The Franchise Memorandum | By Lathrop GPM

To: **Our Franchise and Distribution Clients and Friends**

From: **Lathrop GPM's Franchise and Distribution Practice Group**
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Welcome to *The Franchise Memorandum by Lathrop GPM*, formerly known as *The GPMemorandum*. Below are summaries of recent legal developments of interest to franchisors.

Employment

Court Dismisses Ostensible Agency Claim on Motion for Reconsideration

A federal court in California has granted a motion for reconsideration in light of recent Ninth Circuit precedent, reversing the district court's prior decision and dismissing ostensible agency claims alleged against a franchisor. *Cruz v. MM869, Inc.*, 2020 WL 509109 (E.D. Cal. Jan. 31, 2020). Cruz, an employee of the Merry Maids franchisee and representative of a class action group, alleged that the franchisor Merry Maids and its parent organization ServiceMaster were joint employers and were liable for the franchisee's alleged violation of various wage and hour laws under California's Labor Code. The court previously dismissed Cruz's joint employer claims against ServiceMaster/Merry Maids, but left intact her claims under an ostensible agency theory of liability.

ServiceMaster/Merry Maids filed a motion for reconsideration shortly after the Ninth Circuit's ruling in *Salazar v. McDonald's Corp*., 944 F. 3d 1024 (9th Cir. 2019), which found that a franchisor could not be held liable for wage and hour violations under an ostensible agency theory pursuant to Wage Order 5-2001. The court held that the ostensible agency theory was inconsistent with the plain terms of the Wage Order, and therefore was precluded as a matter of law. Because Cruz's claims were under the purview of the Wage Order, the district court concluded that the new Ninth Circuit ruling required dismissal of Cruz's remaining claims against ServiceMaster/Merry Maids. Lathrop GPM represented ServiceMaster and Merry Maids in this case.

Federal Court Dismisses Joint Employer Claim Against Hotel Franchisor

A federal court in Pennsylvania granted summary judgment to a franchisor on a wage and hour putative collective action brought by an employee of its franchisee. *DiFlavis v. Choice Hotels Int'l, Inc.*, 2020 WL 610778 (E.D. Pa. Feb. 6, 2020). Plaintiff Gina DiFlavis worked as a housekeeper for several weeks at a franchisee's Clarion Hotel. The Clarion brand is franchised by Choice Hotels. DiFlavis alleged that she and other housekeepers at Clarion Hotels nationwide were denied compensation for overtime work

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performed. Choice moved for summary judgment on the basis that it was not DiFlavis's joint employer.

In granting Choice's motion, the court applied the Third Circuit's four-part joint-employer test. First, the court found that Choice had no authority, under the franchise agreement or otherwise, to hire and fire a franchisee's employees. Second, the court found that Choice did not have the authority to promulgate work rules and assignments, or set conditions of employment, such as compensation, benefits, and hours. Third, the court found that Choice did not supervise DiFlavis on a day-to-day basis, in spite of its periodic inspections of the hotel, because the inspections were related to brand standards and not supervising the franchisee's employees. Fourth, the court found that Choice did not control the records of the franchisee's employees, even though the franchise agreement permitted it to review the franchisee's financial records, because Choice's audit rights were aimed at maintaining the value of its marks and computing royalties and fees due, not the maintenance of employee records. Describing the "total employment situation," the court noted that the franchise agreement explicitly stated that the franchisee was an independent contractor with sole responsibility for personnel matters.

California Federal Court Concludes that Franchisees Are not Entitled to Unpaid Overtime Wages

In another case involving the classifications of franchisees, a federal court in California granted a franchisor's summary judgment motion in part, holding that the franchisees were not entitled to unpaid overtime wages, but allowed claims to proceed based on alleged misclassification of franchisees as independent contractors. *Haitayan, v. 7-Eleven, Inc.*, Case No. CV 17-7454 DSF (C.D. Cal. Feb. 19, 2020). The plaintiffs are 7-Eleven franchisees who claimed that 7-Eleven should have classified them as employees rather than independent contractors. The franchisees brought six claims against 7-Eleven stemming from the alleged misclassification relating to unpaid overtime and unpaid business expense reimbursements. 7-Eleven moved for summary judgment on the unpaid overtime and unreimbursed expense claims, and the franchisees moved for summary judgment on the misclassification claim.

The court denied the franchisees' motion, concluding that under the ABC test adopted by the California Supreme Court in *Dynamex Operations West, Inc. v. Superior Court*, 416 P.3d 1 (Cal. 2018), the issue of classification of workers is a fact-specific analysis, so the franchisees' claims ultimately required a fact determination. There were factual disputes as to whether the franchisees engaged in work outside the usual course of 7-Eleven's business, which 7-Eleven claimed included selling franchises, leasing property and equipment, and licensing its marks and operating system, business activities in which the franchisees did not engage. The court did conclude, however, that 7-Eleven was entitled to summary judgement on the overtime claims. The franchisees claimed that 7-Eleven should have known that they were working overtime because it could remotely view footage of the stores from its surveillance cameras. 7-Eleven maintained that the franchisees failed to present any evidence they worked overtime or that it had actual or constructive notice that they were working overtime. The franchisees failed to keep records of the hours spent at their stores and never gave 7-Eleven information about the time spent operating the business. Therefore, the court determined that the franchisees were not entitled to overtime pay and granted 7-Eleven's motion for summary judgment on that issue.

North Carolina Federal Court Declines to Dismiss FLSA Claim Alleging Franchisor of Convenience Store was Joint Employer

Elsewhere, a federal court in North Carolina granted in part and denied in part a motion for partial judgment on the pleadings in a case in which the franchisee's principals asserted that they were

employees of the franchisor. *Elsayed v. Family Fare LLC*, 2020 WL 780701 (M.D.N.C. Feb. 18, 2020). Family Fare entered into a franchise agreement for a gas station convenience store with Almy, LLC, a company owned by plaintiff Elsayed. Family Fare subsequently terminated the agreement based upon allegations that Almy had skimmed proceeds from lottery ticket sales. Elsayed then sued Family Fare asserting various claims under state and federal law, including claims for unpaid overtime under the Fair Labor Standards Act (FLSA) and the North Carolina Wage and Hour Act. Family Fare answered the complaint and filed a motion for partial judgment on the pleadings.

The court granted Family Fare's motion as to the state claims while denying it for the FLSA claim. Both decisions turned on whether Family Fare could be deemed to be Elsayed's employer. In the North Carolina Wage and Hour Act, the North Carolina legislature expressly stated that a franchisor was not a franchisee's employer for purposes of the statute. In contrast, under the FLSA, there was no such definitive exclusion. Even though the franchise agreement explicitly stated that no employer-employee relationship existed between Family Fare and Elsayed, the court determined the degree of control Family Fare exercised over Elsayed could permit the conclusion that an employer-employee relationship existed. Important to the court's determination were allegations that Family Fare made significant decisions at the store, such as what was sold, the price, and advertising; Family Fare supervised Elsayed to the extent that it would not let him sell certain items or give a customer an occasional complimentary coffee; that Family Fare dictated the terms and conditions of employment, such as when the store opened and closed as well as uniforms; that Family Fare commanded Elsayed to follow orders; that the relationship was long-term; and that Family Fare's business depended on franchisees like Elsayed. Taken together, Elsayed pleaded joint employer status sufficiently for his FLSA claim to survive judgment on the pleadings.

NLRB Issues Final Rule on Joint-Employer Standard

On February 26, 2020, the National Labor Relations Board issued its final rule defining the standard for a "joint employer" under the National Labor Relations Act. Under the final rule, a business must exert "such substantial direct and immediate control over one or more essential terms or conditions of their employment as would warrant finding that the entity meaningfully affects matters relating to the employment relationship with those employees." The rule further provides that the "essential terms and conditions" of employment consist solely of the following enumerated list: wages, benefits, hours of work, hiring, discharge, discipline, and direction. This list is intended to be exhaustive, and other terms and conditions are not considered "essential." Evidence of indirect control or contractually reserved control may be considered, but only to the extent that it may supplement or reinforce evidence of direct and immediate control over a particular essential term and condition of employment.

This final rule is significant because it represents a return to the analytical framework that defined the joint-employer standard prior to the landmark 2015 federal decision in *Browning-Ferris Industries, Inc.*, 362 NLRB 1599, 1600 (2015), *affd. in part, reversed in part and remanded* 911 F.3d 1195 (D.C. Cir. 2018). Under *Browning-Ferris*, an entity's ability to exercise actual or potential control, including indirect control or contractually-reserved control, could be sufficient to warrant a finding of joint-employer status. The *Browning-Ferris* standard was substantially broader than the standard implemented under the final rule. This final rule of the NLRB has been referred to as "business friendly," and praised by some as bringing helpful clarity to the joint-employer analysis.

During the comment period, the NLRB received nearly 29,000 comments on the proposed rule. The effective date of the new rule is April 27, 2020, subject to congressional review.

Fraud/Misrepresentation

Illinois Federal Court Concludes that Franchisees are not "Consumers" under the Illinois Consumer Fraud and Deceptive Business Practices Act

A federal court in Illinois held that the Illinois Consumer Fraud and Deceptive Business Practices Act (ICFA) does not apply to a franchise relationship. *Hashmi v. 7-Eleven, Inc.*, 2020 WL 586822 (N.D. Ill. Feb. 2, 2020). Hashmi became a 7-Eleven franchisee in 1997 and quickly increased his involvement in the system, eventually becoming Vice President of the Franchise Coalition. In response to changes 7-Eleven was making, Hashmi began to publicly criticize 7-Eleven. Not long after Hashmi began his public campaign against it, 7-Eleven refused to renew his lease for one of his locations in Illinois and refused to authorize a transfer. Hashmi initially brought a lawsuit under the Illinois Franchise Act, but because his claim was untimely under the statute of limitations, Hashmi brought a claim under ICFA, alleging that 7-Eleven's conduct was retaliatory and an unfair business practice.

The court dismissed Hashmi's complaint on the threshold question of who can sue under the ICFA. The statute permits "any person who suffers actual damage" to bring a lawsuit under the ICFA, and courts have interpreted this to require a plaintiff to make a "showing of consumer injury," because the law only governs consumer transactions. To qualify as a consumer, a plaintiff must purchase or contract for the purchase of merchandise for his use, and not for resale. Hashmi argued that the purchase of the lease and services from 7-Eleven under the franchise agreement was a consumer purchase under the ICFA. The court was unconvinced and instead held that a business purchaser is not a consumer because the purchases, such as the lease, financing and retail agreements, or franchise agreements, were necessary prerequisites for his business. Because 7-Eleven's denial of the lease did not make Hashmi a "consumer" under the ICFA, the court granted 7-Eleven's motion to dismiss.

Damages

Franchisee's Misrepresentation Claims Barred by Economic Loss Doctrine

A Wisconsin federal court has dismissed common law misrepresentation claims against a franchisor because the franchisee's claims were barred by the economic loss doctrine. *Falk v. Wheeler*, 2020 WL 759180 (E.D. Wis. Feb. 13, 2020). This dispute arose from a franchise relationship between plaintiffs and Indoor War, LLC, a franchisor of laser tag facilities. After purchasing more than $500,000 worth of equipment from Indoor War — much of which failed to arrive — the plaintiffs brought suit to recover the amount they invested in the Indoor War franchise. The plaintiffs alleged that Indoor War misrepresented the financial performance of certain Indoor War franchises and made other misrepresentations about the manuals, supplies, and extent of training that they would receive with their purchase. Indoor War moved to dismiss these claims, arguing that they were barred by Wisconsin's economic loss doctrine.

The court agreed. Under Wisconsin's economic loss doctrine, transacting parties may only pursue their contractual remedies when asserting a claim for "economic loss" — damages resulting from a product failing in its intended use or failing to live up to a contracting party's expectations. Here, the court found that the plaintiffs' alleged losses, i.e., the funds they invested in the Indoor War franchise, were purely economic because they arose from the franchise's failure to meet the plaintiffs' expectations. Because the

plaintiffs had the ability to allocate risks arising from the franchise relationship in the contract, the court determined they could not recover any resulting damages under tort law.

The court declined, however, to dismiss the plaintiffs' claims under the Wisconsin Franchise Investment Law and Deceptive Trade Practices Act arising from the same purported misrepresentations. Indoor War argued that these claims were barred by applicable statutes of limitations because they were based on communications made prior to April 20, 2016 (three years before the plaintiffs filed the complaint). While both statutes have a three-year limitations period, the court determined that the Franchise Investment Law's limitations period is triggered by the sale of the franchise. Because the franchise sale occurred within the three-year period, any misleading communications that occurred before the sale could be used as the basis for the claim. However, because the limitations period for the Deceptive Trade Practices Act is the date of the alleged misrepresentation, the court limited those statutory claims to misrepresentations made on or after April 20, 2016.

Choice of Forum/Venue

Delaware Federal Court Declines to Dismiss Hotel Guest's Claims Against Franchisor Based on Alleged Sexual Assault at Turkish Hotel

A hotel guest has sued a Turkish franchisee and several Wyndham entities in Delaware federal court, alleging she was sexually assaulted during her stay at a franchised Wyndham hotel in Istanbul. *Roe v. Wyndham Worldwide, Inc.*, 2020 WL 707371 (D. Del. Feb. 12, 2020). The Wyndham defendants moved to dismiss the negligence and vicarious liability claims against them, arguing both that that the doctrine of *forum nonconveniens* barred litigation in the United States and that the guest had failed to state a valid claim against them. The court denied both grounds for dismissal.

In evaluating the Wyndham defendants' *forum nonconveniens* argument, the court considered four factors: (1) the availability of an adequate alternative forum, (2) the amount of deference to be afforded to the plaintiff's choice of forum, (3) the balance of private interest factors, and (4) the balance of public interest factors. The court agreed that the Wyndham defendants had established — through the affidavit of a Turkish attorney — that Turkey was both an available and adequate forum. The court also found that the balance of private interest factors weighed in favor of dismissal and public interest factors weighed "marginally" in favor of dismissal. For example, the court found that the ease of access to sources of proof, the practical problem that some of the foreign defendants were not subject to the court's jurisdiction, and the burdens associated with resolving conflict of law issues and applying foreign law weighed in favor of dismissal. The court held, however, that the Wyndham defendants' showing, together, was still not enough to overcome the strong deference afforded to a plaintiff's choice of forum.

The court also denied the Wyndham defendants' motion to dismiss for failure to state a claim because the court could not resolve on a motion to dismiss the parties' factual dispute over whether the Wyndham defendants had the requisite degree of control over the franchise to establish liability. The court did, however, dismiss claims against the Turkish franchisee and the UK-based Wyndham franchisor entity because the court lacked personal jurisdiction over the claims alleged against them.

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