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. Since December 1997, The GPMemorandum has been presenting summaries of recent legal developments of interest to franchisors and companies that use distributors and dealers. We have new formatting and a new name, but The Franchise Memorandum by Lathrop GPM will continue providing timely and informative legal updates to our franchise and distribution clients and friends.

Employment

NLRB Directs Judge to Approve Settlements in McDonald's Case Even Though They Do Not Impose Joint Employer Liability

The National Labor Relations Board (NLRB) has vacated a decision by an administrative law judge (ALJ) denying the settlement agreements that had been proposed to resolve complaints against McDonald's USA LLC, McDonald's Restaurants of Illinois, Inc., and 29 McDonald's franchisees alleging various unfair labor practices violations. *McDonald's USA LLC*, 368 NLRB No. 134 (2019). The NLRB's decision upheld the parties' settlement agreements even though they do not impose joint employer liability on the franchisor as had been sought in the complaints.

The highly publicized complaints, filed in 2012, claimed that McDonald's and the franchisees had threatened, interrogated, and surveilled employees, and unlawfully suspended and discharged employees in retaliation against those employees' involvement in the Fight for $15 campaign by fast food workers for higher wages. According to the complaints, McDonald's was liable as a joint employer of those employees due to its control over the franchisees' labor relations policies. After many months of trial, the NLRB General Counsel, McDonald's and the franchisees entered into settlement agreements that provided for various remedies, including back pay, restoration of hours and other working conditions, rescission of alleged unlawful rules, expungement of discipline and discharges, notice provisions, and a settlement fund for victims of future complaints, among others.

The ALJ denied a motion to approve the settlement agreements, in part because they were concluded just as the long trial was ending and because they did not acknowledge that McDonald's was a joint employer with its franchisees. The NLRB disagreed and concluded that the settlement agreements were reasonable, that they provide a full remedy to all affected employees, and that accepting the settlement agreements would serve the policies underlying the Act as well as the Board's longstanding policy of encouraging the amicable resolution of disputes. The NLRB remanded with instructions to approve the settlements. The decision does not ultimately determine whether or under what conditions a franchisor could or could not be a joint employer with its franchisees.

In the wake of the NLRB's decision, lawyers for the Fight for $15 movement have asked the NLRB to reconsider the case, claiming that one of the members of the majority (William Emanuel) should have recused himself because his former law firm (but not Emanuel) had advised McDonald's about dealing with the Fight for $15. Emanuel had been disqualified earlier from participating in the determination of the Hy-Brand case by the NLRB's Inspector General, which lead to the Hy-Brand decision being withdrawn, resulting in the resurrection of the Browning-Ferris joint employment standard.

Federal Court Dismisses Franchisee Allegations of Unjust Enrichment Under Connecticut Anti-Kickback Statute

A federal court in Connecticut concluded that material disputes of fact precluded deciding whether a franchisor had misclassified its franchisees as independent contractors, but nevertheless dismissed the plaintiffs claim for unjust enrichment based on a Connecticut anti-kickback statute. *Mujo v. Jani-King Int'l, Inc.*, 2019 WL 7037794 (D. Conn. Dec. 12, 2019). Mujo, on behalf of a class of over 100 Jani-King franchisees, alleged that Jani-King was unjustly enriched in violation of a Connecticut statute that prohibits employers from demanding any sum of money from any person upon the understanding that the sum is necessary to secure or continue employment. The franchisees alleged that the franchise fees they paid to Jani-King constituted such prohibited sums of money. Their unjust enrichment claim was premised on the argument that Jani-King had unlawfully classified the franchisees as independent contractors rather than employees. Jani-King moved for summary judgment on the unjust enrichment claim arguing that its franchisees could not be classified as employees because of their status as franchisees, which Jani-King viewed as mutually exclusive with being an employee.

In determining employment classifications, Connecticut applies the ABC test under which a court focuses on (A) the purported employers "right to control the means and methods of work," (B) whether the services performed are either outside the purported employer's "usual course of business" or "places of business," and (C) whether the putative employee is customarily engaged in an independently established business of the same nature as that involved in the service performed. Although Jani-King had to meet all three prongs of this test to defeat a presumption of employment, the court concluded that a material dispute of fact precluded resolution of any of the prongs at summary judgment. Nevertheless, the court ultimately dismissed the unjust enrichment claim because the record lacked the evidence necessary to create a genuine issue of fact that the plaintiffs paid Jani-King fees beyond the value of the franchise agreement. In short, the plaintiffs had not shown that any of the amounts they allege they were required to pay as a condition of continued employment were different from legitimate fees owed under a franchise agreement, which were presumptively valid under Connecticut law. Accordingly, the Court granted summary judgement and dismissed the plaintiffs' unjust enrichment claim.

Federal Court Dismisses Joint Employer Claim for Failure to Plead Facts Related to the Franchisor's Purported Control of Franchisee's Employee

A federal court in New York granted 7-Eleven's motion to dismiss a franchisee's employee's complaint, which alleged that 7-Eleven was his joint employer, for lack of sufficient factual allegations to support the claim. *Acharya v. 7-Eleven, Inc.*, 2019 WL 6830203 (S.D.N.Y. Dec. 13, 2019). Acharya's complaint alleged that he was unpaid for, among other things, over 2,000 hours of overtime work and that, as a result, 7-Eleven and the franchisee, as his joint employers, had violated the Fair Labor Standards Act (FLSA) and the New York Labor Law.

In granting 7-Eleven's motion to dismiss, the court held that Acharya's complaint failed to adequately plead facts that would give rise to an inference that 7-Eleven exercised the formal and functional control over Acharya necessary to demonstrate an employment relationship for the purpose of federal or state law. Specifically, the court found that Acharya had failed to plead facts concerning which entity actually offered him his job, or whether 7-Eleven had hiring and firing power, or the ability to control his work schedule and employment conditions, including hours worked or pay received. Finally, the court held that a plaintiff must assert more than boilerplate allegations on "information and belief" to allege a viable claim against a franchisor under the FLSA or New York Labor Law.

Legislation and Rulemaking

Department of Labor Releases Final Joint Employer Rule

In another significant development in the area of joint employer law, the Department of Labor (DOL) has released its final joint employer rule to revise and update its regulation interpreting joint employer status under the FLSA. The new rule provides a four-part test asking: whether or not the company can hire or fire the employee; whether it supervises the employee's work schedule; whether it sets their pay; and if it maintains their employment records. This four-part test returns the standard to its traditional definition. The effective date of the rule is March 16, 2020, and more about the rule can be found here: https://www.dol.gov/agencies/whd/flsa/2020-joint-employment.

Antitrust

Another Federal Court Denies, in Part, Motion to Dismiss in No-Poach Case

A federal court in New Jersey has become the latest to deny a franchisor's motion to dismiss a putative class action complaint based upon a no-poach provision in a franchise agreement. *Robinson v. Jackson Hewitt, Inc.*, 2019 WL 5617512 (D.N.J. Oct. 31, 2019). Jackson Hewitt operates a tax preparation business with franchised and company-owned locations throughout the United States. Its largest franchisee, which owns approximately 20% of all Jackson Hewitt locations, is a co-defendant in the suit. The plaintiffs worked as seasonal tax preparers for franchised and company-owned Jackson Hewitt locations over periods stretching back as far as 2002. They alleged that the no-poach clause in Jackson Hewitt's franchise agreements constitutes a violation of Sections 1 and 3 of the Sherman Act, and sought damages and injunctive relief. Jackson Hewitt agreed to remove the no-poach clause from its franchise agreements and to cease enforcement of it in an Assurance of Discontinuance (AOD) entered into with

Washington State on December 20, 2018. In their motion to dismiss, the defendants argued that the tax preparers lacked standing and failed to state a Sherman Act claim. Alternatively, the defendants argued that the statute of limitations should not be tolled due to alleged fraudulent concealment of the no-poach provisions.

The court found that the tax preparers' allegations of reduced employment mobility and below-average pay were sufficient to plead injury in fact and establish standing. The court also found that the existence of the Washington State AOD was not enough to make it "absolutely clear" that Jackson Hewitt would not use or enforce no-poach clauses in its franchise agreements, so the AOD did not preclude the claim for injunctive relief. Next, the court found that the tax preparers had stated a Sherman Act claim because the independence of Jackson Hewitt franchisees was sufficient "in the employment context" to make them separate economic actors capable of forming a conspiracy. The court declined to rule on the appropriate standard of review for that conspiracy, holding that more factual information was required to make such a determination. Rather than addressing the appropriate standard, the court summarily concluded that the tax preparers had alleged sufficient facts to show an unreasonable restraint of trade.

Unlike other courts that have considered the question, the New Jersey court did find that the plaintiffs had not sufficiently alleged fraudulent concealment of the no-poach provision and, as a result, there was no basis for tolling the Sherman Act's four-year statute of limitations. Thus, the court dismissed any claims related to conduct that occurred more than four years prior to date of the AOD.

Choice of Law

Federal Court Voids Contractual Limitations Period and Holds Franchisor's Claims Are Timely

An urgent care franchisor can pursue claims against a franchisee who refused to use new trademarks after a federal court in Alabama voided a one-year period of limitations in the parties' agreement. *AFC Franchising, LLC v. Fabbro*, 2019 WL 6683781 (N.D. Ala. Dec. 06, 2019). Laura Fabbro entered into a Doctor's Express franchise agreement in 2009 to operate an urgent care center under the franchisor's marks, but the contract obligated Fabbro to comply with the franchisor's directions to modify or discontinue the use of certain trademarks. When AFC Franchising later acquired the Doctor's Express franchise system, it directed franchisees to transition away from the Doctor's Express trademark, eventually discontinuing that mark in favor of American Family Care or AFC Urgent Care. Fabbro, however, refused to implement the new trademarks and after a multi-year effort to secure Fabbro's compliance, AFC eventually filed suit in its home state of Alabama.

Fabbro moved to dismiss on the grounds that AFC's claim was untimely under the franchise agreement's one-year period of limitation, which required that all claims arising out of or relating to the agreement be brought within one year of the discovery of the facts giving rise to an alleged claim. The agreement also included a Maryland choice of law provision, as Doctor's Express was a Maryland-based company. Although Alabama law honors express choice-of-law provisions for purposes of determining substantive legal rights, Alabama courts apply the forum state's own law as to procedural issues. The court held that the validity of the contractual limitations period was procedural rather than substantive, and therefore applied Alabama law. While the contractual limitations period would have been valid and enforceable under Maryland law, under Alabama law the provision was void. Accordingly, the court held that

Alabama's six-year statute of limitations for breach of contract applied to AFC's claims, and the claims were thus timely filed.

State Franchise Laws

Federal Court Concludes that Release Does Not Violate the New Jersey Franchise Practices Act

A federal court in New Jersey held that the release contained in an assignment agreement did not violate the New Jersey Franchise Practices Act (NJFPA). *Scism v. Golden Corral Corp.*, 2019 WL 6522738 (D.N.J. Dec. 4, 2019). The NJFPA prohibits a franchisor from requiring that a franchisee assent to a release that would relieve any person of liability imposed by the Act at the time the franchisee enters into a franchise arrangement. The Scisms entered into a franchise agreement dated May 24, 2007. The franchise agreement was later assigned to GC of Vineland, LLC, in which the Scisms are members, by way of an assignment agreement that contained a release of Golden Corral from any and all claims, debts, liabilities, demands, obligations, costs, expenses, actions, and causes of action arising out of the franchise agreement and the assignment agreement. The Scisms argued that since the release was contained in a document where a franchisee was entering into a franchise arrangement, the release violated the NJFPA.

The court disagreed with the Scisms for two reasons. First, it was not clear that the NJFPA applied to the assignment agreement, or that Golden Corral "required" the franchisee to assent to the release by merely consenting to the assignment agreement. Second, and most compelling, the assignment agreement did not require that the new franchisee, GC of Vineland, assent to the release. The release only applied to the Scisms. Thus, the release did not violate the NJFPA as it did not require the franchisee to assent to a release that would relieve Golden Corral of liability. The court further noted that where New Jersey law does not bar the release of liability the release is enforceable, and thus it dismissed the Scisms' claims relating to events that occurred prior to the execution of the assignment agreement. The court allowed claims arising from events that occurred after the assignment and release were signed to proceed, as those were not subject to the release.

Bankruptcy

Bankruptcy Court Modifies Automatic Stay to Allow Litigation Against Former Franchisee to Proceed in Another Forum

A federal bankruptcy court in Alabama granted limited relief from the automatic stay to a franchisor that wanted to pursue injunctive relief pursuant to the franchise agreement. *In re Mainous*, 2019 WL 6245752 (Bankr. S.D. Ala. Nov. 21, 2019). U.S. Lawns, Inc., the franchisor of businesses offering commercial landscape services, and the Mainouses were parties to a franchise agreement that included noncompete provisions. The relationship between the parties deteriorated and the Mainouses assigned their rights and interests in the franchise to a third party. The Mainouses then filed for bankruptcy. During the pendency of their bankruptcy, the Mainouses filed a complaint in Alabama state court seeking a declaratory judgment against U.S. Lawns related to the enforceability of the franchise agreement and the validity of the noncompetes. U.S. Lawns then moved for relief from the automatic stay in the bankruptcy court seeking permission to pursue injunctive relief against the Mainouses.

Absent certain exceptions, the filing of a bankruptcy petition enjoins litigation against a debtor in another forum unless a bankruptcy court finds "cause" exists to grant relief from the automatic stay. In making such a determination, the bankruptcy court analyzed ten factors, balancing the hardship to the creditor against the potential prejudice to the debtors, the debtors' estate, and other creditors. The bankruptcy court found that, while most of the relevant factors weighed in favor of the Mainouses, limited relief from the automatic stay was appropriate. The Alabama court observed that denying relief from the automatic stay in this case would negatively impact U.S. Lawns, as it would be deprived of fully defending the pending state court action. Additionally, the bankruptcy court considered its limited jurisdiction and concluded that it lacked jurisdiction over the nonfiling third-party assignee. Therefore, the bankruptcy court held that, in the interest of fairness and judicial economy, cause existed to grant U.S. Lawns limited relief from the automatic stay to pursue its claims for injunctive relief in the state court.

Vicarious Liability

Federal Court Denies Motions to Dismiss Vicarious Liability for Sex Trafficking

A federal court in Ohio denied G6 Hospitality and Wyndham's motions to dismiss claims that they are vicariously liable for federal sex trafficking claims brought against their franchisees. *H.H. v. G6 Hospitality, LLC*, 2019 WL 6682152 (S.D. Ohio Dec. 6, 2019). H.H., the sex trafficking victim, alleged that she was trafficked for a period of five months at various Columbus area hotels within G6 and Wyndham's franchise systems. H.H. claimed that the hotels were or should have been aware of the sex trafficking after seeing various items or witnessing certain events, and the hotels did nothing to prevent it.

The court denied G6 and Wyndham's motions to dismiss. The court noted that the Trafficking Victims Protection Reauthorization Act creates civil liability not just for sex traffickers but also for "beneficiaries," which includes persons who knew or should have known about the trafficking, participated, and benefited financially. The court first determined that H.H. had stated a claim against the franchisee hotels under the Act based on the following facts: the hotel repeatedly rented rooms where the sex trafficking occurred; the hotels were paid by H.H.'s trafficker; hotel staff found certain items that were sexual in nature; hotel staff found H.H. physically restrained and begging for help; online reviews about the trafficking scheme at the hotel were publically available; and the hotels failed to train employees or implement policies to stop trafficking. The court then determined that it could not dismiss the vicarious liability claims against G6 and Wyndham because G6 and Wyndham shared profits with their franchisee hotels and set certain policies and standards for hotel employees, training, building maintenance, operating, and prices while conducting inspections to maintain those policies and standards. The shared nature of the profits and "common policies and practices" constituted sufficient allegations of control for H.H. to have pleaded a joint employer relationship establishing vicarious liability for the sex trafficking claims.

Post-Termination Injunctions: Trademarks/Service Mark Violations

Federal Court Grants Temporary Restraining Order in Favor of Franchisor but Emphasizes Need for Showing of Independent Economic Value of Trade Secrets

A federal court in Tennessee granted a franchisor's request for a temporary restraining order, preventing its former franchisee from operating a competing business at its formerly franchised locations and from infringing the franchisor's trade dress, trademarks, and intellectual property. *I Love Juice Bar Franchising, LLC v. ILJB Charlotte Juice, LLC*, 2019 WL 6050283 (M.D. Tenn. Nov. 15, 2019). ILJB was a franchisee of Juice Bar with two locations in Charlotte, North Carolina. Upon ILJB's request for early termination, Juice Bar submitted a termination offer to ILJB that included a termination fee and a noncompetition provision. Over nine months later, ILJB returned an executed copy of the termination offer, crossing through the provisions requiring ILJB to pay the termination fee and abide by the noncompetition provision. Thereafter, ILJB began operating Queen City Juicery out of the two locations that it formerly operated as Juice Bars. Juice Bar sued for (1) breach of the franchise agreement, (2) misappropriation of trade secrets, (3) trademark infringement, (4) trade dress infringement, and (5) unfair competition.

Although the court granted the temporary restraining order sought by Juice Bar, it did so solely based upon Juice Bar's claims for breach of contract and trade dress infringement. ILJB argued that its franchise agreement had been terminated because an agent of Juice Bar had orally agreed to the changes ILJB made to the termination offer, and that Juice Bar therefore lacked an enforceable franchise agreement. The court found that ILJB's evidence of an enforceable termination agreement was insufficient and that Juice Bar was likely to succeed on its claims for breach of contract and trade dress infringement. However, the court also found that Juice Bar had failed to present evidence that any of the "confidential information" Juice Bar claimed ILJB had misappropriated (menu items, recipes, methods, pricing strategies, sales structure, general operations, and customer lists) had independent economic value, as it was generally available to the public. The court also held Juice Bar had failed to identify any specific registered trademark that was allegedly infringed by ILJB

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