In addition, the U.S. House of Representatives passed a bill that would amend Section 2(2) of the NLRA\(^7\) and Section 3(d) of the FLSA to clarify the meaning of “joint employer” under those laws.\(^8\) This article examines the effectiveness of the legislative response. Part I details the various laws that have been passed. Part II describes trends that have emerged in the legislation. Part III concludes by analyzing the effectiveness of the laws and their implications for the future.

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5. Id. §§ 1801–1872.
8. Id. § 203(d).
I. Joint Employer Legislation

In response to the expanding definition of a joint employer, states began proposing and enacting legislation with the goal of restricting (or eliminating) the circumstances in which a franchisor may be deemed the employer of its franchisees or its franchisees’ employees. These efforts were mimicked in the U.S. Congress, although no federal law has been enacted.

A. Eighteen states have enacted legislation in response to “joint employer” concerns.

Alabama, Arizona, Arkansas, Georgia, Indiana, Kentucky, Louisiana, Michigan, New Hampshire, North Carolina, North Dakota, Oklahoma, South Dakota, Tennessee, Texas, Utah, Wisconsin, and Wyoming—eighteen states in total—have enacted joint employer statutes. The language and likely applicability of the laws, which were enacted from 2015 to 2017, are discussed in this section by introduction date to better illuminate trends. The states took widely divergent approaches to the joint employer issue—some enacted general employment statutes, others amended their franchise laws, and still others amended specific provisions of their labor and employment laws. On a certain level, this makes sense as states offer varying degrees of protection to employees generally. However, for franchisors operating on a national level and seeking to mitigate risks, the hoped-for consistency is lacking.

1. Tennessee, Texas, Louisiana, Michigan, and Wisconsin began the trend in 2015.

Tennessee

Tennessee signed its joint employer bill into law on April 10, 2015, and it became effective immediately (codified as TENN. CODE § 50-1-208). The statute adopts the Federal Trade Commission’s (FTC) definitions of “franchisee” and “franchisor” and states:


11. The FTC defines “franchisee” as “any person who is granted a franchise.” 16 C.F.R. § 436.1(i) [hereinafter FTC Definition of Franchisee].

12. The FTC defines “franchisor” as “any person who grants a franchise and participates in the franchise relationship. Unless otherwise stated, it includes subfranchisors. For purposes of this definition, a 'subfranchisor' means a person who functions as a franchisor by engaging in both pre-sale activities and post-sale performance.” Id. § 436.1(k) [hereinafter FTC Definition of Franchisor].
Notwithstanding any voluntary agreement entered into between the United States department of labor and a franchisee, neither a franchisee nor a franchisee’s employee shall be deemed to be an employee of the franchisor for any purpose.\(^{13}\)

The statute is found in Title 50 of the Tennessee Code, which governs employer-employee relationships,\(^ {14}\) and specifically in Chapter 1 (Employment Relationship and Practices), Part 2 (Right to Work). Although appearing in the right to work section, there is nothing in the language to suggest that it is limited to union issues.\(^ {15}\) Indeed, the other parts of Chapter 1 are general statutes that apply to all employment in Tennessee.\(^ {16}\) It appears then that the Tennessee legislature intended this as a general employment law with broad application. This interpretation is supported by the plain language of the statute that it applies “for any purpose.”\(^ {17}\)

**Texas**

Texas introduced its joint employer bill to “exclud[e] a franchisor as an employer of a franchisee or a franchisee’s employees.”\(^ {18}\) The bill was signed into law on June 19, 2015 and became effective on September 1, 2015. Texas chose to use three formulations of similar language to exclude franchisors from specific portions of the Texas Labor Code. In all, the legislature amended seven chapters of the Code by adding one of the three exclusions to each. In each instance the amendments adopt the FTC’s definitions of “franchisee”\(^ {19}\) and “franchisor.”\(^ {20}\)

Specifically, the following language was codified at Texas Labor Code Sections 21.0022, 61.0031, 62.006, 401.014, and 411.005:

> For purposes of this [chapter or subtitle], a franchisor is not considered to be an employer of: (1) a franchisee; or (2) a franchisee’s employees.

[ ] With respect to a specific claim for relief under this [chapter or subtitle] made by a franchisee or a franchisee’s employee, this section does not apply to a franchisor who has been found by a court of competent jurisdiction in this state to have exercised a type or degree of control over the franchisee or the franchisee’s employees not customarily exercised by a franchisor for the purpose of protecting the franchisor’s trademarks and brand.\(^ {21}\)

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14. Title 50 has nine chapters addressing workplace issues that range from employment relationship and practices (Chapter 1) to wages (Chapter 2) to workers’ compensation (Chapter 6). Id. §§ 50-1-101 to 50-9-115.
15. See id. § 50-1-208.
16. E.g., id. § 50-1-301 (restrooms); e.g., id. §§ 50-1-304, 501-1-801 (retaliatory discharge); e.g., id. § 50-1-308 (health insurance payroll deductions); e.g., id. §§ 50-1-401 to -402 (private pensions and retirement); e.g., id. §§ 50-1-501 to -505 (abusive conduct in the workplace); e.g., id. §§ 50-1-1001 to -1004 (employee online privacy).
17. See id. § 50-1-208.
This language amended Texas law regarding employment discrimination, payment of wages, minimum wage, workers’ compensation, and workers’ health and safety. Texas codified similar language in Texas Labor Code Section 91.0013, which amended the professional employer organizations laws (i.e., for staff leasing companies).

Interestingly, unlike the other Texas amendments, Texas explicitly amended the definition of “employer” applied throughout the Texas Unemployment Compensation Act (codified as an amendment to Tex. Lab. Code § 201.021), which states:

The definition of employer provided by this section does not apply to a franchisor with respect to: (1) a franchisee; or (2) a franchisee’s employees.

[] With respect to a specific claim for relief under this subtitle made by a franchisee or a franchisee’s employee, Subsection (d) does not apply to a franchisor who has been found by a court of competent jurisdiction in this state to have exercised a type or degree of control over the franchisee or the franchisee’s employees not customary exercised by a franchisor for the purpose of protecting the franchisor’s trademarks and brand.

Louisiana

Louisiana signed its joint employer bill on July 1, 2015, and it became effective on August 1, 2015 (amending La. Rev. Stat. § 23:921). The statute adopts the FTC’s definitions of “franchise,”

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22. Id. § 21.0022. The language amended all of Chapter 21, which contains Texas’s employment discrimination laws, including discrimination, retaliation, and hiring practices, among others. See generally id. §§ 21.001–.556.

23. Id. § 61.0031. The language amended all of Chapter 61 regarding the payment of wages, including form and delivery of payment, deductions, failure to pay wages, and wage claims. See generally id. §§ 61.001–.104.

24. Id. § 62.006. The language amended all of Chapter 62 regarding minimum wages. See generally id. §§ 62.001–.205.

25. Id. § 401.014. The language amended the Workers’ Compensation Act (Subtitle A of Title 5). See generally id. §§ 401.001–419.007. However, it did not amend the remaining portions of Title 5, which cover other aspects of workers’ compensation such as the discrimination provisions of Subtitle B and the provisions governing workers’ compensation coverage for certain government employees in Subtitle C. See generally id. §§ 451.001–506.002.

26. Id. § 411.005. This language amended Chapter 411 regarding workers’ health and safety. See generally id. §§ 411.001–.110. Chapter 411 is part of the Workers’ Compensation Act, so this provision seems unnecessary in light of the amendment to the Act in full. See supra note 25.

27. Tex. Lab. Code § 91.0013. The amendment applies to all of Chapter 91 regarding professional employer organizations, which governs things like licensing. See generally id. §§ 91.001–.063.

28. See generally id. §§ 201.001–217.007.

29. Id. § 201.021.


31. The FTC defines “franchise” as “any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that: (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark; (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee’s method of operation, or provide significant assistance in the franchisee’s method of operation.”
“franchisee,”32 and “franchisor”33 (with some caveats) and states:

(F)(2) Except as provided in Paragraph (3) of this Subsection, neither a franchisee who is a party to a franchise agreement regulated under the Federal Trade Commission Franchise Disclosure Rule, 16 CFR 436, nor an employee of the franchisee shall be deemed to be an employee of the franchisor for any purpose. A voluntary agreement entered into between the United States Department of Labor and an employer shall not be used by a state department or agency as evidence or for any other purpose in an investigation or judicial or administrative determination, including whether an employee of a franchisee is also considered to be an employee of the franchisor.

(3) Pursuant to Chapter 10 and Chapter 11 of Title 23 of the Louisiana Revised Statutes of 1950, an employee of a franchisee may be deemed to be an employee of the franchisor only where the two entities share or co-determine those matters governing the essential terms and conditions of employment and directly and immediately control matters relating to the employment relationship such as hiring, firing, discipline, supervision, and direction.34

The statute is found in Title 23 of the Louisiana Statutes, entitled Labor and Worker’s Compensation, and specifically in Chapter 9, Part 2, which is Louisiana’s general prohibition against non-competition agreements.35 Despite its name, Title 23 contains the majority of Louisiana’s labor and employment laws, including laws regarding discrimination,36 payment of wages (including minimum wages),37 equal pay,38 labor organizations and disputes,39 workers’ compensation,40 and unemployment compensation,41 among others. The language of the amendment—“for any purpose”—suggests that it is intended as a general employment statute with broad application.42 At the very least, it should apply throughout all of Title 23 because the statute references two other chapters of that title by providing a carve out for workers’ and unemployment compensation claims against a franchisor under Chapters 10 and 11.43
Michigan

Michigan introduced six joint employer bills in the fall of 2015. The first two were signed into law on December 31, 2015, and became effective on March 22, 2016 (codified as MICH. COMP. LAWS §§ 445.1504b, 418.120). The first of these amended Michigan’s Franchise Investment Law by adding Section 445.1504b, which states:

To the extent allocation of employer responsibilities between the franchisor and franchisee is permitted by law, the franchisee shall be considered the sole employer of workers for whom it provides a benefit plan or pays wages except as otherwise specifically provided in the franchise agreement.

And the second amended the Worker’s Disability Compensation Act of 1969 by adding Section 418.120 (and a control test), which states:

An employee of a franchisee is not an employee of the franchisor for purposes of this act unless both of the following apply:

(a) The franchisee and franchisor share in the determination of or codetermine the matters governing the essential terms and conditions of the employee’s employment.

(b) The franchisee and franchisor both directly and immediately control matters relating to the employment relationship, such as hiring, firing, discipline, supervision, and direction.

Both of these statutes amended only the acts in which they are found; however, the amendment to the franchise law can certainly be read to apply more broadly.

Michigan’s four remaining bills were signed into law on February 23, 2016, and became effective on May 23, 2016 (amending MICH. COMP. LAWS §§ 408.412(d), 408.1005(2), 408.471(d), 421.41(11)). Unlike the other bills, they amend the definition of “employer” to include the following:

Except as specifically provided in the franchise agreement, as between a franchisee and franchisor, the franchisee is considered the sole employer of workers for whom the franchisee provides a benefit plan or pays wages.
This language was added to the definition of “employer” in Michigan’s Workforce Opportunity Wage Act, Employment Security Act, Payment of Wages and Fringe Benefits Act, and Employment Security Act. None of Michigan’s amendments adopts the FTC’s definitions or provides any other additional definition of “franchisor” or “franchisee.”

**Wisconsin**

Wisconsin signed its joint employer bill on March 2, 2016, and it became effective the next day (codified as Wis. Stat. §§ 102.04(2r), 104.015, 109.015, 108.065(4), 111.3205). These statutes incorporate the FTC’s definitions of “franchisee” and “franchisor” and state:

[A] franchisor, as defined in 16 CFR 436.1(k), is not considered to be an employer of a franchisee, as defined in 16 CFR 436.1(i), or of an employee of a franchisee, unless any of the following applies:

- [ ] The franchisor has agreed in writing to assume that role.
- [ ] The franchisor has been found by the department or the division to have exercised a type or degree of control over the franchisee or the franchisee’s employees that is not customarily exercised by a franchisor for the purpose of protecting the franchisor’s trademarks and brand.

This language was added as an amendment to Wisconsin’s Worker’s Compensation Act, Minimum Wage Law, wage payments laws, laws governing unemployment insurance and reserves, and Fair Employment
2. Four more states followed in 2016: Utah, Indiana, Georgia, and Oklahoma.

Utah

Utah introduced its joint employer bill to “modify provisions related to insurance, labor, and employment security to address the determination of who is an employer.” It was signed into law on March 29, 2016, and became effective on May 10, 2016 (codified as Utah Code §§ 31A-40-212, 34-20-14 and as amendments to Utah Code §§ 34-28-2, 34-40-102, 34A-2-103, 34A-5-102, 34A-6-103, 35A-4-203). The bill amended eight chapters in three of Utah’s employment law titles in two ways. First, the

1. Determine a prospective employee’s qualifications to perform the services in question and to hire or discharge the employee.
2. Determine the details of the employee’s pay including the amount of, method of, and frequency of changes in that pay.
3. Train the employee and exercise direction and control over the performance of services by the employee and when and how they are to be performed.
4. Impose discipline upon the employee for rule or policy infractions or unsatisfactory performance.
5. Remove the employee from one job or assign the employee to a different job.
6. Require oral or written reports from the employee.
7. Evaluate the quantity and quality of the services provided by the employee.
8. Assign a substitute employee to perform the services of an employee if the employee is unavailable for work or is terminated from work.
9. Assign alternative work to the employee if the employee is removed from a particular job.

(b) Considering which employing unit:
1. Benefits directly or indirectly from the services performed by the employee.
2. Maintains a pool of workers who are available to perform the services in question.
3. Is responsible for employee compliance with applicable regulatory laws and for enforcement of such compliance.

(c) If, after the application of paras. (a) and (b), a franchisor, as defined in 16 CFR 436.1(k), is determined to be the employer of a franchisee, as defined in 16 CFR 436.1(i), or of an employee of a franchisee, applying sub. (4). The department shall apply sub. (4) only as provided in this paragraph.

Id. § 108.065(1e). Thus, for purposes of Chapter 108, there is a two-step process for determining a franchisor’s employer status. See id.

64. Id. § 111.3205. The Wisconsin Fair Employment Law is found in Subchapter II, Chapter 111, and the amendment applies generally throughout the subchapter. See generally id. §§ 111.31–397. The Fair Employment Law contains prohibitions against discrimination in hiring, pay, promotion, training, termination, and so forth on the basis of race, age, arrest, creed, disability, marital status, and sex, among others. See generally id.

FTC’s definitions of “franchise,”“franchisee,” and “franchisor” were adopted. Second, the following language was added:

For purposes of this chapter, a franchisor is not considered to be an employer of: (i) a franchisee; or (ii) a franchisee’s employee.

[ ] With respect to a specific claim for relief under this chapter made by a franchisee or a franchisee’s employee, this Subsection [ ] does not apply to a franchisor under a franchise that exercises a type or degree of control over the franchisee or the franchisee’s employee not customarily exercised by a franchisor for the purpose of protecting the franchisor’s trademarks and brand.

With these two changes, the Utah legislature amended its Professional Employer Organization Licensing Act, laws regarding employment relations and collective bargaining, Minimum Wage Act, other wage laws, Occupational Safety and Health Act, Workers’ Compensation Act, Antidiscrimination Act, and Employment Security Act.

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66. Definition of Franchise, supra note 31. The definitions were codified at Utah Code Sections 31A-40-102(10)–(12), 34-20-2(7)–(9), 34-28-2(1)(e)–(g), 34-40-102(2)(e)–(g), 34A-2-103(11)(a), 34A-5-102(1)(l)–(n), 34A-6-103(1)(b)–(i), and 35A-4-203(3)(a).

67. Definition of Franchisee, supra note 11.

68. Definition of Franchisor, supra note 12.


70. Id. § 31A-40-212(2). This language amended all of Chapter 40 of Utah’s Insurance Code (Title 31a), containing the Professional Employer Organization Licensing Act. See generally id. §§ 31a-40-101 to -402.

71. Id. § 34-20-14(2). This language amended all of Chapter 20 containing Utah’s laws regarding “Employment Relations and Collective Bargaining,” including laws regarding unfair labor practices, the Labor Relations Board, collective bargaining, and the right to strike. See generally id. §§ 34-20-1 to -14. It did not amend the remaining chapters of Title 34, containing Utah’s general labor laws. See generally id. §§ 34-1-1 to 34-19-13, 34-20a-1 to 34-39-3, 34-41-101 to 34-52-201.


73. Id. § 34-28-2(4). The language amended Chapter 28 of Title 34, which contains laws governing the payment of wages such as paydays and disputes over wages. See generally id. §§ 34-28-1 to -19.

74. Id. § 34A-6-103(4). The amendment applies throughout Utah’s Occupational Safety and Health Act. See generally id. §§ 34A-6-101 to -307. But it does not appear to amend all of the chapters of Utah’s Labor Code (Title 34A). See generally id. §§ 34A-1-101 to -409, 34A-3-101 to 34A-4-102, 34A-7-101 to 34A-11-102.

75. Id. § 34A-2-103(11)(b). The amendment applies throughout Utah’s Worker’s Compensation Act. See generally id. §§ 34A-2-101 to -1005.

76. Id. § 34A-5-102(4). The amendment applies throughout Utah’s Antidiscrimination Act. See generally id. §§ 34A-5-101 to -112. The Act prohibits discrimination in hiring, promotion, termination, and more on the basis of race, color, sex, age, religion, or national origin (among others). Id. § 34A-5-106.

77. Id. § 35A-4-203(3)(b). The amendment applies throughout the Employment Security Act, which is Utah’s unemployment insurance program. See generally id. §§ 35A-4-101 to -508. The amendment does not appear to apply to the remaining chapters of Utah’s Workforce Services Code (Title 35A). See generally id. §§ 35A-1-101 to 35A-3-802, 35A-5-101 to 35A-14-304.
Indiana

Indiana signed its joint employer bill on March 23, 2016, and it became effective July 1, 2016 (codified as IND. CODE § 23-2-2.5-0.5). The statute adopts the FTC’s definitions of “franchisee” and “franchisor” and states:

[A] franchisor is not considered to be an employer or co-employer of: (1) a franchisee; or (2) an employee of a franchisee; unless the franchisor agrees, in writing, to assume the role of an employer or co-employer of the franchisee or the employee of a franchisee.

This statute appears in the Indiana Franchise Act. Because no additional amendments were made to Indiana’s labor and employment statutes, the scope of the amendment may be subject to litigation and interpretation by the courts.

Georgia

The Protecting Georgia Small Business Act was signed into law on May 3, 2016, and became effective on January 1, 2017 (codified as GA. CODE § 34-1-9). The statute adopts the FTC’s definitions of “franchisee” and “franchisor” and states:

(b) Notwithstanding any order issued by the federal government or any agreement entered into with the federal government by a franchisor or a franchisee, neither a franchisee nor a franchisee’s employee shall be deemed to be an employee of the franchisor for any purpose.

(c) This Code section shall not apply to Chapter 9 of this title.

This statute is found in the general provisions chapter of Title 34, which governs labor and industrial relations. Interestingly, the statute expressly does not apply to Chapter 9 of Title 34, which contains Georgia’s workers’ compensation laws, but otherwise applies “for any purpose.” Because the Georgia legislature enumerated this one specific exclusion, it is likely that the law will be interpreted as a general employment statute protecting franchisors from treatment as an employer under a wide variety of laws, includ-

79. Definition of Franchisee, supra note 11.
80. Definition of Franchisor, supra note 12.
81. IND. CODE § 23-2-2.5-0.5.
82. See generally id. §§ 23-2-2.5-0.5 to .51.
84. Definition of Franchisee, supra note 11.
85. Definition of Franchisor, supra note 12.
86. GA. CODE § 34-1-9.
87. See generally id. §§ 34-1-1 to 34-10-6.
88. Id. § 34-1-9(c); see generally id. §§ 34-9-1 to -25 (containing Georgia’s workers’ compensation laws).
89. Id. § 34-1-9(b).
ing Georgia’s antidiscrimination and wage and hour laws (which are also found in Title 34).90

**Oklahoma**

Oklahoma signed its joint employer bill91 on May 24, 2016, and it became effective on November 1, 2016 (codified as OKLA. STAT. tit. 59, § 6005). The statute does not incorporate the FTC’s definitions of “franchisor,” “franchisee,” and “franchise” by reference, but instead copies those definitions exactly into its own language.92 It goes on to state:

B. A franchisor shall not be considered the employer of a franchisee or a franchisee’s employees.

C. The employees of a franchisee shall not be considered employees of the franchisor neither shall the employees of a franchisor be considered employees of a franchisee.93

This statute is found in the miscellaneous chapter under the professions and occupations title, which governs the employment of accountants, plumbers, welders, mechanics, electricians, cosmetologists, barbers, realtors, and a variety of medical professionals, among others.94 Because of its placement and broad wording, it appears likely that the Oklahoma legislature intended the protection for franchisors (and franchisees) to apply throughout Oklahoma’s employment statutes.

3. In 2017, nine more states enacted joint employer laws.

**North Dakota**

North Dakota signed its joint employer bill95 on March 22, 2017, and it became effective on August 1, 2017 (codified as N.D. CENT. CODE § 51-19-18). The statute amends the North Dakota Franchise Investment Law and states:

Notwithstanding any other provision of law or any voluntary agreement between the United States department of labor and a franchisee, a franchisee or an employee of a franchisee is not considered an employee of the franchisor.96

The North Dakota Franchise Investment Law (Chapter 19 of Title 51)97 already contained definitions for “franchise,” “franchisee,” and “franchisor,”

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90. See, e.g., id. §§ 34-4-1 to -6 (governing minimum wages); see, e.g., id. §§ 34-5-1 to -7 (governing discrimination based on sex); see, e.g., id. §§ 34-6a-1 to -6 (governing discrimination based on disability).
93. OKLA. STAT. tit. 59, § 6005.
94. See generally id. §§ 15.1 to 6005.
97. Id. §§ 51-19-01 to -18.
which apply throughout the law.\textsuperscript{98} Similar to Indiana’s joint employer law, the North Dakota legislature did not make further amendments to North Dakota’s labor and employment statutes, meaning the scope of this amendment may be subject to litigation and interpretation by the courts.

\textit{Wyoming}

Wyoming introduced its joint employer bill to “clarify[] the business relationships between franchisors and franchisees and between franchisors and employees of franchisees.”\textsuperscript{99} It was signed into law on March 8, 2017, and became effective on July 1, 2017 (codified as \textsc{Wyo. Stat.} § 27-1-116). The statute adopts the FTC’s definitions of “franchisee”\textsuperscript{100} and “franchisor”\textsuperscript{101} and states:

Neither a franchisee nor a franchisee’s employee shall be deemed to be an employee of the franchisor for any purpose under this title, unless otherwise agreed to in writing by the franchisor and the franchisee. This section shall not apply to a voluntary agreement entered into between the United States department of labor and a franchisee.\textsuperscript{102}

This statute applies to Wyoming’s labor and employment title (Title 27),\textsuperscript{103} which includes Wyoming’s workers’ compensation,\textsuperscript{104} unemployment compensation,\textsuperscript{105} right to work and labor,\textsuperscript{106} wage,\textsuperscript{107} and fair employment practices\textsuperscript{108} laws, among others.

\textit{Arizona}

Arizona signed its joint employer bill\textsuperscript{109} on March 21, 2017, and it became effective on August 9, 2017 (codified as \textsc{Ariz. Rev. Stat.} § 23-1604). The statute adopts the FTC’s definitions of “franchisee”\textsuperscript{110} and “franchisor”\textsuperscript{111} and states:

\begin{itemize}
  \item Id. § 51-19-02(5), (7)–(8). North Dakota defines these terms in ways that are similar to, but not the same as, the FTC definitions. \textit{Compare id. with} Definitions of Franchisee, Franchisor, and Franchise, \textit{supra} notes 11–12, 31.
  \item Id. note 11.
  \item Id. note 12.
  \item \textsc{Wyo. Stat.} § 27-1-116.
  \item See generally \textit{id.} §§ 27-1-101 to 27-15-103.
  \item Id. §§ 27-14-101 to 27-14-806.
  \item Id. §§ 27-3-101 to -706.
  \item Id. §§ 27-7-101 to -115.
  \item Id. §§ 27-4-101 to -508. This chapter includes laws regarding minimum wages, equal pay, and collection of unpaid wages, among others. See generally \textit{id.}
  \item Id. §§ 27-9-101 to -108. The fair employment practices chapter includes laws against discrimination and other unfair employment practices on the basis of age, sex, race, creed, color, national origin, or ancestry (among others). See generally \textit{id.}
  \item Id. note 11.
  \item Id. note 12.
\end{itemize}
1. A franchisor is not an employer or co-employer of either a franchisee or an employee of the franchisee, unless the franchisor agrees, in writing, to assume the role of employer or co-employer of the franchisee or the employee of the franchisee.

2. The owner of a mark is not an employer or co-employer of either the licensee or an employee of the licensee, unless the owner of the mark agrees, in writing, to assume the role of employer or co-employer of the licensee or the employee of the licensee.\textsuperscript{112}

This statute applies to Arizona’s labor title (Title 23).\textsuperscript{113} Title 23 contains a significant portion of Arizona’s labor and employment statutes, including, for example, laws governing wages and working conditions,\textsuperscript{114} unemployment,\textsuperscript{115} workers’ compensation,\textsuperscript{116} and labor,\textsuperscript{117} and the Employers’ Liability Law\textsuperscript{118} and Employment Protection Act.\textsuperscript{119} Notably, Arizona’s Civil Rights Act, which protects employees from discrimination and other unlawful employment practices, is found in Title 41, which was not amended.\textsuperscript{120} Arizona was also the first state to include additional protection for trademark owners who license their marks.\textsuperscript{121}

\textit{New Hampshire}

New Hampshire signed its joint employer bill\textsuperscript{122} on July 20, 2017, and it became effective immediately (amending N.H. REV. STAT. § 275:4). The statute adopts the FTC’s definitions of “franchisor”\textsuperscript{123} and “franchisee”\textsuperscript{124} and states:

\ldots A franchisor is only an employer if the franchisor agrees in writing to assume the role of employer or co-employer of the franchisee or the employee of the franchisee. [ ] For the purposes of this section, “franchisee” and “franchisor” have the same meanings as in Part 436.1 of Title 16 of the Code of Federal Regulations.\textsuperscript{125}

The statute is codified in Chapter 275, specifically Section 275.4, which is a definitions section.\textsuperscript{126} It includes the definitions of “employer” and “employee,” and now “franchisor” and “franchisee.”\textsuperscript{127} The statutory definitions
are limited alternately to “this subdivision,” “this section,” or the “preceding section,” so the scope is unclear. Notably, there are additional definitions of “employer” and “employee” in New Hampshire’s labor code (Title XXIII, Chapters 273–83) that were not explicitly amended. The scope of the amendment will therefore likely be the subject of litigation.

**South Dakota**

South Dakota introduced its joint employer bill to “establish certain provisions regarding joint employer liability protection.” It was signed into law on March 6, 2017 (codified as S.D. CODIFIED LAWS § 60-1-6). The statute does not define “franchisee” or “franchisor” or adopt the FTC’s definitions. It states:

Notwithstanding any other provisions of law or any voluntary agreement between the United States Department of Labor and a franchisor, a franchisee or an employee of a franchisee is not considered an employee of the franchisor.

This statute is codified in South Dakota’s labor and employment title, and particularly in the title’s first chapter named “Nature and Terms of Employment.” Given this placement and its expansive language, the amendment may fairly be read as a general labor and employment statute governing all employment in South Dakota.

**Kentucky**

Kentucky signed its joint employer bill on March 16, 2017, and it became effective on June 29, 2017, amending five labor and employment statutes either by excluding franchisors from the definition of “employer” or providing them with a general carve out from the law (KY. REV. STAT. §§ 337.010(1)(e)(1),

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128. See id. The “preceding section” requires an employer to pay for an employee’s or applicant’s medical examination or records if required by the employer as a condition of employment. Id. § 275:3.
129. Id. §§ 273.1–283:9.
130. For example, the definition of “employer” and “employee” in the sections regarding minimum wages, payment of wages, and discrimination were not amended. See id. §§ 275:36, 275:42, 279:1.
133. Id. §§ 60-1-1 to 60-14-6.
134. Id. §§ 60-1-1 to 60-1-6. This first chapter also contains the definition of “employee.” Id. § 60-1-1.
135. Notably, South Dakota’s laws regarding unemployment compensation (Title 61) and workers’ compensation (Title 62) contain their own definition sections, including specific sections defining “employer.” Id. § 61-1-1 (defining terms for unemployment compensation laws); id. § 61-1-4 (defining employer for unemployment compensation laws); id. § 62-1-1 (defining terms for workers’ compensation laws); id. § 62-1-2 (defining employer for workers’ compensation laws). These laws also appear outside of the labor and employment title (Title 60). See generally id. §§ 60-1-1 to 60-14-6.
338.021(2), 341.070(14), 342.690(4), 344.030(5)). The statutes adopt the FTC’s definitions of “franchisee”137 and “franchisor”138 and state:

Notwithstanding any voluntary agreement entered into between the United States Department of Labor and a franchisee, neither a franchisee nor a franchisee’s employee shall be deemed to be an employee of the franchisor for any purpose under this chapter[. . . .]

Notwithstanding any voluntary agreement entered into between the United States Department of Labor and a franchisor, neither a franchisor nor a franchisor’s employee shall be deemed to be an employee of the franchisee for any purpose under this chapter.139

The Kentucky legislature amended laws regarding wage and hour,140 occupational health and safety,141 unemployment compensation,142 workers’ compensation,143 and civil rights.144 However, the entire labor and employment law title (Title XXVII, Chapters 336–47) was not explicitly amended.145

North Carolina

North Carolina signed its joint employer bill146 on May 4, 2017, and it became effective immediately (codified as N.C. GEN. STAT. § 95-25.24A). The statute adopts the FTC’s definitions of “franchisee”147 and “franchisor”148 and states:

Neither a franchisee nor a franchisee’s employee shall be deemed to be an employee of the franchisor for any purposes, including, but not limited to, this Article and Chapters 96, 97, and 105 of the General Statutes. 149

137. Definition of Franchisee, supra note 11.
138. Definition of Franchisor, supra note 12.
139. KY. REV. STAT. §§ 337.010(1)(e)(1), 338.021(2), 341.070(14), 342.690(4), 344.030(5).
140. Id. § 337.010(1)(e)(1). This language applies throughout Chapter 337 governing wage and hour laws, including payment of wages, minimum wages, and equal pay, among others. See generally id. §§ 337.015–994.
141. Id. § 338.021(2). This language applies throughout Chapter 338 governing the occupational safety and health of employees. See generally id. §§ 338.010–991.
142. Id. § 341.070(14). This language applies throughout Chapter 341 governing unemployment compensation. See generally id. §§ 341.005–990.
143. Id. § 342.690(4). This language applies throughout Chapter 342, which covers a wide variety of workers’ compensation issues, including hazardous employment, medical benefits, and payments. See generally id. §§ 342.0011–990.
144. Id. § 344.030(5). This language applies explicitly to Kentucky Revised Statutes Sections 344.030–110 and not to the entire civil rights chapter (Chapter 34). See id. § 344.030. Those sections cover a variety of discriminatory practices, including discrimination in hiring, firing, or other terms of employment based on race, color, religion, national origin, sex, or disability, among others. See, e.g., id. § 344.040.
145. See supra notes 140–44. For example, the child labor laws (Chapter 339) and laws regarding employment agencies (Chapter 340) were not explicitly amended. See generally id. §§ 339.010–340.990.
147. Definition of Franchisee, supra note 11.
148. Definition of Franchisor, supra note 12.
149. N.C. GEN. STAT. § 95-25.24A.
Although codified in North Carolina’s Wage and Hour Act, the statute is broadly worded and states that it applies “for any purposes,” so it will likely be interpreted to grant franchisors broad protections. In addition to the Wage and Hour Act, the amendment explicitly applies to the Employment Security Law, the Workers’ Compensation Act, and the Revenue Act.

Arkansas

Arkansas introduced its joint employer bill “to clarify the relationship between a franchisor and franchisee regarding the definition of ‘employee.’” It was signed into law on April 6, 2017, and it became effective on August 1, 2017 (amending Ark. Code § 11-2-125). The statute adopts its own definitions of “franchise,” “franchisee,” “franchisor,” and “subfranchisor,” but they are nearly identical to the FTC’s definitions. The statute provides:

Notwithstanding a voluntary agreement entered into between the United States Department of Labor and a franchisee, neither a franchisee nor a franchisee’s employee shall be deemed to be an employee of the franchisor or subfranchisor.

This statute is enacted in the “General Provisions” subchapter of the Arkansas Department of Labor laws (Title 11, Chapter 2). There is nothing in its language that limits its application to any specific title, chapter, or section of Arkansas law. Given that, the broad language, and the generality of the legislature’s stated purpose for the bill, it is expected to apply expansively.

Alabama

Alabama signed its joint employer bill, the Franchise Business Protection Act, on May 17, 2017, and it became effective on August 1, 2017 (codified as Ala. Code § 25-6-5). The Act adopts the FTC’s definitions of “franchisee” and “franchisor” and states:

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150. Id. §§ 95-25.1 to -25.
151. Id. § 95-25.24A.
152. Id. §§ 96-1 to -40. The Employment Security Law governs North Carolina’s unemployment plan, including payments by employers and administration of benefits. See generally id.
153. Id. §§ 97-1 to -200. Chapter 97 contains the Workers’ Compensation Act and other provisions, including specific applications of the Act to individual employers. See generally id. § 97-165 to -200.
154. Id. §§ 105-1 to -570. The Revenue Act governs state taxes. See generally id.
158. See generally id. §§ 11-2-101 to -206.
160. Definition of Franchisee, supra note 11.
161. Definition of Franchisor, supra note 12.
(c) Except as provided in a voluntary agreement entered into between the United States Department of Labor and a franchisor, the following persons may not be deemed or construed to be employees of a franchisor:

1. A franchisee.
2. An employee of a franchisee.
3. An independent contractor working for a franchisee.

(d) To the extent that this section does not conflict with federal law, this section shall only apply to the following:

1. The enforcement or enactment of rules or ordinances by state agencies or local governmental bodies.
2. Labor relations and collective bargaining.\(^{162}\)

The amendment is codified in the chapter named “Employer’s Liability for Certain Injuries” in Alabama’s Industrial Relations and Labor title.\(^{163}\) Its language appears to apply broadly. However, the Alabama legislature included the limitation that the statute applies only to “(1) [t]he enforcement or enactment of rules or ordinances by state agencies or local governmental bodies [or] (2) [l]abor relations and collective bargaining,” to the extent the statute does not conflict with federal law.\(^{164}\) What constitutes a “local governmental bod[y]” and specifically if the Alabama legislature is a local governmental body is not defined by the statute.\(^{165}\)

B. Additional states are expected to enact laws in 2018 and beyond.

State legislative efforts to address joint employer liability are expected to continue. Three states have joint employer bills pending—South Carolina,\(^{166}\)

\(^{162}\) Ala. Code § 25-6-5.
\(^{163}\) See generally id. §§ 25-6-1 to -5.
\(^{164}\) Id. § 25-6-5(d).
\(^{165}\) See id.
\(^{166}\) South Carolina introduced its joint employer bill on January 10, 2017. H.B. 3031, 2017 Gen. Assemb., 122nd Sess. (S.C. 2017). If enacted, it will amend South Carolina Code Section 41-1-30. It is currently in committee in South Carolina’s House of Representatives. The bill seeks to take effect immediately upon passage and to add definitions for “franchise,” “franchisee,” and “franchisor,” similar to the FTC’s definitions. The bill states:

For purposes of this title, a franchisor is not considered to be an employer or co-employer of a franchisee or an employee of a franchisee unless the franchisor agrees, in writing, to assume the role of an employer or co-employer of the franchisee or the employee of a franchisee. These provisions apply notwithstanding a voluntary agreement between the United States Department of Labor and a franchisor.

H.B. 3031, 2017 Gen. Assemb., 122nd Sess. (S.C. 2017). The amendment would expressly apply to South Carolina’s labor and employment title (Title 41), which includes chapters controlling the right to work (S.C. Code §§ 41-7-10 to -130), payment of wages (id. §§ 41-10-10 to -110), occupational health and safety (id. §§ 41-15-10 to -640), and employee benefits and claims (id. §§ 41-35-10 to -760), among others. See generally id. §§ 41-1-10 to 41-45-60.
Nebraska, and Washington. In addition to these three, the International Franchise Association, a key player in the effort to enact joint employer legislation, has targeted Idaho, Iowa, Kansas, Ohio, Mississippi, Missouri, West Virginia, and Pennsylvania for joint employer legislation in 2018. The ad-

167. Nebraska introduced its joint employer bill on January 17, 2017. L.B. 436, 105th Leg., 1st Sess. (Neb. 2017). The last committee hearing was on March 13, 2017. It adopts the FTC’s definitions of “franchisee” and “franchisor” and states:

(1) Except as provided in subsection (2) of this section, a franchisor shall not be considered to be an employer of a franchisee or a franchisee’s employees.

(2) Subsection (1) of this section does not prevent a franchisor from being considered an employer of a franchisee or a franchisee’s employees in a specific case if the franchisor is found to have exercised a type or degree of control over the franchisee or the franchisee’s employees that is not customarily exercised by a franchisor for the purpose of protecting the franchisor’s trademarks and brand.

The bill seeks to amend several of Nebraska’s labor and employment laws, including the: Workers’ Compensation Act (Neb. Rev. Stat. §§ 48-101 to 48-1,118); Employment Security Law (id. §§ 48-601 to -683); Wage and Hour Act (controlling minimum wages) (id. §§ 48-1201 to -1209.01); Wage Payment and Collections Act (id. §§ 48-1228 to -1234); Age Discrimination in Employment Act (id. §§ 48-1001 to -1010); Fair Employment Practice Act (id. §§ 48-1101 to -1126); Non-English-Speaking Workers Protection Act (id. §§ 48-2207 to -2214); New Hire Reporting Act (id. §§ 48-2301 to -2308); Workplace Privacy Act (id. §§ 48-3501 to -3511), and certain other labor and employment laws regarding employee medical examinations (id. §§ 48-220 to -223), adoptive parental leave (id. § 48-234), genetic testing (id. § 48-236), use of employees’ Social Security numbers (id. § 48-237), secondary boycott (id. §§ 48-901 to -912), sex discrimination (id. §§ 48-12190 to -1227.01), and drug and alcohol testing (id. §§ 48-1901 to -1910).

168. Washington introduced its joint employer bill on February 1, 2017. H.B. 1881, 65th Leg., Reg. Sess. (Wash. 2017). It is still in committee, having been reintroduced and retained in its present form three times. If enacted, it will amend Washington Revised Code Sections 49.12.005, 49.17.020, 49.46.010, 49.60.040, 50.04.080, and 51.08.070, and codify a new section in Chapter 52 of Title 49. The bill states:

The legislature finds that franchising is an important business model which provides small business opportunities, creates jobs, and benefits communities throughout this state. Franchisees are able to own their own businesses but with protections such as brand name recognition and proven methods. The legislature further finds that under employment laws, persons who work for a franchisee are the employees of only the franchisee. Recent developments, however, have suggested that franchisors may be found to be joint employers with franchisees. Joint employer status of franchisors threatens the independence of franchisees and the entire franchise model. Therefore, the legislature intends to clarify that franchisors are not employers of franchisees or of the employees of a franchisee. . . . A franchisor, as defined in RCW 19.100.010, is not an employer of a franchisee, as defined in RCW 19.100.010, or of an employee of a franchisee.

The bill seeks to amend the definition of “employer” under Washington’s industrial welfare chapter (which includes wage discrimination due to sex, time-off and sick leave for care of family members, and parental leave) (WASH. REV. CODE §§ 49.12.005 to .093); Industrial Safety and Health Act (id. §§ 49.17.010 to .910); Minimum Wage Act (id. §§ 49.46.005 to .920); wages, deductions, contributions, and rebates chapter (id. §§ 49.52.010 to .090); law against discrimination chapter (id. §§ 49.60.010 to .505); unemployment compensation title (id. §§ 50.01.005 to 50.98.110); and industrial insurance title (id. §§ 51.04.010 to 51.98.080).

169. This would be Mississippi’s second bite at the apple, having failed to pass a joint employer bill once before. See S.B. 2110, 2017 Leg., Reg. Sess. (Miss. 2017) (the bill died in committee on Feb. 28, 2017).

170. Email from Jeff Hanscom, Vice President, State Government Relations for the International Franchise Association, to Adrienne L. Saltz (Nov. 13, 2017) (on file with author).
dition of these states could be a tipping point for federal efforts because over half of the states would then have joint employer legislation on the books.

C. The U.S. House of Representatives recently passed the Save Local Business Act.

On November 7, 2017, the U.S. House of Representatives passed the Save Local Business Act. If enacted, it will amend the definition of “employer” in the NLRA and FLSA. The bill states:

(a) Section 2(2) of the National Labor Relations Act (29 U.S.C. 152(2)) is amended—(1) by striking “The term ‘employer’” and inserting “(A) The term ‘employer’” and (2) by adding at the end the following: “(B) A person may be considered a joint employer in relation to an employee only if such person directly, actually, and immediately, and not in a limited and routine manner, exercises significant control over essential terms and conditions of employment, such as hiring employees, discharging employees, determining individual employee rates of pay and benefits, day-to-day supervision of employees, assigning individual work schedules, positions, and tasks, or administering employee discipline.”

(b) Fair Labor Standards Act of 1938.—Section 3(d) of the Fair Labor Standards Act of 1938 (29 U.S.C. 203(d)) is amended—(1) by striking “ ‘Employer’ includes” and inserting “(1) ‘Employer’ includes”; and (2) by adding at the end the following: “(2) A person may be considered a joint employer in relation to an employee for purposes of this Act only if such person meets the criteria set forth in section 2(2)(B) of the National Labor Relations Act (29 U.S.C. 152(2)(B)).”

The proposed act returns to a direct control standard, but stops short of conclusively defining or limiting the “essential terms and conditions of employment[.]” And it does not preempt state law or amend the majority of federal employment statutes.

II. Trends in the State Joint Employer Statutes

The language of each joint employer bill varies state-to-state, as does the scope of the employment and other statutes amended, but some interesting trends have emerged.

A. The states rely upon the FTC’s definitions.

The state joint employer statutes overwhelmingly adopt the FTC’s definitions of “franchisee” and “franchisor.” Michigan, Oklahoma, North Dakota, South Dakota, and Arkansas are the only exceptions, but Oklahoma, North Dakota, and Arkansas either already had or added their own defini-


\[172.\] Id.

\[173.\] In its present state, the Save Local Business Act does not amend any of the following federal laws: Age Discrimination in Employment Act of 1967 (29 U.S.C. §§ 621–634); Americans with Disabilities Act of 1990 (42 U.S.C. §§ 12101–12113); Title VII of the Civil Rights Act of 1964 (id. §§ 2000e to 2000e-17); Family and Medical Leave Act (29 U.S.C. §§ 2601–2654); Migrant and Seasonal Agricultural Worker Protection Act (id. §§ 1801–1872); or Occupational Safety and Health Act of 1970 (id. §§ 651–678).
tions mirroring (or nearly mirroring) the FTC’s definitions. Interestingly, the statutes are not as likely to adopt the FTC’s definition of “franchise” nor are they likely to define “franchise” on their own, which is strange because that term is included in and critical to understanding the FTC’s definitions of “franchisee” and “franchisor.”

B. The states generally codify their joint employer bills in one of three ways.

The states typically take one of three approaches to codify their joint employer bills. The bills (1) amend specific labor and employment chapters or acts by adding a carve out or amending the definition of “employer,” (2) craft a general labor and employment law and house it somewhere in the labor and employment title, or (3) amend the state franchise law. Although each approach has its strengths and weaknesses, the overall result is that the joint employment statutes are often not comprehensive, amending certain laws but neglecting others with no explanation and for no apparent reason, and they are certainly not consistent from state-to-state. This leaves franchisors exposed to liability and does not put the current uncertainty to rest.

In 2015, three of the five states proposing joint employer bills followed the first approach (Texas, Michigan, and Wisconsin), but over time, there has been a noticeable move away from amending specific labor and employment laws and toward implementing a general law governing all employment. The year 2017 saw six states propose general laws (Wyoming, South Carolina’s joint employer bill likewise did not expressly adopt the FTC’s definitions but has similar definitions. H.B. 3031, 2017 Gen. Assemb., 122nd Sess. (S.C. 2017).

175. Definitions of Franchisee, Franchisor, and Franchise, supra notes 11–12, 31.


180. See Part I.A.1.

181. See Part I.A.
Arizona, South Dakota, North Carolina, Arkansas, and Alabama) with only one (Kentucky) choosing to amend specific chapters or acts. The amendments to state franchise laws (Michigan, Indiana, and North Dakota) are spread equally over time.

Of the three approaches, the amendments to the franchise laws arguably create the most ambiguity. Unlike Michigan, both Indiana and North Dakota did not make any further changes to their labor and employment statutes or specify where and to what extent amendments to the franchise law might apply more broadly.

There is a degree of consistency among the states that choose to amend specific labor and employment statutes. Namely, four of the five states taking this approach (Kentucky, Texas, Utah, and Wisconsin) explicitly included protection for franchisors under the state’s wage and hour laws and laws against discrimination.

C. Carve outs for joint employer liability are common.

The amendments are typically willing to carve out circumstances under which a franchisor may be deemed a joint employer. In fact, sixteen of the eighteen states have at least one type of carve out (with North Carolina and Oklahoma as the only two exceptions). These carve outs generally take one of three forms:

- Alabama, Arkansas, Georgia, Kentucky, North Dakota, South Dakota, Tennessee, and Wyoming each have a carve out for a voluntary agreement entered into between the DOL (or the federal government for Georgia) and a franchisee or a franchisor.

- Arizona, Indiana, New Hampshire, Michigan, Wisconsin, and Wyoming allow the franchisor to agree in writing to assume the role of an employer of the franchisee or employees of the franchisee.

- Louisiana, Michigan, Texas, Utah, and Wisconsin have some form of carve out for franchisor control.

182. See Part I.A.3.

183. See supra notes 46–47, 81–82, 96–98 and accompanying text.


D. Only five states included some form of control test in their joint employer legislation.

The states generally steer clear of control tests. However, Texas, Utah, and Wisconsin state that if the franchisor has been found to exercise a type or degree of control over the franchisee or the franchisee’s employees not customarily exercised by a franchisor for the purpose of protecting its trademarks and brand, the franchisor may be deemed an employer of the franchisee or the franchisee’s employees.189

Only Michigan and Louisiana reference the “essential terms and conditions” of employment, but neither defines that term.190 Louisiana states that a franchisor may be deemed the employer of a franchisee’s employees “where the two entities share or co-determine those matters governing the essential terms and conditions of employment and directly and immediately control matters relating to the employment relationship[].”191 Similarly, Michigan allows for joint employer liability where the “[t]he franchisee and franchisor share in the determination of or codetermine the matters governing the essential terms and conditions of the employee’s employment [and] [t]he franchisee and franchisor both directly and immediately control matters relating to the employment relationship, such as hiring, firing, discipline, supervision, and direction,” but only as it relates to Michigan’s Worker’s Disability Compensation Act of 1969.192

Interestingly, the control tests are found in some of the first statutes to be enacted. None of the states enacting bills in 2017 included this type of language. It remains to be seen how the courts will interpret these provisions and if the exception will swallow the rule.

E. Several states address matters beyond franchisor liability as a joint employer.

Finally, some of the states took their legislation beyond franchisor liability as a joint employer or aggressively limited liability in certain circumstances, such as for control exercised over a trademark. For example:


190. LA. STAT. § 23:921; MICH. COMP. LAWS § 418.120. The Save Local Business Act also references the “essential terms and conditions[].” Save Local Business Act, H.R. 3441, 115th Congress (2017–2018).

191. LA. STAT. § 23:921(F)(3). Importantly, this carve out applies only to workers’ and unemployment compensation claims. Id.

192. MICH. COMP. LAWS § 418.120.
Arizona is the only state to legislate explicitly that the owner of a trademark is not an employer of the licensee or an employee of the licensee (unless the licensor agrees in writing to assume that role). This provides an interesting second layer of protection under Arizona law and could even be used to protect accidental franchisors.

• Alabama is the only state to provide that an independent contractor of a franchisee cannot be deemed or construed to be an employee of the franchisor. Because Alabama’s joint employer statute may be limited to “[t]he enforcement or enactment of rules or ordinances by state agencies or local governmental bodies” and does not define “local governmental bodies,” the usefulness of this provision is dubious until the scope of Alabama’s joint employer statute is determined.

• Kentucky and Oklahoma grant an extra level of protection for franchisees by clarifying that the employees of a franchisor are not employees of the franchisee.

• Louisiana states that “a voluntary agreement entered into between the United States Department of Labor and an employer shall not be used by a state department or agency as evidence or for any other purpose in an investigation or judicial or administrative determination, including whether an employee of a franchisee is also considered to be an employee of the franchisor.”

• Michigan states that as long as the franchisee provides a benefit plan or pays wages and there is nothing in the franchise agreement that provides otherwise, the franchisee is considered the sole employer of its employees.

• Wisconsin applies a two-part test for determining a franchisor’s employer status under its unemployment insurance and reserves chapter.

III. Analysis and Implications

Judging whether the flurry of legislative activity over the course of the last three years has been effective depends on the goal. Does the state or federal legislature want to provide franchisors with certainty regarding which activities they may control without incurring liability as an employer? Is the goal to ensure franchisors can protect their trademarks and goodwill, protect the

195. See id. § 25-6-5(d).
franchisor-franchisee relationship, or the franchisee’s independence? What about job creation? Or perhaps the goal is to limit costly litigation?

A good deal of the discussion surrounding the recent legislative actions concentrates simply on dismantling the threat of joint employer liability.200 This goal glosses over the fact that joint employer liability is not one thing, but rather arises from a litany of statutes, regulatory agency decisions, and common law precedent. This has led to a patchwork of fixes that do not uniformly address a franchisor’s need for predictability and nationwide consistency or a franchisee’s need to control its own employment practices.

A. Uncertainty remains: The state joint employer statutes provide a patchwork of (untested) coverage.

Because so much of the legislative activity has occurred at the state level, the resulting protections for franchisors are inconsistent.201 Some states have instituted sweeping changes to their labor and employment laws, effectively protecting franchisors from liability as joint employers for the full range of employment related claims.202 However, other states have instituted minimal changes203 or the application of their joint employer laws remains unclear.204 In large part, this is to be expected because the underlying state laws regarding employment issues, such as wage and hour, sexual harassment, and discrimination, vary from state-to-state and nationwide franchisors have come to expect state law inconsistencies and nuances.

Here, not only are the underlying laws and the joint employer amendments different, but the scope of the language also remains untested. Judicial interpretation of the state joint employer laws is virtually non-existent. In fact, there are no published decisions applying any of the enacted joint employer statutes. This presents a challenge to franchisors whose potential liability will depend on the reach of the joint employer statutes.

Even so, one recent development sheds light on where judicial interpretation could head under the Texas law. The Texas Department of Labor recently conducted a routine audit of a master franchisee.205 The auditor originally found the master franchisee to be a joint employer with all of it sub-

200. For example, the stated goal of the Save Local Business Act is “to clarify the treatment of two or more employers as joint employers[.]” Save Local Business Act, H.R. 3441, 115th Congress (2017–2018).
201. See supra Part I.A. In addition, some states like California have actually expanded the bases for liability. See, e.g., CAL. LAB. CODE § 2810.3(b) (creating liability for the payment of wages and provision of workers’ compensation coverage for companies, referred to as “client employer[s],” that use workers from staffing agencies or other “labor contractor[s]”).
203. See, e.g., IND. CODE § 23-2-2.5-0.5; see, e.g., N.D. CENT. CODE § 31-19-18.
204. See, e.g., N.H. REV. STAT. § 275:4; see, e.g., ALA. CODE § 25-6-5.
205. Email from Jeff Hanscom, Vice President, State Government Relations for the International Franchise Association, to Adrienne L. Saltz (Aug. 31, 2017) (on file with author).
franchisee.206 The master franchisee challenged the determination based on the Texas joint employer statute, and the Texas Department of Labor revised its finding, determining the master franchisee was not a joint employer.207 In this instance, the decision-maker accepted a broad reading of the applicable joint employer statute.

Perhaps more telling than this decision is the fact that there are no published decisions interpreting the joint employer laws, despite some of them being over two years old. Anecdotal evidence suggests that franchisors are facing a barrage of sexual harassment, wage and hour, discrimination, and other employment claims. This begs the question of why there are no decisions. Several forces (or a combination thereof) may be at work: (1) parties may be fighting these battles in state courts that do not publish their opinions, (2) the new legislation may be deterring the plaintiffs from bringing joint employer claims against franchisors in states with joint employer laws, (3) judges might be exercising caution in relying on these new statutes to limit franchisor liability, (4) some of the new statutes may be too limited in application and therefore not relied upon by franchisors for the majority of joint employer claims, or (5) these statutes may simply be too recent to have published case law. Further, at least in Texas and Wisconsin, the joint employer amendments limit liability only for conduct occurring after the effective date.208

B. The Save Local Business Act is unlikely to resolve the uncertainty and inconsistency.

It is unlikely that the uncertainty regarding a franchisor’s nationwide status as a joint employer under state law will be resolved by the federal Save Local Business Act.209 The Act itself does not propose a consistent test for the states or even hint at preemption.

The Save Local Business Act, if enacted, would only apply to the FLSA and the NLRA.210 It would provide some much needed clarity under those statutes,211 but it would not resolve inconsistency under federal employment stat-

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206. Id.
207. Id.
210. See id.
211. For example, Hall v. DIRECTV, LLC, a recent FLSA case in which the Fourth Circuit reversed the district court’s decision, found that the plaintiffs stated a claim under the FLSA and created a new test for joint employment. Hall v. DIRECTV, LLC, 846 F.3d 757, 770–71, 774, 779 (4th Cir. 2017). The joint employment test in Hall is comprised of six factors: ““(1) the degree of control that the putative employer[s] ha[ve] over the manner in which the work is performed; (2) the worker’s opportunities for profit or loss dependent on his managerial skill; (3) the worker’s investment in equipment or material, or his employment of other workers; (4) the degree of skill required for the work; (5) the permanence of the working relationship; and (6) the degree to which the services rendered are an integral part of the putative employer[s’] business.”” Id. at 774. The Fourth Circuit found that “‘the entity must only play a role in establishing the key terms and conditions of the worker’s employment’ and ‘‘one factor alone’” can give rise to a reasonable inference that the entities are “‘not completely disassoci-
utes, much less state law. For example, it will not change or clarify the “joint employer” standard under the antidiscrimination laws enforced by the Equal Employment Opportunity Commission,212 which applies a liberal definition of joint employer,213 the Occupational Safety and Health Act,214 or the Family and Medical Leave Act,215 among others.216

It is unlikely that the final iteration of the Save Local Business Act, or a different, yet-to-be-proposed federal law, will be so broad as to effectively replace state joint employer standards. First, states protect employees on issues like wages very differently, and Congress is slow to impose federal standards on top of states’ rights to set policies.217 Second, state laws often provide more expansive protections to employees than federal laws.218 A federal employment law is unlikely to entirely “occupy the field,” which leaves states to set their own standards for joint employment on a host of issues. The most likely way the Save Local Business Act will impact franchisor liability for state law claims is that the courts will consider the federal standard as persuasive in rendering decisions.

C. The judicial process will likely bring some clarity—but slowly.

Because state law tests for “employment” or “joint employment” are often highly fact specific,219 franchisors must engage in costly discovery to defeat...
them. The joint employer statutes—and in particular, the broader statutes in Tennessee, Texas, North Carolina, South Dakota, Utah, and Wyoming—should foreclose this for specific state law claims. Over time, the courts will hopefully bring some certainty to the meaning and scope of the more ambiguous joint employer statutes. This will benefit franchisors both in planning to avoid liability and in defeating spurious claims.

It also seems probable that addressing joint employer liability at the state level will lead to inconsistent judicial decisions. A particular activity might expose a franchisor to liability for say wage and hour violations in one state but not another. These discrepancies make planning for a nationwide franchisor and its franchisees a challenge. They will also lead to incongruous results particularly in the class action context.

D. An alternate approach: Amend the Lanham Act.

Although the recent state legislation and the proposed Save Local Business Act are helpful in limiting joint employer liability under specific laws, they do not directly address the overall concern that a franchisor’s control over its trademark will be deemed control over employment issues. And perhaps the most fundamental goal of the joint employer legislation should be to ensure that franchisors can protect their trademarks and control the goods and services offered under them.

The Lanham Act requires all licensors—including franchisors—to control their licensees’ use of their trademark or else the rights in that mark may be lost. Recent cases have found joint employer liability on the basis that the law does not “distinguish between controls put in place to protect a franchise’s goodwill and intellectual property and controls for other purposes.” This is in part because the “Lanham Act does not define the extent or manner of supervision necessary to satisfy the requirement of reasonable control by the employers” and (2) whether “that employer and the other joint employers each control or supervise such rendering of services[,]” Restatement of Employment Law § 1.04(b). Tests under state laws can have many more factors. For example, the New Jersey Law Against Discrimination relies on a multi-factor test to determine whether or not a worker is an employee. Thomas v. Cnty. of Camden, 902 A.2d 327, 334 (N.J. Super. Ct. App. Div. 2006). Courts consider factors like the employer’s right to control the means and manner of the worker’s performance, who furnished the equipment and workplace, the method of payment, the manner of termination, and whether the employer pays Social Security taxes, among others. Id. at 335.

Little is required at the initial pleading stages; all the purported employee must do is allege sufficient facts that make it plausible that the franchisor is its joint employer. See Federal Rule of Civil Procedure 8(a); see also Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009).

220. Indeed in states with comprehensive joint employer statutes, employees would be well advised to focus on alternate theories of liability such as integrated enterprise or ostensible agency.


control.” A possible solution then is to amend the Lanham Act to define the controls that trademarks owners must exercise over their trademarks and provide that those controls do not create liability as an employer or joint employer under federal or state law. Such an amendment would provide additional certainty to a nationwide franchisor and its franchisees.

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226. For example, the amendment could state that a trademark owner may exercise control over the nature and quality of the goods or services offered under the mark in order to preserve its quality and to ensure that public expectations are met and goodwill is preserved. Going further, the amendment could specify that the controls exercised under the Lanham Act for these purposes do not create employment or agency relationships under any federal or state law.
Is It Possible to Fully Insulate Yourself from Personal Liability?

Megan B. Center

The owners of any entity may think that by creating an entity, they are fully insulated from liability stemming from the entity’s actions or illegal conduct. Generally, courts are reluctant to disregard the corporate entity and impose personal liability upon an entity’s shareholders; however, a corporate entity will be disregarded if there is, for example, undercapitalization or failure to observe corporate formalities. The creation of an entity does not in and of itself fully protect owners, officers, and other executives from liability under either common law or certain state laws. In the franchise context, state franchise statutes impose potential personal liability and in some cases, individuals can be held liable if they did not participate in the culpable conduct.

I. Background and State Law Liability

When franchising first became a popular mode of business expansion, some observers perceived that franchisors exercised their superior bargaining position and consistently took advantage of franchisees. In response to the perceived rampant abuse, many states enacted laws to protect their franchisees. Courts have highlighted the purpose of these statutes in their decisions when holding for franchisee claimants. Further, courts have interpreted state franchise statutes broadly in order to effectuate the purpose of the statute,

2. Id.

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namely, to protect franchisees.\footnote{2012 WL 683384.} Prior to the availability of claims under state franchise statutes, franchisees were merely left with common law claims, such as fraud or negligent misrepresentation, and with claims under certain consumer protection statutes. Under this regime franchisees faced, and continue to face, significant difficulties in pleading fraud and similar claims due to the requirement to comply with heightened pleading requirements.\footnote{See, e.g., Schwartzco Enters. LLC v. TMH Mgmt., LLC, 60 F. Supp. 3d 331 (E.D.N.Y. 2014) (holding that a franchisee failed to plead the circumstances constituting the fraud with the requisite specificity).} To successfully defeat an initial motion for summary judgment as to a fraud claim, a franchisee must “plead with particularity” the facts surrounding the fraud claim by specifying the fraudulent statements, identifying the speaker, stating where and when the statements were made and why the statements were fraudulent.\footnote{See, e.g., Berglund v. Cynosure, Inc., 502 F. Supp. 2d 949 (D. Minn. 2007) (holding that a franchisee’s allegations of fraud in connection with purchase of a franchise failed to satisfy the particularity requirement for a fraud claim).} As such, franchisees have a difficult time passing the summary judgment phase due, in part, to the inclusion of standard disclaimer language in franchise agreements.\footnote{See, e.g., Coraud LLC v. Kidville Franchise Co., LLC, 109 F. Supp. 3d 615 (S.D.N.Y. 2015) (holding that the disclaimer language contained in the franchise agreement sufficiently waived any possibility that the plaintiff relied on any misrepresentations outside of the franchise agreement or franchise disclosure document, precluding a claim for fraud).} In response, states began implementing state franchise statutes to provide franchisees with additional remedies and causes of action under which to plead their case.

The first place to look, then, for potential personal liability of certain officers, directors, and other personnel (collectively, the nonfranchisor defendants) of a franchisor is under the various state franchise statutes that specifically outline the joint and several liability of the franchisor’s representatives. At this time, fourteen states provide for joint and several liability for certain non-franchisor defendants, including California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Washington, and Wisconsin.\footnote{CAL. CORP. CODE § 31302 (West 2017); HAW. REV. STAT. § 482E-9 (West 2009); 815 ILL. COMP. STAT. ANN. 705/26 (West 2008); IND. CODE ANN. § 23-2-2.5-29 (West 2009); MD. CODE ANN., BUS. REG. § 14-227(d)(1), (2) (West 2009); MICH. COMP. LAWS ANN. § 445.1532; MINN. STAT. ANN. § 80C.17(d); N.Y. GEN. BUS. LAW § 691 (McKinney 2009); N.D. CENT. CODE § 51-19-12(2) (2008); OR. REV. STAT. ANN. § 650.020 (West 2009); R.I. GEN. LAWS § 19-28.1-21(b) (2008); S.D. CODIFIED LAWS § 37-5B-49 (2009); WASH. REV. CODE ANN. §§ 19.100.010, 19.100.190 (West 2009); WIS. STAT. ANN. § 553.51 (West 2009).} The language of each statute varies slightly but many of the statutes are similar to the New York Franchise Sales Act (NYFSA), which states that:

A person who directly or indirectly controls a person liable under the NYFSA, a partner in a firm so liable, a principal executive officer or director of a corporation so liable, a person occupying a similar status or performing similar functions, and an employee of a person so liable, who materially aids in the act of transaction constituting the violation, is also liable jointly and severally with and to the
same extent as the controlled person, partnership, corporation or employer. It shall be a defense to any action based upon such liability that the defendant did not know or could not have known by the exercise of due diligence the facts upon which the action is predicated.9

These state franchise statutes provide for joint and several liability for violations of the registration, disclosure, and anti-fraud provisions of each statute. In addition to the above-listed states, courts in Florida have noted that nonfranchisor defendants could be held individually liable if they are an “active participant” in the illegal conduct even if the statute does not explicitly provide for joint and several liability, as discussed later in this article.10 As a preliminary matter, a franchisee must successfully prove that the franchisor violated the state franchise statute in order to hold a nonfranchisor defendant jointly and severally liable.11 However, this does not mean that the franchisee must have been successful in obtaining a judgment against the franchisor for violation of a state franchise statute to hold the nonfranchisor defendant liable.12

A. Who Is Held Liable Jointly and Severally?

At the outset, it is important to highlight which nonfranchisor defendants are subject to personal liability under state franchise statutes. Most have two categories of personnel who may be held jointly and severally liable. The first category includes certain employees of the franchisor. The second category includes principal executive officers, directors, partners, any person exerting direct or indirect control over the franchisor, or any person occupying a similar position (collectively, the control people).

Courts universally agree that in order for a franchisor’s employees to be held personally and severally liable, the employee must have materially aided in the culpable conduct.13 It logically follows that courts would require franchisees to proffer more significant involvement to hold employees personally liable because it is likely that the employees will not exert control over the franchisor’s day-to-day activities. It may be the case that a franchisor’s employees may not have any knowledge that the franchisor is even engaging in fraudulent behavior or violations of state franchise statutes.

A court applying Michigan law has even gone so far as to say that an independent contractor holding itself out as an employee of a franchisor is per-

9. N.Y. GEN. BUS. LAW § 691(3) (McKinney 2009).
12. See Courtney v. Waring, 191 Cal. App. 3d 1434 (1987) (holding that a franchisee does not have to successfully sue the franchisor in order to obtain remedies against a secondary seller but only must establish that the franchisor could have been liable under the California Franchise Investment Law).
13. See, e.g., Shipman v. Case Handyman Servs., L.L.C., 446 F. Supp. 2d 812 (N.D. Ill. 2006) (holding that employees of franchisor entities are liable only if they materially aided in the act or transaction constituting the violation).
In *Lofgren v. AirTrona Canada*, Brian Lofgren brought suit against AirTrona Canada and a nonfranchisor defendant for rescission of its franchise agreement and restitution for the harm caused by the lack of disclosure under a proper Franchise Disclosure Document (FDD). Here, Lofgren had initially purchased a car deodorizing franchise from AirTrona Green Technologies, AirTrona Canada’s predecessor. After the creation of AirTrona Canada, its representative, Sam Barberio, presented Lofgren with a new business plan to update his current franchise. He paid $35,000 Canadian dollars for the right to operate this updated franchise in Michigan. Lofgren was also required to spend $28,000 Canadian dollars on updated equipment. Neither AirTrona Canada nor Barberio provided Lofgren with an updated FDD in connection with this purchase. During the negotiations, Barberio promised to secure three full-line automobile dealerships that would agree to use Lofgren’s franchise for their deodorizing services as a stream of revenue. Barberio failed to deliver on this promise, and Lofgren was forced to shut down his franchise after which he filed suit.

First, the Sixth Circuit held that the second purchase constituted an additional franchise requiring proper disclosure with a new FDD. Barberio’s argument that AirTrona Canada did not prescribe a “marketing plan” under the updated franchise failed to pass muster as the court focused on the fact that Lofgren was reliant on Barberio and AirTrona Canada to provide support, training, equipment, and guidance on the new business model. Further, the court noted that the $35,000 payment constituted a franchise fee that was not connected to the purchase of new equipment because Lofgren made a clear second payment for the new equipment. The second issue the court determined was whether Barberio was an employee of AirTrona Canada, subjecting him to personal liability under the Michigan Franchise Investment Law (MFIL). Barberio argued that he was an independent contractor and consultant of AirTrona Canada but the court disagreed. The court examined the totality of the circumstances surrounding Barberio’s association with AirTrona Canada, noting that the president of AirTrona Canada had named him chief executive officer and chief operating officer. Barberio admitted that he provided advice to AirTrona Canada with respect to franchise management,

15. Id. at 1006.
16. Id.
17. Id.
18. Id.
19. Id.
20. Id.
21. Id. at 1007.
22. Id.
23. Id.
24. Id.
25. Id. at 1008.
26. Id.
27. Id.
Barberio held himself out as an employee of AirTrona Canada, and Barbiero represented AirTrona Canada in negotiations with franchisees. The court held that the evidence therefore supported his designation as an employee and that Barbiero could not rely on the employee safe harbor provision to plead ignorance of law as a shield from personal liability. As such, Barberio was jointly and severally liable for AirTrona Canada’s violation of the MFIL because he materially aided in the illegal conduct by failing to properly provide Lofgren with a FDD and making fraudulent statements regarding the updated franchise.

Generally, courts have imposed personal liability on those executives who have control over a franchisor’s decisions regarding the operation of the franchise system and those individuals who control the franchise sales process. In California and Michigan, courts have imposed liability on a person serving as an officer and director who had responsibility for franchise sales. In New York, the member-managers and controlling principals of a franchisor entity were held jointly and severally liable.

Despite the fact that the language of several state franchise statutes is substantially similar, there is a divide in the interpretation of this language. Specifically, some states require that each individual materially aid in the violations of the state franchise statutes in order to be held liable for the franchisor’s violations. Other states have held that control people do not have to materially aid in the violations of state franchise statutes to be liable unless the person involved had no knowledge of the circumstances constituting a violation of a state franchise statute.

B. Applicability of the Material Aid Standard

Many states have yet to address what side of the material aid argument they land on. To further compound the problem, three states have arrived at both sides of this debate. Although cases in New York have primarily held that a control person must materially aid in the violation, a recent outcome in New York may signify a shift.

An analysis of applicable New York case law begins with A.J. Temple Marble & Tile, Inc. v. Union Carbide Marble Care, Inc. In this case, A.J. Temple Marble & Tile, Inc. filed a suit against Union Carbide Marble Care, Inc. and

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28. Id. at 1009.
29. Id.
30. Id.
other nonfranchisor defendants for violation of the anti-fraud provision of the NYFSA.\textsuperscript{36} As noted above, the language in the NYSFA provides for joint and several liability of certain control people and employees of a franchisor entity that violate the provisions of the NYFSA requiring pre-sale registration of a franchise and disclosure with an FDD. Here, A.J. Temple claimed that Union fraudulently misrepresented certain facts regarding the franchise system. A.J. Temple sought to hold certain nonfranchisor defendants personally liable under the NYFSA provision providing for joint and several liability.\textsuperscript{37} At issue in this case is whether the material aid standard applies to all or only some of the enumerated parties.\textsuperscript{38} In overturning the New York Supreme Court’s decision, the Court of Appeals of New York relied on the plain meaning of the statute in holding that the material aid standard applied to each category of people.\textsuperscript{39} As such, the court held that the nonfranchisor defendant who assisted in the preparation of the fraudulent solicitation materials, prepared the concealed business plan, and directly participated in the unlawful franchise sales was jointly and severally liable.\textsuperscript{40} The court further held that the other nonfranchisor defendants were not liable because the plaintiffs failed to establish that any of them materially aided in the fraudulent conduct.\textsuperscript{41}

In further support of the proposition that the material aid standard applies to all categories of people, the U.S. District Court for the Southern District of New York in Coraud LLC v. Kidville Franchise Company, LLC arrived at a similar conclusion.\textsuperscript{42} Here, Coraud LLC brought a claim against Kidville Franchise Company, LLC and certain nonfranchisor defendants for fraud, negligent misrepresentation, and violation of the NYFSA and the New Jersey Franchise Practices Act.\textsuperscript{43} The court held that Coraud could not proceed on its common law claims for fraud and negligent misrepresentation due to the existence of disclaimer language in the franchise agreement.\textsuperscript{44} However, those disclaimers cannot bar claims under the NYFSA.\textsuperscript{45} Next, the court determined that two of the nonfranchisor defendants were jointly and severally

\textsuperscript{36} Section 687 of the NYFSA provides that it is unlawful for any person to engage in any “act, practice or course or business which operates . . . as a fraud or deceit upon a person.” N.Y. GEN. BUS. LAW § 687(2)(c) (McKinney 2009).
\textsuperscript{37} A.J. Temple, 663 N.E.2d 890.
\textsuperscript{38} Id.
\textsuperscript{39} In an additional indication that future courts may shift their interpretation of what categories of people to which the materially aid standard applies, Chief Judge Kaye noted in her concurring opinion that “interpretation may impose secondary liability on such a limited class of individuals to render it essentially meaningless.” Id. at 896.
\textsuperscript{40} Id. at 895.
\textsuperscript{41} Id.
\textsuperscript{42} 109 F. Supp. 3d 615 (S.D.N.Y. 2015)
\textsuperscript{43} Id. at 619.
\textsuperscript{44} The court held that the disclaimer language contained in the franchise agreement sufficiently waived any possibility that Coraud relied on any misrepresentations outside of the franchise agreement or franchise disclosure document. Id.
\textsuperscript{45} Id. at 620.
liable and two of the nonfranchisor defendants were not liable.\textsuperscript{46} Here, the court said that those employees who actually used inaccurate misrepresentations in the recruitment of Coraud and swore to the representations contained in the FDD were jointly and severally liable.\textsuperscript{47} However, the conduct of the two nonfranchisor defendants who generally encouraged the purchase of the franchise, approved unspecified sales materials, and drafted the franchise agreement did not rise to the level of material aid.\textsuperscript{48} The court went on to note that, although the preparation of a franchise agreement may be sufficient to rise to the level of material aid, it did not here because the alleged misrepresentations were not contained in the franchise agreement.\textsuperscript{49}

We contrast the above cases with \textit{Schwartzco Enterprises LLC v. TMH Management, LLC} in the U.S. District Court for the Eastern District of New York.\textsuperscript{50} Here, Schwartzco Enterprises LLC brought a claim against TMH Management, LLC and certain nonfranchisor defendants for fraud, fraudulent inducement, negligent misrepresentation, breach of fiduciary duty, gross negligence, violation of the NYFSA (registration provision and anti-fraud provision), and unlawful deceptive business acts or practices.\textsuperscript{51} Here, the court determined that Schwartzco satisfied its burden to survive dismissal of its claims under the NYFSA with respect to the nonfranchisor defendants.\textsuperscript{52} Schwartzco claimed that all of the defendants made materially false representations and/or omissions, generated fraudulent financial spreadsheets, and failed to supply sufficient disclosures to Schwartzco or register the franchise with the New York Attorney General’s Office.\textsuperscript{53} With regard to the nonfranchisor defendants, the court focused on each person’s active involvement independent of TMH in the provision of the fraudulent information.\textsuperscript{54} Because the nonfranchisor defendants had access to the accurate information that would establish the falsity of the provided information, the court held that this evidence was enough to state a claim upon which relief can be granted, especially given that the language of the NYFSA provides for control person liability “merely by virtue of their position in an entity liable for NYFSA violations.”\textsuperscript{55} This is a departure from the holdings in Coraud and \textit{A.J. Temple}. 

\textsuperscript{46} Id. at 623. 
\textsuperscript{47} Id. 
\textsuperscript{48} Id. 
\textsuperscript{49} Id. 
\textsuperscript{50} 60 F. Supp. 3d 331 (E.D.N.Y. 2014). 
\textsuperscript{51} The court dismissed each claim except for the claims of negligent misrepresentation and claims under the NYFSA. For the negligent misrepresentation claim, the court held that the determination of whether a special relationship exists between parties requires a fact-sensitive inquiry and it was inappropriate to make a determination at this initial motion to dismiss phase. Id. at 351. 
\textsuperscript{52} Id. at 358. 
\textsuperscript{53} Id. 
\textsuperscript{54} Id. 
\textsuperscript{55} Id.
In Illinois, a control person, initially, had to materially aid in the violation in order to be held liable. However, there appears to have been a shift in the rule of law with court decisions stating that “control persons, who, because they are in a position to prevent a violation, are liable unless they had no knowledge . . . and employees . . . are liable only if they materially aided in the act or transaction constituting the violation.” Similarly, in Minnesota, an officer could only be jointly and severally liable if that person “materially aids in the act or transaction constituting the violation.” Consequently, a chief operating officer was not individually liable because he did not materially aid in the violation. Specifically, the court held that that “he must have been a control person at the time of the alleged violation, or must have materially participated in the violation—his status as COO, alone, does not establish liability.” This line of reasoning seems to suggest that a control person could be held liable even if he did not participate in the violation. Unfortunately, the only other case in Minnesota to address the issue did not reference either of the previous Minnesota cases in arriving at its conclusion and instead referenced securities laws in holding that the nonfranchisor defendant must have actually participated in the violations to be held liable.

Last, the state franchise statutes of California, Maryland, Michigan, and Wisconsin similarly do not apply the material aid standard to control people. These state franchise statutes create a presumption that the control people are liable once the franchisee has stated a claim of violation based on the franchisor’s conduct. At that point, the burden then shifts to the control persons to invoke the defense that they had no knowledge of the facts supporting the violation of the state franchise statute. In Indiana and Oregon, the language of each state’s franchise statute is clear with respect to the requirement that in order to be liable, individuals have to participate in the culpable conduct.

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62. Id.
63. Indiana’s statute states that “[e]very person who materially aids or abets in an act or transaction constituting a violation of this chapter is also jointly and severally liable.” IND. CODE ANN. § 23-2-2.5-29 (West 2009). Similarly, the Oregon statute imposes joint and several liability on “every person who participates or materially aids in the sale of a franchise.” OR. REV. STAT. ANN. § 650.020 (West 2009).
C. No Knowledge Affirmative Defense

As noted above, once a plaintiff franchisee fulfills its burden of proving liability of the franchisor, it is then up to the nonfranchisor defendant to prove that he or she had “no knowledge or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist.”64 In the past, nonfranchisor defendants failed in proffering the required evidence to rebut the presumption; however, a recent case in Michigan sheds new light on this affirmative defense.

In Tankersley v. Lynch, the U.S. District Court for the Eastern District of Michigan examined whether certain nonfranchisor defendant officers could be held personally liable for an arbitration award obtained against a franchisor.65 As background, Marian Tankersley obtained an arbitration award against Collision on Wheels International, L.L.C. (COW) for violation of the MFIL and filed suit against certain officers of COW (COW officers) to hold them jointly and severally liable for the arbitration award.66 As determined in the arbitration proceeding, COW violated the MFIL by providing Tankersley with pro forma spreadsheets that contained earnings claims outside of the uniform franchise offering circular (UFOC).67 Further, COW failed to provide accurate disclosures regarding the differences between the current franchise offering and the predecessor business.68 Finally, COW failed to accurately disclose applicable environmental regulations.69

Here, in its motion for summary judgment, the COW officers argued that Tankersley was prohibited from litigating their knowledge of the facts because that issue was already litigated in the arbitration proceeding.70 The court disagreed and held that the issue of knowledge of the facts was not previously litigated to a necessary outcome for purposes of violation of the MFIL because the knowledge issue was raised in a different context.71 In response to Tankersley’s motion for summary judgment, the COW officers argued that they were entitled to re-litigate the issue of COW’s liability under the MFIL because they were not parties to the arbitration proceeding.72 The court again disagreed and held that the arbitrator’s decision of COW’s liability stands.73 Further, the COW officers argued that they did not materially aid in the culpable conduct as required for liability under MFIL.74 The court disagreed and held that the material aid standard applied to employees only and the only way for a control person to avoid liability is to prove he or

65. Id. at *2.
66. Id.
67. Id.
68. Id. at *3.
69. Id. at *5.
70. Id. at *6.
71. Id.
72. Id. at *9.
73. Id.
74. Id. at *10.
she had no knowledge of or reasonable grounds to believe the requisite facts.  

Last, the COW officers argued that there was a genuine issue of material fact regarding their knowledge of facts.  

Here, the court finally agreed.  

In denying Tankersley’s motion for summary judgment, the court determined that each of the COW officers proffered sufficient evidence signifying that he may not have had knowledge of the facts.  

Specifically, each of the COW officers either offered affidavits stating his lack of knowledge of the facts or testified in deposition that he had no knowledge of the illegal spreadsheets or environmental regulations.  

The court’s final determination in this case could potentially open a new door for control people to escape personal liability by merely stating that they did not have knowledge of the circumstances.

In California, however, courts have been hesitant to give weight to this affirmative defense. In *Neptune Society Corp. v. Longanecker*, the California Court of Appeal determined that two nonfranchisor defendants were personally liable and that each did not correctly invoke the no knowledge exemption.  

First, the court found that nonfranchisor defendant Charles Denning (Mr. Denning) sought out an attorney who confirmed the proposed arrangement was a franchise under the Federal Trade Commission Rule on Franchising (FTC Rule) and was advised to avoid this arrangement due to the level of paperwork necessary to comply with the California Franchise Investment Law (CFIL) and FTC Rule.  

Even after such advice, Mr. Denning chose to proceed with the arrangement without providing a UFOC.  

With respect to the second officer, Barbara Denning (Ms. Denning), the court held that she failed to submit sufficient evidence to sustain her burden.  

Ms. Denning argued that the record was “completely silent” as to whether she had the requisite knowledge of the illegal conduct.  

Ms. Denning was the secretary of the franchisor and provided the plaintiffs with the franchise agreement.  

The court held that even though the evidence against Ms. Denning was “skimpy,” she did not, as a matter of law, establish that she had no knowledge of the illegal conduct.  

As such, the court held that the trial court properly ruled against the Dennings.  

Based on these cases, there seems to be a small, but significant, distinction between arguing that the record is silent as to a nonfran-

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75. *Id.*
76. *Id.* at *11.
77. *Id.* at *12.
78. *Id.*
79. *Id.*
81. *Id.* at 1244.
82. *Id.*
83. *Id.* at 1247.
84. *Id.*
85. *Id.*
86. *Id.* at 1248.
87. *Id.*
chisor defendant’s knowledge of the facts and outright stating that nonfranchisor defendant did not have knowledge of the facts.

Further, multiple courts have refused to accept the defense that the non-franchisor defendant lacked any knowledge of the applicable law as a defense.88 In *Sterling Vision DKM, Inc. v. Gordon*, an officer of the franchisor claimed that he was not individually liable because the franchisee could not prove that the officer knew of the registration requirement under the Wisconsin Franchise Investment Law (WFIL).89 The U.S. District Court for the Eastern District of Wisconsin noted that the particular section referenced knowledge of the facts by which the liability exists, not the underlying statute.90 In dismissing the officer’s argument, the court held that the “officer is presumed to know the law of the state in which he sells franchises.”91

Similarly, in *Dollar Systems, Inc. v. Avcar Leasing Systems, Inc.*, two non-franchisor defendants attempted to avoid personal liability because they were unaware of the requirements of the CFIL that the franchisor violated.92 Again, the Ninth Circuit highlighted the fact that the “no knowledge” defense specifically references the facts surrounding the culpable conduct, not the law itself that provides for liability.93 One of the individuals was an officer and director while the other was in charge of franchise sales.94 The court held that these individuals were in the best position to know whether the franchisor had either registered or filed a notice of exemption in connection with its obligations under the CFIL.95 As such, the defendants could not avoid personal liability under the CFIL.96

II. Common Law Claims and Other State Statutes

An additional remedy that may be available to franchisees is a claim under a state’s consumer protection statute (CPS). CPSs were originally put in place to expand the FTC’s mission in protecting consumers from “unfair or deceptive acts or practices.”97 Each state currently has some form of CPS; however, the CPSs vary widely in the conduct covered and the liability provided to claimants. Florida courts have examined the liability of a nonfranchisor defendant under Florida’s CPS, the Florida Deceptive and Unfair Trade Practices (FDUTPA), and the Florida Franchise Act (FFA). Under the FFA, it is unlawful for a person to engage in certain fraudulent behavior and a person is defined as an “individual, partnership, corporation, association, or other entity.

89. *Id.* at 1198–99.
90. *Id.* at 1199.
91. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
Florida courts have held that in order to be liable under the FFA, a nonfranchisor defendant must have personally participated in the culpable conduct. Further, a contract person’s position with the franchisor alone does not suffice to trigger personal liability.

In *KC Leisure, Inc. v. Haber*, KC Leisure, Inc. (KC) brought suit against Lawrence Haber, an officer and shareholder of Relay Transportation, Inc. (Relay), for violations of the FDUTPA and the FFA for failure to provide KC with an FDD as required under the FTC Rule. The complaint alleged that Haber advised Relay of the potential liabilities associated with failing to comply with the FTC Rule (and other state statutes) and advised Relay to structure the arrangement through a license agreement. The trial court dismissed the claim under the FDUTPA because Haber was not a “seller” and dismissed the claim under the FFA because KC had failed to show that Haber was a direct participant in the culpable conduct. The District Court of Appeal of Florida disagreed with these conclusions and reversed the decisions. First, examining Haber’s liability under the FDUTPA, the court held that an individual may be liable under the FDUTPA if the underlying corporate entity is liable and the individual “actively participated in or had some measure of control over the corporation’s deceptive practices.” Here, the complaint sufficiently alleged that Haber knew of the requirements under the FTC Rule and willfully “cooked up the scheme” of treating the relationship as a license arrangement instead of a franchise arrangement. Further, Haber assisted in the preparation of pro forma financial statements based on “conjecture and speculation,” resulting in unsubstantiated and misleading representations to KC. As such, the court held that this conduct demonstrated that Haber personally participated in the violations of the FDUTPA and FFA by Relay and that KC had therefore adequately pled a claim under the FDUTPA.

**III. Conclusion**

One question that remains is whether more states will shift their interpretation of whether the “materially aids” standard applies to all categories of potential nonfranchisor defendants. It is difficult to predict the behavior of
the courts; however, control people should at all times be mindful of their potential personal liability stemming solely from their position within a franchisor’s management team. It is advisable for those nonfranchisor defendants to seek the advice of counsel. A second remaining question is what direction the courts will take with respect to the development of the “no knowledge” affirmative defense and what facts the courts will accept as satisfying the non-franchisor defendant’s burden. Finally, another question that remains is whether more franchisees will continue to take advantage of the state franchise statutes providing for joint and several liability. The answer to this question is directly tied to the answer to the first two questions. If franchisees (and franchisee attorneys) continue to see control people held jointly and severally liable despite no participation in the offending conduct, or they continue to see that courts make relying on the “no knowledge” defense increasingly difficult, franchisees will continue to bring claims against the non-franchisor defendants.
You are the general counsel of a medium-sized fast casual restaurant franchise concept. It has been a typical day at the office, and you are leaving to go home. As you head out of the building, you notice two federal agents with badges at the reception area, and you approach them to inquire whether they need help. They pull out grand jury subpoenas for testimony and documents from you and the company, requiring that you and the company testify in two weeks, and at the same time produce documents concerning potential immigration issues at certain corporate and franchised locations of your company. They serve the subpoenas on you. You have never been served with grand jury subpoenas before. After the initial shock you head back to your office, drink a tall glass of water, slouch back in your chair, and start thinking about what to do.

This situation is not unusual. The federal government has greatly increased its resources over the years to combat civil and criminal white-collar matters, creating greater exposure than ever before for companies and their higher-level employees. In the franchise world, we have seen government inquiries concerning alleged wage and hour violations, tax fraud, food and health safety issues, occupational and health administration issues, immigration fraud, health care fraud, import and export control issues, data security and privacy, consumer protection, and many other matters. In this article, we review the various methods typically utilized by the government in its investigation of potential wrongdoing and how franchisors and franchisees should respond if they are the subject of a government investigation.  

1. This article focuses on investigations conducted by federal government lawyers and agents. The methods used by state investigators in conducting investigations are generally similar to those used by federal investigators, and many of the principles applicable to responses to federal
cuses on responses by franchisors to government investigations, many of the matters discussed apply equally to franchisees that are the subject of an investigation. In addition, Section VI discusses special considerations for franchisors when their franchisees are under investigation.

I. How the Government Seeks to Obtain Information

An investigation commences when the government has sufficient predication indicating that a civil or criminal violation of the law may have occurred. Predication can take various forms. It can come from a newspaper article, a tip from a whistleblower, information from a witness who observed an act taking place, the government’s own observation of events, consumer complaints, or a variety of other means. Once the government believes that civil or criminal wrongdoing may have occurred, one or more government agencies or entities with jurisdiction may investigate the matter. Jurisdiction may vest with the federal government, state government, or both, and within the government a single agency or multiple agencies or entities may have jurisdiction. For example, while the U.S. Food and Drug Administration may investigate an outbreak of food-borne illnesses emanating from certain corporate and franchised restaurant locations, the U.S. Senate Committee on Health, Education, Labor, and Pensions may also choose to conduct its own investigation. When parallel investigations take place, this creates further complications for the entity that may be the subject of the investigations.

A. Informal Requests for Information

The government has a number of tools in its investigative toolbox. In the first instance, the government may make an informal request for information through a letter or even a telephone call. Although it is often wise for companies to fully cooperate with the government and provide the information requested, there is no legal requirement to do so. The company should carefully consider whether it is in its best interests to comply with the government’s request. If the government requests information that is typically kept private and confidential, such as customer information, there may be reason not to cooperate. In fact, cooperation in such an instance could lead to lawsuits by those whose information has been divulged. Similarly, the company may not want to provide trade secret, strategic, or other classified information to the government.
There are ways to still project a cooperative tone with the government, even while resisting its informal request for information. You could request that the government issue a subpoena to the company, which would compel the company to produce the information but insulate it from the potential liability that could result from disclosing the information voluntarily. You could also negotiate a confidentiality agreement with the government that would protect the company’s trade secret or other sensitive information from disclosure. Be aware, however, that there are times when a government request for information may be emergent. A robbery and violent crime has taken place in one of your franchised hotels and the police need customer information immediately. A customer has become violently ill after eating food at one of your franchises and was rushed to the hospital, and the authorities need the credit card receipt immediately to obtain critical identifying information. In these situations, you may determine that you need to cooperate with the authorities right away and then ask them to follow-up with a formal subpoena for the information as soon as possible.

Voluntary cooperation can also occur in the form of interviews. Typically, government agents will knock on the door of an employee’s home early in the morning or late in the evening, seeking to interview her. This scenario occurs frequently and is fraught with danger for the employee and the company. The employee is usually not represented by counsel, has no true idea of the nature of the government’s investigation, and is often unaware that the interview can and will be used against her and/or the company and other employees.

In this situation, the government’s goal is to catch the employee unaware and before she has obtained counsel. The government believes it is more likely that the witness will fully cooperate and provide full information if she is unrepresented. While there may be some truth to the government’s position, many individuals are unaware that their words can easily be twisted, that the precision of their statements can be critically important, and that if they guess or speculate in response to a question, the government may still take their statements as factual and, if later proven untrue, could prosecute them for obstruction of justice or making false statements to a government agent. Accordingly, it is usually wise for an individual whom the government seeks to interview to respectfully decline to be interviewed, retain counsel, and then determine with counsel whether an interview is in her best interests.

B. Administrative Subpoenas

Administrative subpoenas allow executive branch agencies to issue compulsory requests for documents or testimony without prior approval from a grand jury, court, or other judicial entity. They do not ordinarily require probable cause and consequently can be used at the outset of an inquiry for the purpose of gathering information to further a government inquiry or investigation.

Because administrative agencies are statutory creations, a statute must authorize the issuance by the agency of administrative subpoenas. Congress has granted administrative subpoena authority to most federal agencies. The In-
spector General Act of 1978\textsuperscript{2} is the single most significant source of administrative subpoena power, but there are now over 300 instances where federal agencies have been granted administrative subpoena power of one kind or another, giving the agencies broad power to use subpoenas to investigate wrongdoing by individuals and companies that fall under their purview.\textsuperscript{3} Statutes governing administrative subpoenas ordinarily describe the circumstances under which an agency may exercise its subpoena authority, the scope of authority, enforcement procedures, and sometimes limitations on dissemination of the information subpoenaed. Most agencies with statutory administrative subpoena authority also have a structured protocol of issuance in place, requiring pre-approval from various agency officials on the propriety of issuance based on scope, necessity, and other considerations.\textsuperscript{4} The recipient of an administrative subpoena for documents is typically given thirty days to respond to the subpoena.

Federal agencies depend upon U.S. district courts to enforce administrative subpoenas. Those courts, however, must enforce an agency’s subpoena authority unless the evidence sought by the subpoena is “plainly incompetent or irrelevant to any lawful purpose of the [requesting official] in the discharge” of his or her statutory duties.\textsuperscript{5} The majority of statutes authorizing administrative subpoena enforcement in federal district court authorize the court to impose contempt sanctions when a recipient continues to refuse to comply even after a court order of compliance.

Administrative subpoenas can be extremely expensive and disruptive for the person or entity to whom they are addressed long before the thresholds of overbreadth and oppression (the point at which a subpoena will not be enforced) are reached.\textsuperscript{6} For example, in October 2015, McDonald’s Corporation asked a district court judge to reject an administrative subpoena issued by the National Labor Relations Board (NLRB). The case involved the NLRB’s claim that McDonald’s was a joint employer of franchise workers, and the subpoena stemmed from already discovered evidence suggesting that McDonald’s may have exerted control over the working conditions of its franchise employees.\textsuperscript{7} The subpoena sought emails and other documents from more than fifty McDonald’s executives and employees who worked di-

\begin{itemize}
\item \textsuperscript{2} 5 U.S.C.A. § 6 (West 2017). This act “gives the Inspectors General both civil and criminal investigative authority and subpoena powers coextensive with that authority.” United States v. Aero Mayflower Transit Co., Inc., 831 F.2d 1142, 1145 (D.C. Cir. 1987).
\item \textsuperscript{3} U.S. DEP’T OF JUSTICE, REPORT TO CONGRESS ON THE USE OF ADMINISTRATIVE SUBPOENA AUTHORITY BY EXECUTIVE BRANCH AGENCIES AND ENTITIES 5 (2002) (hereinafter the DOJ REPORT), available at http://www.usdoj.gov/olp/intro.pdf (last visited July 31, 2017). This report is the most recent government report on the use of administrative subpoenas.
\item \textsuperscript{5} Endicott Johnson Corp. v. Perkins, 317 U.S. 501, 509 (1943).
\item \textsuperscript{6} See, e.g., In re Grand Jury Proceedings, 115 F.3d 1240, 1244 (5th Cir. 1997).
\item \textsuperscript{7} NLRB v. McDonald’s USA LLC, No. 1:15-mc-322-P1 (S.D.N.Y. 2015).
\end{itemize}
rectly with franchise owners. The subpoena also sought information on McDonald’s opposition to union-supported nationwide protests advocating a $15 minimum hourly wage for fast food workers, a fact that the NLRB believed could indicate a joint employment relationship.

In its opposition to the NLRB’s motion to compel, McDonald’s argued that the subpoena was unfair, costly, and burdensome, pointing out that it already had spent more than $1 million over a few months producing over 160,000 pages of documents in response to the subpoena. McDonald’s paid this amount to comply with the NLRB’s subpoena even though McDonald’s asserted that it would owe no more than about $50,000 if it were found liable for alleged labor violations at twenty-nine franchises in five states. Nevertheless, the district court judge ordered that the administrative subpoena be enforced in full, with minor exceptions.

C. Civil Investigative Demands

Another common way by which some federal agencies obtain information in connection with civil investigations is through civil investigative demands (CIDs).8 CIDs can be used to obtain documents, answers to interrogatories, and witness testimony through depositions.

CIDs are commonly used by the government to investigate false claims.9 These are instances in which an individual or company has submitted a false claim to the government and, as a result, has wrongfully obtained monies from a government payer.10 Any franchisor or franchisee that produces goods or provides services to the government, or utilizes the government’s Medicare or Medicaid programs for reimbursement for health care services, must be sure not to run afoul of the False Claims Act.

CIDs may take the form of subpoenas that require the recipient to produce documents. Such subpoenas typically provide a return date of twenty days.11 They are often quite comprehensive and invasive and may require the individual or company to provide many thousands of pages of documents. The subpoenas include the nature of the government’s investigation, the investigative agency, the return date of the subpoena, and the name of the investigative agent.12 The subpoena will also usually set forth the form in which the government wants the documents, including electronically stored information. The recipient of the subpoena has a limited time—typically no more than

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8. CIDs are a type of subpoena that allows government agencies to demand information from targets of investigations. The information provided by targets may be in the form of documents, answers to interrogatories, or deposition testimony. An example of an agency rule from the Federal Trade Commission that provides for civil investigative demands can be found at 16 C.F.R. §§ 3729 et seq. (West 2017).
12. See, e.g., 16 C.F.R. §§ 2.6, 2.7 (West 2017); 12 C.F.R. §§ 1080.6, 1080.7 (West 2017).
twenty days—to seek to quash, modify, or limit the scope of the subpoena by filing an appropriate motion in court.\textsuperscript{13}

Alternatively, or in conjunction with a document subpoena, a civil investigative demand may include interrogatories and require the recipient to produce answers within a set period of time.\textsuperscript{14} The questions are often quite broad and can require a considerable amount of time to be answered. Again, the questions may be objected to by a proper filing in court, but failing to do so before the time to answer may constitute a waiver of the right to object.

Finally, CID\textsuperscript{s} may include notices for the testimony of witnesses.\textsuperscript{15} The government is authorized to seek the testimony of the witness within as few as seven days from the date of the issuance of the notice, and the notice can call for the deposition to take place wherever it is convenient for the government.\textsuperscript{16} There is no limit on the number of witnesses whom the government may notice for their testimony. A CID can be a highly effective means for the government to obtain information relevant to its investigation.

D. Grand Jury Subpoenas

The government uses the grand jury as a tool to investigate potential criminal conduct and, when appropriate, to bring criminal charges against individuals and corporations.\textsuperscript{17} Federal grand juries are comprised of up to twenty-three individuals, a vote by twelve being necessary to indict (a true bill). If fewer than twelve persons vote for the person or company to be charged, there is no indictment (no bill).\textsuperscript{18}

Grand jury subpoenas for the production of documents are common in criminal cases. A motion to quash or modify the subpoena may be filed in federal court. Otherwise, all non-privileged documents must be produced. In rare instances, an individual may claim that the production of the documents themselves may implicate him in criminal activity, and thus he should not have to produce the documents. In such instances, the individual will seek what is known as act of production immunity.\textsuperscript{19}

Grand jury subpoenas may also seek the testimony of the individual served. The individual is required to appear at the courthouse or other designated location to testify before the grand jury. The court reporter, witness, prosecuting attorney or attorneys, and federal agents are the only individuals, besides the grand jurors themselves, who are allowed inside the grand jury room during questioning.\textsuperscript{20} Counsel for the witness is not permitted inside the grand jury room and cannot interpose objections, although counsel

\textsuperscript{13} 16 C.F.R. § 2.7 (West 2017); 12 C.F.R. § 1080.6(e) (West 2017).
\textsuperscript{14} 16 C.F.R. § 2.7 (West 2017); 12 C.F.R. § 1080.6(a)(3) (West 2017).
\textsuperscript{15} 16 C.F.R. § 2.7 (West 2017); 12 C.F.R. § 1080.6 (West 2017).
\textsuperscript{16} 16 C.F.R. § 2.7 (West 2017); 12 C.F.R. § 1080.6 (West 2017).
\textsuperscript{17} FED. R. CRIM. P. 6 (West 2017).
\textsuperscript{18} FED. R. CRIM. P. 6(f) (West 2017).
\textsuperscript{19} That is, an individual may assert her Fifth Amendment right against self-incrimination and refuse to produce documents. See, e.g., Fisher v. United States, 425 U.S. 391, 400 (1976).
\textsuperscript{20} FED. R. CRIM. P. 6(d) (West 2017).
may sit outside the grand jury room, and the witness can take a break to talk to her attorney if she needs to do so. The grand jurors are usually given an opportunity to ask questions during or after the prosecutor’s examination. The witness is not entitled to receive a copy of her transcript, although the prosecutor may permit her to review the transcript before trial. The government and grand jurors are required to keep the grand jury proceedings secret and thus may not disclose testimony or other aspects of the grand jury process to third parties.21

E. Search Warrants

The government may apply to a federal magistrate or federal district court judge for a search warrant.22 The judge will issue the warrant if, upon review of the government’s affidavit in support of the warrant, the judge finds probable cause to believe that the warrant will uncover evidence of criminal activity.23

Search warrants can be quite broad in scope and may allow the government to search a company’s files, computers, desks, and other areas where information may be stored. The government must provide a copy of the warrant to a responsible person within the organization, if possible, before conducting the search. Government agents must also leave a copy of a list of the inventory they have taken upon leaving the premises. Search warrants are quite serious, even if the company itself is innocent of any criminal conduct, and can be very disruptive of a company’s business and employee morale. If a company is served with a search warrant, it is important that it immediately do the following:

(1) Determine who within the organization will be the point person for questions and any issues that may arise. If possible, this should be determined as a matter of company policy ahead of time.

(2) Immediately contact outside or in-house counsel, as appropriate.

(3) Identify and obtain the contact information for the government agent in charge. Ask the agent for copies of the search warrant and the affidavit in support of the warrant. This will provide you with information about the scope of the items that the government is allowed to seize and the nature of the government’s investigation.

(4) Identify whether it is a state, federal, or joint investigation and the agencies involved.

(5) Ask the agent to seal the premises and delay the search until the company’s attorney arrives. If the agent refuses, monitor the search vigilantly but do not attempt in any way to obstruct or impede the search.

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(6) Ask the agent not to interview any employees until the company’s attorney arrives. If agents insist on questioning employees, inform them that they have a choice to either answer or to refuse to answer any question posed to them by the agents. The search warrant does not give them the legal right to interrogate employees.

(7) Do not tell employees that they should not answer an agent’s questions. This may be seen as obstructing justice.

(8) Send all nonessential employees home and advise the agent that you are doing so. The agent does not have authority to detain the employees, but may ask for employees’ contact information.

(9) Ensure that, prior to any employees leaving, you have the following: (a) keys to the offices, desks, file cabinets, safes, and lockboxes covered by the scope of the search warrant (agents may force locks in order to examine physical areas covered by the warrant); and (b) the ability to access and copy computerized data.

(10) Do not attempt to remove, destroy, or hide company property or materials.

(11) Advise the agent of any paper or electronic documents that are critical to your ongoing business operations. Ask the agent to copy or take mirror images of those documents so that you can retain a version of each of them. Also request that the agent make copies at your facility of all documents seized or make copies as soon as possible and provide these copies to you.

(12) Advise the agent if you believe that any of the materials seized are privileged.

(13) Record the search in progress with a video or still camera (not audio), if possible. Take notes of your conversations with the agent, and of any activity or actions, including items seized that might appear to go beyond the scope of the warrant.

(14) The company’s data processing or information technology team can assist the agents in accessing the computerized information, but they do not have any obligation to interpret the data for the agents.

(15) Consult with your attorney or your in-house or outside public relations personnel about issuing a press release or statement. Government execution of search warrants and seizure of information are often reported in the media.

(16) Send a litigation hold letter (see Section II.B.4 below) to all employees to ensure that all materials that relate to the government’s investigation are retained and not destroyed.
The government may ask the company to consent to the search. The company should not do so. If the company consents to the search, it will be waiving its right to challenge the scope and other aspects of the search at a later date.

II. Considerations for Franchisors

A. Setting Up Appropriate Policies and Procedures

Franchisors and multi-unit franchisees should have policies and procedures in place in anticipation of a government investigation. Having procedures in place helps smooth the process when a government inquiry comes in, prevents inconsistencies in the handling of government investigations, and reduces the level of anxiety management and employees feel when having to respond quickly to government requests. The policies and procedures need not be complex, but rather should provide general guidance to management and employees in the event of a government inquiry.

At a minimum, the policies and procedures should include the person or persons within the company who will be responsible for responding to government inquiries and their contact information; the name and contact information of the company’s primary in-house and outside counsel; and the general procedures for the handling of any government requests. More specifically, the policies and procedures ordinarily should advise employees: (1) that government inquiries should be referred to the point persons within the company or in-house counsel; (2) that documents should not be provided to the government without seeking guidance from the point person and/or in-house counsel; (3) that they may but need not talk to government agents who seek to ask them questions (and should always make sure they ask the agents for proper identification); (4) that they should not divulge any attorney-client or other privileged communications to the government; (5) that they should highly prioritize any requests from the point persons or counsel that relate to government requests for information; and (6) that the fact of the government investigation and any documents or information that the company is providing is highly confidential and should not be divulged to third parties.

B. Key Considerations

1. Whether Outside Counsel Should Be Hired

When the government does come knocking on your door, there are a number of matters for the company to consider. One of the first considerations is whether the company should handle the matter internally or refer it to outside counsel. The answer is, of course, that it depends. Routine or small matters where the company or its employees are not targets of the investigation ordinarily can be handled more cost effectively and efficiently by in-house counsel, and outside counsel may not be needed. Similarly, matters
in which there is deep in-house expertise, and where in-house counsel has
the internal resources to handle the matter, may not require outside counsel.

On the other hand, there are many instances where it is prudent for the
company to retain outside counsel to assist it in responding to a government
investigation. If the company or its employees are the subject or target of the
government’s investigation, the company may have a conflict of interest if it
were to try to respond to the government’s inquiries on its own. Moreover,
in such circumstances, the government may not trust the company to provide
it with reliable and accurate information. Outside counsel will generally be
perceived by the government as more neutral and trustworthy in these situ-
ations. Further, if the matter is serious, outside white collar counsel who
have dealt with the government in the past and are familiar with the type
of investigation being conducted will be able to provide the company with
critical guidance throughout the process and may be able to limit the com-
pany’s exposure.

Depending on the nature of the government’s investigation, the company
may not be the only one that needs counsel. If the company’s decisions or
actions are being questioned, and are the source of the alleged wrongdoing,
the company’s managers or executives may need counsel. As a threshold mat-
ter, the question is whether the company’s counsel can and should represent
the managers and executives as well. If the possibility exists that the com-
pany’s position will be adverse to the position of the managers or executives,
it may be wise to recommend that the employees retain their own counsel.24

The company’s employees may request that the company pay for the at-
torneys they retain. In the first instance, whether the company is required to
pay for its employees’ attorneys depends upon the company’s by-laws, oper-
ating agreement, and/or policies and procedures. Even if the company’s pol-
ices do not require the company to pay for its employees’ counsel in govern-
ment investigations, state indemnification laws may require the company to
pay for its employees’ counsel, and thus it is important for the company to
review the law on indemnification in its state.25

2. Hiring of Subject Matter Experts

In addition to hiring counsel, the company may need to hire consultants
or subject matter experts in order to respond appropriately to the govern-
ment’s requests and otherwise properly respond to the issues raised by the
government. For example, if the government decides to investigate the com-
pany’s food distribution channels due to an E. coli outbreak that has caused
many of the company’s customers to become sick, the company may need to
hire an expert familiar with E. coli. If a franchisor becomes the subject of a
government investigation due to a breach of its computer system leading to

the theft of information on its customers, it may need to hire a data security expert. It is important for the company to ensure that it can thoroughly and accurately respond to government requests, and to understand that, in certain instances, this will require the company to hire subject matter experts. To protect the confidentiality of communications with the expert, the company should consider retaining the expert through outside counsel.

3. Insurance Coverage

The cost for the company to appropriately respond to a government investigation can be daunting. There may be thousands of documents to be reviewed, employees to be interviewed, legal research to be done, meetings and conferences with the government, white papers or other submissions to the government, and other costs. Accordingly, the company should closely review its insurance policies to determine whether insurance will cover the cost of the company’s response to the investigation as well as the fines, penalties, or other assessments the company may eventually be required to pay. In addition, the company’s directors’ and officers’ insurance policies may cover the cost of individual responses and defenses, and thus, those policies should be carefully scrutinized as well. It is important that the company send a demand letter to its insurance company soon after it is on notice of the possible claims so that it does not waive its right to insurance coverage.26

4. Litigation Hold Letters

When the company receives a subpoena, or other government demand or request, it is then on notice of the possibility of pending or potential litigation. At that juncture, it is important that the company send out a litigation hold letter to all employees who may have information bearing on the government’s inquiry. The letter should specify, in sufficient detail, the documents and information that the employee should retain based upon the government’s subpoena or other request. The letter should include a description of the investigation matter and explain that all information in the employees’ possession must be retained and not be deleted, altered, modified, or destroyed, and that the company’s usual document retention policies in connection with the subject matter will be suspended pending further notice. The letter should also identify the person within the organization to contact in the event the employee has any questions.

It is critical that litigation hold letters be sent out on a timely basis. Failure to preserve all relevant evidence can lead to sanctions, including an adverse inference at trial against the company (that the records would have yielded information adverse to the company’s interests), financial penalties or, in the most egregious circumstances, a default judgment against the company.27

27. Zubulake v. UBS Warburg LLC, 229 F.R.D. 422, 437 (S.D.N.Y. 2004) (the court granted an adverse inference instruction to the jury regarding the discovery misconduct and imposed
ther, it is not enough for the company to send an appropriate letter to its employees. The company must follow-up thereafter to remind the employees of their obligations and to ensure compliance with the letter. Such follow-up may include written communications or face-to-face meetings in which the need for compliance with the litigation hold letter is re-emphasized.

5. Disclosure to Relevant Parties

A government investigation can have major repercussions for the company and those doing business with it. It is important that the company immediately notify key constituents in connection with the company’s response to the investigation. To that end, the Board of Directors and, if the company has one, the Audit Committee, will need to be informed at the outset of the nature and scope of the government’s investigation. The company may also be required by contract to notify others, including insurance companies, vendors, and customers. Depending upon the seriousness and nature of the investigation, at some point all shareholders or owners of the company will need to be notified as well.

6. Public Relations

Depending on the nature and scope of the government’s investigation, the investigation could become public. Controlling the message in the press may be important to the company inasmuch as whether the public perceives the company as a good corporate citizen, to be guilty of wrongdoing, or to be responding appropriately to questions about its conduct, may affect the company’s short and long-term prospects. Accordingly, it is important for the company, early on, to develop a plan to handle press inquiries and, if necessary, to develop press releases and other pro-active messaging. The company’s own in-house communications department may be able to create an appropriate communications plan. Many franchisors and multi-unit franchisees, however, do not have in-house communications expertise and will need to hire an outside public relations firm to assist it. In either case, the company’s communications team should work closely with the legal team to make sure that all messages and press releases are consistent with the company’s legal approach.


28. See Palkon v. Holmes, Civil Action No. 2:14-CV-01234 (SRC), 2014 U.S. Dist. N.J. LEXIS 148799 (D.N.J. Oct. 20, 2014). This case involved a shareholder who brought a complaint seeking to compel the board of directors of Wyndham Worldwide Corporation to bring a lawsuit on the company’s behalf. The court dismissed the complaint. Mr. Nowak, a co-author of this paper, is the Executive Vice President and General Counsel of Wyndham Hotel Group, LLC, a brand of Wyndham Worldwide Corporation.
III. The Internal Investigation

Whether the government’s investigation is criminal or civil in nature, in most instances the government will provide the company with an opportunity to conduct its own internal investigation and convince the government that it is not liable or guilty of wrongdoing or, alternatively, that it should not receive a stiff penalty for the alleged wrongful conduct. The company’s level of cooperation, its truthfulness, and its ability to conduct a thorough and skillful investigation will often have a significant impact on the government’s decision as to whether, and to what extent, it should seek to penalize the company for the alleged wrongdoing and may impact the sentence imposed on the company in a criminal case.29

As a threshold matter, the company needs to decide whether to cooperate. In most instances, it will behoove the company to fully cooperate with the government because the government may well be able to obtain the information it needs through other sources, and because cooperation will likely lead to lesser sanctions than might otherwise be imposed. However, if the government appears to be on a witch-hunt with little or no evidence to support any allegations of wrongdoing or the government’s investigation may unearth highly sensitive or confidential information or otherwise greatly disrupt the company’s business, the company may choose not to cooperate. The company will still have to abide by all court orders and formal processes, but the company may choose not to turn over any information to the government that is not compelled by subpoena or other court order.

A. Compliance Programs

Counsel should assess the company’s compliance program in connection with the matter being investigated and determine whether the program was being executed appropriately. A strong compliance program can be useful in trying to stave off or minimize the effects of a government investigation. Let’s say, for example, that you are an international franchisor in the business of selling automotive parts. Your franchisee in Peru is accused of paying a large bribe to a government official in order to secure permits for a prime real estate location in Lima. Your field representative in Lima was allegedly involved in setting up the transaction. The U.S. Department of Justice Civil Fraud Division has opened up an investigation to determine whether the company and its franchisee have violated the Foreign Corrupt Practices Act (FCPA). The FCPA prohibits the intentional offering of something of value to a foreign official in exchange for a business opportunity or advantage.30

An initial question for the franchisor is whether it has a robust FCPA compliance program. If the franchisor is conducting international business that involves the shipment of goods into foreign countries, the securing of

real estate locations in those countries, or other matters that may involve touch points with foreign government officials, having a strong FCPA compliance program is important. When determining whether to assess penalties against the company, the government will consider whether the company has policies prohibiting the violation of the FCPA; whether the Board or upper management has set the right tone for compliance with the FCPA and other laws; whether there is anticorruption language in the company’s agreements with its franchisees, vendors, and others; and whether it provides training to its employees on how to comply with the act.\footnote{31} If the company has a compliance program that it takes seriously and vigorously attempts to enforce, a one-time violation may lead to a small sanction or perhaps no sanction at all. If, however, the company has no FCPA compliance program or has a program on paper but one that it does not execute or enforce, the government is likely to be far less sympathetic. The penalties can be severe.\footnote{32}

The FCPA is but one example of an area in which a franchisor may be wise to have a strong compliance program. The areas where compliance programs are needed will vary from franchisor to franchisor. For some, health care regulatory compliance programs will be important, while for others food safety, financial data security and privacy, or environmental compliance programs will be important. Strong compliance programs are important because they can prevent wrongdoing or liability from occurring in the first place and, should the company or its employees engage in prohibited conduct, greatly increase the likelihood that the government will not impose significant penalties.

B. Response to Subpoenas or Other Information Requests

A robust compliance program, while extremely helpful, is rarely enough. The government will still want to make sure that the company has not engaged in intentional wrongdoing and will conduct an investigation to determine whether that is the case. Accordingly, even if the company has an effective compliance program that is recognized as such by the government, it is likely that the company will, at a minimum, receive a subpoena or other request for information from the government and that the government will take any other investigative steps it deems prudent to ensure that it reaches an appropriate result.

When a request for information from the government is received and the company intends to fully cooperate, there are several things to consider. First, it is important for in-house or outside counsel to introduce themselves to the agent who has requested the information. The relationship that you develop with the agent and/or prosecutor is critically important as the investigation proceeds. Counsel should establish a relationship built on trust. If at


\footnote{32. 15 U.S.C.A. § 78ff (West 2017).}
any point the government no longer trusts counsel for the company, the govern-ment will be more apt to pursue its investigation aggressively and on its own without relying on input from the company’s counsel. On the other hand, if the government trusts the company’s counsel, counsel can have a substantial and continuing influence on the government’s investigation.

The company should carefully and thoroughly review the subpoena or document request. The document will likely contain detailed definitions and instructions, including the date by which the government expects the documents to be produced; the way in which electronically stored information should be produced; and whether the company can produce charts or other listings of information in lieu of original documents.

Counsel assisting in the investigation should learn as much as possible about the case from the agent or prosecutor, which will inform counsel as to the types of documents in the company’s files that will assist the government in its investigation, enabling counsel to attempt to narrow the scope of the subpoena or document request. Because the government may be largely unfamiliar with the company’s files and recordkeeping, its document requests are often extremely overbroad and burdensome. Competent counsel can work with the government to attempt to narrow the subpoena to areas in which the government is truly interested, which will allow the company to more efficiently and cost-effectively respond to the requests.

Although the return date on the subpoena is often unreasonably short, most government agents and prosecutors are willing to extend the return date, especially when the number of responsive documents is likely to be large. At times, the government may request a rolling production of documents, allowing the company to produce documents in response to some of the queries earlier and produce others at a later date. Extending the subpoena’s return date can be critically important to the company. Often, considerable time will be needed to review all of the documents for relevance and privilege. Having time to review the documents is often a helpful means for you and the company to ensure that you can learn the extent of the company’s exposure and what defenses to the government’s claims may be available.

It is important that responsive documents be collected carefully and thoroughly. A failure to do so can cause legal problems for the company, including the possibility of claims of obstruction of justice. A plan should be developed early on for the proper collection of all documents. Paper documents should be retrieved from all custodians. As to electronically stored information, the company must decide whether it has the in-house capability to search for and collect the documents and, if so, whether its in-house information technology department should be tasked with the project. Alternatively, the company can hire an outside litigation support firm to assist it in the search for and collection of responsive electronically stored information.

It is generally advisable to work with the government to determine the search terms to use to find electronic information responsive to the subpoena. If you fail to do so, and the government is dissatisfied with your docu-
ment production, the government may ask for a list of the search terms you used and could request that you conduct additional searches. An agreement ahead of time with the government can save your company considerable time and money.

In cases where subpoenas seek large volumes of information, predictive coding can be used in lieu of or in addition to search terms. Predictive coding software utilizes mathematical model programming to review electronic documents and then locate the documents that are relevant to the case. The company’s counsel and their assistants first select a sample of relevant documents. The predictive coding software reviews those documents and then is given a new set of documents to determine which are relevant and should be reviewed. Counsel and their assistants then review the program’s decisions to determine whether they appear to be accurate and acceptable. If so, the program will continue to be used to conduct further searches. If not, the process will be repeated until the program learns how best to determine how to collect relevant documents and an acceptable level of confidence has been achieved.

Once all paper and electronic documents have been collected, it is critical that they be well-organized and prepared appropriately for production. The documents to be produced should be stamped with sequential numbers so that you can keep track of what was produced and can easily discuss them with the government and others. Privileged documents and documents you determine are non-responsive should be maintained in separate files. Keep in mind that should you later find additional responsive documents, they must be produced. You should make sure to have a written record of all steps you have taken during the process of collecting and producing documents in case you have to re-create those steps at a later time. When producing documents to the government, you should lay out the Bates-stamp range of the documents you are producing; memorialize any agreement you have with the government concerning the narrowing of the subpoena (if you have not communicated with the government about that topic already); and highlight any decisions you have made or issues concerning the documents of which the government should be aware, so that there are no surprises. You want to make sure that there are no misunderstandings between you and the government.

Finally, you should mark documents that contain sensitive, private, or trade secret information as confidential when you produce them to the government. You should also discuss with the government the maintenance of such documents as confidential. There are various statutes and regulations that require the government to maintain the confidentiality of documents produced to it under certain circumstances.33

C. Interviews of Witnesses

In most serious government investigations, counsel will want to interview witnesses within the company—and perhaps people outside the company—

to ascertain exactly what occurred. There are a number of reasons for this. Many of the documents that you have gathered may be ambiguous, and witness interviews may be necessary to help you understand the meaning and context of the documents. Witnesses may also help you understand weaknesses within the company that can be corrected so that wrongdoing or liability does not occur in the future. And, of course, interviews of witnesses can also help you understand exactly what happened, how the alleged wrongdoing occurred, and who was involved. In many instances, the government will ask you to conduct interviews and then disclose, either orally or in a white paper, the results of your interviews and your findings. Despite the folklore, the government does not have unlimited resources and is often happy to have you assist them in their investigation.

Generally, you will not want to interview witnesses until you have had an opportunity to thoroughly review the documents (although in emergency or time-sensitive matters you may have to interview witnesses early in the process). Reviewing the documents and interviewing witnesses can give you an advantage over the government because the government may not have had the opportunity to review as many documents and talk to as many witnesses as you. This allows you to begin to shape your response to the government early and perhaps influence the government’s thinking as it decides what course of action to take.

The list of witnesses with whom you will want to talk could be extensive. It may include C-suite employees, middle managers, and/or lower level employees. You should set up each interview in a setting that will be comfortable for the witness and not be intimidating. If the interview is being conducted by outside counsel, in-house counsel may or may not want to be present. Sometimes, employees will feel more comfortable and be more open if in-house counsel is not present. At other times, employees may feel more comfortable having a company employee in the room. This is an issue that will need to be discussed prior to the interviews taking place. In any event, it is important that someone other than you be present as a witness to the interview and to take detailed notes of the substance of the interview. Accordingly, in-house counsel or a paralegal or other firm attorney should serve as the note-taker. It is important to have a written record of the interview to, among other things, minimize any misunderstandings as to what was said and be able to share the information with the government in an organized manner if appropriate. The company should also keep track of the documents used in each interview.

The issue of attorney representation of the witness in the interview may become important. Just as the government prefers to interview individuals without their attorneys present, you may feel the same way. At times, people are more willing to provide more thorough and complete information without counsel present. Nevertheless, at the outset of the interview, it is important that the witnesses clearly understand the purpose of the interview and your role in the process, so that they can make a considered choice as to whether to obtain counsel. If the witness is clearly a target of the govern-
ment’s investigation, you may want to recommend that the witness retain her own attorney.

1. Upjohn Warnings

The Supreme Court has highlighted the importance of a witness in an internal investigation being fully informed as to the nature of the interview. In *Upjohn v. United States*, the Court found that warnings (referred to as Upjohn warnings) should be given to witnesses at the outset of interviews. The warnings should make clear that: (1) counsel taking the interview represents the corporation; (2) the communications with the employee are privileged; and (3) the privilege is held by the corporation, not the employee. The American Bar Association suggests that the following Upjohn warning be given:

I am a lawyer for Corporation A. I represent only Corporation A, and I do not represent you personally. I am conducting this interview to gather facts in order to provide legal advice for Corporation A. This interview is part of an investigation to determine the facts and circumstances of X in order to advise Corporation A on how best to proceed. Your communications with me are protected by the attorney-client privilege. But the attorney-client privilege belongs solely to Corporation A, not you. That means that Corporation A alone may elect to waive the attorney-client privilege and reveal our discussion to third parties. Corporation A alone may decide to waive the privilege and disclose this discussion to third parties such as federal and state agencies, at its sole discretion, and without notifying you. In order for this discussion to be subject to the privilege, it must be kept in confidence. In other words, you may not disclose the substance of this interview to any third party, including other employees or anyone outside of the company. You may discuss the facts of what happened but you may not discuss this discussion.

Upjohn warnings ensure that the attorney-client privilege that exists between counsel and the interviewee will be maintained. It also allows the company to waive the privilege, which the company may need to do as part of its cooperation with the government and to obtain a lenient penalty or sentence. Finally, if counsel does not make it clear to the witness that he or she only represents the company, the witness may understandably believe that counsel represents her and that the privilege belongs to her and cannot be waived without her consent.

2. Joint Representation of the Franchisor and Individuals

For the witness who should have counsel, or who desires to have counsel, one question is whether the company’s attorney should also represent the witness. Franchisor counsel often represents affiliated companies, officers, and employees in litigation for a variety of reasons. In the context of internal or government investigations, different issues are involved and there may be...
greater reason for separate counsel to be retained for the witness, especially if
she appears to be or may become a subject or target of a government inves-
tigation. While in some instances the parties’ interests may be aligned and joint
representation will help rather than harm them, it is still important at the out-
set for counsel to consider whether joint representation is advisable. This will
depend on a number of factors, including whether the parties’ interests, even if
currently aligned, could diverge in the future; whether the parties may have
different interests should settlement or plea negotiations with the government
occur; and whether counsel can provide competent representation to all of the
parties. In considering a multiple representation engagement, counsel should
carefully review the ABA Model Rules of Professional Conduct, the Canons
under the Code of Professional Responsibility, and variations of the profes-
sional standards in the local jurisdiction involved.

Rule 1.13(2)(g) of the Model Rules states: “A lawyer representing an orga-
nization may also represent any of its directors, officers, employees, members,
shareholders or other constituents, subject to the provisions of Rule 1.7. If the
organization’s consent to the dual representation is required by Rule 1.7, the
consent shall be given by an appropriate official of the organization other than
the individual who is to be represented, or by the shareholders.”

ABA Model Rule 1.7 states:

Rule 1.7: CONFLICT OF INTEREST: CURRENT CLIENTS

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if
the representation involves a concurrent conflict of interest. A concurrent
conflict of interest exists if:

(1) the representation of one client will be directly adverse to another cli-
et; or

(2) there is a significant risk that the representation of one or more clients
will be materially limited by the lawyer’s responsibilities to another cli-
et or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under
paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide
competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one cli-
et against another client in the same litigation or other proceeding be-
fore a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

Under Rule 1.7(b), even if a conflict of interest exists, the lawyer may still
represent multiple parties if the multiple representations are not prohibited by
law, the lawyer believes she can represent all parties competently, and the law-
ner obtains the informed consent of all affected parties in writing. Neverthe-
less, in a government or internal investigation, multiple representations can be
tricky, and the lawyer should consider a number of issues before deciding to
represent a company and one or more of its employees, including, but not limited to: (1) whether the government will be concerned about collusion between the company and its employees if all are represented by the same attorney, which could create discord between the government and the company; (2) whether there is a possibility that the discovery of further evidence will create a conflict between the company and the employees; or (3) whether the company or its employees may change their positions concerning the matter at some point, which could create a conflict of interest. If a conflict arises, counsel may have to recuse themselves from representing any party, which could be quite costly to the company. On the other hand, joint representation is an efficient way to proceed, in that it is likely to help keep the company’s legal costs down and make the sharing of information and development of a cohesive strategy much easier. Accordingly, counsel must think through all of the issues carefully when determining whether to represent not only the company but also one or more of its employees in an investigation.

3. Joint Defense/Common Interest Arrangements

Even if employees are being represented by other counsel, counsel for all parties (or a subset of the parties) can enter into a “Joint Defense” or “Common Interest” agreement that would permit counsel to share information and develop legal strategies together without waiving the attorney-client privilege. Typically, disclosure of an attorney-client confidence to a third party waives the attorney-client privilege. However, if parties enter into a joint defense or common interest agreement, then the disclosure of confidences among the parties to the agreement will not waive the privilege. Under these arrangements, multiple clients facing an investigation have separate, rather than identical, counsel. The parties agree, in order to share information and mount a joint defense, to maintain the confidentiality of all information exchanged. In general, the privilege can be asserted if: (1) the communications were made in the course of a joint defense/common interest effort; (2) the communications were designed to further the effort; and (3) the privilege has not been waived.

There are a number of advantages and disadvantages for franchisor counsel to consider in determining whether to enter into a Joint Defense Agreement. Through the sharing of information with others, counsel can obtain a better understanding of the government’s investigation and thereby develop a more robust and comprehensive response to the government’s inquiry. Counsel can develop, together with others in the joint defense group, a common and potentially more coherent legal strategy. Moreover, significant cost savings can occur through a joint defense arrangement if the company is not paying for the attorneys representing others in the group. The sharing of in-

37. Schmitt v. Emery, 2 N.W.2d 413, 416 (Minn. 1942) (extended joint defense privilege to civil cases); Chahoon v. Commonwealth, 62 Va. (21 Gratt.) 822, 836–42 (1871) (established joint defense privilege in criminal cases).

formation can enable counsel to reduce investigation costs; research, expert, and other costs can be divided among the members of the group. When a franchisee is the subject of a government investigation, the franchisor may consider entering into a common interest agreement with the franchisee so that the parties can fully and frankly discuss the issues raised by the government’s investigation without fear that their discussions will be disclosed. The discussions, which generally take place between counsel, will be protected by the attorney-client and work product privileges.

On the other hand, there are a number of risks to entering into a joint defense or common interest arrangement that franchisor counsel must consider. The government may view the arrangement with disfavor, especially if the company has indicated that it intends to fully cooperate with the government in the investigation. The government may consider a joint defense arrangement as the company’s attempt to control witnesses from whom the government seeks cooperation and candor. The company may also want to distance itself from potential individual wrongdoers within its ranks and be in a position to inform the government that the acts of the wrongdoers were isolated and do not reflect a broader culture or pattern of wrongful conduct within the company. If the franchisor’s counsel is working with counsel for the wrongdoers, the government may question the sincerity of the company’s position.

There are other risks as well. The confidential communications that are shared among counsel and their clients could be used against the company at a later point in time, despite the existence of the agreement. There could be a dispute over whether the information was already known independently by others or whether it was learned only through joint defense discussions. Further, because there is no obligation for the attorneys or their clients to share information, some clients may use the arrangement to learn facts helpful to their case while withholding information from other participants in the joint defense arrangement. In addition, privileged information or documents may be inadvertently disclosed to the government or third parties.

Parties may choose to withdraw from the joint defense arrangement and are generally required to inform the other parties of their decision. This may happen, for example, when an individual decides to plead guilty or settle with the government. The communications divulged during the individual’s participation in the joint defense arrangement will remain privileged despite the individual’s withdrawal from the agreement, although the party may choose to waive the privilege with regard to any communications with her own attorney even if the attorney disclosed those communications to the joint defense group.

Thus, an attorney representing a franchisor needs to carefully consider the pros and cons of entering into a joint defense arrangement with others. These arrangements should not be entered into blindly, and often it may not be in the best interests of the franchisor to enter into such an arrangement during a government investigation. Franchisor counsel should keep in mind that, even if it decides not to enter into a joint defense or common interest
arrangement, it may still discuss logistics and even strategy with counsel for others. Counsel will simply need to be careful not to disclose confidential and privileged communications during such conversations.

IV. Dealing with the Government

As discussed, in many instances the franchisor will cooperate with the government in its investigation. When dealing with the government, counsel must be transparent and honest at all times. The government, after all, is attempting to decide whether the company has engaged in wrongdoing and, if so, what, if any, penalty it should impose. Hiding information from or not being honest with the government will not help the company’s cause and may put the company in greater jeopardy than it would otherwise be in.

The Department of Justice has issued guidelines for how prosecutors are to deal with corporations, many of which have been laid out in memoranda drafted by various U.S. Deputy Attorney Generals entitled “Principles of Federal Prosecution of Business Organizations.” These factors are similar to those that other agencies take into account when determining whether to seek to prosecute, or otherwise charge or fine corporations. The factors include:

(1) the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime;

(2) the pervasiveness of the wrongdoing within the corporation, including the complicity in or condoning of the wrongdoing by corporate management;

(3) the corporation’s history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it;

(4) the corporation’s timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents;

(5) the existence and adequacy of the corporation’s pre-existing compliance program;

(6) the corporation’s remedial actions, including any effort to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies;

(7) collateral consequences, including disproportionate harm to shareholders, pension holders, and employees not proven personally culpable, and the impact to the public arising from the prosecution;

(8) the adequacy of the prosecution of individuals responsible for the corporation’s misconduct; and

(9) the adequacy of civil or regulatory remedies.

40. Id. § 9-28.400.
In September 2015, then Deputy Attorney General Sally Yates announced new guidance, emphasizing the Department of Justice’s priority to identify culpable individuals in corporate investigations.\textsuperscript{41} The guidance was not intended to supplant the principles set forth above, but rather was intended to expand upon existing Department of Justice practices.

In the memorandum, Yates required prosecutors to fully leverage their resources to identify culpable individuals at all levels in corporate cases.\textsuperscript{42} No cooperation credit will be awarded to the corporation if full and complete information on individuals is not provided.\textsuperscript{43} Higher level officials within the Department of Justice are required to approve any result in which no action is taken against individuals.\textsuperscript{44} And whether to bring a civil suit against an individual must be based on considerations other than an individual’s ability to pay.\textsuperscript{45}

The Yates memorandum has potentially broad-ranging implications for corporations, including franchisors that face government investigations. The franchisor’s internal investigation, at least in Department of Justice investigations, will plainly be more extensive and costly because it is now tasked with unearthing individual culpability. The investigation is also likely to be prolonged, since the government must determine the extent to which individuals, as well as the corporation, engaged in misconduct. Conflicts between the company and its employees are now more complex, as is the decision on whether the company should voluntarily disclose or self-report any wrongdoing it finds.

Dealing with the government, whether with the Department of Justice or other federal agencies, plainly involves a number of critical decisions for the company and its counsel. If the company finds other misconduct during the government’s investigation, should it voluntarily disclose the wrongdoing to the government? To what extent should the company change its current compliance programs and remediate any wrongdoing? Should the company cooperate in the first place? Should the company disclose the misconduct of any individuals to the government? Certainly, in the case of possible criminal sanctions against the company, the company’s full and complete cooperation will be expected by the government, and the company’s failure to fully cooperate could lead to severe penalties, debarment from government programs, and other harsh results. Cooperation, on the other hand, can mean that the government will be willing to enter into a non-prosecution or deferred prosecution agreement with the company, or a substantially smaller penalty than might otherwise obtain.\textsuperscript{46}

\textsuperscript{41} U.S. Dep’t of Justice, Memorandum from Deputy Att’y Gen. Sally Quillian Yates to Asst. Att’y Gen. and U.S. Att’ys (Sept. 9, 2015).
\textsuperscript{42} Id. at 2.
\textsuperscript{43} Id. at 3.
\textsuperscript{44} Id. at 5.
\textsuperscript{45} Id. at 6.
\textsuperscript{46} A deferred prosecution agreement is an agreement between the prosecution and a defendant pursuant to which a prosecutor agrees to grant amnesty in exchange for the defendant agreeing to fulfill certain conditions, usually including cooperation.
V. Investigations Specific to Franchising

Franchise companies are subject to specific federal and state laws and regulations.47 On the federal side, the Federal Trade Commission (FTC) oversees and enforces laws that promote fair competition and protect the public from unfair and deceptive business practices in the advertising and marketing of goods and services.48 While there is no private right of action under the FTC Act, unfair and deceptive practices are considered unlawful under the Act, and the FTC may seek equitable relief, civil penalties, or rescission and restitution.49

The Bureau of Consumer Protection is the division of the FTC that investigates and prosecutes franchisors for violations of the Act. The Bureau has promulgated a number of trade regulations, including the FTC Franchise Rule, which govern pre-sale disclosures, including financial performance representations.50 When a complaint is filed with the Commission concerning an alleged violation of the Franchise Rule or other laws, the FTC staff decides whether to initiate an investigation. If an investigation is initiated, it is non-public, and thus the identity of the complainant (such as a franchisee) and the particular franchisor that is the subject of the investigation, are not revealed by the FTC.51

The FTC may choose to investigate using voluntary or non-compulsory investigative procedures, such as an access letter requesting that the franchisor voluntarily produce documents to the Commission, interviews with knowledgeable individuals, or mystery queries at the franchisor’s trade show booths. If the FTC sends an access letter to the franchisor, it must notify the franchisor of the conduct constituting the alleged violation and the law applicable to the alleged violation.52

The FTC also has the ability to issue civil investigative demands in its investigations of potential violations of the FTC Act by a franchisor.53 The CID may request the production of documents and tangible things, require answers to interrogatories, or seek the depositions of individuals with knowledge of the conduct at issue. As in the case of other CIDs, counsel for the franchisor may seek to quash the CID, or at least limit the scope of the CID through discussions with government counsel. In any event, counsel for the franchisor will

47. This article does not delve in-depth into the enforcement of FTC Franchise Rule compliance or state franchise regulations because those topics have been covered extensively in prior forum papers. See, e.g., Martin Cordell, Mark B. Forseth & Brian B. Schnell, The Ultimate Remedy: Managing Regulatory Enforcement Actions, ABA 34th Annual Forum on Franchising W-23 (2011) and Shelly Harris-Horn, Theresa Leets, Susan Meyer & Shelley B. Spandorf, Effective Strategies for Working with State Franchise Regulators, ABA 35th Annual Forum on Franchising W-18 (2012).
49. See 15 U.S.C.A. §§ 45(m), 53(b), 57b(b) (West 2017).
50. 16 C.F.R. § 436 (West 2017).
52. 16 C.F.R. § 2.6 (West 2017).
53. 15 U.S.C.A. § 57b-1(b) (West 2017); 16 C.F.R. § 2.7(b) (West 2017).
want to thoroughly investigate the matter internally in order to be in the best position possible to argue to the government for leniency or that the prosecutor should decline to pursue the matter altogether.

If, however, the FTC determines that there has been a violation of Section 5 of the Act (unfair and deceptive practices) or the Franchise Rule, it has a number of options available, including, among others, seeking to have the franchisor enter into a consent order agreement or filing a complaint in the U.S. District Court seeking civil penalties, injunctive relief, or restitution for consumers. In deciding whether to seek a consent decree or bring a formal action, the FTC will consider a number of factors, including the nature and duration of the alleged wrongdoing, the extent of injury to the affected parties, the franchisor’s ability to pay restitution or civil penalties, and the Commission’s likelihood of success.

As in the case with investigations initiated by the FTC, state investigations are often triggered by a complaint from an existing franchisee. State investigators will generally focus on the nature of the complaint and whether similar complaints have been lodged against the franchisor in the past. Typically, state investigators will take action only if the complaint relates to fraud or misrepresentation in the offer and sale of the franchise. This includes allegations of unlawful financial performance representations, an understatement of the initial investment required to become a franchisee, or the failure to provide a disclosure document. The states have limited resources to pursue franchise matters and thus tend to pursue the most serious transgressions or instances in which there have been numerous complaints filed against a franchisor in the past. The information gathered during the course of an investigation, and even the existence of the investigation, is generally kept confidential.

There are several principles to keep in mind when dealing with state franchise investigations. As in all investigations, it behooves franchisor counsel to respond carefully and fully to the investigation and to conduct a vigorous internal investigation to get to the bottom of the problem. Cooperation will likely be key to developing a good relationship with the state regulator or enforcement agency and minimizing your client’s exposure. If your client determines on its own that it has violated a state law/regulation, then you should consider self-reporting. Generally, the state will treat a self-reporting franchisor more leniently than it will a franchisor that fails to report and takes action only when it is caught by the state. In addition, you should have your client immediately correct any wrongdoing that has occurred because the state will, no doubt, want to ensure that the violation will not be repeated in the future.

A state can decide to file a franchise enforcement proceeding. In some instances, administrative proceedings may be available, either held by a franchise

54. 16 C.F.R. § 2.31-2.34 (West 2017); 15 U.S.C.A. §§ 45(m), 53(b), and 57b(b) (West 2017).
administrator or an administrative law judge, that could, following a hearing, lead to a stop or cease and desist order to suspend the franchisor’s registration in the state or to end the violation. Alternatively, a state may bring a state court action to enjoin the franchisor’s conduct.

Not all matters end up in litigation. State agents may attempt to resolve the matter informally and, in such instances, will try to broker a resolution between the franchisor and franchisee. In some instances, especially where the franchisee seeks to obtain rescission damages or other monetary relief, the state may seek to have the franchisor agree to a consent order rather than bring an enforcement action. Franchisor counsel, after doing extensive due diligence, need to work with their clients to develop an appropriate strategy to respond to the state. Often, entering into a consent decree may be more palatable than fighting an enforcement action.

VI. Special Considerations in Investigations of Franchisees

Franchisees, like franchisors, are sometimes the subject of state and/or federal investigations. Government investigations of franchisees have involved the failure to report sales tax, immigration fraud, wage and hour violations, employment discrimination, food and safety violations, and many others. While the investigations are usually on a smaller scale than the investigations of franchisors, the implications for franchisees can be quite serious. Franchisee counsel needs to consider the same issues as franchisor counsel in determining how to respond to a government investigation.

The investigation of a franchisee can have implications for the system as a whole, and thus franchisor counsel needs to closely monitor any government investigation of franchisees of which it becomes aware. If there is a food safety concern involving franchisees in a particular geographic area, and the word spreads to the public at large about the issue, the impact on the system will likely not be confined to the geographic area where the food safety problem exists. The public often thinks of the brand as a whole, not just franchise locations, and consumers may well attach any problem to the brand rather than to particular franchise locations.

This creates challenges for the franchisor. If a problem at franchise locations could spread to the system as a whole, the franchisor may want to step in, expend resources to respond to the investigation, and even take control of the strategic direction of the internal investigation and response. But such a decision would create risks for the franchisor. The franchisor may be perceived as having more control over the franchisees’ business, leading to an increased risk of the franchisor becoming vicariously liable for these and other acts of its franchisees.56 There is also a risk that if the franchisor

56. Kerl v. Dennis Rasmussen, Inc., 682 N.W.2d 328, 341 (Wis. 2004) (noting that most courts that have addressed the matter “have adopted the traditional master/servant ‘control or right of control’ test to determine whether the relationship between the franchisor and the fran-
takes control of the investigation and any dealings with the government, the
publicity will be increasingly focused on the franchisor and the system as a
whole rather than the franchisees. The franchisor can, alternatively, try to
act behind the scenes on behalf of its franchisees, but this is not always
easy and can create difficulties in the management and control of the re-
sponse to the government. Regardless of the extent of the franchisor’s in-
volvelement in the investigation of its franchisees, it is important that the fran-
chisor does not provide legal advice to the franchisee. Franchisor counsel
does not want to be viewed incorrectly as the franchisees’ counsel, which
could lead to serious conflict of interest and other ethical problems.

VII. Conclusion

Government investigations of franchise companies are serious matters that
require thoughtful and appropriate responses to the government’s requests.
As a general rule, the company will cooperate with the government, but the
lawyers representing the company must fully apprise themselves of the scope
of the government’s authority, the nature of the investigation, and the range
of options available to the company to appropriately advise the company on
how it should respond to the government’s inquiries. In order to limit the com-
pany’s exposure, lawyers usually must conduct a thorough internal investiga-
tion themselves, gather and review appropriate documents, interview key em-
ployees, and research and understand the key legal principles applicable to the
matter being investigated.
Resale Programs for Franchise Systems:
A Different Perspective on Franchisees Exiting the System

Sarah Walters and Noah Leszcz

The sale of franchised units often are associated with low sales, an underperforming operator, or a poor market—in essence, a failing store with an owner desperate to exit the system and a franchisor eager to bring in a new operator to save the unit and the brand reputation in the local market. Although distressed franchised units for sale exist in any franchise system, such units typically comprise only a portion of the total franchised units for sale at a given time. Other common reasons for sales of franchised units are due to franchisees seeking to exit the system to pursue other investment opportunities or prepare for retirement with no viable successor, situations where the franchisee is unwilling or unable to adapt to changes in the market or new initiatives implemented by the franchisor, a realization that the brand or owning a franchise does not meet the franchisee’s expectations, or as an alternative to termination following a franchisee’s breach and failure to cure such breach. Additionally, as franchising increasingly becomes attractive to investors and private equity groups as an avenue to diversify their portfolios, the likelihood that franchises will be purchased, developed, and sold prior to expiration of the franchise term also increases. The motivation for selling an operating unit drives the strategy for marketing the unit to potential buyers; however, owners—whether successful or unsuccessful operators—often lack the skills and resources to market, negotiate, and finalize the sale of a business. Owners of underperforming units anxious to sell may entertain offers from any buyer willing to purchase the unit, thus positioning the franchisor at the crossroads of a

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closed unit and a buyer that does not meet the criteria for new franchisees. For owners of successfully operating units, the process of selling a business may be lengthy, time-consuming, and may present challenges for owners inexperienced at valuing a business, potentially resulting in a successful unit becoming an underperforming unit due to owner fatigue with the sales process. Any of the above scenarios has the potential to lead to a transfer to a less-than-ideal candidate and subsequent churn of the unit, with the related cost to the franchisor both in transitioning to another new owner and in its overall brand reputation.1

In light of the myriad of reasons underlying the transfer of a franchise and the potential consequences of an unsuccessful transfer, franchisors may consider the benefits of a structured process whereby franchisees may exit the system by way of a formal franchise resale program. Franchise resale programs are gaining popularity in many franchise systems, and as described in detail below, these franchise resale programs can take many forms, including franchisor-administered programs or the use of specialized consultants as franchisor-approved or optional suppliers. This article explores the evolving trend in franchisor-established franchise resale programs and examines the business and legal considerations under United States and Canadian law related to such programs and the sale of franchised units. The authors also seek to promote consideration of business factors that underlie development of a strong franchise resale program tailored to the franchise system instead of utilizing business brokers that take a one-size-fits-all approach to selling franchised units.

I. Overview of Franchise Resale Programs

Most franchise agreements include conditions that must be satisfied before a franchisor will consent to a franchisee transferring its rights in the franchise agreement and franchised business to a new owner. Such conditions may include securing a buyer that satisfies certain criteria established by the franchisor, such as financial criteria and creditworthiness, training, upgrades to the unit consistent with the franchisor’s then-current standards, and payment of a transfer fee, all of which are integral to a transfer to ensure uninterrupted delivery of products and services to the unit’s customers. However, satisfaction of such conditions is not triggered until the franchisee requests the franchisor’s consent to transfer and presents a prospective buyer for the franchisor’s consideration. An established franchise resale program can provide support to franchisees seeking to exit the system at the initial stages of the sales process, beginning with selection of a buyer from a pool of qualified candidates.

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1. While churning units is damaging in any franchise system, it can cause significant damage in franchise systems where services form the basis of the system (e.g., tutoring services provided by an owner-operator to students who are required to adjust to multiple instructor changes as the franchise transfers hands again and again).
To that end, a critical component of a franchise resale program is a pipeline of qualified buyers. This pipeline may be comprised of prospective franchisees that meet the franchisor’s operational criteria to become a franchisee but lack the capital required to meet the initial investment for development of a new unit. The pipeline may also include entrepreneurs interested in expanding their portfolios and existing franchisees seeking to capitalize on the skills they have developed to turnaround an underperforming unit. A healthy pipeline of prospective franchisees for resale units provides immediate options to owners interested in exiting the system, regardless of whether the unit is struggling or successfully operating. But, unlike the selling franchisee or third party business brokers retained by the franchisee outside of an established franchise resale program, the franchisor or its designated administrator of the franchise resale program has access to such a pipeline. A franchise resale program also provides access to the franchisor’s resources for marketing the brand to prospective franchisees. The skills necessary to successfully operate a franchise and to successfully market for sale a franchised business are distinct. A franchisor is in the business of selling franchises, while its franchisees are in the business of operating the type of business franchised by the franchisor, thereby making the franchisor better suited to market for sale operating units. Providing franchisees access to the benefits of franchisor’s strategic approach to marketing its franchises through an established franchise resale program ensures that the message conveyed to prospective buyers seeking to enter the system is consistent with the franchisor’s message to prospective franchisees and targets the type of buyer that historically has demonstrated success in operating units within the franchise system.

For clarification, the franchise resale programs described in this article are distinct from simply listing units for sale with a broker. A franchise resale program is customized for the brand to maximize the return on investment of the services provided through the franchise resale program, including identifying the characteristics of franchisees that have been successful in operating in the franchise systems and targeting buyers that demonstrate similar characteristics. As noted above, franchisees are increasingly more often sophisticated business owners interested in diversifying their investment portfolios and less the once-common operator seeking to be his own boss. An established franchise resale program is an attractive value-add to a franchisee that desires the flexibility to sell its operating units if a better investment opportunity presents itself.

In addition, a franchise resale program provides a clear pathway for the buyer post-closing with respect to advertising the unit, training personnel, and growing (or in some cases rehabilitating) the brand in the market that may vary depending upon the type of unit acquired (i.e., underperforming unit versus a successful unit). This may include a different tier of advertising, personnel training services, and fee deferrals provided to the buyer of a distressed resale unit on an interim basis while such buyer invests in rebuilding the market compared to the buyer acquiring a package of multiple successful
units and who is a seasoned operator, thereby requiring minimal training and advertising support during the transition. While many franchisors likely provide varying forms of resale services to franchisees seeking to sell their units, it often is not part of an established process that is applied consistently to all transfers and instead is focused primarily on distressed franchisees. Maintaining an established franchise resale program with defined pre- and post-closing paths not only improves consistency across transfers and promotes stability across operating units but also may be attractive to prospective franchisees that the franchise system has a vehicle by which the franchisee may exit the system when desired.

II. Legal Considerations

Franchisors must consider the implication of disclosure requirements, relationship laws, labor and employment laws, and common laws in providing franchise resale services to franchisees. For the purposes of this article, the authors address the legal considerations of developing a franchise resale program under U.S. and Canadian law.\(^2\)

A. United States

1. Disclosure Requirements

The Amended FTC Rule requires a franchisor to comply with the disclosure requirements unless the transaction is exempt.\(^3\) The FTC specifically addresses disclosure obligations in situations where an existing unit is transferred to a new owner: the definition of “sale of a franchise” expressly excludes the transfer of a franchise by an existing franchisee where “the franchisor had no significant involvement with the prospective transferee.”\(^4\) Further, a franchisor’s approval or rejection of a franchisee’s proposed transfer alone is not deemed to constitute “significant involvement.”\(^5\) However, most transfers do not qualify for a disclosure exemption because the underlying franchise agreement requires the transferee to sign the franchisor’s then-current form of franchise agreement. In connection with the transferee entering into such franchise agreement, the franchisor is obligated to satisfy the disclosure requirements under the Amended FTC Rule for the sale of a new franchise.\(^6\)

Where a transferee is not required to sign the franchisor’s then-current form of franchise agreement and no other exemption from the disclosure requirements applies, whether a franchisor must comply with disclosure requirements depends upon the franchisor’s involvement in the contemplated

\(^2\) Franchisors providing resale services to franchisees operating in other jurisdictions are encouraged to consult local counsel regarding laws applicable to such services.

\(^3\) FTC Trade Regulation Rules, 16 C.F.R. § 436.2 (2007).

\(^4\) Id. § 436.1(t).

\(^5\) Id.

\(^6\) Id.
transfer. A franchisor that maintains a franchise resale program pursuant to which it provides services for existing franchisees in connection with the sale of their units (including identifying potential transferee candidates, promoting the unit for sale, and engaging in negotiations related to the sale of the unit), has likely interjected itself into the sales process beyond simply approving or rejecting a proposed transferee presented by the existing owner, which may give rise to a determination that the franchisor has had “significant involvement” in the transfer.\(^7\) Franchisors that wish to take advantage of exemptions from disclosure may consider utilizing third party providers to administer the franchise resale program instead of providing such resale services to franchisees directly.

In addition to complying with disclosure obligations under the Amended FTC Rule, franchisors that maintain franchise resale programs whereby they provide support to exiting franchisees during the sales process should also be mindful of registration and disclosure law requirements under applicable state law. Although many states generally follow the lead of the FTC in exempting registration and disclosure requirements in situations where an existing unit is sold to a transferee, most states have restrictions on the applicability of such exemption where a franchisor is involved in the sale of the unit to the transferee.\(^8\) In addition to complying with disclosure obligations under the Amended FTC Rule and state registration and disclosure requirements, franchisors should be mindful of requirements with respect to franchise advertising when crafting advertisements for franchised units for sale.\(^9\)

\(^7\) The Amended FTC Rule does not expressly define the conduct by franchisors that would give rise to significant involvement in the sale and it is beyond the scope of this article to examine the case law on this issue, which is limited. In addition, franchisors engaging in the resale of operating units should be mindful of laws applicable to business brokers in the relevant jurisdiction. See Brian B. Schnell & Sarah J. Yatchak, Let’s Make a Deal: Developing a Successful Franchise Resale Program, 27(4) Franchise L.J. 215, 218 (2008).

\(^8\) See Washington Franchise Investment Protection Act, Wash. Rev. Code Ann. § 19.100.030(1) (Lexis Nexis 2017) (providing that the registration requirements do not apply to the offer or sale or transfer of a franchise by a franchisee unaffiliated with the franchisor for the franchisee’s own account, provided the franchisee’s entire franchise is sold and “the sale is not effected by or through the franchisor”); see also Cal. Corp. Code § 31102 (Deering 2017); Haw. Rev. Stat. Ann. § 482E-4(a)(7) (Lexis Nexis 2017); 815 ILL. COMP. STAT. 705/7 (2017); Md. Code Ann., Bus. Reg. § 14-214(c)(1) (Lexis Nexis 2017); Mich. Comp. Laws Serv. § 445.1506(1)(b) (Lexis Nexis 2017); Minn. Stat. § 80C.03(a) (West 2017); N.Y. Gen. Bus. Law § 684.5 (Lexis Nexis 2017); N.D. Cent. Code § 51-19-04.2 (Lexis Nexis 2017); Or. Admin. R. 441-325-030(4) (2017); 19 R.I. Gen. Laws § 19-28.1-6(b) (2017); S.D. Codified Laws § 37-fA-13 (2017), Va. Reg. § 5-110-75; Wis. Stat. § 553.23 (West 2017) (each providing similar exclusions from the registration and disclosure exemption where a franchisor is not involved in the sale of the franchised unit).

\(^9\) With respect to franchisor-administered resale programs, franchisors should consider in crafting advertisements for units for sale that the advertisement also may constitute an advertisement for the franchise that will be purchased in connection with acquiring an operating franchised unit. Accordingly, such advertisements must comply with applicable state law. See, e.g., Cal. Corp. Code § 31201 (Deering 2017); Ind. Code Ann. §23-2-2.5-27 (Lexis Nexis 2017); Md. Code Ann., Bus. Reg. § 14-229 (Lexis Nexis 2017); see also Matthew Kreutzer, Are You in Compliance With Franchise Sales Advertising Filing Laws, Forward Franchising (Apr. 20, 2011),
2. Relationship Laws

Franchise agreements customarily include conditions that a franchisee must satisfy in connection with a proposed transfer. Such conditions must comply with relationship laws in the applicable states (in addition to any standards—e.g., reasonability, good faith—applicable to approving or rejecting franchisee requests for transfer under applicable state law).\(^{10}\) For example, under both Hawaii and Michigan statutes, a franchisor’s refusal to permit a transfer without good cause is deemed an unfair or deceptive act.\(^{11}\) Other franchise relationship statutes create transfer procedures that a franchisor and franchisee must follow.\(^{12}\) Maintaining a franchise resale program can facilitate smoother transfers under applicable relationship laws by providing a qualified pool of transferee candidates as prospective buyers that meet the franchisor’s criteria for franchisees, thereby reducing the likelihood that a franchisee’s request for consent to transfer may be denied. In addition, establishing a structured framework whereby a franchisor is notified of the franchisee’s desire to sell much earlier in the transfer process—upon the franchisee entering the franchise resale program—will provide the opportunity for the franchisor to be involved at the early stages of the transfer and ensure the franchisee adheres to all steps in the transfer process.

3. Financial Performance Representations

Providing a prospective buyer with the financial information related to a franchised unit in connection with the sale of that unit does not constitute a financial performance representation.\(^{13}\) However, franchisors administering a franchise resale program via its development personnel who also are responsible for new franchise sales should be cautious that discussions with prospective buyers in connection with the sale of an existing unit through the franchise resale program does not lead to the creation of projections or disclosure of financial performance representations beyond historical financial information (e.g., projections and system-wide financial data) that are inconsistent with the disclosures made in Item 19 of the franchisor’s disclosure document.

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\(^{10}\) It is the intent of the authors to highlight certain legal considerations under state relationship laws but a thorough analysis of issues arising under state relationship laws and standards applicable to a franchisor’s right to approve or reject a franchisee’s request for consent to transfer is beyond the scope of this article. See Terrence M. Dunn, *The Franchisor’s Control over the Transfer of a Franchise*, 27(4) FRANCHISE L.J. 223, 223–40 (2008).

\(^{11}\) See Hawaii Franchise Investment Law, HAW. REV. STAT. ANN. § 482E-6 (Lexis Nexis 2017); Michigan Franchise Investment Law, MICH. COMP. LAWS. § 445.1527 (Lexis Nexis 2017).


\(^{13}\) 16 C.F.R. § 436.5(s)(1) (2007).
4. Due Diligence/Common Law

During the course of due diligence for the sale of a franchised unit, information and records related to the operation of the franchised unit often are provided to prospective buyers. Franchisors should make clear the source of the information—i.e., whether the information was prepared by the franchisor or the franchisee—and, if the latter, identify whether the franchisor has independently verified the completeness and accuracy of the information. As discussed further below, an approach to shifting some of the risk of franchisor involvement in the sale of a franchised unit while retaining the benefit of a structured franchise resale program to facilitate the transfer to a qualified candidate, franchisors may consider working with a franchise resale consultant to develop and administer the franchise resale program such that the franchisor is not involved in communications with prospective buyers with respect to due diligence and negotiation of business terms of the sale.

5. Complying with Other Applicable Laws and Requirements

In addition to complying with disclosure requirements under the Amended FTC Rule and registration and disclosure requirements under applicable state law, a franchisor’s involvement in the sale of franchised units through a franchise resale program may trigger the obligation to comply with other state laws and licensing requirements, including without limitation those applicable to real estate brokers and business brokers and, if the sale of the franchised business involves securities, the required securities license.  

B. Canada

Franchise resale programs, while less common in Canada, are quickly gaining traction as U.S. brands continue to expand north of the border. As further discussed in this section, the considerations for franchisors facilitating the sale of operating units in Canada are similar to those under U.S. law.

Currently, six of Canada’s provinces have passed and have in force franchise legislation (Alberta, British Columbia, Manitoba, New Brunswick, Ontario, and Prince Edward Island, collectively referred to herein as the “Disclosure Provinces”). The six Disclosure Provinces have similar legislation, although there are several minor variances in the statutes. As Ontario’s franchise law is arguably the most onerous, most references in this article will be to Ontario’s disclosure laws, and any material differences between the provincial statutes relevant to this analysis will be mentioned below as necessary.

1. Disclosure Requirements

Ontario’s legislation, along with the other provincial statutes, requires that a pre-sale franchise disclosure document (FDD) be delivered if a fran-
chise is to be wholly or partly operated in any of the Disclosure Provinces.  
There is an additional requirement in Alberta that the franchisee must be a resident of that province. A franchisor must provide a prospective franchisee with a FDD not less than fourteen days before: (a) the signing of the franchise agreement or any agreement relating to the franchise, which includes a letter of intent, except for limited confidentiality agreements outside of Ontario, and (b) the payment of any consideration by the franchisee.

In contrast with the United States, FDDs are not registered with any governmental authority, and the onus for compliance with disclosure laws rests solely on the franchisor without any regulatory oversight. Failure to deliver a compliant FDD grants franchisees with a statutory sixty-day rescission period starting from the day it received the FDD. Even further, failure to deliver a FDD altogether grants a franchisee with a statutory right of rescission for up to two years following execution of the franchise agreement. On rescission, a franchisor must return all monies paid and recoup all losses suffered by the franchisee while owning the franchise. As one can imagine, recouping a franchisee’s investment after up to twenty-four months of operation can be extremely costly.

Aside from a few narrow exemptions, disclosure is required (1) when purchasing a new franchised business, (2) when purchasing an existing franchised business (whether through a franchisor resale program or otherwise), or (3) when renewing or extending a franchise agreement. There is an exemption in the legislation, however, which applies when the grant or sale “of the franchise is not effected by or through the franchisor.” The legislation outlines that a sale is not effected by or through the franchisor merely because the franchisor has the right, on reasonable grounds to approve or disapprove the sale, or if a transfer fee is required. While this exemption is not often used in practice in Canada, the courts have ruled in favor of franchisors that have relied on this exemption when used appropriately. For example, it has been established that a franchisor can rely on this exemption if it takes a passive role in a transfer, merely agrees to a sale, and “does little else beyond providing some documents.” However, a resale or transfer effected by a franchisor with a formal franchise resale program certainly cannot rely on this statutory exemption due to the level of franchisor involvement.

19. Id. at § 6.
20. Id.
21. Id. at § 5. It should be noted that this exemption to provide a FDD contains three other requirements, in addition to the one listed above, that must all be met, but the above requirement is the most important at issue.
23. Id. at ¶ 12.
In fact, franchisors in the Disclosure Provinces are obligated to disclose all material facts, including, in certain cases, site-specific information in the FDD. A material fact includes any information about the business, operations, capital, or control of the franchisor or franchisor’s associates, or about the franchise or the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise. In the resale context, factors such as historical operating information are sometimes viewed as material facts needing to be included in the FDD, even though the franchise statutes state that the disclosure of financial performance representation is voluntary. This is because the business for which the FDD is being given is one already in existence, with facts and circumstances that could impact a prospect’s decision to purchase the franchise. A copy of the lease, and sublease, if applicable, for the existing location, may in certain cases be necessary inclusions in a FDD provided to prospective purchasers of an existing unit.

2. Relationship Laws

Unlike the United States, Canada does not have specific relationship laws. However, the Disclosure Provinces do provide for relationship type provisions within their franchise legislation. For example, franchisees in Canada are provided with a statutory right to associate with other franchisees and to form or join an organization of franchisees. This protection enables existing franchisees to create groups, associations, and coalitions to empower themselves as a collective unit.

In Ontario and the other Disclosure Provinces, the legislation prohibits the waiver of statutory requirements. Accordingly, a contractual clause requiring franchisees to provide a general release of all claims upon a transfer (or renewal, or in any other case where the release is compelled as a condition of exercising some other right) is unenforceable. However, if the requirement to give the release and the release form explicitly carves out those rights and obligations imposed by the applicable franchise law that cannot be released or waived pursuant to such law, the release of all other claims can be enforceable.

3. Financial Performance Representations

The law in Ontario and the other Disclosure Provinces provides that the provision of a financial performance representation in a FDD is voluntary. However, Ontario’s statute provides that if one is provided, the estimate

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27. Id. at § 11, which states “Any purported waiver or release by a franchisee of a right given under this Act or of an obligation or requirement imposed on a franchisor or franchisor’s associate by or under this Act is void.”
of annual operating costs or earnings projection must include: (1) a statement specifying the basis for the estimate or projection; (2) the assumptions underlying the estimate or projection; and (3) a location where information is available for inspection that substantiates the estimate or projection.\(^2\) It should be noted that there are minor variations in the laws of the Disclosure Provinces surrounding financial performance representations, and attention should be paid to the applicable provincial statute, as necessary. However, in the case of a transfer, the overarching principle to provide all material facts prevails, and franchisors may desire to provide certain pieces of financial information from the existing franchised business, as these may in certain cases be deemed site specific material facts.

In contrast with the United States, providing a prospective buyer with the financial information related to a franchised business in connection with the sale of that business does constitute a financial performance representation. This is fine, as long as the above-mentioned requirements are adhered to. Franchisors should be cautioned not to provide any oral representations through their resale program that contradicts or includes additional information beyond what is contained in the FDD. Due to the requirement in Ontario to deliver FDDs in “one document at one time,” all financial performance representations must be included in the FDD, so as to avoid a situation where additional disclosure is provided beyond the FDD, thus violating the “one document at one time” rule.\(^2\)

4. Due Diligence/Common Law

Due to the aforementioned “one document at one time” rule, franchisors must be cautious during a prospective franchisee’s due diligence to avoid the provision of supplemental disclosure of information not otherwise contained within the FDD, or otherwise making contradicting or inconsistent disclosure at any time. Canadian legislation provides for a tool to offer additional disclosure to prospective franchisees when there has been a material change, as defined in the footnotes below, since the FDD was provided in a different document known as a Statement of Material Change.\(^3\) In relation to a franchisor resale program, the desire to disclose prospects early to initiate the sales process may exist, and following disclosure, material changes regarding the target franchised business may come to light. A Statement of Material Change can be used to assist prospective franchisees in their due diligence

\(^3\) Material change means “a change in the business, operations, capital or control of the franchisor or franchisor’s associate, a change in the franchise system or a prescribed change, that would reasonably be expected to have a significant adverse effect on the value or price of the franchise to be granted or on the decision to acquire the franchise and includes a decision to implement such a change made by the board of directors of the franchisor or franchisor’s associate or by senior management of the franchisor or franchisor’s associate who believe that confirmation of the decision by the board of directors is probable.” Arthur Wishart Act (Franchise Disclosure), 2000 S.O. 2000, c. 3, § 1.
in this fashion. Of course, if the information is known at the time the FDD is provided, it must be included therein, and Statements of Material Change cannot be used as a tool to circumvent providing all known material facts in the FDD.

5. Other Applicable Provincial Laws (Broker, Real Estate)

Franchisors maintaining franchise resale programs should be cognizant of other areas of law that may be triggered in the context of administering such a program or upon a transfer or resale itself. Across Canada, real estate and business brokers are regulated provincially and the laws differ by each jurisdiction. Franchisors should be aware of these real estate and business broker laws in the province in which they are operating. Canadian jurisprudence has never found a franchisor liable for operating as a real estate or business broker as a result of its involvement in a resale or transfer, but certain third party brokers may be at risk. However, depending on the size and scope of the franchise transaction, and each situation’s unique facts, franchisors should give careful consideration to provincial real estate and business brokerage laws to ensure compliance, especially when involved in franchise resale programs.

III. Business Considerations

Notwithstanding the legal considerations that a franchisor must navigate in administering a franchise resale program, there are numerous advantages to a franchisor in establishing such a program, including maintaining a stable system of operating units to enable consistent growth that is not offset by closure and churn of units, an efficient process through which franchisees may exit the system that permits the franchisees to continue to focus on operation of their units instead of dividing attention and resources between operations and marketing their businesses, and the flexibility to create multi-unit packages of existing units that may be attractive to sophisticated buyers.31 A franchisor, unlike a general business broker, has intimate knowledge of what factors contribute to strong performance in its franchise system and may draw on that knowledge in identifying candidates that have the greatest potential to achieve success and strengthen the brand. The franchisor may utilize that knowledge to craft a franchise resale program that targets candidates with such success factors and maximizes efficiencies in the resale process by marketing resale units to a broad base of potential buyers. A franchise resale program may also facilitate a franchisor restructuring its network of

franchisees through packaging of available units with development rights to multi-unit operators and sophisticated investors.

A. Heightened Involvement by Franchisors in Sale of Existing Units Leads to Stronger Franchisees

As could be predicted, franchisees leaving the system are often not concerned with the strength of the incoming franchisee; that is the franchisor’s concern. Franchisors can take advantage of the opportunity to strengthen their system by replacing struggling franchisees with strong prospects. While franchisors almost always provide themselves with the opportunity to approve the proposed transferee in their franchise agreements, franchisors may be hesitant to disapprove of a prospect when there are no other viable options waiting in queue. Franchisors may feel pressure to accept under-qualified prospects to avoid stymieing the deal. Formal resale programs allow franchisors to create pools of prospects awaiting transfers, allowing them to pick the most qualified candidate for each transfer or resale.

In addition, formal resale and transfer programs will assist in the creation of exit strategies for non-compliant franchisees. A franchise resale program can provide an alternative to termination in circumstances where a franchisee is unwilling or unable to cure its default under the franchise agreement. Further, participation in a franchise resale program concurrently with a cure period running allows the franchisee to focus on the day-to-day operations of its business, as attention paid towards an exit-strategy will detract from attention to operations. In the absence of a franchise resale program, a franchisee destined for termination may perform even worse when it is trying to negotiate an exit in advance of a deadline to cure. Participation in a franchise resale program allows the franchisee to continue to focus on the operations of the business, while the franchise resale program administrator focuses on finding acceptable buyers.

Further, opening a new location of a franchised business requires a different range of abilities than operating an existing location. When opening a new location, a franchisee must focus on site selection and controlling costs during construction. When operating an existing location, a franchisee must focus on the actual operation of the franchised business. Resale programs allow franchisors to select candidates that have the requisite range of abilities for the task upon which they are embarking.

B. Key Components of a Franchise Resale Program

The value of a consultant familiar with developing and administering a franchise resale program cannot be understated. The consultant provides

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32. See generally Schnell & Yatchak, supra note 7.
33. For example, consultants like FranchiseResales.com provide services to franchisors to assist in developing and administering a franchise resale program that meets the needs of the franchise system. FRANCHISE RESALES, http://www.franchiseresales.com (last visited Feb. 3, 2018).
services beyond simply listing the business for sale—establishing a franchise resale program includes working cooperatively with the franchisor to establish the framework by which units at varying performance levels will be transitioned to new owners, including methods of valuing the business, characteristics of the type of candidate best suited for each category of unit, timeline for transitioning units, and strategy for promotion of the units consistent with franchisor’s brand positioning.

The terms and conditions of a franchisee’s participation in an established franchise resale program will be contained in a separate participation agreement signed by the franchisee and franchisor (or consultant if the consultant is retained to administer the program). Participation in the program typically involves compensation to the program administrator, which may be in the form of a fixed fee, percentage of the purchase price, or combination thereof. If the program is administered by the franchisor, the participation agreement also should include provisions to mitigate risk of the franchisor’s participation in the sale of the franchisee’s business, including indemnification for any third party claims related to information provided to prospective buyers by the franchisor that was supplied by the seller franchisee, confidentiality obligations with respect to franchisor’s methods, and strategies for promoting the business for sale and general releases in favor of the franchisor and its affiliates. Participating franchisees also should acknowledge that there is no guarantee that the franchisor will be successful in its effort to sell the unit and the participation agreement should provide for a fixed term during which the unit will be for sale to avoid “stale” units cluttering the franchise resale program.

C. Potential Concerns for Franchisors in Maintaining Franchise Resale Program

While it is critical to have franchisor input in developing the franchise resale program, increased franchisor participation in the franchise resale process as administrator of the program may produce undesirable results, including exposure to claims involving disputes related to the sale and deleterious effects on the franchisor-franchisee relationship due to franchisee expectations during the resale process. Additionally, with heightened involvement, the disclosure exemption for the sale of existing locations may not be available, as noted above.

Finally, the costs of administering the program for franchisors may be unduly burdensome, including establishing the infrastructure to support the program and allocating personnel resources to promoting the units and negotiating sales as well as reviewing financial information and preparing materials for distribution to potential buyers. Training requirements are inherently different for the sale of new franchises and franchise resales, positioning the two as competitors for a franchisor’s limited resources. In addition, because transfer fees commonly are lower than initial franchise fees, there would need to be a financial incentive for the resale program to compensate for
this disparity. For the reasons described above, a franchisor may opt to work with a consultant to facilitate implementation of the program in its franchise system.

IV. Conclusion

Most franchisors participate at some level in the sale of existing units (particularly when units are struggling), commonly on a transaction-by-transaction basis without a formal program or established franchise resale procedures in place. This approach to supporting franchisees seeking to exit the system can occupy franchisor resources necessary for supporting the franchise system. A franchise resale program established to promote the growth objectives of the franchise system and continued strengthening of the brand can facilitate efficient use of franchisor resources and a structured process whereby franchisees may exit the system. Experienced franchise resale consultants can be an invaluable tool in assisting a franchisor in developing a franchise resale program and may remain involved in the launch and implementation of such program so that the franchisor may receive the benefits of maintaining the franchise resale program without the risk and expense of administering the program directly.

Enforceability of Choice of Law Clauses in Arbitration When Such Clauses Are Contrary to the Public Policy of the Puerto Rico Relationship Statutes

Rossell Barrios

I. Introduction

The issue of the enforceability of choice of law clauses in arbitration arises whenever state public policy would be defeated if the case is decided under a law chosen by the parties that is inconsistent with such public policy. Normally, the issue revolves around the public policy of the forum where enforcement is sought and/or where the controversy arose. Sometimes, state or territorial public policies emanate from commercial relationship statutes applicable to distributors, franchisees, sales brokers, and other independent contractors that act as commercial intermediaries. These policies are raised in arbitration proceedings that putatively involve those commercial relationship statutes.

II. Enforceability of Choice of Law Clauses Prior to Arbitration When Such Enforcement Might Collide with Public Policy of Relationship Statutes

Federal courts have passed on the issue of the enforceability of choice of law clauses prior to arbitration if state or territorial law would consider such clauses unenforceable because they violate such state’s or territory’s public policy. The seminal case on the subject of how public policies interact

2. These statutes often require “cause” for the nonrenewal, termination, or impairment of a covered distribution, franchise, or similar commercial relationship.

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with arbitration and choice of law agreements involved federal public policy. In Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, the U.S. Supreme Court remarked that “in the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party’s right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy.” This language only refers to federal public policy under the federal antitrust statutes. The issue of state or territorial public policy was not addressed in Mitsubishi. Other courts have tackled the problem based on state public policies.

To determine which law should be applied in an arbitration proceeding or whether the choice of law clause agreed by the parties should be enforced, the court, sitting in diversity, should look to the law of the forum where the court sits. The Puerto Rico federal district court followed this same principle in Medika International, Inc. v. Scanlan International, Inc.

In contrast to some of the cases cited above, the U.S. District Court for the District of Puerto Rico has ruled that the arbitrator, not the court, has the authority to decide whether to enforce the choice of law clause. The First Circuit, which includes the District of Puerto Rico, adopted this conclusion in P.R. Hospital Supply, Inc. v. Boston Scientific Corp. Actually, the First Circuit followed Mitsubishi by referring the issue of the enforceability of the choice of law clause to the arbitrator. The ruling in Mitsubishi was reaffirmed by the U.S. Supreme Court in Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer.

Later, in Diagnostic Imaging Supplies & Services, Inc. v. General Electric Co., the U.S. District Court for the District of Puerto Rico held, in a case brought under Act 75 of June 24, 1964, that it was also up to the arbitrator to decide the enforceability of a choice of law clause agreed by the parties. It cited a Puerto Rico Supreme Court case captioned World Films Inc. v. Paramount Pictures Corp. as well as Mitsubishi and Medika International and concluded:

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4. Id.
5. See Ticknor v. Choice Hotels Int’l, Inc., 265 F.3d 931 (9th Cir. 2001) (choice of law clause was not enforced because Montana public policy trumped the application of Maryland law which was chosen by the parties in the agreement); Am. Express v. Yantis, 338 F. Supp. 2d 818 (N.D. Iowa 2005) (Iowa public policy would be violated if the state law chosen by the parties was applied).
6. Ticknor, 265 F.3d at 937; Zinser v. Accufix Research Inst., Inc., 253 F.3d 1180, 1187 (9th Cir. 2001).
8. Id.
9. 426 F.3d 503 (1st Cir. 2005).
12. Puerto Rico Dealers Act (Act 75), P.R. LAWS ANN. tit. 10, § 278 et seq. This statute affords distributors and franchisees the same protection that Act 21 affords sales representatives.
The general rule is that arbitration agreements are to be enforced according to their terms.

.. . . . [I]t would be inappropriate for the Court to reach the issue of whether Law 75 should be applied to resolve any dispute arising out of the distribution agreement in the event of future arbitration because—pursuant to the FAA and the strong federal policy favoring arbitration—such a question is for the arbitrator not this Court. 15

As we have seen, some courts, such as the Ninth Circuit in Ticknor v. Choice Hotels International, Inc., have decided, prior to arbitration, the issue of the enforceability of the choice of law clauses vis à vis state or territorial public policy. 16 Other courts, like the First Circuit, have abstained from deciding that issue and have referred it to the arbitrator.

The parties to the arbitration will dispute before the arbitrator whether any public policy has been violated. The franchisor has an additional argument based on the reasonable uniformity which it has a right to seek by applying the same law to all franchisees. 17 Moreover, the laws expressly chosen in franchise agreements are, normally, the laws of the states where the franchisors are either incorporated or headquartered and, thus, where the franchisor sometimes performs most, if not all, its duties. Thus, the chosen law normally has substantial ties to at least one of the parties. 18

III. Contesting Arbitration Awards Based on the Law Applied by the Arbitrator Despite the Public Policy of Relationship Statutes

After the arbitration, however, an award could be contested in court and vacated because it violates public policy. This was so at least before Hall Street Associates, L.L.C. v. Mattel. 19 Hall Street Associates decided that the bases for vacatur under the Federal Arbitration Act (FAA) 20 were only those specifically listed in that statute. 21 Violation of public policy is not one of the bases to vacate an award listed in the FAA. Rather, it was created by the courts. In particular, the First Circuit has yet to decide whether the “violation of public policy” survived Hall Street Associates. 22

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18. See Restatement (Second) of Conflict of Laws § 187(2) (1971).
21. Id.
22. Id. After Hall v. Mattel, other courts have held that violation of public policy is no longer a viable basis to vacate an arbitration award. See Am. Postal Workers Union, AFL-CIO v. U.S. Postal Serv., No. 3:09-CV-1084-B, 2010 WL 1962676 (N.D. Tex. May 14, 2010). Other courts have been noncommittal. See Legacy Trading Co. v. Hoffman, 363 F. App’x 633 (10th Cir.
Vacating an arbitration award based on the violation of public policy derives from the basic notion that no court will enforce an award to commit an immoral or illegal act. The public policy relied on “must be explicit, well defined, and dominant.” The policy advanced must reference “laws and legal precedents” rather than “general considerations of proposed public interests.” The relevant focus is not on any mischief leading up to the award, but the impact of implementing the award itself. Thus, such public policy must militate against the relief ordered by the arbitrator.

In Puerto Rico, vacatur based on public policy has been specifically addressed by the U.S. District Court for the District of Puerto Rico. In *Hawayek v. A.T. Cross Co.*, the court held that the policy behind Act 21 of December 5, 1990 (Puerto Rico’s Sales Representative Act) did not make the choice of law clause unenforceable because the plaintiff did not prove “manifest disregard of the law” on the part of the arbitrator when the latter decided to apply Rhode Island law. In *Hawayek*, “violation of public policy” and “manifest disregard of the law” were conflated without explanation. Thus, the court denied the request to vacate an interim arbitration award that decided that Rhode Island law would be applied to the arbitration instead of Puerto Rico’s Act 21, citing, inter alia, *Mitsubishi*. The court concluded:

> The Court understands, and in fact finds very persuasive, Plaintiff’s argument that the Arbitrator’s interpretation of Mitsubishi and World Films effectively destroys the power of Law 21. In fact, we find that the Arbitrator’s decision creates a loophole to the requirements established as the clear and compelling public policy embodied in Law 21. Under such jurisprudence, a manufacturer need only include in its contracts an arbitration clause specifying the substantive law it prefers, to avoid the grip of Law 21.

Nonetheless, we cannot safely say that the Arbitrator’s decision is in manifest disregard of the law. Again, the strict standard by which we measure the Arbitrator’s decision requires that we let stand his reasonable decision, even though we might

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28. This statute affords protection against the nonrenewal, termination, or impairment of a principal-sales broker relationship without “just cause.” Puerto Rico’s Sales Representative Act (Act 21), P.R. LAWS ANN. tit. 10 § 279 et seq.

disagree with its wisdom. “As long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, that a court is convinced he committed serious error does not suffice to overturn his decision.” *Challenger Caribbean*, 903 F.2d at 861. In this case, this Court’s difference of opinion with the Arbitrator is not enough to overturn his verdict.\(^{30}\)

The drafting of the relevant section of Act 21 might explain why the court in *Hawayek* found that the arbitrator did not evince “manifest disregard of the law.” Act 21 provides:

The sales representation contracts referred to in this chapter shall be construed pursuant to, and shall be governed by the laws of the Commonwealth of Puerto Rico, and any stipulation to the contrary shall be null. However, this nullity shall not include any arbitration clause agreed upon.\(^{31}\)

The last sentence could be read to exempt the arbitrator from the statutory bar against enforcing the choice of law clause. The choice of law and arbitration clauses are separable, but were conflated in this provision. Thus, the exemption of arbitration from nullification could also save the choice of law clause applicable to the arbitration. Otherwise, it would be difficult to explain the use of the word “however” in the second sentence when the previous sentence refers to which law may be applied, not to which forum will adjudicate the controversy. Thus, the conclusion that arbitration acts as a safe harbor for the choice of law clause is a plausible interpretation of the cited provision.

**IV. New York Convention and Vacatur Based on Public Policy of Relationship Statutes**

Vacatur in arbitration covered by the New York Convention\(^{32}\) for international\(^{33}\) arbitration requires the application of a more stringent standard to the “public policy” exception against enforcement of arbitration awards. Article V(2)(b) of the Convention\(^{34}\) provides, inter alia, that enforcement of an arbitration award is barred if it violates the public policy of the country in

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30. *Id.* at 257–58.
31. P.R. LAWS ANN. tit. 10 § 279f.
33. Article I of the New York Convention provides:

This Convention shall apply to the recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought, and arising out of differences between persons, whether physical or legal. It shall also apply to arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought.

*Id.* at art. I.
34. According to art. V(2)(b):

Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:
which recognition and enforcement are sought. The First Circuit has yet to address the specific issue of vacatur on the specific basis of the violation of public policy under the New York Convention.

The Convention applies only when arbitral awards are not considered domestic in the jurisdiction where their recognition and enforcement is sought.35 The Second Circuit has held that the phrase “public policy” refers to “basic notions of morality or justice.”36 Moreover, the violation of “public policy” to which the Convention refers to is the “national public policy, not the policy of the states within the country.”37 In any event, the concept of “public policy” must be construed narrowly.38 The First Circuit could easily follow these general principles to limit the instances in which arbitration awards governed by the New York Convention may be overturned.

V. Conclusion

In conclusion, under First Circuit and Puerto Rico case law, the arbitrator has the authority to decide the fate of the choice of law clause. Moreover, overturning an arbitration award based on the violation of Puerto Rico public policy of its relationship statutes appears to be a difficult if not insurmountable task.

b. The recognition or enforcement of the award would be contrary to the public policy of that country.

Id. 35. Yusuf Ahmed Alghanim & Sons v. Toys “R” Us, Inc., 126 F.3d 15, 18 (2d Cir. 1997).
38. Id.
Franchising (& Distribution) Currents

Kevin M. Shelley, William M. Bryner, and Larry M. Weinberg

ACCOUNTING

This case is discussed under the topic heading “Damages.”

ADVERTISING AND MARKETING

This case is discussed under the topic heading “Antitrust.”

This opinion is perhaps the final chapter of a long-running feud between UPS and its Manhattan area franchisees against fellow UPS franchisees Robert Hagan, Thomas Hagan, and their associated entities (the Hagans). After years of litigation, the lone remaining claims were the Hagans’ counterclaims for false advertising under § 43(a) of the Lanham Act, 15 U.S.C. § 1125(a). UPS moved for summary judgment to dismiss those claims. The U.S. District Court for the Southern District of New York granted UPS’s motion.

The Hagans asserted two false advertising theories. First, the Hagans alleged that UPS’s franchisees conducted a coordinated campaign to inform customers incorrectly that UPS’s ground service was not guaranteed in order to sell customers UPS’s higher-margin air ser-
vice instead (the Ground Guarantee Claims). Second, the Hagans asserted that the franchisees allegedly conspired to over-dimension packages on a consistent basis in order to charge more for shipments priced by size and weight (the Over-Dimensioning Claims). The Hagans alleged that they refused to participate in these schemes and that customers who later learned from the Hagans that ground service was guaranteed refused to do any further business with UPS, causing the Hagans’ franchise to fail.

The court granted UPS’s motion for summary judgment and dismissed these counterclaims, largely on evidentiary grounds. The evidence on which the Hagans relied to resist summary judgment consisted of two declarations: one from Robert Hagan and one from an investigator, Paul Puccini, hired by the Hagans. Mr. Hagan’s declaration described dozens of instances in which customers would come into the Hagans’ stores, express shock about the ground guarantee and the Hagans’ lower prices, and leave the store saying they would never do business with UPS again. The Puccini declaration authenticated videos of the investigator secretly shopping at the Manhattan franchisees’ stores, with store clerks consistently stating that ground service was not guaranteed. The Puccini declaration also referenced receipts and shipping estimates that purported to establish the Over-Dimensioning Claims, as well as other statements from Mr. Puccini about both schemes.

The court first ruled that the Hagan declaration contained hearsay and then analyzed whether there was an applicable exception to the hearsay rule under Federal Rule of Evidence 803(3). The court held that this testimony concerned evidence of the lost customers’ motives for ceasing to do business with UPS. The evidence therefore went a step beyond proving the customers’ then-existing state of mind and, as such, was admissible only if the Puccini declaration was also admissible.

The court then determined that, although the Puccini declaration exhibits (in the form of the secret-shop videos and shipping quotes and receipts) were admissible for their contents, the remaining portions of the Puccini declaration were not admissible in evidence. In particular, the court held that because the Puccini declaration was laden with argumentation, it did not constitute a summary under Federal Rule of Evidence 1006. Moreover, the Puccini declaration was not subject to Rule 803(3)’s exception to the hearsay rule because it did not constitute a survey of UPS consumers’ then-existing state of mind. As such, the inadmissibility of the Puccini declaration also rendered the Hagan declaration inadmissible.

Having made these evidentiary rulings, the court held that there was no genuine issue of material fact supporting the Hagans’ standing to bring their false advertising counterclaims. On the Over-Dimensioning Claims, the court determined that the record of shipping quotes and receipts appended to the Puccini declaration did not support a causal connection between the alleged over-dimensioning of packages and a loss of business to the Hagans. As to the Ground Guarantee Claims, the court ruled that the Hagans had not submitted admissible evidence that incensed customers,
who learned the truth about the ground guarantee, ceased doing business
with the Hagans out of anger at UPS. Consequently, there was no evidence
connecting the defendants’ alleged false advertising with any injury to the
Hagans’ franchise, and the court therefore granted summary judgment dis-
missing those claims.

ANTITRUST

ABC Distrib., Inc. v. Living Essentials LLC, Bus. Franchise Guide (CCH)
The U.S. District Court for the Northern District of California denied the
parties’ respective motions for summary judgment in a case alleging price
discrimination in violation of the Robinson-Patman Act, finding disputed is-
sues of fact concerning whether the parties were in actual competition.

Defendant Living Essentials LLC and its parent company Innovation
Ventures LLC (collectively, Living Essentials) manufacture and distribute
a dietary supplement product called 5-Hour Energy, which it sold to several
wholesale distributors. The plaintiffs, ABC Distributing Inc., Elite Whole-
sale Inc., and Tonic Wholesale, Inc. are small wholesalers located in Los An-
geles that purchased the 5-Hour Energy from Living Essentials.

The plaintiffs filed an action alleging that Living Essentials violated Sec-
tions 2(a) and 2(d) of the Robinson-Patman Act, 15 U.S.C. § 13 (RPA), the
California Business and Professions Code Sections 17045 and 17200, and
California’s Unfair Competition Law, and engaged in unjust enrichment
by selling their product at different prices to larger wholesalers, namely
Costco Wholesale Corporation. Although some discounts were offered uni-
formly to all wholesalers, Living Essentials sold the product to Costco at un-
ique discounts through business scan promotions, instant rebates, and dis-
play allowances. The plaintiffs moved for a partial summary judgment on
the price discrimination claim and Living Essentials moved for a summary
judgment for all of the plaintiffs’ claims.

The court began by examining the claim for secondary-line competitive in-
jury under Section 2(a) of the RPA. The only disputed element of the claim was
that the effect of the discrimination was to injure, destroy, or prevent compet-
tition. To prove this, the plaintiffs would have to demonstrate that there was
actual competition between Costco and the plaintiffs through either direct evi-

dance of diverted profits or through a Morton Salt inference, which requires
demonstrating a significant price reduction over a substantial period. The par-
ties relied only on the latter method and therefore had to first prove the thresh-
old question that there was actual competition between the parties.

The plaintiffs argued that there was actual competition because Costco
held the same place in the supply chain and sold to a common geographic
market as the plaintiffs. However, the court held that this was insufficient evi-
dence to demonstrate actual competition. Because there was a genuine fac-
tual dispute over whether there was true competition between the parties, the court denied the motion for summary judgment. Similarly, the court denied Living Essential’s motion for summary judgment over the plaintiffs’ Morton Salt claim because there were genuine disputes over the extent and nature of the price advantages Costco received.

The court then analyzed the claim under Section 2(d) of the RPA, which prohibits price discrimination disguised in the form of advertising or promotional services by requiring allowances to be made available on proportionately equal terms. For similar reasons as above, the factual disputes between the parties left the question open as to whether the discounts offered were for a purely promotional purpose. For this reason, the motion for summary judgment on the Section 2(d) claim was also denied.

Finally, the court denied both parties’ motions for summary judgment on the claims under the California statute and for unjust enrichment, finding that the claims relied heavily on the previously discussed RPA liability.


This case is discussed under the topic heading “Statutory Claims.”

**ARBITRATION**


In an unpublished opinion, the California Court of Appeal affirmed a trial court order dismissing a petition to compel the arbitration of a franchisee’s claims alleging several violations of the California Labor Code, finding that those claims did not arise out of the parties’ franchise agreement and therefore were not within the scope of the arbitration provision set forth therein.

In July 2009, franchisee Richard Danker entered into a franchise agreement with SuperShuttle Los Angeles, Inc. (SSLA) to operate a franchised SuperShuttle route business. The franchise agreement granted Danker use of SuperShuttle’s marks and system in connection with his operation of a SuperShuttle van and provided that Danker would pay a franchise fee, royalty fee, and other fees to SSLA. The franchise agreement contained various provisions acknowledging that Danker would operate his business as an independent contractor, and not as an employee. Further, the franchise agreement contained an arbitration provision, which provided in part: “[A]ny controversy arising out of this Agreement, including without limitation an allegation that this Agreement is void *ad initio*, shall be submitted to the American Arbitration Association . . . for final and binding arbitration. . . .”

Six years after signing the franchise agreement, Danker filed a complaint with the California Labor Commissioner, seeking damages and other relief
under the California Labor Code. Essentially, the complaint asserted that Danker was an SSLA employee and, therefore, he was entitled to certain benefits under the California Labor Code. In response, SSLA filed a petition to compel arbitration, arguing that the issues raised by Danker arose out of the franchise agreement because Danker was seeking to change the nature of the parties' contractual relationship, including its financial terms. In opposition, Danker contended that he was seeking to enforce employee rights arising under the Labor Code, and not seeking to enforce rights under the franchise agreement, and therefore, the arbitration provision did not apply. Danker also asserted that the arbitration provision was unconscionable and therefore unenforceable.

The trial court denied SSLA’s petition, finding that the arbitration provision did not cover Danker’s Labor Code claims, relying on Elijahjuan v. Superior Court, 147 Cal. Rptr. 857 (Ct. App. 2012).

The Court of Appeal began its analysis with a summary of contractually stipulated Delaware law, noting that when the arbitrability of a claim is disputed, the court is faced with two issues: first, the court must determine whether the arbitration clause is broad or narrow in scope; and second, the court must apply the relevant scope of the provision to the asserted legal claim to determine whether the claim falls within the scope of the contractual provision that requires arbitration. If the arbitration provision is narrow, the cause of action must directly relate to a right in the contract. If the arbitration provision is broad in scope, the court will generally defer to arbitration on the issues that touch on contract rights or contract performance. In the case of a broad arbitration provision, which signals an intent to arbitrate matters that touch on the rights and performance related to the contract, the analysis turns on whether the claims would be assertable had there been no contract between the parties.

Turning to the arbitration provision in the parties’ franchise agreement, the court quickly concluded that the arbitration provision was broad in scope. Thus, the court proceeded to determine whether the alleged Labor Code violations fell within the scope of the contractual provision that requires arbitration. The court noted that the franchise agreement does not provide that Danker would receive the wages and other employee-related benefits under the Labor Code. Thus, because the franchise agreement does not set forth an employee-employer relationship, Danker could not sue for these remedies under the franchise agreement. In other words, the court held, Danker’s complaint is not seeking an interpretation of the agreement, nor is it seeking to enforce rights under the agreement. Instead, he asserted that because he worked like an employee, he should have been compensated in the manner of an employee. Essentially, the court characterized Danker’s complaint as one seeking to formalize a new relationship between Danker and SSLA, in particular, the relationship of employee-employer.

The court therefore concluded that Danker’s complaint was not based upon the franchise agreement, because he asserted an entirely different relationship existed between the parties, one that had not been formalized by an
agreement but that needed to be legally determined by the Labor Commissioner. Because Danker was alleging a different relationship (employee/employer) and was asserting statutory violations based on that relationship, the court concluded Danker’s complaint was not based upon the franchise agreement. Therefore, the controversy did not arise out of the agreement, and was therefore not arbitrable.

In so holding, the court relied on two analogous California decisions (Narayan v. EGL, Inc., 616 F.3d 895 (9th Cir. 2010)) and Elijahjuan, and declined to be persuaded by two prior cases in which courts had enforced the arbitration provisions in other SuperShuttle franchise agreements, finding them unpersuasive due to the lack of analysis (Reid v. SuperShuttle International, Inc., 2010 U.S. Dist. LEXIS 26831 (E.D.N.Y. 2010) and Kary v. Super Shuttle, Inc., 2012 U.S. Dist. LEXIS 134945 (N.D. Cal. 2012).

Finally, the court rejected SSLA’s demand that the arbitrator, and not the court, decide whether the dispute is arbitrable. Citing well-established Supreme Court precedent (Howsam v. Dean Witter Reynolds, 537 U.S. 79 (2002)), the court held that courts should not assume that the parties agree to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so. Absent such evidence or provision in the parties’ franchise agreement, the court declined to disinvest itself of jurisdiction to determine arbitrability in this case.

ATTORNEYS’ FEES

This case is discussed under the topic heading “Contract Issues.”

CHOICE OF FORUM

This case is discussed under the topic heading “State Disclosure/Registration Laws.”

Plaintiff ServiceMaster of Fairfax, Inc. entered into a series of franchise agreements, as a franchisee, with franchisor defendant ServiceMaster Residential/Commercial Services, L.P. (ServiceMaster). The franchise agreements granted the plaintiff a license to operate ServiceMaster businesses in territories covering the District of Columbia, Virginia, and Maryland. The franchise agreements contained a forum selection clause that specified that
“all litigation” under the agreements “must and will be venued exclusively in Memphis, Tennessee.” Pursuant to that forum selection clause, the plaintiff also consented to personal jurisdiction in the State of Tennessee and waived any rights to contest venue and jurisdiction. The choice of law provisions in the agreements, however, were subsequently amended to provide, “The Maryland Franchise Registration and Disclosure Law allows a franchisee to bring a lawsuit in Maryland for claims arising under this law.”

When a dispute under the agreements arose between the plaintiff and ServiceMaster, the plaintiff brought suit in Maryland state court. ServiceMaster removed the case to the U.S. District Court for the District of Maryland, on the basis of diversity of citizenship, and then moved, pursuant to 28 U.S.C. § 1404(a), to transfer the case to the U.S. District Court for the Western District of Tennessee, citing the agreements’ forum selection clause. The court granted ServiceMaster’s motion.

Relying on the clear language of the agreements’ forum selection clause, the court first determined that the forum selection clause was valid and mandatory in nature. The court further held that the later amendments to the agreements’ choice of law provisions were only permissive and applied only in a circumstance, not at issue in this case, in which the law of Maryland required suit to be brought there. In this case, however, the amendments made clear that Maryland law did not require suit to be brought in Maryland, but only permissively allowed for the same.

Because of the mandatory nature of the forum selection clause, the court held that it was only required to analyze § 1404’s public interest factors. The court rejected the plaintiff’s assertion that the vast majority of the complained-of conduct occurred in Maryland, holding that the plaintiff had provided no factual basis for that contention. The court also ruled that the laws of Maryland, Virginia, Tennessee, and the District of Columbia appeared to be at issue in the case and ruled that familiarity with Maryland law was therefore not outcome determinative. The court therefore held that the plaintiff had not met its burden of proving that the case should not be transferred to Tennessee.

**CHOICE OF LAW**


This case is discussed under the topic heading “State Disclosure/Registration Laws.”


This case is discussed under the topic heading “State Disclosure/Registration Laws.”
CLASS ACTIONS


The plaintiffs in this putative class action were distributors who delivered baked goods for the defendants (Flowers Foods). The plaintiffs asserted claims that Flowers Foods violated California wage and hour laws when Flowers Foods misclassified its distributors as independent contractors or franchisees, rather than as employees. The plaintiffs sought class certification, but the U.S. District Court for the Northern District of California denied that motion.

The court first analyzed whether the putative class satisfied the requirements of Federal Rule of Civil Procedure 23(a), which requires (1) that the class be so numerous that joinder of all members is impracticable; (2) that there are questions of law or fact common to the class; (3) that the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) that the representative parties will fairly and adequately protect the interests of the class. The court held that the plaintiffs satisfied these requirements. The court held that the class contained approximately 150 distributors, which it believed made it impractical to bring all class members before the court on an individual basis. It also held that the plaintiffs’ claims were typical of the class because they all arose out of Flowers Foods’ policy, under the same distributor agreement, of misclassifying distributors as independent contractors or franchisees, therefore resulting in a similar or common injury to members of the class.

The court similarly held that the named plaintiffs and their counsel adequately represented the class. The court found that the plaintiffs sought relief for common injuries that would benefit the class, that the plaintiffs and their counsel actively and sufficiently served the class’s interests, and that the plaintiffs responded to discovery and sat for depositions. The court rejected Flowers Foods’ contention that there were conflicting interests because certain distributors whom the class would encompass did not want to be classified as employees and, instead, wanted to be classified as independent contractors. The court found that these distributors represented a statistically insignificant sample of the views of their fellow class members.

Further, the court found that Rule 23(a)’s commonality requirement was satisfied. In particular, the court held that the issue of whether Flowers Foods misclassified its distributors as independent contractors under California law was a common question capable of common resolution for the class based on a distributor agreement that all putative class members signed. The court rejected Flowers Foods’ argument that assessing the misclassification issue would require the court to look beyond the distributor agreement and analyze the various alleged differences in the way that distributors performed their jobs in order to evaluate whether Flowers Foods’ level of control gave rise to an employer-employee relationship. The court ruled, in-
stead, that these relationships all stemmed from the same distributor agreement and therefore had sufficient commonality to satisfy Rule 23(a)(4).

However, the court declined to certify the class because Federal Rule of Civil Procedure 23(b) was not satisfied. Specifically, the court rejected the plaintiffs’ contention that, under Rule 23(b)(3), “the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy.” This inquiry is a more rigorous analysis than the commonality assessment under Rule 23 (a)(4) and requires the court to weigh the common issues against the individual issues. For the court, the key question, therefore, was whether Flowers Foods right of control was sufficiently uniform to permit class-wide treatment. The court ultimately held that it was not, even though it ruled that Flowers Foods’ right to control, as opposed to the ways in which it actually exercised control, was subject to common proof under the distributor agreement. The tipping point for the court appeared to be that any class-wide trial would be derailed by individualized inquiries about whether, when, and for how many hours each distributor “personally serviced” her route. As a result, the court concluded, a class action was no more efficient or convenient than individual trials and presented manageability issues given the individual inquiries necessary to establish Flowers Foods’ liability to each of the putative class members. Class-wide resolution was not the superior method of adjudicating the claims, in the court’s opinion, and the plaintiffs’ motion for class certification was therefore denied.

**CONTRACT ISSUES**

*Andy Mohr Truck Ctr., Inc. v. Volvo Trucks N. Am.*, Bus. Franchise Guide (CCH) ¶ 16,029, 869 F.3d 598 (7th Cir. 2017)

This case is discussed under the topic heading “Statutory Claims.”

*Benson v. City of Madison*, Bus. Franchise Guide (CCH) ¶ 16,015, 897 N.W.2d 16 (Wis. 2017)

This case is discussed under the topic heading “Definition of a Franchise.”


Plaintiffs Carstens Chevrolet, Inc. and Robert H. Carstens (collectively, Carstens) owned and operated an automobile dealership in Alturas, California, pursuant to a franchise agreement with defendant General Motors, LLC (GM). Under that agreement, GM was required to distribute adequate quantities of vehicles to Carstens. In addition, if Carstens wished to transfer the franchise, GM was contractually obligated to consider that proposal and could not unreasonably withhold approval of such a transfer.
On April 1, 2015, Carstens entered into a stock purchase agreement (SPA) with Billy Marker, a third party. The SPA would effectively transfer ownership of Carstens’ franchise to Marker, provided GM approved the transaction. On April 29, 2015, GM refused to approve the transaction because, in 2002, Marker had signed a settlement agreement with GM’s predecessor-in-interest (Old GM) in which Marker agreed never to seek ownership of any GM dealership. GM asserted that it had acquired this agreement with Marker through Old GM’s bankruptcy proceedings on 2009.

Carstens brought eight claims against GM and twenty-five unnamed Doe defendants. These claims alleged violations of the CAL. VEH. CODE § 11713.3(a) and (d) (claims one and two), tortious interference of various types (claims three, four, and five), contractual breaches (claim six), breaches of the covenant of good faith and fair dealing (claim seven), and unfair business practices (claim eight). GM named Marker as a third-party defendant. GM moved under Federal Rule of Civil Procedure 12(b)(6) to dismiss all of Carstens’ claims against GM. The U.S. District Court for the Eastern District of California granted GM’s motion in its entirety, but granted leave for Carstens to amend the complaint with regard to those portions of Carstens’ claims that related to GM’s alleged failure to deliver sufficient vehicles. Carstens was not granted leave to amend as to any claims arising from GM’s refusal to consent to the SPA.

Regarding Carstens’ first claim—alleging violations of CAL. VEH. CODE § 11713.3(d) by virtue of GM’s purportedly willful and unreasonable failure to approve the attempt to transfer the franchise by means of the SPA—the court agreed with GM that Carstens had failed to show that its pecuniary loss was “because of” GM’s refusal to consent to the SPA. Instead, the court held, it was GM’s settlement agreement with Marker, which predated the SPA, that caused any loss Carstens may have suffered. The court also held, as a matter of law, that GM had duly obtained ownership rights to that settlement agreement through the course of Old GM’s 2009 bankruptcy. The court did not grant leave to amend this claim because it did not believe that Carstens could rectify this claim’s shortcomings through amendment.

Regarding Carstens’ second claim—alleging violations of CAL. VEH. CODE § 11713.3(a) for GM’s purported failure to deliver reasonable quantities of vehicles—the court held that Carstens’ complaint did little more than track the statutory language without stating any relevant facts. The court therefore dismissed this claim, but granted Carstens leave to amend it.

Carstens’ third and fourth claims were for intentional interference with contractual relations and negligent interference with prospective economic advantage, respectively. Both of these claims were rooted in GM’s refusal to approve the SPA. The court opined that because (1) GM’s approval was a condition precedent to the SPA, (2) GM’s refusal to approve the SPA did not cause the disruption of the SPA, and (3) GM exercised legitimate means to secure Marker’s performance of his settlement agreement with GM, the intentional interference claim failed to state a claim on which relief
could be granted. As to the negligent interference claim, the court held that, because Carstens stated no independent basis for this claim beyond GM’s alleged breach of its contract by withholding consent to the SPA, this claim was subject to dismissal as well. Carstens was not granted leave to amend either of these claims.

Carstens was, however, granted leave to amend its fifth claim—intentional interference with prospective business advantage. This claim arose from Carstens’ allegations of GM’s failure to deliver sufficient vehicles, and therefore was analyzed and disposed of in similar fashion to Carstens’ second claim.

Carstens also alleged breach of the franchise agreement on two theories, one arising from GM’s failure to consent to the SPA and one arising from GM’s alleged failure to deliver sufficient vehicles. As to the former theory, the court again held that any damage to Carstens arose not from GM’s failure to consent to the SPA, but from Marker’s earlier settlement agreement with GM. The court dismissed this claim and did not grant Carstens leave to amend it. As to the latter theory, the court held that Carstens failed to plead sufficient facts to support the claim, but granted Carstens leave to amend.

Similarly, Carstens asserted a claim for breach of the covenant of good faith and fair dealing on the same two theories. For this claim, the court again held that any damage arose not from GM’s withholding of consent, but from Marker’s ineligibility to enter into the SPA in the first instance. The court also held that Carstens allegations in support of this claim were the same as for its breach of contract claim. The court therefore dismissed this claim as well, but granted leave for Carstens to amend it with respect to the theory that GM failed to deliver sufficient vehicles.

Finally, a similar outcome was reached regarding Carstens claims for unfair business practices under CAL. BUS. & PROF. CODE § 17204. The court held that Carstens again failed to demonstrate causation between GM’s denial of the SPA and Carstens’ injury, but also granted Carstens leave to amend its claim with respect to the allegations that GM failed to deliver sufficient vehicles.

This case is discussed under the topic heading “Damages.”

This case is discussed under the topic heading “Encroachment.”

This case is discussed under the topic heading “State Disclosure/Registration Laws.”
This case is discussed under the topic heading “Termination and Nonrenewal.”

This case is discussed under the topic heading “Arbitration.”

In an unpublished opinion, the California Court of Appeal affirmed a trial court’s ruling that a petroleum distributor/franchisor breached a franchise agreement by unreasonably attempting to coerce the purchaser of a franchised service station to execute a franchise agreement. The court further held that the liquidated damages provision in the franchise agreement for the station was unenforceable under California law.

Plaintiff Westco Petroleum Distributors is a distributor of petroleum that acts as a franchisor for “76” branded gasoline stations. One of these franchised dealers was A&A Dynamic, which attempted to sell its franchised gasoline station to West Covina Gas & Market, Inc. without first obtaining the consent of Westco. Prior to the sale, A&A notified Westco of the pending sale of the gas station and asked Westco to send the necessary documents to assign the franchise agreement to West Covina. Westco then provided a package of documents that included a credit application, and West Covina submitted the completed documents to Westco.

After trying several times to contact Westco about the status of the application, A&A received no indication as to whether the agreement would be approved. Westco’s representative later conceded that Westco had disregarded West Covina’s application because it did not take the application seriously. As a result, A&A and West Covina removed the assignment of the franchise agreement as a contingency the close of the gas station sale.

Following the sale to West Covina, Westco ceased providing gasoline deliveries to the station. After West Covina met with Westco and informed it that West Covina was in urgent need of gasoline, Westco refused to make further deliveries unless West Covina signed a 64-page contract during the same meeting and refused any additional time for review of the contract. Westco also threatened to sue West Covina and put it out of business unless it signed the agreement.

At trial, the court found that Westco breached its franchise agreement with A&A by failing to respond to an assignment request and unreasonably attempting to coerce the purchaser West Covina into signing a franchise
agreement for its station. On appeal, the appellate court affirmed that sub-
stantial evidence supported the trial court’s findings.

Westco argued that Cal. Bus. & Prof. Code § 21148 allowed it forty-
five days to respond to the request. Because only twenty-three days had 
elapsed, Westco argued that this duration was not unreasonable under 
law. However, the court noted that Westco had not raised this argument 
at trial and therefore could not raise the argument on appeal. Furthermore, 
even if the court were to consider this argument, there was no evidence that 
Westco made any effort to investigate West Covina’s qualifications or fi-
nancial resources and, as a result, it could not in fact respond within the 
permitted period of time.

The court held that a contract may be avoided on the grounds of coercion 
or on the basis of an improper threat. The court cited this proposition from the 
Restatement of Contracts, which under the heading of economic compulsion 
includes threats that: (1) are a breach of the duty of good faith and fair dealing, 
(2) would harm the recipient without significantly benefitting the party making 
the threat, or (3) are otherwise a use of power for illegitimate ends. For these 
reasons, the court held that the trial court did not err by concluding that West-
co’s conduct was a material breach of the franchise agreement.

A second issue on appeal was whether Westco breached the thirty days’ 
notice requirements in the franchise agreement regarding the stoppage of 
gasoline delivery. Because Westco provided no notice to A&A or West Co-
vina before stopping gasoline deliveries to the station, the court held that 
substantial evidence supports the trial court’s finding that Westco breached 
this provision.

The court also held that substantial evidence supports the trial court’s de-
termination that the liquidated damages provision was unenforceable. This 
was because the clause was prepared by Westco as part of a standard form 
contract with no substantial bargaining between the parties. Westco addi-
tionally was not able to show that proof of actual damages would have 
been impossible or overly costly.

The final issue the court examined was in relation to attorneys’ fees 
awarded at trial. Westco argued that the provision awarding attorneys’ 
fees in the franchise agreement did not apply to West Covina, since it was 
not privy to the contract. However, the court held that West Covina was 
not precluded from recovering attorneys’ fees, because the provisions were 
governed under Cal. Civ. Code § 1717, which aims to prevent the oppres-
sive use of one-sided attorneys’ fees provisions. Furthermore, Westco’s argu-
ment that no contractual claims were asserted against West Covina was con-
tradicted by Westco’s other claims against West Covina that specifically 
referred to contractual provisions in the agreement. Additionally, the attor-
neys’ fee provisions in the agreement were broadly worded to include non-
contractual claims.
The U.S. District Court for the District of South Dakota granted summary judgment to a hotel franchisor on its breach of contract claims against a terminated franchisee, but referred the action to an evidentiary hearing to determine whether the liquidated damages provision in the parties’ franchise agreement was enforceable under applicable New Jersey law. The court also granted the hotel franchisor summary judgment and dismissed the terminated franchisee’s counterclaims.

Defendant Greg Miller is a resident of South Dakota who, after running an independent twenty-nine unit motel in Murdo between 1988 and 1998, met with a representative of Days Inns Worldwide, Inc. to discuss opening a new hotel licensed under the Days Inn brand. Because Miller’s previous hotel underperformed, the representative assured Miller that the Days Inn Reservation System would provide him with sufficient customers to operate his hotel. Miller and Days Inn then entered into a license agreement on April 11, 1997, followed by an addendum to the agreement on the same day.

Miller began operating the hotel around June 1999, and by 2005 the hotel was facing financial hardships that caused Miller to meet with representatives from Days Inn in Chicago. The parties agreed to enter into an amendment to the agreement to lower several of Miller’s fees during off-season, and a separate amendment that lowered the fee on gross room revenues between May 1, 2006, and April 30, 2008. Despite these two amendments, Miller fell behind in making payments of the required fees. Days Inn then elected to remove Miller from the licensed Reservation System.

In order to regain access to the licensed system, Days Inn requested that Miller purchase a software update and make additional payments. Miller borrowed $14,000 to pay for the software update, but could not fully make the remaining payments owed. Days Inn allowed Miller back on the Reservation System for a brief period, but later suspended him from the system. Days Inn then sent a notice of monetary default claiming that Miller owed $182,465.32 in fees. Miller did not respond to the letter within the ten-day notice period. After receiving the letter, Miller made no payments to Days Inn, removed the branded sign in his motel, and began operating the motel under the name Range Country.

Days Inn commenced an action in the district court, seeking an accounting and damages arising from Miller’s breach of contract for premature termination of the agreement, breach of contract for non-payment of recurring fees, and unjust enrichment for the non-payment of fees. Miller responded and filed a counterclaim for: (1) negligent misrepresentation that induced Miller into the agreement, (2) tortious interference by suspending his access to the Reservation System, (3) deceit and fraudulent misrepresentation, and
Days Inn filed a motion for summary judgment on both its claims and Miller's counterclaims.

The first claim by Days Inn for an accounting under the agreement was quickly dismissed because the record filed by Days Inn left the court unclear as to whether an accounting was still being sought. The court then denied summary judgment on the second count because of the ambiguity in the contracts, because the potential that the damages calculation pursuant to the premature termination clause by Days Inn in the amount of $414,572.40 was unconscionable, and because the amount for future damages was speculative.

However, the court granted summary judgment on Days Inn's claim for breach of contract for non-payment of recurring fees. The court reasoned that §7 of the agreement unambiguously entitled Days Inn to receive recurring fees, that Miller admitted that he fell behind in these payments, and that Days Inn sustained damage as a result. However, the motion was only partially granted since the exact amount of fees and interest was disputed and still required calculation. Because this claim was linked to the fourth claim for unjust enrichment, the court dismissed the claim for unjust enrichment as moot.

In regard to the counterclaims by Miller, the court granted summary judgment, dismissing the first and third claims for negligent and fraudulent misrepresentation that the Reservation System would supply Miller with sufficient customers to operate the hotel successfully. The court reasoned that the integration clause in the license agreement specifically outlined that all prior representations, agreements, and understandings were superseded by the written contract. The court further held that there was no alleged misrepresentation that the motel needed to upgrade to a 5 Sunburst or Chairman's Award property to maximize occupancy rates in the Reservation System. This was because there was no evidence that these statements were known to be untrue or recklessly made and in fact produced favorable results at the hotel.

The court then dismissed the second and fourth claims by Miller, which alleged breach of contract and tortious interference with their business relationships for suspending access to the Reservation System. The court explained that the breach of contract claim failed because §11.4 of the agreement expressly provided Days Inn with the option to suspend the Reservation System for failure to pay or perform under the agreement. The claim for tortious interference was dismissed as Days Inn did not engage in an intentional and unjustified act of interference. In fact, Days Inn had restored Miller's access to the Reservation System for a brief period of time until he was able to make further payments. Because the contract provided Days Inn the right to suspend the Reservation System, Days Inn's actions could not be held as an intentional and unjustified act of interference. For this reason, the court dismissed both of these claims by Miller.
DEFINITION OF A FRANCHISE

Benson v. City of Madison, Bus. Franchise Guide (CCH) ¶ 16,015, 897 N.W.2d 16 (Wis. 2017)

The Supreme Court of Wisconsin held that the Wisconsin Fair Dealership Law applied to the City of Madison and that the relationships between the city and four golf professionals that it hired to oversee clubhouse operations at four city-owned golf courses were “dealerships” under that statute. The court also reversed the lower courts’ rulings that the golf professionals’ claims under the statute were time-barred and barred under the doctrine of governmental immunity, and remanded the case to the trial court for further proceedings.

In 1977, the city began contracting with golf professionals to provide services to four of its city-owned golf courses. These contracts designated one golf professional for each of the golf courses, where they would supervise the course, operate the clubhouse, collect green fees, manage staff, and provide lessons and other related services. For compensation, the golf professionals were paid a fixed amount with additional commission income related to their services.

Prior to the expiration date of the contracts, the city informed the golf professionals that it would not be renewing their contracts. In response, the golf professionals commenced an action against the city alleging non-compliance with the Wisconsin Fair Dealership Law (WFDL), Wis. Stat. Ann. § 135.01 et seq. The WFDL governs statutorily defined “dealership” agreements between “grantors” and “dealers.” A dealership agreement under the WFDL is based in three parts: (1) the existence of a contract or agreement between two or more persons, (2) by which a person is granted one of the rights specified, and (3) in which there is the requisite “community of interest.” The WFDL requires ninety days’ written notice prior to termination of a dealership agreement, absent statutorily defined good cause. In this case, the city provided notice less than ninety days before the expiration of the contracts.

The trial court dismissed the lawsuit on summary judgment on the basis that the contract was not a “dealership” as defined under the WFDL. On appeal by the golf professionals, the intermediate appellate court affirmed the trial court, and the golf professionals appealed to the state supreme court.

Reversing the lower courts, the supreme court held that the relationship between the city and the golf professionals constituted a dealership under the WFDL. To determine this, the court first analyzed whether the city fell under the statutory definition of a “grantor” under the WFDL, which is defined as a “person who grants a dealership.” The court held that the definition of “person” under the WFDL included a “corporation or other entity,” and as a municipal corporation, the city satisfied this definition. Furthermore, municipalities or cities were not listed in WFDL § 135.07, which specifically outlines parties that are excluded under the statute, such as those in the insurance business.
The court then turned to the definition of dealership contracts under the WFDL and ultimately held that the contract met the remaining two statutory requirements of the WFDL. The second element was met by granting the golf professionals the right to sell the city’s services of providing a functional golf course to the public for a fee. In regard to the third element of a “community of interest,” the court identified two “guideposts” for the analysis: (1) a shared financial interest in the operation of the dealership or marketing of a good or service; and (2) interdependence, such as cooperation and coordination between the parties’ common goals. Based on the substantial investment by the golf professionals, who had to train, hire, and compensate the staff, the court held that there was the requisite community of interest.

The court ultimately concluded that the WFDL applies to the city and remanded the case to the trial court for further proceedings.


This case is discussed under the topic heading “State Disclosure/Registration Laws.”

**DISCRIMINATION**


This case is discussed under the topic heading “Antitrust.”

*Andy Mohr Truck Ctr., Inc. v. Volvo Trucks N. Am.*, Bus. Franchise Guide (CCH) ¶ 16,029, 869 F.3d 598 (7th Cir. 2017)

This case is discussed under the topic heading “Statutory Claims.”

**ENCROACHMENT**


The U.S. District Court for the District of Colorado denied, in part, a motion to dismiss a complaint against an automobile dealership franchisor by its franchisee, thereby permitting the franchisee to pursue its claim that its franchisor violated Colorado law by unreasonably approving a new dealership near the plaintiff’s franchised dealership.

Since 1996, Mercedes-Benz of Littleton (MBOL) was a franchised dealer of Mercedes-Benz automobiles, which were distributed and manufactured by Mercedes-Benz USA (MBUSA) under a dealership agreement. After conducting market research in 2015, MBUSA invited co-defendant Bobby Rahal Motorcar Company (BRMC) to establish a new Mercedes-Benz deal-
ership less than nine miles away from the dealership operated by MBOL. MBUSA did not inform MBOL of its intent to establish a new dealership until July 2016, when an employee of MBUSA informally mentioned the plans to the management of MBOL.

The dealership agreement between MBOL and MBUSA designated MBOL with an “area of influence,” which is used to evaluate the dealer’s performance. Although the dealership agreement between MBUSA and MBOL featured a clause that stated MBUSA may establish a new dealership within MBOL’s AOI at any time, the additional dealership would result in an alteration of MBOL’s current AOI.

MBOL proceeded to file five claims against MBUSA: (1) unreasonably approving the new dealership, (2) fraudulent concealment, (3) breaching the implied contractual duty of good faith and fair dealing, (4) an independent claim for a permanent injunction against MBUSA and BRMC, and (5) attempting to modify MBOL’s AOI without providing notice. BRMC brought a motion to dismiss the claim for permanent injunction and MBUSA brought a motion against the other four claims.

The court began by holding that the claim for a permanent injunction was moot because the City of Centennial repealed an ordinance that in effect precluded the establishment of the dealership by MBUSA and BRMC. The court then proceeded to analyze whether MBOL had standing to bring its first claim that MBUSA unreasonably approved the new dealership in violation of COLO. REV. STAT. §§ 12-6-120(1) and 12-6-120.3(1.5). The court took a plain language approach to interpretation of the statute and found that existing dealers are able to sue manufacturers for unreasonably approving an initial site location. As a result, the court denied MBUSA’s motion to dismiss the claim.

The court next discussed the second claim against MBUSA, i.e., violating its duty to disclose its intention to establish a new dealership nearby MBOL’s premises. The court held that the duty to disclose arises where there is a level of trust beyond the typical manufacturer/dealer relationship or where objective circumstances would cause a reasonable expectation of disclosure. MBOL claimed that it had placed trust in MBUSA by investing in upgrades to its facilities. However, in this situation, the court held that the relationship between the parties did not give rise to a duty to disclose. Additionally, the court held that the language in the contract contained certain provisions, such as a clause that provided MBUSA with the ability to establish a new dealership at any time, that would discourage MBOL from reasonably expecting disclosure.

The court next dismissed MBOL’s third claim alleging that MBUSA breached the implied covenant of good faith and fair dealing. The court held that MBOL failed to allege how MBUSA’s conduct deprived MBOL of a reasonably expected benefit under the contract.

The final claim by MBOL was dismissed by the court for failing to allege that MBUSA took a substantial step toward altering its AOI. Because MBOL asserted only that MBUSA had made plans to establish the dealership, with-
out having yet established the dealership, the court held this was not sufficient to cause a violation of the statute and dismissed the claim.

GOOD FAITH AND FAIR DEALING

This case is discussed under the topic heading “Contract Issues.”

This case is discussed under the topic heading “Encroachment.”

This case is discussed under the topic heading “Statutory Claims.”

This case is discussed under the topic heading “Contract Issues.”

INJUNCTIVE RELIEF

This case is discussed under the topic heading “Encroachment.”

This case is discussed under the topic heading “Statutory Claims.”

The Sixth Circuit reversed the U.S. District Court for the Southern District of Ohio’s issuance of a preliminary injunction preventing a craft beer manufacturer from terminating a distributor’s franchise agreement as a result of the distributor’s merger with another company without seeking the manufacturer’s consent. The appellate court held that the district court erred as a matter of law in ruling that the distributor was likely to succeed on the
merits of its claims; to the contrary, because the parties' consent provision was valid under Ohio law and, specifically, the Ohio Alcoholic Beverages Franchise Act, the distributor had no likelihood of success on the merits of its breach of contract claims. As a result, the Sixth Circuit reversed the district court and vacated the preliminary injunction.

The Great Lakes Brewing Company is a craft beer manufacturer that entered into a franchise agreement with its distributor Glazer’s of Ohio, Inc. (Ohio Glazer’s), Great Lakes’ distributor in the Columbus, Ohio, market. Ohio Glazer’s was a subsidiary of a larger company called Glazer’s, Inc., which distributed a variety of alcoholic beverages in several states. The parties’ franchise agreement contained two typical and, in this case, critical provisions. In § 9(a), the parties agreed that Ohio Glazer’s “must obtain [Great Lakes’] prior written consent to any change in . . . ownership.” In connection therewith, in § 9(d), Great Lakes agreed that “[it] must not unreasonably withhold its consent to an Ownership Change . . . and shall be guided in its decision by its reasonable business judgment.” Section 10(b) provided that “[Great Lakes] may initiate the termination of this Agreement for cause at any time if [Ohio Glazer’s] fails to substantially comply with any of its obligations under this Agreement. . . .” This termination provision granted Ohio Glazer’s an opportunity to cure if the defaults were curable and specifically provided that Great Lakes could terminate for cause immediately upon written notice upon the occurrence of certain defaults not subject to cure, one of which was that Ohio Glazer’s “undertakes an Ownership Change . . . without the written consent required by § 9.”

When Great Lakes heard rumors about a potential merger between Glazer’s, Inc. and another large distributor, Great Lakes asked Ohio Glazer’s for details of the impending deal “in order to assess its options in the Greater Columbus market.” In response, Ohio Glazer’s acknowledged that a merger was anticipated, but asserted that the proposed transaction did not require Great Lakes’ consent, citing the Ohio Alcoholic Beverages Franchise Act, Ohio Rev. Code § 133.84(F) and a district court decision, Jamison Crosse, Inc. v. Kendall-Jackson Winery, Ltd., 917 F. Supp. 520 (N.D. Ohio 1996). Great Lakes disagreed and advised Ohio Glazer’s that it considered the described merger plan as a change of ownership as defined by their franchise agreement. Further, Great Lakes advised Ohio Glazer’s that it expressly withheld consent to that ownership change and offered to provide evidence to support its reasonable business judgment in that regard.

Nonetheless, Glazer’s Inc. proceeded with the merger, which created a new parent corporation, Southern Glazer’s Wine & Spirits, Inc. (Southern Glazer’s); Ohio Glazer’s became Southern Glazer’s Distributors of Ohio (Ohio Southern Glazer’s), a subsidiary of Southern Glazer’s. Thereafter, Great Lakes sent Ohio Southern Glazer’s a written notice that it was terminating the franchise agreement. Citing § 9 of the franchise agreement, Great Lakes stated that the change in ownership required its prior consent, which Ohio Glazer’s did not request.
After Great Lakes declined Ohio Southern Glazer’s invitation to retroactively cure the purported breach and sought to implement a mutually agreeable plan to ensure an orderly transition to a new distributor, Ohio Southern Glazer’s filed a declaratory action in the district court, seeking to preliminarily enjoin Great Lakes from terminating its franchise agreement. The district court granted the motion for a preliminary injunction, and Great Lakes appealed to the Sixth Circuit.

After summarizing the applicable standards of review, the Sixth Circuit identified the primary issue presented on appeal: whether the consent provision in the parties’ franchise agreement, which supported the proposed termination by Great Lakes, was invalid under the Act.

The Act regulates the relationship between alcoholic beverage manufacturers and their distributors in Ohio. It imposes two requirements relevant to this case on all franchise agreements subject to the Act. First, it legislates a “just cause” requirement into every franchise agreement: “[N]o manufacturer or distributor shall cancel or fail to renew a franchise . . . without the prior consent of the other party for other than just cause and without less than sixty days’ written notice. . . .” OHIO REV. CODE § 1333.85. Second, the Act renders “void and unenforceable” “any provision of a franchise agreement that waives any of the prohibitions of, or fails to comply with [the Act].” OHIO REV. CODE § 1333.83. “Prohibited acts” are listed in § 1333.84 (F), which provides:

Notwithstanding the terms of any franchise, no manufacturer or distributor engaged in the sale and distribution of alcoholic beverages, or a subsidiary of any such manufacturer, shall:

(F) Refuse to recognize the rights of surviving partners, shareholders, or heirs and fail to act in good faith in accordance with reasonable standards for fair dealing, with respect to the distributor’s right to sell, assign, transfer or otherwise dispose of the distributor’s business, in all or in part, except that the distributor shall have no right to sell, assign, or transfer the franchise without the prior consent of the manufacturer, who shall not unreasonably withhold the manufacturer’s consent.

OHIO REV. CODE § 1333.84(F).

Ohio Southern Glazer’s contended that § 9(a) of the franchise agreement is “void and unenforceable” because that it “waives . . . the prohibitions of, or fails to comply with” § 1333.84(F) of the Act. Noting the explicit statutory requirement of manufacturer consent for transfers of a distributor’s franchise, but no such requirement for transfers of a distributor’s business (i.e., an ownership interest), Ohio Southern Glazer’s argued that § 1333.84(F) reflected a legislative decision that a manufacturer’s consent is not required for a change of ownership and by requiring that consent, Great Lakes sought to impose by contract the consent that the legislature expressly omitted from the statute, thereby purporting to broaden the scope of the prohibition in § 1333.84(F) of the Act.

The Sixth Circuit disagreed. The court focused on the language of § 1333.84(F), which does not prohibit a manufacturer from requiring con-
sent with respect to the sale of a distributor’s business. Rather, the provision prohibits manufacturers from “failing to act in good faith in accordance with reasonable standards for fair dealing with respect to” a distributor’s right to sell its business. The court held that the parties’ agreement does not waive that statutory prohibition but, instead, echoed the Act’s requirements of good faith and reasonable standards for fair dealing in § 9(d), which states that Great Lakes cannot “unreasonably withhold its consent” and must exercise “reasonable business judgment” in deciding whether to consent to a change of ownership. Thus, the court held that there was no meaningful inconsistency between § 9 of the franchise agreement and the Act and, indeed, § 1334.84(F) of the Act actually anticipated that the parties will include such consent provisions in their written franchise agreements. The court reasoned that if the concept of consent in the sale of business context were actually prohibited by the Act, as the plaintiff contends, there would be no reason for the Act to require manufacturers to act reasonably in that scenario, as it does in the first clause of this statutory provision.

After distinguishing the *Jamison Crosse, Inc.* case previously relied upon by Ohio Southern Glazer’s, the court concluded that the contractual basis for Great Lakes’ proposed termination was valid under the Act and thus, the sole basis on which Southern Ohio Glazer’s intended to succeed at trial was without legal support. Therefore, the district court erred as a matter of law in concluding that Ohio Southern Glazer’s had established a likelihood of success on the merits.

Interestingly, the Sixth Circuit proceeded to analyze the remaining three traditional preliminary injunction factors (after likelihood of success on the merits): irreparable harm to the plaintiff, substantial harm to others, and the public interest. First, the court held that the plaintiff had established it would likely suffer irreparable harm in the absence of a preliminary injunction, in that the plaintiff had established a substantial loss of goodwill in the form of a threat to its relationships with its retailers that could no longer get the highly sought after Great Lakes beer from it. The court also found that the third factor—whether the injunction would cause substantial harm to others—also favored granting the preliminary injunction, because there was no indication in the record that enjoining Great Lakes from terminating the franchise would harm third parties. However, the court held that the final factor—whether the public interest would be served by the issuance of the injunction—weighed against the injunction, because the public has a strong interest in holding private parties to their agreements and there was no conflict between the agreement at issue and the Act.

The court concluded that although two factors favored the injunction and two factors weighed against it, the district court’s legal error constituted an abuse of discretion and required reversal. The basis upon which the plaintiff contended it would succeed at trial—that § 9(a) of the parties’ franchise agreement was invalid under the Act—was without legal support and, therefore, the plaintiff had no likelihood of succeeding at trial under that legal
theory. Because the district court committed an error of law on the “all important likelihood of success factor,” it abused its discretion in granting the preliminary injunction.

FRAUD


This case is discussed under the topic heading “State Disclosure/Registration Laws.”

LABOR AND EMPLOYMENT


In this action, the U.S. Secretary of Labor, as the plaintiff, asserted in an amended complaint that defendant Jani-King of Oklahoma, Inc. violated §§ 211(c) and 215(a)(5) of the Fair Labor Standards Act (FLSA), 29 U.S.C. §§ 211(c), 215(a)(5), by failing to “make, keep, and preserve” records of the “wages, hours, and other conditions and practice of employment,” 29 U.S.C. §§ 211(c), of the persons whom Jani-King purportedly employed as janitorial cleaners.

Jani-King operates as a franchisor of janitorial services in the Oklahoma City area. Among the Secretary’s allegations was that, although Jani-King initially sold franchises to individuals in their individual capacities, in recent years Jani-King required those individuals to form new corporate entities in order to continue performing janitorial work for Jani-King. The Secretary further alleged that the persons providing janitorial services were economically dependent on Jani-King and were therefore Jani-King’s employees for purposes of the FLSA, rather than independent contractors as Jani-King had classified them. Therefore, according to the Secretary, Jani-King had violated the FLSA by failing to keep and preserve various types of employment records about its employees.

Jani-King moved to dismiss the Secretary’s amended complaint under Federal Rule of Civil Procedure 12(b)(6) (failure to state a claim) and 12(b)(7) (failure to join a party under Federal Rule of Civil Procedure 19). Because the U.S. District Court for the Western District of Oklahoma granted Jani-King’s motion under Rule 12(b)(6), it did not address Jani-King’s Rule 12(b)(7) argument.

Jani-King contended that the Secretary had failed to allege sufficient facts plausibly to suggest that each janitorial cleaner qualified as an “employee” under the FLSA and that Jani-King therefore was not an “employer” subject to the FLSA’s requirements. The FLSA defines an “employer” to “include any person acting directly or indirectly in the interest of an employer in rela-

In the court’s view, the fatal flaw in the amended complaint was that the Secretary failed to distinguish between janitorial cleaners that Jani-King engaged to perform cleaning services as artificial, corporate entities and those who were so engaged as individuals. Instead, the Secretary simply lumped together, in conclusory fashion, all janitorial cleaners that Jani-King engaged through its franchise agreements. By statute, the court concluded, only “individuals” can be “employees.” Moreover, because the statutory definition of “person” included other legal entities and therefore emphasized the distinction between “persons” and “individuals” that Jani-King was asserting, the court agreed that a corporate entity can never be an “individual” under the FLSA, and therefore can never be an “employee.” The court therefore granted Jani-King’s motion to dismiss. In addition, because the Secretary already had sufficient opportunity to amend his pleading, the court dismissed the action with prejudice and without further leave to amend.


The U.S. District Court for the District of Maryland declined to dismiss Fair Labor Standards Act and Age Discrimination in Employment Act retaliation claims brought by a manager of a franchised pizza restaurant against the franchisor of the restaurant, finding that the manager adequately pleaded a joint employer relationship between the franchisor and the franchisee’s manager. In addition, the district court held that the franchisor and franchisee were not entitled to dismissal of a defamation claim brought by the terminated manager, but were entitled to dismissal of an abusive discharge claim.

Defendant Ledo Pizza Systems, Inc. (Ledo or franchisor) is a corporation that franchises Ledo’s Pizza Restaurants. Defendants P.V. Shah and Trupti Prakash Shah own and operate Annapurna Inc., which operates a Ledo Pizza franchise in Owings Mills, Maryland.

After plaintiff Lenin Lora worked at a different Ledo’s Pizza Restaurant for a number of years, at the recommendation of Ledo’s president, Annapurna hired Lora as the general manager of the Owings Mills store in March 2016. Later that month, Lora met with the Shahs and Damen Richards, a corporate Ledo employee, to ask if he could hire plaintiff Jazmyn Miller, with whom he had a romantic relationship, as a bartender at the Owings Mills store.

Interestingly, even though Richards was a Ledo employee, he worked occasionally at the Owings Mills store. Richards directed Lora as to which items to stock in the bar; prepared inventory lists; and provided training, consultation, and operational support. Richards also required that Lora provide him with daily and weekly reports on the status of the Owings Mills
store for Ledo. The complaint alleges that Richards also hired at least one server at the Owings Mills store and that he set the work schedules for Lora and his assistant.

In March 2016, Lora hired a 64-year old bartender. Richards told Lora that the bartender was too old and would not be able to make and sell drinks at a fast enough pace and ordered Lora to fire her. When Lora objected, Richards told him that he would regret it if he did not fire her.

At around the same time, Lora began processing payroll for the Owings Mills store and noticed several unlawful or improper payroll practices. Thereafter, the Shahs eliminated Lora’s payroll responsibilities; began processing payroll exclusively on their own; and resumed the improper payroll activities, resulting in underpayment to Annapurna’s employees. Thereafter, Lora complained to the Shahs about the payroll practices. The next day, Shah and Richards told Lora that he was being fired because of the poor performance of the Owings Mills store. When Miller called two days later to ask for her shift schedule for the week, Shah told Miller that “corporate” had told her not to put Lora “or his girlfriend” on the schedule, effectively terminating Miller’s employment at the Owings Mills store. Both plaintiffs were underpaid in their final paychecks. After firing the plaintiffs, the Shahs and Richards told third parties and other employees at the Owings Mills store that Lora was a “bad manager,” that he “did not care about the store,” and that he had been stealing from the restaurant.

The plaintiffs each filed charges of discrimination with the U.S. Equal Employment Opportunity Commission and, thereafter, filed this action. In the original complaint, the plaintiffs alleged that the defendants fired each of them in retaliation for Lora raising wage issues, in violation of the Fair Labor Standards Act (FLSA); the defendants fired each of them in retaliation for Lora refusing to fire the bartender because of her age, in violation of the Age Discrimination in Employment Act of 1967 (ADEA); the defendants defamed Lora after he was fired; the defendants fired Lora because he complained about their unfair wage practices, in violation of public policy and thus constituting an abusive discharge under Maryland law; and that the Owings Mills defendants intentionally underpaid each of them on their last paychecks in violation of the Maryland Wage Payment and Collection Law.

Ledo filed a motion to dismiss all of the claims against it, and the Owings Mills defendants filed a motion to dismiss certain of the claims against them. In response to the motions, the plaintiffs filed a motion to amend their complaint, to which the Owings Mills defendants consented, but Ledo did not. The court granted the plaintiffs’ motion to amend their complaint. Because the amended complaint did not cure all of the defects raised by the defendants in their motions to dismiss, the court addressed the merits of the defendants’ respective motions.

In the amended complaint, the plaintiffs alleged that the defendants fired Lora in retaliation for opposing the defendants’ attempts to pay employees at the Owings Mills store less than minimum wage and less than they were re-
quired to pay for overtime; they further alleged that the defendants fired Miller because of her relationship with Lora, in violation of FLSA. In support of its motion to dismiss the FLSA claims, Ledo contended that it did not qualify as the plaintiffs’ employer under the statute. The plaintiffs did not argue that they work directly for Ledo, but rather that Ledo, Annapurna, and the Shahs were joint employers at the Owings Mills store.

The FLSA defines an employee as “any individual employed by an employer,” 29 U.S.C. § 203(e)(1), and an employer as “any person acting directly or indirectly in the interest of an employer in relation to an employee,” 29 U.S.C. § 203(d). Citing Nationwide Mutual Insurance Co. v. Darden, 503 U.S. 318 (1992), the court noted the “striking breadth” of the FLSA’s definitions and that an entity may constitute an employer for FLSA purposes even if it is not an employer under other federal statutes. Even so, the court noted that “courts evaluating franchise relationships for joint employment have routinely concluded that a franchisor’s expansive control over a franchisee does not create a joint employment relationship” on its own. Jacobsen v. Comcast Corp., 740 F. Supp. 2d 683, 690 (D. Md. 2010). Rather, the plaintiff must plead and prove a relationship among the franchisor, the franchisee, and the plaintiff that demonstrates an employment relationship. Under controlling Fourth Circuit precedent, courts must consider “the circumstances of the whole activity” and ask the “fundamental threshold question” of “whether a purported joint employer shares or co-determines the essential terms and conditions of the worker’s employment.” This analysis considers six factors to analyze the nature of the purported joint employer’s relationship to the employee. Reviewing these factors and the amended complaint, the court held that the plaintiffs had adequately pleaded a joint employer relationship. The amended complaint alleged that Richards specifically, and Ledo generally, had at least some power to control and supervise workers and to hire, fire, or modify conditions of employment at the Owings Mills store. Further, the court concluded that the franchisor-franchisee affiliation also suggested a long-lasting relationship between Ledo and Annapurna and at least some degree of control by Ledo over Annapurna. These allegations, the court held, were sufficient to survive a motion to dismiss.

Ledo next moved to dismiss the claims against it under the ADEA, which prohibits employers from discriminating against an employee or prospective employee because of the individual’s age and prohibits an employer from retaliating against an employee because he opposes the employer’s policy or practice that violates the ADEA. Ledo argued that it did not qualify as the plaintiffs’ joint employer for ADEA purposes and that the plaintiffs did not adequately plead a causal link between the protected activity and the adverse action.

First, the court noted that the definition of an employer under the FLSA is more expansive than it is under other federal statutes, including the ADEA. Noting that the Fourth Circuit has applied a different test to deter-
mine whether two entities qualify as joint employers under the ADEA, the court reviewed the factors previously identified in the Fourth Circuit and concluded that the plaintiffs had sufficiently pleaded a joint employment relationship for purposes of their ADEA claims. Again, the allegations in the amended complaint suggested that Ledo, acting through Richards, may have had control over hiring and firing decisions, day-to-day supervision, and formal and informal training. At the motion to dismiss stage, the court concluded that these allegations were sufficient to allege joint employer status under ADEA.

In addition, the court held that the allegations in the amended complaint identified direct evidence of discrimination, thereby eliminating the plaintiffs’ need to rely on timing of the protected activity and the adverse action to draw an inference of discrimination. As a result, the allegations constituting direct evidence of discrimination sufficiently plead a causal relationship between Lora’s protected activity and his termination, thereby meriting denial of the motion to dismiss on this ground.

Next, all the defendants moved to dismiss Lora’s defamation claim. The defendants moved to dismiss under three distinct theories: first, Ledo argued that Lora had failed to alleged necessary details for a defamation claim; second, Ledo argued that any defamatory statements made by the Shahs or Richards cannot be imputed to it; and, third, all the defendants argued that they are protected from suit for the alleged defamatory statements by a qualified privilege extended to employers under Maryland law. Denying the motion, the court first held that the amended complaint contained sufficient specificity to state a claim for defamation under Maryland law. Second, the court held that the statements allegedly made by Richards were within the scope of his employment and may be attributed to Ledo. Third, under Maryland law, a privilege applies when the employer makes a statement about a previous employee or when discussing with other employees the circumstances giving rise to the employee’s termination. However, a plaintiff can overcome the employer’s privilege if he can show actual malice. Because the amended complaint alleged that the defendants acted maliciously, the court declined to dismiss the defamation claim based upon the asserted privilege defense.

Finally, the court granted the defendants’ motion to dismiss Lora’s abusive discharge claim. Under Maryland law, a claim for abusive discharge exists when “the motivation for the discharge contravenes some clear mandate of public policy.” However, where a statutory provision supplies the source of public policy in the analysis of a wrongful discharge claim and that statute already provides an adequate and appropriate civil remedy for the wrongful discharge, the claim must fail. Because Lora’s abusive discharge claim was premised on violation of 8 U.S.C. § 1324a, which makes it illegal to hire, or to recruit or refer for a fee, for employment a known unauthorized alien, and which provides for civil remedies, the abusive discharge claim was dismissed.
This case is discussed under the topic heading “Arbitration.”

**NON-COMPETE AGREEMENTS**

This case is discussed under the topic heading “Termination and Nonrenewal.”

**ORAL AGREEMENTS**

**Andy Mohr Truck Center, Inc. v. Volvo Trucks N. Am.,** Bus. Franchise Guide (CCH) ¶ 16,029, 869 F.3d 598 (7th Cir. 2017)
This case is discussed under the topic heading “Statutory Claims.”

This case is discussed under the topic heading “Damages.”

**STATE DISCLOSURE/REGISTRATION LAWS**

In a wide-ranging opinion discussing numerous issues of interest to franchise counsel, the U.S. District Court for the Eastern District of Michigan dismissed misrepresentation claims asserted by a franchisee under the Michigan Franchise Investment Law and common law for failure to plead with requisite particularity. The court also ruled on issues relating to choice of law, choice of forum, the definition of a franchise under the Michigan Franchise Investment Law, tortious interference, quasi-contract claims, and *Colorado River* abstention.

Although the court’s discussion of the various legal issues presented is certainly interesting, the facts underlying the parties’ putative franchise relationship are more so, and justify a brief summary before our discussion of the legal issues. This action arose out of the parties’ agreement whereby the defendants provided cryotherapy chambers to plaintiff Live Cryo, LLC (Live Cryo) for use at its Michigan locations. Cryotherapy chambers, which use liquid nitrogen to maintain a temperature of approximately 240° below zero, are used by clients for alleged health benefits. Whole body cryotherapy exposes the entire body to temperatures as cold as 240° below zero for about three minutes. The alleged benefits of cryotherapy are more restful sleep, improved mood, enhanced athletic performance, increased energy, a stronger immune system, and faster healing of injuries and muscle aches.
Defendants CryoUSA Import & Sales, LLC (Cryo Import), CryoUSA Franchising, LLC, CryoUSA Holding, LLC, and CryoUSA Mobile, LLC were organized in and operating from Texas. The two individual defendants, Eric Rauscher and Mark Murdoch, are the owners of the defendant corporations. The defendants market themselves as experts in whole-body cryotherapy businesses. The plaintiff alleges that it entered into a franchise agreement with the defendants following its attendance at a seminar meeting in Texas in 2016. The agreement is memorialized in a document entitled “Distribution Agreement.” The plaintiff alleges that prior to executing the distribution agreement, it received various marketing materials that included a return on investment worksheet projecting that the plaintiff could earn as much as $30,350 per month. The plaintiff claims that there was no factual basis for the projection; that representations about the effectiveness of the chambers were fraudulent; and that the chamber it purchased from the defendants did not operate properly.

The distribution agreement provided that the plaintiff may exclusively distribute cryotherapy chambers in Michigan for a twenty-four month period and that the plaintiff must purchase fifteen chambers within the first six months to maintain its exclusive dealership status. The distribution agreement also provided that the defendants controlled marketing and training, and all of its chambers were labeled with its name and trademark. In order to purchase a chamber, the plaintiff was required to execute a purchase agreement; the cost of each chamber was $50,000. The defendants trained and certified five individuals on chamber operations as part of the purchase price, charged $250 for each subsequent person trained, and required that only certified individuals operate the chambers in order for the limited warranty to remain in effect. Both the distribution agreement and the purchase agreement contained choice of law and choice of forum provisions, designating Texas as the governing law and Dallas, Texas, as the venue for the adjudication of disputes.

After a dispute arose between the parties, Cryo Import commenced an action against the plaintiff in the state district court in Dallas, alleging breach of contract arising out of the parties’ distribution agreement (on the grounds that the plaintiff did not purchase a sufficient quota of cryotherapy chambers) and breach of the purchase agreement (by failing to comply with its obligations to submit timely warranty claims and repairs). Before receiving notice of the Texas lawsuit, the plaintiff filed this action in Michigan state court and the defendants removed the action to federal court. The plaintiff’s first amended complaint filed in the district court contained eleven claims: (i) violation of the Michigan Franchise Investment Law, MICH. COMP. LAW § 445.1501 et seq. (MFIL); (ii) violation of the MFIL § 445.1532; (iii) fraud; (iv) silent fraud; (v) innocent misrepresentation; (vi) tortious interference with business relationship with a third party, Orchard Fitness; (vii) tortious interference with business relationships with its customers; (viii) breach of warranty; (ix) breach of contract; (x) promissory estoppel; and (xi) unjust en-
After reviewing the legal standards applicable to a Rule 12(b)(6) motion, the court addressed six primary issues in connection with the defendants’ motion to dismiss, discussed immediately below.

**Choice of Law.** The defendants first argued that the choice of law provisions in the distribution agreement and purchase agreement calling for the application of Texas law required dismissal of the plaintiffs’ claims under Michigan law. Both the distribution agreement and purchase agreement contained so-called narrow choice of law provisions, providing only that the agreement shall be construed or governed in accordance with the law of the State of Texas (as opposed to a broad choice of law, which may provide that the parties’ agreement, relationship, and any contractual, tort, statutory or other claims asserted between them will be governed by the selected state’s laws). The court bifurcated its analysis, first addressing the effect of the provision on the plaintiff’s breach of contract claims, and then upon its statutory and tort claims. Applying Michigan law, and particularly the Restatement (Second) of Conflict of Laws § 187, the court easily held that the parties’ choice of law provisions would be enforced with respect to the parties’ contractual dispute. Proceeding to the more difficult question of whether such a narrow choice of law provision was limited solely to the contractual claims arising out of the agreement, or whether it also applies to statutory or tort claims, the court reviewed Sixth Circuit precedent and ultimately concluded that narrowly drafted choice of law provisions did not apply to non-contractual claims. Therefore, the court held that the law of the forum, Michigan, would govern the plaintiffs’ tort, quasi-tort, statutory, and quasi-contractual claims.

**Choice of Forum.** The defendants argued that the forum selection provisions in the parties’ agreements required dismissal of the action in total. However, before reaching that issue, the court was required to determine whether the amended complaint stated a claim under MFIL, such that the MFIL provision rendering any contractual choice of forum provision which required arbitration or litigation to be conducted outside of Michigan void and unenforceable was applicable. In order to determine the applicability of MFIL, the court examined the allegations in the amended complaint to determine whether the plaintiff had adequately alleged a franchisor-franchisee relationship such that the MFIL applied. In order to do so, the court reviewed the definition of a franchise under MFIL § 445.1502(3), which defines a franchise as a contract between two or more persons in which (1) a franchisee is granted the right to engage in the business of offering, selling, or distributing goods and services under a marketing plan or system prescribed in substantial part by a franchisor; (2) a franchisee is granted the right to engage in the business of offering, selling, or distributing goods and services substantially associated with the franchisor’s trademark, service mark, trade name, or other commercial symbol; and (3) the franchisee is required to pay a franchise fee. Given the plain terms of the distribution agreement, the court held that the
first two elements were adequately pleaded. With regard to the third factor, whether the plaintiff was required to pay directly or indirectly a franchise fee, the court held that the plaintiff adequately alleged three methods of indirect payment of a franchise fee, sufficient to create a triable issue of fact as to whether that element can be established.

Having found that a question of fact existed as to whether the parties entered into a franchise agreement, the court held that both Restatement (Second) of Conflicts of Laws § 187 and MFIL § 445.1527(f) compelled the court to find that the forum selection provision in the parties’ agreements was void and unenforceable and therefore permitted the claims to be asserted in this forum.

*MFIL and Common Law Fraud Claims.* The court next analyzed the defendants’ motion to dismiss the plaintiffs’ MFIL and common law fraud claims. The amended complaint alleged violation of § 445.1505 of the MFIL, which prohibits fraudulent conduct in connection with the filing, offer, sale, or purchase of any franchise, and also alleged derivative liability against the non-franchisor defendants under MFIL § 445.1532.

The defendants first argued that the amended complaint failed to plead statutory and common law fraud with sufficient specificity as required by Federal Rule of Civil Procedure 9(b). Reviewing Rule 9(b) and its applicability to MFIL, the court agreed, finding that allegations of fraud are deficient when the speaker is not identified individually, but the claims are directed at the defendants *en masse* (i.e., impermissible “group pleading”). Because the amended complaint failed to specify the defendants allegedly responsible for the allegedly fraudulent misrepresentations, or the statements those individuals made, the court held that the plaintiff failed to plead fraud under both common law and MFIL with the requisite particularity. In addition, the court held that the fraud claims were deficient to the extent they alleged forward-looking projections, which are not actionable under the MFIL and Michigan common law. The plaintiff alleged that it was induced to enter into a cryotherapy business based on estimates of its possible future earnings, but these estimates of future profits were merely erroneous conjectures as to future events, which are not actionable.

Finally, the court held that the plaintiffs’ MFIL and common law fraud claims also must be dismissed because the plaintiff cannot show reasonable reliance on any of the alleged misrepresentations and agreed that there were no such promises in the written distribution agreement and purchase agreements. Because justifiable reliance is necessary for both common law fraud and the MFIL claim, the court held that any reliance on promises not contained in the written agreements would have been unreasonable as a matter of law. As a result of the subsequent written agreements between the parties, the court held that the common law fraud and MFIL claims were deficient as a matter of law.

*Tortious Interference with Contractual Relationships.* The court next held that the plaintiff’s claims for tortious interference with contractual relationships
would also be dismissed, based upon the economic loss doctrine, which prohibits recovery in tort for a warranty claim. Further, the claims were deficient because the plaintiff expressly agreed that Cryo Import could not be liable for any special, incidental, consequential lost profits, or lost business damages arising from any defect in a chamber, which limitations of remedies are valid and enforceable under Michigan law. Accordingly, the court dismissed the tortious interference claims.

**Quasi-Contract Claims.** The amended complaint also alleged promissory estoppel and unjust enrichment claim. However, the court held that these claims were barred in light of the parties’ express distribution agreement and purchase agreements, which the plaintiff relied upon in its breach of contract and breach of warranty claims. Because, under Michigan law, a court may not imply a contract where an express contract covers the same subject matter, these quasi-contractual claims were dismissed.

**Colorado River Abstention.** Having dismissed the plaintiff’s MFIL, tort, and quasi-contractual claims, the court turned to the question of whether *Colorado River* abstention warranted dismissal of the plaintiff’s remaining breach of warranty and breach of contract claims. The court began its analysis by noting that a federal court has a “virtually unflagging obligation” to exercise the jurisdiction bestowed upon it, which obligation may be avoided in only a few “extraordinary and narrow” circumstances (such as where a parallel state matter is pending). The *Colorado River* doctrine provides that abstention in deference to ongoing proceedings in state court may be appropriate when the actions are truly parallel and when a careful balancing of eight factors established by the Supreme Court heavily weighs in favor of abstention. Applying those factors to allegations in the amended complaint, the court held that *Colorado River* abstention was not warranted.


Remarkably, and contrary to the majority of courts that have addressed the issue, the U.S. District Court for the Southern District of Florida has held that a contractual provision designating Maryland law precluded a Florida-based franchisee from asserting claims against its franchisor under the otherwise applicable Florida Franchise Act. However, the court declined to dismiss the plaintiff’s Florida Deceptive and Unfair Trade Practices Act claim, permitting it to amend its complaint to allege the requisite damages, and likewise declined to dismiss the plaintiff’s promissory estoppel and breach of contract claims.

In February 2011, plaintiff Maurice’s Jewelers II, Inc. and defendants Pandora Jewelry, LLC and Pandora Franchising, LLC (together, Pandora) entered into a master purchase authorization agreement that permitted Maurice to retail Pandora jewelry at a Dolphin Mall location in Miami. The complaint alleged there are five different types of Pandora franchises, which differ in the types of Pandora products authorized to be sold and the physical
layout of the retail location: Concept Store, Shop-in-Shop, Gold, Silver, and White. The agreement designated Maurice’s Dolphin Mill location as a Silver dealer and stated that an authorized retailer may elect to be a Gold, Silver, or White retailer at its discretion and may elect to change such retailer’s status at any time. The plaintiff alleges that a Pandora employee advised Maurice that although the Dolphin Mall location was designated as a Silver dealer, Maurice would be permitted to carry all Pandora jewelry lines and products with the exception of watches at the Dolphin Mall location. In essence, it was promised that although the agreement designated it a Silver dealer, it could operate as a Concept Store. In reliance on these assurances, Maurice alleges it proceeded to develop the Dolphin Mall location by negotiating and signing a six-year lease for retail space, undertaking improvements, and purchasing fixtures for jewelry display.

Once Maurice opened the store, however, the defendants did not permit it to purchase the full line of Pandora products. Maurice advised the defendants that its financial growth was inhibited by its inability to sell the full product line. In response, the defendants sent a termination notice to Maurice without any advance notice, effective immediately. Thereafter, Maurice commenced this action, alleging violation of the Florida Franchise Act, the Florida Deceptive and Unfair Trade Practices Act, promissory estoppel, and breach of contract. The defendants moved to dismiss all claims.

The defendants first sought to dismiss Maurice’s claim under the Florida Franchise Act (FFA), Fla. Stat. Ann. § 817.416, based on the parties’ choice of Maryland law to govern the parties’ agreement. The FFA prohibits the use of any misrepresentations in connection with the sale of a franchise and provides a private right of action for damages. Citing two federal district court cases, the court made the (somewhat remarkable) leap from the mundane conclusion that a choice of law provision is presumptively valid under Florida law to the conclusion that the effect of a valid choice of law provision is to preclude a franchisee from asserting a claim under an otherwise applicable franchise statute, here the Florida Franchise Act. The authors doubt that the result would have been similar in any of the registration/disclosure states that generally require an FDD or a franchise agreement addendum specifying that a choice of law provision will not act to render an otherwise applicable registration/disclosure statute inapplicable. Further, many such registration/disclosure statutes contain so-called “anti-waiver” provisions, which render any contractual provision that has the effect of waiving or rendering inapplicable the protection afforded by the statute void. Thus, it is the authors’ experience that this court’s conclusion is somewhat of an outlier and that the majority of courts facing this issue have concluded that a franchisee may assert claims under an otherwise applicable franchise statute, even when the parties’ franchise agreement contains a choice of law designating another state’s law to govern the parties’ franchise agreement (or even their relationship).

The court next addressed the defendants’ motion to dismiss Maurice’s claim under the Florida Deceptive and Unfair Trade Practices Act (FDUTPA), Fla.
Statutory Claims


This case is discussed under the topic heading “Antitrust.”

**Andy Mohr Truck Center, Inc. v. Volvo Trucks N. Am.,** Bus. Franchise Guide (CCH) ¶ 16,029, 869 F.3d 598 (7th Cir. 2017)

The Seventh Circuit reversed a jury verdict in favor of a franchised truck dealer against its manufacturer on its claim for unfair discrimination under the Indiana Deceptive Franchises Practices Act, finding that the evidence at trial failed as a matter of law to establish that the manufacturer unfairly discriminated against its dealer.

Andy Mohr Truck Center was a franchised dealer of Volvo Trucks North America. After completing negotiations for a dealership agreement in early 2010, the relationship between the parties became hostile. The parties commenced separate lawsuits against each other in 2012; however, the only claim to survive summary judgment was that Volvo caused damages to Mohr by discriminating unfairly among its franchisees, contrary to the Indiana Deceptive Franchise Practices Act (IDFPA), Ind. Code §§ 23-2-2.7-1 et seq. At trial, a jury awarded Mohr $6.5 million on this claim based on evidence
of thirteen transactions of other Volvo dealers that were compared to Mohr’s own concessions. Volvo appealed the award on the ground that the evidence did not support the verdict.

On appeal, the Seventh Circuit held that the court would reverse the award only if no rational jury could have found in Mohr’s favor. Because there were no reported Indiana cases describing what a plaintiff needs to establish to succeed in a claim of unfair discrimination under the IDFPA, the court turned to the 1983 case of *Canada Dry Corp. v. Nabi Beverage Co., Inc. of Indianapolis*, 723 F.2d 512 (7th Cir. 2010), for guidance. That case held that unfair discrimination means “as between two or more similarly situated franchisees, and under similar financial and marketing conditions, a franchisor engaged in less favorable treatment toward the discriminatee than toward other franchisees.” The court also rejected a comparison of the IDFPA with the Robinson-Patman Act, because the latter is not concerned with competition law.

The critical issue in the case turned on a disagreement of what constituted unfair discrimination. Although the court did conclude that there was unequal and different treatment between the parties, it continued that the discrimination must be viewed in the context of the agreement. Due to the lack of evidence provided by Mohr to show that the different treatment was in fact discriminatory, the court held that the agreement provided Volvo with the discretion to treat dealers differently without being considered discriminatory. For this reason, the court ultimately ruled in favor of Volvo and reversed the $6.5 million in damages awarded at trial.

The court concluded by affirming the trial court’s judgment that the previously dismissed claims by both parties cannot survive summary judgment. These claims involved extra-contractual promises by both parties that were dismissed as a result of an integration clause, which held that the written agreement constituted their entire agreement. Due to the sophistication of the parties, the court held that the parties should have incorporated any extra-contractual terms into their contracts.


This case is discussed under the topic heading “Encroachment.”


The U.S. District Court for the Western District of New York rejected a request for a temporary restraining order, preliminary injunction, and expedited hearing by a metal supply store franchisee against its franchisor in connection with an installation of new operating software at the franchisee’s stores, declining to hold that the franchisor’s imminent and mandatory soft-
ware installation would violate the Washington Franchise Investment Protection Act.

JDS Group Ltd. has been a franchisee of the Canadian franchisor Metal Supermarkets Franchising America (MSFA) for approximately ten years. It operates two franchises licensed by MSFA as retail vendors of metal components in Kent, Washington, and Portland, Oregon. To assist with their financial operations, MSFA had provided JDS and its other franchisees with a computer software system called Metal Magic. On determining that Metal Magic was outdated and inefficient, MSFA began developing a new software system for its franchisees called MetalTech. MSFA had sought to install the software at the two franchised retail stores of JDS, which was initially planned for May 14, 2017, and rescheduled for June 23, 2017.

JDS did not want to have MetalTech installed in its stores, claiming that the software was unreliable, inaccurate, and more time-consuming than Metal Magic. Although counsel for JDS sent a letter in August 2016 to MSFA about its concerns over MetalTech, JDS subsequently signed a new franchise agreement in January 2017 that explicitly allowed MSFA to develop and require JDS to install new computer software. Although JDS recognized that it understood the provisions in the franchise agreement regarding the installation of the software, it argued that it was coerced into signing the agreement and did not believe MSFA would install the software until it was running functionally.

On May 9, 2017, JDS commenced an action and filed a motion for a preliminary injunction and temporary restraining order to prevent MSFA from requiring it to install MetalTech in its stores. JDS claimed that by requiring it to install the software, the franchisor had violated the Washington Franchise Investment Protection Act (FIPA), WASH. REV. CODE §§ 19.100.010 et seq.

The court outlined that to obtain a preliminary injunction, a movant must demonstrate that: (1) it is subject to irreparable harm; and (2) either (a) it will likely succeed on the merits or (b) there are sufficiently serious questions going to the merits of the case to make them a fair ground for litigation, and that a balancing of the hardships tips “decidedly” in favor of the moving party. The court ultimately concluded that none of the claims against the franchisor had a likelihood of succeeding on the merits.

In relation to the good faith requirement in FIPA § 1, the court held that the case law in Washington recognizes that a lack of good faith is equivalent to bad faith, which requires a “dishonest purpose” and “embraces actual intent to mislead or deceive another.” The court noted that there is evidence of MSFA’s significant investment in developing the software, supporting the conclusion that it was not acting in bad faith. Additionally, the court held that the good faith provision in FIPA § 1 will not override the express terms of a contract, such as in the franchise agreement that expressly permitted MSFA to develop and designate software.
The court then turned to the other two claims against MSFA for violating FIPA §§ 2(b) and 2(h). FIPA § 2(b) states that it is unlawful for a franchisor to require a franchisee “to purchase or lease goods or services of the franchisor or from approved sources of supply unless and to the extent that the franchisor satisfies the burden of proving that such restrictive purchasing agreements are reasonably necessary for a lawful purpose.” The court recognized that although there was no case law specifically interpreting FIPA § 2(b), the statute provides that the courts should be guided by cases interpreting U.S. antitrust laws. Because JDS did not identify authority that requiring a franchisee to use computer software violates antitrust laws, and had itself used the previously required software Metal Magic for ten years, JDS has not met the burden required. Additionally, the courts have held that it is permissible for a franchisor to require use of its proprietary computer systems.

JDS also claimed that MSFA violated FIPA § 2(h), which states it is unlawful for a franchisor to require any standard of conduct unless it can prove that it is reasonable and necessary. The court recognized that although there is also no case law interpreting this section, the Washington courts generally “give considerable deference to franchisors’ efforts” over their franchise systems, and that the section should not be interpreted to undercut a franchisor’s business judgment in establishing standards for its system. For this reason, the court held that there was no violation of § 2(h).

Finally, the court turned to the first branch of the test for a preliminary injunction and held that the requirement to use MetalTech would not cause JDS irreparable harm. The court held that despite some evidence by JDS to the contrary, the software had been implemented in seventy-eight out of eighty-six of MSFA’s stores, which on average experienced a 7.4% increase in sales following the installation.

For these reasons, JDS did not satisfy the threshold to obtain a preliminary injunction and the court denied the motion.

This case is discussed under the topic heading “State Disclosure/Registration Laws.”

This case is discussed under the topic heading “Injunctive Relief.”

This case is discussed under the topic heading “Contract Issues.”
TERMINATION AND NON-RENEWAL


In a not-for-publication opinion, the Ninth Circuit affirmed the dismissal by the U.S. District Court for the District of Oregon of a veterinary hospital franchisee’s breach of contract claim for failure to renew the parties’ franchise agreement.

Plaintiff James Robinson purchased a veterinary hospital franchise from defendant Charter Practices International, LLC (CPI) and at the same time owned and operated independent veterinary clinics that were not part of the CPI franchise. CPI had not enforced a non-competition provision in the franchise agreement but, when the term of the original franchise agreement expired and Robinson tried to renew, CPI notified Robinson of its intent to enforce the non-competition provision in the renewal agreement—the then-current form of the franchise agreement. Because Robinson refused to disinvest from his independent clinics, CPI did not offer the renewal agreement, and Robinson commenced this action alleging that CPI improperly refused to renew the franchise. On CPI’s motion, the district court dismissed each of the three claims asserted by Robinson, and he appealed to the Ninth Circuit.

Affirming the dismissal of the breach of contract claim, the Ninth Circuit noted that the plain language of the franchise agreement’s renewal provision allowed for CPI to condition renewal on compliance with the non-competition provision that would be in the renewal agreement. The renewal provision further provided that the renewal agreement would be substantially similar to the then-current form of the franchise agreement and that the terms thereof might differ from the original franchise agreement. Notably, the court held that CPI’s waiver of the non-competition provision in the original franchise agreement did not extend to the corollary provision in the renewal agreement, because CPI provided notice of its intent to enforce the non-competition provision and gave Robinson a chance to disinvest if he wanted to renew the franchise while not competing. Further, the court held that CPI never promised or represented that it would never enforce the non-competition provision in the future.

Second, the court quickly dispatched Robinson’s claim for breach of the implied duty of good faith and fair dealing, because the parties’ franchise agreement stated that the renewal agreement would be substantially similar to the terms and conditions of the then-current form of the franchise agreement.

Finally, the court affirmed the dismissal of Robinson’s intentional interference with economic relations claim, because the conduct between business competitors is not “improper” if the conduct is in the defendant’s competitive interest and not done for an “improper purpose,” such as “spite or ill will.” Further, the court noted that a competitor is not liable for intentional interference if the conduct is done to further its own legitimate business in-
interests, such as profit maximization. Because Robinson did not allege any improper means that were “independently wrongful by reason of statutory or common law,” the claim was properly dismissed.


This case is discussed under the topic heading “Injunctive Relief.”

**TORTIOUS INTERFERENCE**


The U.S. District Court for the Western District of Wisconsin held that a franchisor’s communications with its licensee, which had sublicensed the right to operate a franchised store to the defendant operator, were justified as a matter of law and, therefore, dismissed the plaintiff operator’s claim for tortious interference based upon those communications.

Pursuant to a variety of business relationships dating back decades, defendant Universal Investment Corp. or its predecessors operated a Dairy Queen restaurant on Menomonie Street in Eau Claire for more than forty years. They did so, since 1973, in reliance on a set of agreements between Stephen Partnership or its predecessors and plaintiff American Dairy Queen Corp. (ADQ). These agreements dated back, in some respects, to 1955. The most recent of these arrangements was a 2000 agreement between Universal and Stephen Partnership by which Universal obtained the right to sell soft serve ice cream products under ADQ’s trademarks as a sublicensee to Stephen Partnership’s license arrangement with ADQ.

On February 15, 2013, ADQ issued a notice of default to Stephen Partnership and, later, a notice of termination effective August 6, 2013. Subsequently, on September 28, 2013, ADQ advised Universal’s predecessor that Universal was now considered a direct licensee of ADQ because Stephen Partnership’s relationship with ADQ had been terminated. A lawsuit between ADQ and Stephen Partnership ensued on March 24, 2014. This suit was ultimately settled by an agreement effective December 1, 2014, by which Stephen Partnership transferred to ADQ all of Stephen Partnership’s rights under the prior agreements. These rights expressly included Stephen Partnership’s rights as Universal’s sublicensor of ADQ’s trademarks. As this litigation was occurring, however, Universal and Stephen Partnership were separately conducting negotiations for Universal to purchase Stephen Partnership’s territory rights to operate Dairy Queen restaurants in Eau Claire County. But once Stephen Partnership and ADQ settled their lawsuit, Stephen Partnership did not transfer its territory rights to Universal, having bargained those rights to ADQ.
During the course of 2015, ADQ had several communications with Universal occasioned by Universal’s becoming a direct licensee of ADQ. Thereafter, on August 28, 2015, ADQ issued a notice of default and indicated that it would terminate the 2000 license effective November 30, 2015, if the defaults were not cured. This lawsuit ensued, with ADQ agreeing to stay termination of Universal’s license until the court decided ADQ’s claims for declaratory relief under the Wisconsin Fair Dealership Law and the Lanham Act.

ADQ asserted various claims against Universal, including a claim for declaratory relief that ADQ properly terminated the franchise and for trademark infringement under the Lanham Act. Universal alleged counterclaims against ADQ for, among other things, tortious interference with its prospective contract to purchase greater territory rights in Eau Claire County. Universal moved for partial summary judgment, seeking dismissal of ADQ’s Lanham Act claim on the basis of laches. ADQ also sought summary judgment against Universal’s tortious interference counterclaims, claiming privilege and justified interference with the transfer of territory rights.

Regarding ADQ’s motion for summary judgment to dismiss Universal’s tortious interference counterclaims, the court held that ADQ’s conduct vis-à-vis the negotiations between Universal and Stephen Partnership was justified as a matter of law. The court determined that ADQ’s arm’s length settlement with Stephen Partnership provided justification for ADQ’s conduct. The court concluded that, even viewing all facts in Universal’s favor, a reasonable jury would necessarily find that ADQ was justified and privileged in asserting its interest in any transfer of territorial rights from Stephen Partnership to Universal, and in entering into a settlement by which Stephen Partnership released and transferred its rights to ADQ. The court therefore granted ADQ’s motion for partial summary judgment and dismissed Universal’s tortious interference counterclaim.

The court also granted, in part, Universal’s motion for summary judgment, finding that the equitable doctrine of laches barred ADQ’s trademark infringement claims for the time period preceding October 2015. The court held, as a matter of law, that ADQ would be charged with constructive knowledge of Stephen Partnership’s lax trademark enforcement practices for the time period preceding ADQ’s December 2014 termination of its relationship with Stephen Partnership. The court therefore determined that ADQ could not obtain relief for any acts of trademark infringement occurring before the date of ADQ’s notice of default to Universal and the period of time for curing that default, namely, late October 2015. A ruling on the laches defense for conduct after October 2015 was reserved for a later stage of the litigation.


This case is discussed under the topic heading “Contract Issues.”
This case is discussed under the topic heading “Damages.”

This case is discussed under the topic heading “State Disclosure/Registration Laws.”

TRADEMARK INFRINGEMENT

This case is discussed under the topic heading “Tortious Interference.”

UNFAIR COMPETITION/UNFAIR AND DECEPTIVE PRACTICES

This case is discussed under the topic heading “Antitrust.”

Andy Mohr Truck Ctr., Inc. v. Volvo Trucks N. Am., Bus. Franchise Guide (CCH) ¶ 16,029, 869 F.3d 598 (7th Cir. 2017)
This case is discussed under the topic heading “Statutory Claims.”

This case is discussed under the topic heading “Damages.”

This case is discussed under the topic heading “Encroachment.”

VICARIOUS LIABILITY

In a not-for-publication opinion, the U.S. District Court for the District of New Jersey denied a franchisor’s motion for summary judgment in an action brought against it by an employment agency arising from the agency’s former employee’s extended stay at a hotel owned and operated by a franchisee of the defendant’s subsidiary.
On very unusual and not wholly explained facts, the employment agency asserted various claims against the hotel’s franchisor arising from unauthorized charges incurred by the agency’s former employee at the franchised hotel. Remarkably, although authorized by the employment agency to stay at the hotel for five days, the former employee stayed at the hotel for approximately fifteen months, resulting in more than $80,000 in unauthorized charges. The employment agency asserted claims against the franchisor for violation of the New Jersey Consumer Fraud Act, negligence, equitable fraud, negligent misrepresentation, and unjust enrichment. Interestingly, the court’s opinion does not discuss whether the employment agency asserted claims against the franchised hotel, which was not a party to this action, or its former employee.

In October 2013, plaintiff eTeam, Inc. authorized one of its employees to stay at a franchised Hilton Garden Inn Hotel in San Francisco. An employee of the hotel communicated with an eTeam employee in New Jersey and obtained authorization to charge eTeam’s corporate credit card for the employee’s stay of five days. The employee stayed at the hotel after the authorized five days had passed and even after her employment with eTeam was terminated. Incredibly, the employee stayed at the hotel from mid-October 2013 to mid-January 2015; during this period, eTeam incurred charges on its corporate account approximately every seven to ten days. Ultimately, the employee’s stay resulted in more than $80,000 in unauthorized charges.

The hotel was operated by franchisee BRE Select Hotels Operating LLC, pursuant to a franchise agreement between BRE and franchisor Hilton Garden Inn Franchise LLC (HGI), a wholly owned subsidiary of defendants Hilton Worldwide, Inc. and Hilton Worldwide Holdings, Inc. (collectively, Hilton). The franchise agreement contained a typical “no agency relationship” provision and the franchisee’s acknowledgment that the franchisee had “exclusive day-to-day control of the business and operation of the hotel and [franchisor] [does] not in any way possess or exercise such control.” The franchise agreement incorporated by reference the Hilton Garden Standards Manual, which outlined the standards, procedures, rules, regulations, policies, and techniques that HGI franchisees must adhere to. The Manual required franchisees to maintain all aspects of the hotel, including “personnel, buildings, grounds, furnishings, fixtures, décor, equipment, signs, vehicles, linens, supplies, glass, printed matter and any other element thereof that affects the guest, directly or indirectly,” in accordance with the Hilton standards described in the Manual.

eTeam asserted claims against Hilton for violation of the New Jersey Consumer Fraud Act, negligence, equitable fraud, negligent misrepresentation, and unjust enrichment. Hilton moved for summary judgment on the basis that as a franchisor, it did not own or operate the hotel, exercised no control over the hotel, and was not involved in its day-to-day operations. Accordingly, Hilton argued that it could not be held legally responsible for the plaintiff’s damages.
The district court commenced its analysis with an analysis of agency principles under applicable New Jersey law, stating that a court must find the existence of an agency relationship between the parties in order to hold a franchisor liable for the acts of its franchisee and that the hallmark of an agency relationship is that the principal has the right to control the manner in which the agent performs its duties. The court further specified that in the franchise context, this means that the franchisor is able to exercise control over the day-to-day operations of the franchisee. Citing *Drexel v. Union Prescription Centers, Inc.*, 582 F.2d 781 (3d Cir. 1978), the court acknowledged the difficulties of applying traditional principles of agency to the relationship between a franchisor and a franchisee. The court noted that although some degree of control is inherent in the franchisor-franchisee relationship, the mere existence of a franchise relationship does not necessarily create an agency relationship, nor does it automatically insulate the parties from such a relationship. Ultimately, the question of whether a franchisor has retained sufficient control to establish an agency relationship depends entirely on the facts of each individual case, including the extent of the control as defined by the franchise agreement and the actual practices of the parties.

Applying these principles, the court noted, as a preliminary matter, that the language used in the franchise agreement has no bearing on the actual nature of the relationship between the parties so that the “no agency relationship” provision in the parties’ franchise agreement was not determinative to the question of whether the franchisor could be held vicariously liable for its franchisee’s action. Instead, relevant for this inquiry was the actual degree of control that the franchisor exercised, or reserved the right to exercise, over its franchisee.

Turning to that issue, Hilton claimed that the control it exercised over its franchisee was limited to that which was necessary to ensure conformity among its franchised locations and to protect its brand and trademarks. However, the plaintiff identified sufficient factual support for the assertion that the control exerted by Hilton over the hotel’s operations extended far beyond that which would ordinarily be necessary for a franchisor to protect its brand and trademarks. The court reviewed various provisions of the Manual that gave Hilton control over many aspects of the hotel’s operations, including its day-to-day operations, and concluded that Hilton either was exercising, or reserved the right to exercise, an extensive degree of control over day-to-day operations of the hotel. Interestingly, although the court did not rely on the emerging “instrumentality” analysis adopted in many jurisdictions on this issue (see e.g., *Depianti v. Jan-Pro Franchising International, Inc.*, 990 N.E.2d 1054 (Mass. 2013) and *Kerl v. Dennis Rasmussen, Inc.*, 682 N.W.2d 328 (Wis. 2004)), the court did note that Hilton retained direct control over the instrumentality at issue—the reservation, processing, and payment system of the hotel—by delineating highly specific rules and procedures for reservation processing and payment, which the franchisee was required to adhere to pursuant to the terms of the franchise agreement. Thus,
although not adopting the instrumentality test, the court held that such test, if applicable, was satisfied.

In sum, the court concluded that the complaint alleged that Hilton retained a great deal of control over the day-to-day operations of the hotel, beyond that necessary to protect the integrity of its brand and trademarks. These allegations gave rise to a genuine question of material fact as to the existence of an agency relationship between Hilton and BRE and thus required denial of Hilton’s motion for summary judgment.