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.

Damages to Franchisor

Ohio Federal Court Awards Damages to Matco for Breach of Contract, Trademark Infringement, and Misappropriation of Trade Secrets

A federal court in Ohio has granted a franchisor's unopposed motion for summary judgment against a former franchisee, awarding damages for the franchisee's attempt to continue to use Matco's marks and trade secrets after termination. *Matco Tools Corp. v. Urquhart*, 2020 WL 364242 (N.D. Ohio Jan. 22, 2020). In July 2014, Urquhart entered into a distributorship agreement with Matco. In March 2019, Urquhart effectively stopped buying tools from Matco, even though his truck still bore the trademarked Matco logos, and he was still servicing the "List of Calls and Potential Customers" provided to him by Matco. Given Urquhart's purported abandonment of his Matco distributorship, Matco terminated the distributorship. In contravention of the post-termination restrictions contained in the agreement, Urquhart continued to sell non-Matco tools to the customers on the List of Calls provided to him by Matco, and to use Matco's marks in the operation of his competing business.

Matco filed suit for breach of the post-termination obligations, federal trademark infringement, and misappropriation of trade secrets. The court found that Matco was entitled to judgment as a matter of law on all three counts. The court held that there was no genuine issue of material fact as to whether Urquhart breached the nonsolicitation covenant in the agreement by continuing to call on Matco customers after the agreement was terminated. The court also found that Urquhart's continued, post-termination use of the Matco marks while operating his competing business caused customer confusion and constituted trademark infringement. Finally, the court found that Matco's List of Calls contained trade secrets entitled to protection under Ohio law. Because the record demonstrated that Urquhart relied on these trade secrets when he continued to call on Matco customers without Matco's permission, Matco was also entitled to judgment as a matter of law on that count. The court granted Matco's summary

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judgment motion in all respects with leave for Matco to file a petition for costs and attorney's fees under the contract. Lathrop GPM served as counsel for Matco in this action.

Employment

Federal Court Declines to Retroactively Apply Oklahoma Law that Specifies a Franchisor is Not an Employer of its Franchisees' Employees

A federal court in New Jersey partially denied franchisor Jackson Hewitt Tax Service's motion to dismiss, allowing claims to proceed that allege Jackson Hewitt was an employer of certain of its franchisees' employees. *Mardis v. Jackson Hewitt Tax Service, Inc.*, 2019 WL 7207551 (D.N.J. Dec. 26, 2019). In so holding, the court disagreed with Jackson Hewitt's arguments that Oklahoma statute § 59-6005(B) and (C) — which expressly states that "[a] franchisor shall not be considered the employer of a franchisee or a franchisee's employees" — should be applied retroactively.

The plaintiffs were tax preparers employed at franchised Jackson Hewitt outlets who claimed that Jackson Hewitt was their employer, as defined under the Oklahoma Protection of Labor Act. The plaintiffs claimed that Jackson Hewitt had violated that law by failing to pay them certain earned commissions that constituted wages under the law. Jackson Hewitt moved to dismiss those claims, arguing that it could not be the plaintiffs' employer under Oklahoma statute § 59-6005. The effective date of § 59-6005 was November 1, 2016, and the majority of the plaintiffs' claims arose before that date. The plaintiffs essentially conceded that the claims that arose after November 1, 2016 were precluded by Oklahoma statute § 59-6005, but argued that the law did not apply to claims arising before that date. The court agreed. It found that Oklahoma laws operate only prospectively unless there is clear legislative intent to the contrary. The court was unable to discern any intent by the Oklahoma legislature to make the statute apply retroactively, although the court did concede that the law was enacted in response to the U.S. Department of Labor's 2016 Opinion letter regarding joint employer standards and the National Labor Relations Board's 2015 *Browning-Ferris* case. It further disagreed with Jackson Hewitt's claim that the Oklahoma statute could be considered a "clarifying amendment" that should be applied retroactively, because it was entirely new legislation that did not serve to amend any prior law. The court therefore permitted the plaintiffs' claims that arose before November 1, 2016 to proceed, and denied Jackson Hewitt's motion to dismiss those claims.

California Federal Court Dismisses Joint Employer Claim Against Chick-Fil-A

In another joint employer claim against a franchisor, a federal court in California has dismissed without prejudice a discrimination complaint filed by a franchisee's former employee proceeding *pro se* against the franchisee, its owners, and the franchisor. *Stewart v. Chick-fil-A*, 2020 WL 264578 (S.D. Cal. Jan. 17, 2020). Plaintiff Lindsey Stewart is a 62 year-old woman who worked at a Chick-fil-A franchise in California owned by Defendants 3 Little Cows, Inc., Danny Putnam, and Becky Putnam. Stewart's complaint alleged one count of "corporate failure to supervise their franchises against discrimination claim for relief age gender discrimination" and one count of "corporate failure to supervise their franchises claim for relief retaliation for reporting sexual harassment." Chick-fil-A filed a motion to dismiss for failure to state a claim on which relief may be granted, and 3 Little Cows and the Putnams filed a separate motion on the same basis.

Stewart alleged that her employment with 3 Little Cows was terminated after she observed the sexual harassment of others in the workplace and reported this behavior to her supervisors. While her termination also followed negative performance reviews, she maintained that these were mere pretext. The court dismissed Stewart's claims against Chick-fil-A because her complaint contained no specific allegations as to how Chick-fil-A may have jointly employed her. Stewart's opposition to Chick-fil-A's motion to dismiss made reference to a single text message between a Chick-fil-A and a 3 Little Cows employee discussing a 3 Little Cows employee. The message, however, was not described in the complaint and was sent prior to Stewart's employment with 3 Little Cows. The court concluded, therefore, that no allegations in Stewart's complaint supported any cause of action against Chick-fil-A. The court also dismissed the claims against 3 Little Cows and the Putnams, finding that Stewart's complaint failed to allege properly the violation she apparently wanted to pursue, a claim for retaliation under Title VII of the Civil Rights Act of 1964. The court ruled, however, that Stewart would be permitted to amend her complaint.

Settlement

Missouri Federal Court Partially Grants Franchisee's Motion to Enforce Settlement and Awards Attorneys' Fees

A federal court in Missouri has granted in part a franchisee's motion to enforce a settlement agreement and awarded the franchisee its attorneys' fees as the "prevailing party." *Biologix Franchise Marketing Corp. v. Kay Logic*, 2020 WL 33108 (E.D. Mo. Jan. 2, 2020). Biologix and its former franchisee, Kay Logic, entered into a settlement agreement whereby Kay Logic would make monthly installment payments to Biologix. A portion of each installment payment would serve as a credit toward the purchase of Biologix's products, which Kay Logic was permitted to sell without restriction, using the Biologix trademark. After Kay Logic communicated its intention to sell Biologix products on Amazon and requested Biologix's cooperation in creating an Amazon storefront (including providing a trademark registration certificate and safety data sheets meeting Amazon's approval), Biologix verbally informed Kay Logic it could no longer sell products using the Biologix trademark. Kay Logic thereafter moved to "enforce" the settlement agreement seeking (1) termination of the settlement agreement and its payment obligation thereunder, (2) a refund of past payments, (3) attorneys' fees and costs, and (4) damages in the form of its investment costs in the Amazon storefront.

The court found that Biologix breached the settlement agreement by attempting to restrict Kay Logic's use of the Biologix trademark and sale of Biologix products. However, the court found the parties did not reach a meeting of the minds regarding the extent of Biologix's "further assurances" obligation such that Biologix would be required to modify its safety data sheets to support Kay Logic's Amazon fulfillment plans. The court therefore granted specific performance of the settlement agreement to the extent Kay Logic was entitled to use the Biologix trademark to sell Biologix products without restriction. The court found Biologix's conduct did not, however, constitute a default sufficient to excuse the entirety of Kay Logic's remaining debt under the agreement. Despite the narrow relief awarded, which maintained the former franchisee's obligations under the settlement agreement, the court found Kay Logic to be the "prevailing party" and awarded its attorneys' fees.

Terminations

Florida Federal Court Agrees that Tim Hortons Properly Terminated Franchisee for Defaulting on Rent Obligation and Grants Permanent Injunction

A federal court in Florida has held that Tim Hortons had properly terminated a franchise agreement with its former franchisee and was entitled to summary judgment and a permanent injunction against the former franchisee. *Tim Hortons USA, Inc. v. Tims Milner LLC,* No. 18-cv-24152-DPG (S.D. Fla. Jan. 7, 2020). As previously reported in Issue 243 of The GPMemorandum, Tims Milner entered into franchise and lease agreements with Tim Hortons and its affiliates in 2016 to own and operate seven locations in Michigan. The franchise agreements provided that, if Milner defaulted under a lease or failed to pay Tim Hortons any amounts within three days of written notice, Milner would be in default of the agreements. Additionally, Tim Hortons could terminate the franchise agreements if the leases were terminated for any reason. On October 10, 2018, Tim Hortons issued a notice of default to Milner demanding payment for a total of $523,189, which included $292,747 in past due rent. Milner never paid Tim Hortons, so on November 13, 2018, Tim Hortons terminated the franchise agreements and lease agreements. Tim Hortons filed suit and moved for summary judgment on its breach of contract claim, arguing it had properly terminated the franchise agreements. Tim Hortons also sought a permanent injunction against Milner because, despite a June 2019 preliminary injunction it issued against Milner, Milner was still operating six of the seven locations in October 2019.

The court found the following facts were undisputed: (1) Milner owed Tim Hortons and its affiliates past due amounts for royalties and rent, (2) Milner was provided notice of the past due amounts, (3) Milner failed to pay any past due amounts, and (4) Tim Hortons terminated Milner for failure to pay those past due amounts on November 13, 2018. Milner argued, however, that it did not owe any money to Tim Hortons because there was a prior, verbal agreement regarding rent between Milner and a few Tim Hortons employees. Milner also argued that Tim Hortons failed to provide sufficient documentation that Milner owed the amounts Tim Hortons claimed, and Milner argued that it had actually overpaid Tim Hortons. The court held that Milner failed to produce any evidence to support its arguments, and therefore failed to create a question of material fact. The court granted summary judgment on Tim Hortons' breach of contract and Lanham Act claims, and entered a permanent injunction.

Preliminary Injunctions

Federal Court Enjoins Owners of Former Franchisee from Operating Competing Business and Using Franchisor's Confidential Information

A federal court in Michigan granted a franchisor, Liberty Tax, a preliminary injunction against the owners of its former franchisee in *JTH Tax, Inc. v. Magnotte*, 2020 WL 127949 (E.D. Mich. Jan. 10, 2020). On January 16, 2018, after significant defaults, Liberty Tax terminated multiple franchise agreements with franchisee Reliable Income Tax. Liberty's notice of termination reminded Reliable and its owners, the Magnottes, of their post-termination restrictive covenants regarding noncompetition, nonsolicitation, and return of customer information. Despite this, in January 2019, the Magnottes launched "Phoenix Tax" within the restricted territory, actively solicited former clients of Reliable, and failed to return to the franchisor client information and the confidential Liberty Tax Operations Manual. The franchisor brought suit and sought a preliminary injunction against both the Magnottes and Reliable.

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The court granted Liberty's request for injunctive relief against the Magnottes, finding that all four factors the court is required to balance weighed in the franchisor's favor. First, the Magnottes failed to perform their post-termination obligations and violated the legally binding terms of the franchise agreements. Thus, Liberty would be likely to succeed on the merits of its breach of contract claim. Second, the court found that Liberty was suffering an ongoing, irreparable injury due to the Magnottes' violation of the post-termination noncompetition and nonsolicitation covenants, and would continue to do so without injunctive relief. Finally, the court found that the last two factors (the harm to others and the public interest) were satisfied. Preliminary injunctive relief would force the Magnottes to cede an improperly gained competitive advantage and require them to abide by the post-termination restrictive covenants contained in the franchise agreements. The court found that the Magnottes' compliance with their contractual commitments would not cause substantial harm. Further, the court held that enforcing the Magnottes' contractual obligations served the public interest. Thus, for those reasons, the court granted Liberty's request for a preliminary injunction against the Magnottes. The court did not grant the preliminary injunction against Reliable, however, because there was no evidence that Reliable was properly served and no attorney filed an appearance on its behalf.

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

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