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.

Given the widespread and evolving impact of the COVID-19 pandemic, this issue also includes current developments and resources related to COVID-19.

Tortious Interference

Fourth Circuit Vacates Dismissal of Claims that Franchisor Tortiously Interfered with the Business Relationship of its Franchisees

The Fourth Circuit Court of Appeals has vacated a judgment dismissing claims that Mid-Atlantic Restaurant Corporation (owner of the Smithfield's Chicken 'N Bar-B-Q franchise system) interfered with the business relationship between owners of certain of its franchisees. *Musselwhite. v. Mid-Atlantic Restaurant Corp.*, 2020 WL 1873330 (4th Cir. Apr. 15, 2020). In the underlying action, Musselwhite, a part-owner of several Smithfield's Chicken 'N Bar-B-Q franchisees, alleged that Mid-Atlantic wrongfully interfered with the business relationship between Musselwhite and his longtime business partner, Brian Cheshire, by inducing Cheshire to execute a Buyout Agreement with Musselwhite, divesting Musselwhite of his interest in a company leasing property to several franchise locations. A federal district court in North Carolina had dismissed the claims, but the Fourth Circuit vacated and remanded the judgment, concluding that the district court misapplied the doctrine of collateral estoppel and improperly relied on the findings of fact in a state court judgment dismissing similar claims.

The district court had concluded a state-judgment conclusively established that Mid-Atlantic lacked malice and, therefore, Musselwhite was collaterally estopped from bringing his claim for tortious interference against Mid-Atlantic. The Fourth Circuit disagreed, finding that the issue of Mid-Atlantic's alleged malice had not been adjudicated by the state court in the course of rejecting Musselwhite's claim of fraud. Mid-Atlantic also contended that, because the state court found Musselwhite was derelict in his obligations under his franchise agreements with Mid-Atlantic, Mid-Atlantic had a legitimate business reason to act as it did. The Fourth Circuit found this argument unpersuasive because these findings were not "necessary and essential" to the state court's judgment, which would be required to invoke collateral estoppel. The Fourth Circuit similarly found errors in the District Court's conclusion that other claims had been released, and vacated the judgment and remanded for further proceedings.

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Arbitration

Connecticut Federal Court Denies Motion to Compel Arbitration in TCPA Class Action Brought by Subway Customers

A federal court in Connecticut has ruled that Subway customers can pursue class action claims against the company for unwanted text messages in violation of the Telephone Consumer Protection Act (TCPA). *Soliman v. Subway Franchisee Advertising Fund Trust Ltd.*, 2020 WL 161328 (D. Conn. Mar. 5, 2020). Named-plaintiff Marina Soliman, along with other Subway customers, alleges that, upon entering a Subway restaurant, a Subway employee informed her of a promotion whereby customers could sign up for text messages to receive discounts and other promotional information from Subway. Although Soliman did want an initial discount, she continued to receive text messages even after attempting to opt out of the text message program. After Soliman brought suit, Subway argued that she had agreed to certain terms and conditions in order to enter the program, including an agreement to arbitrate any claim arising out of the promotional texting program.

The court denied Subway's motion to compel arbitration. The standard governing the enforceability of the arbitration provision required both that Soliman received reasonable, conspicuous notice of the terms and unambiguously manifested assent to those terms. The court found neither in this case, focusing on a series of obstacles Soliman would have had to overcome to receive notice of and agree to the provision. First, according to the court, the small font of the arbitration terms was dwarfed in comparison to the other colorful text and images surrounding them. Second, the court held that the immediately preceding language, indicating that consent was not required to buy goods and services, undercut Subway's position that the plaintiffs had given their consent to arbitrate claims. Third, in order to see all the terms of the arbitration provision, Soliman would have had to type a long, tiny URL into a browser. If Soliman managed to go to that website, she would have had to understand that the language at the top of the web page, which said "FOR THIS WEBSITE," applied not only to the website, but also to the promotional text message program. Lastly, Soliman would have needed to scroll down two to three pages to find the arbitration provision. The court held that in light of these facts, the plaintiffs neither received fair notice, nor assented to the arbitration provision. Thus, the arbitration provision was unenforceable.

Federal Court Grants Stay of Employee Misclassification Suit Brought by Janitorial Services Franchisees and Compels Arbitration

In another putative class action in Connecticut, a federal court declined to dismiss an employee misclassification lawsuit against Coverall North America, Inc., a janitorial services franchisor, but agreed to stay the action and compel arbitration. *Bille v. Coverall N. Am., Inc.*, 2020 WL 1185251 (D. Conn. Mar. 11, 2020). Plaintiffs Caribe Billie and Quincy Reeves, both Coverall franchisees, alleged that Coverall had misclassified them as independent contractors and withheld portions of their wages in violation of Connecticut law. Coverall sought to dismiss the case, in part, for lack of personal jurisdiction or for failure to state a claim. Alternatively, Coverall sought to stay the action and compel arbitration. The court declined to dismiss the suit for lack of personal jurisdiction or for failure to state a claim, but it granted Coverall's request for a stay and motion to compel arbitration.

In arguing that the court should not exercise personal jurisdiction over Coverall, the company first argued that it was not subject to Connecticut's long arm statute because it was not a party to the Coverall franchise agreements that the franchisee-plaintiffs had signed. Rather, those Coverall franchises were granted by a master franchisee of Coverall to the franchisees. However, the court found that the long arm

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statute nonetheless reached Coverall because it derived significant benefits from the agreements, both due to the control that Coverall exercised over the franchisees as well as the fees that franchisees paid to Coverall. In addition, Coverall's contacts to Connecticut included providing support and services to franchisees in Connecticut (including through in-person visits) and maintaining an interactive website that offered services in Connecticut, among others. These contacts were sufficient to satisfy the requirements of due process.

Despite declining to dismiss the case, the court ultimately found that a stay was required because of the parties' arbitration agreement. The franchisees sought to avoid arbitration, arguing that the arbitration provision in the parties' agreements was procedurally and substantively unconscionable. The court disagreed, finding that the franchisees' claims regarding the adhesive nature of the contract or unequal bargaining power were insufficient, and that the arbitration clause — which was written in bold, capital letters — was not "obscure and buried," as the franchisees alleged. The court further found insufficient evidence that the cost-splitting provision, provision that assigned attorneys' fees to the prevailing party, or the confidentiality provision were substantively unconscionable. The court found that there was a lack of case law to support these claims and, further, a lack of evidence in the record to demonstrate, for instance, that the costs would be exorbitant or that the plaintiffs lacked the ability to pay. The court further held that inclusion of the confidentiality provision, which applied equally to the plaintiff and defendant, was not unilateral and was supported by existing case law. The court therefore issued a stay and administratively closed (but did not dismiss) the case pending the outcome of arbitration.

Injunctive Relief

Maryland Federal Court Awards Franchisor Permanent Injunction and Attorneys' Fees as Part of Default Judgment Against Holdover Franchisee

A federal court in Maryland recently granted a franchisor default judgment and awarded it a permanent injunction and attorneys' fees under the Lanham Act, against a holdover franchisee that failed to respond to a lawsuit. *ICENY USA, LLC v. M&M's LLC*, 2020 WL 1890511 (D. Md. Apr. 16, 2020). ICENY is the franchisor of Thai ice cream roll shops, and M&M was an ICENY franchisee in Yuma, Arizona. ICENY terminated the franchise agreement after M&M failed to pay various required fees. Following termination, M&M did not comply with its post-termination obligations, and ICENY filed suit in Maryland seeking an injunction enforcing the post-termination obligations and damages. Despite properly serving all defendants, M&M and its co-defendants did not respond to the complaint or any motions and continued to operate the formerly franchised business, even after the court ordered it to stop.

ICENY moved for a default judgment requesting, among other remedies, a permanent injunction and attorneys' fees. The court granted the default judgment, determining that M&M's breach of the franchise agreement's bar on post-termination use of ICENY's intellectual property, trademark infringement, and breach of the noncompete caused irreparable harm not fairly redressed by monetary damages, and that the balance of the hardships and public interest favored an injunction. The court also ordered M&M to pay ICENY's attorneys' fees and costs under the Lanham Act's fee-shifting provision, finding that M&M's conduct was so objectively unreasonable that it rendered the case "exceptional," as required to collect attorneys' fees under the Act.

Federal Court Enjoins Terminated Franchisee from Violating Restrictive Covenants, but Declines to Enforce Bond-Waiver in Franchise Agreement

A federal court in Washington has granted a preliminary injunction against a terminated tax preparation services franchisee, preventing it from operating a competing business and soliciting the franchisor's customers. *JTH Tax LLC (d/b/a Liberty Tax Service) v. McHugh*, 2020 WL 1689731 (W.D. Wash. Apr. 7, 2020). Plaintiffs Liberty Tax Service and SiempreTax+ operate thousands of tax preparation service centers nationally. Defendant Lorraine McHugh entered into a Liberty Tax Franchise Agreement in 2015, and ultimately operated the franchise through her business KVC. By spring 2019, McHugh had effectively abandoned the franchise and her Franchise Agreement was terminated by Liberty Tax. After termination, Liberty Tax discovered that McHugh was running a competing tax preparation service through KVC and soliciting former Liberty Tax customers in violation of the post-termination covenants in her Franchise Agreement. Liberty Tax filed suit and sought an injunction to enforce McHugh's Franchise Agreement and prevent her from further unlawful competition and solicitation of its customers.

The court concluded that McHugh likely breached or intended to breach valid and enforceable noncompetition, nonsolicitation, and nondisclosure agreements by operating a competing tax business within 25 miles of the former franchise and soliciting former franchise customers. The court concluded that the noncompetition provisions in the franchise agreement were appropriately limited in time and geography. Moreover, the provisions were not barred by Washington's recent anti-noncompete law, which went into effect on January 1, 2020, because they were contained in a franchise agreement rather than an employment contract. Liberty Tax made a sufficient showing of irreparable harm by arguing that McHugh's actions risked a loss of customer goodwill and damage to the franchise system, and the court concluded that the balance of harms and likelihood of customer confusion weighed in favor of equitable relief. Although the franchise agreement also provided a bond-waiver for injunctive relief, the court was not convinced that such a waiver was enforceable and therefore set a bond at $100,000 to protect against the potential harm from the injunction if it were determined that McHugh was wrongfully enjoined.

Fraud/Misrepresentation

Missouri Federal Court Grants in Part and Denies in Part a Motion to Dismiss Fraud Allegations, but Creates Uphill Battle for Franchisee to Establish Reliance

A federal court in Missouri has held that a franchisee's fraud claim cannot be based upon the franchisor's alleged prediction of future success at a franchise expo, but allowed other fraud claims to be re-pled while questioning the likelihood that the franchisee will successfully demonstrate reasonable reliance. *Fabius v. Medinexo USA, LLC*, 2020 WL 1666468 (E.D. Mo. April 3, 2020). Fabius, a franchisee of the Medinexo franchise system, alleged that Medinexo made several oral and written financial performance representations outside of the FDD, both at a franchise expo and during the sales process, which falsely projected his future success as a franchisee. Such statements included estimates regarding the amount Fabius would earn during the first two years, and a budget analysis with earnings projections attached to the franchise agreement. Fabius brought suit against Medinexo claiming, in part, fraud in the inducement. Medinexo moved to dismiss.

The court dismissed the fraud claim without prejudice, holding that the oral predictions of future success are not misrepresentations of past or existing facts, and therefore could not support a fraud claim. The court also found such statements to be mere puffery because Medinexo allegedly made these statements

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at the expo without knowing Fabius's background, experience, or expected level of investment. However, the court granted leave to permit Fabius to amend his complaint to add specificity for its other claims of fraud, but signaled that it may be difficult for Fabius to demonstrate reliance on such statements. The fact that, prior to signing the franchise agreement, Fabius had experience in the relevant industry, conducted due diligence on the system, had an attorney review the FDD, and signed the franchise agreement — despite concerns about Medinexo's lack of historical data — all seemed to weigh against Fabius in the eyes of the court. Nevertheless, the court concluded that fact questions remained on the issue of reliance, and ruled that this element would not require dismissal if Fabius amended his complaint to state with particularity which misrepresentations were attributable to each defendant.

Americans with Disabilities Act

Federal Court Dismisses ADA Claims Against Franchisor Because the Complaint Failed to Demonstrate the Franchisor Caused the Injury

A federal court in North Carolina has granted a quick-service restaurant franchisor's motion to dismiss allegations that it violated the Americans with Disabilities Act (ADA). *Chapman v. CKE Rests. Holdings, Inc.*, 2020 WL 1230130 (E.D.N.C. March 12, 2020). Chapman, a quadriplegic, alleged that CKE violated the ADA by denying her full and equal access to one of its restaurants where "she experienced unnecessary difficulty and risk due to excessive slopes in a purportedly accessible parking area." Chapman alleged that she desires to return to that restaurant in the future, but is deterred by CKE's non-compliance with the ADA. Chapman also alleged that CKE employed "centralized policies, practices, and procedures with regard to the design, construction, alteration, maintenance and operation of their facilities," and that, as a result of these centralized policies and practices, CKE had "systematically and routinely violated the ADA by designing, constructing, and altering facilities so that they are not readily accessible and usable, by failing to remove architectural barriers, and by failing to maintain and operate facilities so that the accessible features of [CKE's] facilities are maintained." Chapman sought a declaratory judgment, a permanent injunction, class certification, payment of the costs of suit, and reasonable attorneys' fees. CKE moved to dismiss the case for lack of standing.

The court held that Chapman lacked standing to bring the action because she failed to allege either that CKE itself had caused her injury or that CKE was the proper party to remedy that injury. The court found that Chapman had failed to adequately allege causation because she failed to allege facts showing (1) that CKE — rather than a third party, such as a franchisee — controlled the premises at issue or (2) that any "excessive sloping" at the premises was the result of any CKE policy or lack thereof. For the same reasons, the court found Chapman had failed to allege sufficient facts to show that CKE was in a position to remedy the alleged harm. Accordingly, the court dismissed the complaint without prejudice.

Choice of Forum

Michigan Federal Court Enforces Choice of Minnesota Forum

A federal court in Michigan recently dismissed a complaint filed by a distributor against its former manufacturer, rejecting the application of Michigan franchise laws and enforcing the choice of a Minnesota forum in the agreements between the parties. *Lakeside Surfaces, Inc. v. Cambria Co.*, 2020 WL 1227047 (W.D. Mich. Mar. 13, 2020). Lakeside is a Michigan countertop distributor; Cambria is a

Minnesota manufacturer of countertops. Cambria unilaterally terminated the relationship between the two over a disagreement concerning Lakeside's offering of non-Cambria products. When Lakeside sued Cambria in Michigan, Cambria moved to dismiss the complaint based upon the forum selection clauses in the parties' agreements. Lakeside responded that Michigan law invalidated the forum selection clause.

First, the court held that, under Sixth Circuit precedent, forum selection clauses are procedural and therefore subject to federal law, which generally supports the enforcement of forum selection clauses. The court was not persuaded by the argument that the Michigan Franchise Investment Law invalidated the forum selection clause as contrary to a strong public policy of Michigan. The court noted that the parties' agreements contained a Minnesota choice of law provision, which the court determined violates no Michigan public policy, since the Minnesota Franchise Act (MFA) provides slightly more protection to franchisees than the Michigan franchise law. Michigan law does not prohibit parties from choosing another state's law to govern their franchise agreements, and Minnesota law does not prohibit forum-selection clauses. Finally, the court considered the possibility that the application of Minnesota law to Cambria's offer of a distributorship would deprive Lakeside of the protection of the Michigan law governing the offer and sale of franchises — since some courts have held that the protections of the MFA do not extend to franchisees located outside of Minnesota. The court rejected this argument, concluding that the text of the MFA "suggests that it applies to out-of-state franchisees, and no Minnesota state court has held otherwise." It cited to a 2018 Minnesota state court decision permitting claims by a Pennsylvania distributor against Cambria to proceed under the MFA. Based upon that decision, Lakeside requested leave to amend its complaint against Cambria to add claims under the MFA. The court denied this request and ultimately dismissed Lakeside's complaint, ruling that it must pursue its claims in Minnesota in accordance with the forum selection clauses contained in the parties' agreements.

COVID-19 Pandemic

COVID-19 Resources for Franchisors and Distributors

Lathrop GPM continues to provide clients with alerts, articles, and other resources to help clients navigate important legal information regarding the COVID-19 pandemic. Some of the following may be of particular interest to franchisors and distribution-based businesses:

- **Employment Alert**: Opening for Business? Issues for Employers by Brian Woolley and Megan Anderson
- **CARES ACT Update**: More Money More Problems? The Sequel: Should My Company Return The Money It Received from the CARES Act? by Susan Gaertner, Jackson Hobbs and Daryn McBeth
- **Litigation Alert**: COVID-19 Leads to New Class Actions by Brian Fries and Richard Bien
- **Upcoming Webinar**: Guidance for Employers on Reopening and Returning to Work by Megan Anderson, Mark Mathison, Bridget Romero, and Brian Woolley. **Tuesday, May 12, 2020, 12:00-1:00 p.m. CDT**

These updates and resources from Lathrop GPM's cross-disciplinary team are available at the **Lathrop GPM COVID-19 Client Resource website**.

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For more information on our Franchise and Distribution practice and for recent back issues of this publication, visit the Franchise and Distribution Practice Group at **https://www.lathropgpm.com/services-practices-Franchise-Distribution.html**.

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

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