

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*. Below are summaries of recent legal developments of interest to franchisors.

Post-Termination Injunction: Noncompete Covenants

California Federal Court Enforces Noncompete Against Former Franchisee

A federal court in California granted a franchisor's motion for a preliminary injunction against a former franchisee alleged to have misappropriated trade secrets and breached a noncompetition provision related to the continued operation of a formerly franchised restaurant. *Bambu Franchising, LLC v. Nguyen*, 2021 WL 1839664 (N.D. Cal. May 7, 2021). Bambu licenses the operation of restaurants that sell Vietnamese beverages utilizing confidential recipes. After the sale of Bambu to the current owner, the original owner, Jenny Nguyen and her company Bambu Delight Hostetter, Inc., continued to operate a Bambu location under the terms of a franchise agreement. Nguyen ultimately, without the approval of Bambu, transferred management of her franchise to Phu Tien Vu. After Bambu decided not to renew the Hostetter franchise agreement, Vu's company, Lyche, Inc., began operating the location as a competing store. Bambu filed suit and sought an injunction against Nguyen, Hostetter, Vu, and Lyche, alleging trade secret misappropriation and violations of the noncompetition provision in the franchise agreement.

In opposing the preliminary injunction, the defendants contended that (1) Bambu's recipes did not constitute protectible trade secrets as Bambu failed to take reasonable efforts to maintain their secrecy; (2) Bambu lacked direct evidence of Lyche's use of the recipes; (3) neither Vu nor Lyche were bound by the noncompete provision in the franchise agreement; and (4) Lyche and Vu, not Nguyen, were operating the location. The court disagreed. First, the court found strong evidence of the recipes' status as trade secrets in the terms of the franchise agreement and the confidentiality provisions entered into by Bambu's franchisees and their employees. Second, the court found strong circumstantial evidence of misappropriation in Vu's unauthorized management of the location and Lyche's subsequent ownership and ongoing operation of the location. Third, the court found that Lyche and Vu contractually assumed the obligations of Hostetter under the noncompetition provision through Lyche's purchase of Hostetter. Finally, the court found that as a result of Vu's position at Hostetter, Vu's activities were attributable to Hostetter; therefore, although Nguyen had not violated the noncompetition provision, Hostetter had. Although the court recognized that California statute 16600 restricts enforcement of some types of

noncompetition provisions, it noted that statute created exceptions meant to prevent unfair competition, which permitted the noncompete in this case. As a result, the court granted the preliminary injunction.

New Jersey Federal Court Grants Franchisor Preliminary Injunction to Stop Franchisee's Breach of Post-Termination Covenants

A federal court in New Jersey granted the franchisor Jackson Hewitt a preliminary injunction enjoining a franchisee from violating the franchise agreement's post-termination covenants. *Jackson Hewitt Inc. v. Njoku*, 2021 WL 1827277 (D.N.J. May 6, 2021). Njoku was a Jackson Hewitt franchisee, but Jackson Hewitt terminated the franchise agreement after determining that Njoku underreported his revenue. Under the franchise agreement's post-termination provisions, Njoku was bound by noncompetition and nonsolicitation covenants. When Jackson Hewitt discovered that Njoku had failed to comply with those post-termination covenants, it sued Njoku and sought a preliminary injunction.

In response, Njoku first argued that the franchise agreement was invalid because it contained an illegal resale price maintenance provision, which rendered his subsequent breaches of the post-termination covenants moot. The court disagreed, finding that the average fee provision at issue was only applied to those returns for which Njoku failed to provide sufficient revenue information, which did not constitute illegal resale price maintenance. Because the franchise agreement was enforceable, the court found that Jackson Hewitt was likely to succeed in showing that Njoku had breached the post-termination covenants by operating a competing business within a ten-mile radius of his former Jackson Hewitt office and soliciting his former clients. Despite these breaches, Njoku argued that a preliminary injunction would be improper because Jackson Hewitt's delay of over one year in seeking an injunction demonstrated a lack of irreparable injury. Again, the court disagreed, holding that Jackson Hewitt only delayed because it believed Njoku was complying with its post-termination covenants and, once the breaches were discovered, Jackson Hewitt immediately brought suit. Irreparable harm did exist, according to the court, because Njoku's operation would impede Jackson Hewitt's ability to transition Njoku's customers to one of its nearby locations. Although the court determined that a preliminary injunction would not cause Njoku to suffer significant harm, it found that many of Njoku's customers would suffer harm because of the proximity to the extended IRS filing deadline. Accordingly, the court granted the preliminary injunction but allowed Njoku to finish filing on behalf of his customers whose returns had to be filed by the IRS deadline.

Disqualification/Practice of Franchise Law

Virginia Federal Court Permits Franchisor's Former In-House Counsel to Represent Area Developers in Dispute with Franchisor

A federal court in Virginia denied a franchisor's motion to disqualify its former in-house counsel from representing two area developers in a lawsuit that was not "substantially related" to the work the lawyer had performed for the franchisor. *Road King Dev., Inc. v. JTH Tax, LLC*, 2021 WL 2003549 (E.D. Va. May 19, 2021). JTH Tax, franchisor of the Liberty Tax franchise system, uses area developers to support franchisees as part of its business model. Attorney Christopher Davis spent six years working in JTH's in-house litigation team, ending in 2013. Davis's responsibilities included enforcing JTH's area development agreements and dealing with franchisee royalty issues, and he was generally privy to JTH's litigation strategies. Seven years after he left JTH, two Texas Liberty Tax area developers retained him to represent them in a lawsuit against JTH involving their development agreement renewal and royalties allocation. JTH moved to disqualify Davis.

JTH argued that Davis should be disqualified because his in-house work was “substantially related” to the area developers’ lawsuit. The developers offered a contrasting depiction of Davis’s work for JTH, asserting that he primarily worked on franchisee post-termination obligations and covenants against competition. The court largely accepted JTH’s characterization of the work, but nevertheless concluded that it was not “substantially related” to the suit at hand. While Davis’s work for JTH involved disputes with area developers, it did not involve the area developers in the lawsuit. Those developers began working with JTH after Davis had left his employment with JTH, and the disputes at issue in the lawsuit first arose in the 2019-2020 period. The court concluded that Davis’s general familiarity with JTH’s litigation strategies in prior years did not make him privy to confidential information in a substantially related matter sufficient to support Davis’s disqualification.

Standing

Franchisee Association Suit Against Franchisor Dismissed for Lack of Standing

A franchisee association’s claims against a franchisor, brought on behalf of the association’s franchisee-members, were summarily dismissed because the court decided that the association “simply [was] not in as good a position” as the individual franchisees to present the subtleties of the claims. *APFA Inc. v. UATP Mgmt., LLC*, 2021 WL 1814695 (N.D. Tex. May 6, 2021). UATP is the franchisor of the Urban Air franchise system, which has nearly 200 locations across the United States. The Adventure Park Franchisee Association (APFA) represents more than 50 Urban Air franchisees. Between 2016 and 2020, UATP implemented various changes to the franchise system, including an increased royalty fee, removal of the development fund fee, and the addition of a membership program and new fees. APFA alleged that UATP unlawfully identified new designated vendors, received rebates from those vendors, and engaged in financing that was not properly disclosed in the FDD. The association brought suit in New Jersey federal court against UATP for alleged violation of Texas and New Jersey laws, breach of contract, and breach of good faith and fair dealing, and sought a declaratory judgment and injunctive relief. UATP successfully moved to have the litigation transferred to the Northern District of Texas because of a forum selection clause, and then brought a motion to dismiss all of APFA’s claims on the grounds that APFA lacked standing to bring the lawsuit.

The court agreed and dismissed the association’s claims. When considering whether an association has standing to bring suit on behalf of its members, the association must show that (1) the members have standing to sue in their own right, (2) the interests the association is seeking to protect are part of the association’s mission, and (3) neither the claims asserted, nor the relief requested, requires the participation of the individual members. To satisfy the first prong, courts have held that an association only has to show that one member has standing, which APFA was easily able to satisfy. APFA also satisfied the second prong by showing that their organization’s goal was to protect and preserve the rights of the Urban Air franchisees. To satisfy the third prong, the courts held that an association must demonstrate its “claims can be proven by evidence from representative injured members, without a fact intensive-individual inquiry.” The court held that APFA was not in the best position to present the subtleties of its members’ contract and tort claims and that APFA failed to show how it would argue its claims without its individual members’ participation. Therefore, APFA did not have standing and the court dismissed its lawsuit.

Tortious Interference

New Hampshire Federal Court Rules that Franchise Agreement Does Not Excuse Franchisor from Tortious Interference with Franchisee's Third-Party Contracts

A federal court in New Hampshire recently denied franchisor Planet Fitness's motion for judgment on the pleadings that it did not tortiously interfere with the prospective contracts of one of its franchisees. *Planet Fitness Int'l Franchise v. JEG-United, LLC*, 2021 WL 1946426 (D.N.H. May 14, 2021). In June 2020, Planet Fitness sued its franchisee, JEG-United, which operates five Planet Fitness gyms in Mexico. In response, JEG-United filed a counterclaim alleging that Planet Fitness had intentionally interfered with JEG-United entering into three separate prospective business contracts. Specifically, JEG-United alleged that Planet Fitness intentionally interfered in (1) JEG-United's negotiations with a major retail company to secure potential future gym locations; (2) JEG-United's preliminary partnership agreement with an investor to accelerate the development of gyms in Mexico; and (3) JEG-United's attempted purchase of a competing fitness company's gyms in Mexico. Planet Fitness moved for judgment on the pleadings, asserting it could not legally be found to tortiously interfere with JEG-United's relationships because Planet Fitness was a necessary party to the prospective contracts.

The district court disagreed. It explained that, although Planet Fitness would be a party to any future franchise agreements between itself and JEG-United that resulted from the three contractual relationships, Planet Fitness was not a party to JEG-United's attempts to develop the three business opportunities. JEG-United's negotiation with the retailer was for a lease agreement; JEG-United's dealing with the investor was a preliminary agreement for partnership; and JEG-United's negotiations with the competitor-business was a potential purchase. The fact that Planet Fitness might later have the right to reject any potential franchises borne out of those deals did not make Planet Fitness a party to them. Planet Fitness also alleged that, for JEG-United's tortious interference claim to stand it should have alleged that Planet Fitness acted with malice. However, under New Hampshire law, a plaintiff alleging tortious interference need only plead that a defendant's interference was intentional and improper; the plaintiff does not need to allege that the defendant's actions were motivated by malice. For those reasons, the district court denied Planet Fitness's motion for judgment on the pleadings.

Choice of Forum/Venue

Eighth Circuit Holds Forum Non Conveniens Argument Is Untimely

The Eighth Circuit Court of Appeals reversed a district court's dismissal of a lawsuit against a franchisor based on the doctrine of *forum non conveniens*. *Estate of I.E.H. v. CKE Rests. Holdings, Inc.*, 2021 WL 1653036 (8th Cir. Apr. 28, 2021). A child playing on an indoor playground at a Hardee's restaurant franchise in Amman, Jordan died after being electrocuted from touching an exposed wire. The child's parents sued the franchisor and related entities in Missouri, Hardee's home forum at the time. After the close of discovery and 18 months after the case began, Hardee's moved for dismissal based on the doctrine of *forum non conveniens*, arguing that Jordan was a more suitable forum. The district court agreed and dismissed the lawsuit. The child's parents appealed. The Eighth Circuit determined that Hardee's motion was untimely, reversed the dismissal, and remanded for further proceedings.

In reaching its holding, the Eighth Circuit concluded that Hardee's motion was untimely regardless of whether the court considered timeliness among the many private- and public-interest factors assessed in

a *forum non conveniens* decision, or as an independent hurdle to prevailing on such a motion. The court reasoned that Hardee's knew the relevant facts that supported its motion from the date the complaint was filed yet waited 18 months and until discovery closed to file the motion. The court declined to adopt a specific approach to evaluating the timeliness of motions to dismiss based on *forum non conveniens*, but focused its ruling on three considerations: (1) parties should file these motions at an early stage to promote judicial economy; (2) a party that spends substantial time in a forum betrays its argument that the forum is inconvenient; and, (3) defendants should be discouraged from raising *forum non conveniens* only after they determine that litigation is not proceeding in their favor.

Antitrust

Illinois Federal Court Affirms Exclusion of Plaintiff's Expert Testimony on Certification Motion in Anti-Poaching Class Action

A federal court in Illinois denied reconsideration of its decision to exclude plaintiff's expert testimony in connection with a motion seeking class certification. *Conrad v. Jimmy John's Franchise, LLC*, 2021 WL 1736887 (S.D. Ill. May 3, 2021). Employees and former employees of franchised Jimmy John's restaurants alleged that anti-poaching provisions formerly contained in many franchise agreements constituted an unlawful conspiracy in restraint of trade in violation of Section 1 of the Sherman Antitrust Act. After extensive discovery, plaintiff filed for class certification and both parties submitted expert testimony with respect to whether damages in the form of allegedly suppressed wages could be proven on a class-wide basis. Both sides sought to exclude the opposing side's expert testimony, and in a decision summarized in [Issue 263](#) of The Franchise Memorandum, the court excluded only the testimony of plaintiff's expert. Plaintiff then moved for reconsideration, which the court denied.

Plaintiff failed to meet the high standard for reconsideration. Despite plaintiff's contentions otherwise, the court found that it did not misapprehend plaintiff's expert's report, that new explanations and arguments proffered by plaintiff's expert in a supplemental report were not based on newly discovered evidence, and that interests in finality were promoted by affirming the prior decision. The court therefore affirmed the exclusion of the testimony of plaintiff's expert based on his failure to adopt a reliable method for establishing that purported damages were susceptible to proof on a class-wide basis.

State of Litigation

Join Us for Lathrop GPM's State of Litigation Virtual Event Series

Please join Lathrop GPM for our annual State of Litigation, being held virtually for the second year. This free, three-part webinar and CLE series will explore the latest trends in litigation, risks facing companies today, and how to manage those risks, and will include presentations by Franchise and Distribution Partners Justin Sallis and Katie Bond. A full agenda and registration information is available [here](#).

Along with the attorneys on the next page, litigation associates Brad Johnson, Kristin Stock, and Shoshanah Shanes contributed to this issue.

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On January 1, 2020, Gray Plant Mooty and Lathrop Gage combined to become Lathrop GPM LLP.

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