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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Date: **July 9, 2020 — Issue # 255**

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 recent developments and resources related to COVID-19.

Preliminary Injunctions

Sixth Circuit Affirms Preliminary Injunction Against Holdover Franchisee

The Sixth Circuit Court of Appeals recently upheld the district court's grant of Little Caesar's motion for a preliminary injunction preventing a holdover franchisee from continuing to operate its restaurants. *Little Caesar Enters., Inc. v. Miramar Quick Serv. Rest. Corp*., Case. No. 19-1860 (6th Cir. June 25, 2020). Lathrop GPM represented Little Caesar in this case. As we previously reported in Issues 244 and 246 of *The GPMemorandum*, this case involves a franchisee of four Little Caesars franchises in Connecticut and Massachusetts that was terminated for its failure to adhere to operational standards. Nearly a year after the case was filed, Little Caesar sent supplemental notices of termination arising from Miramar's failure to report gross sales and pay the corresponding royalty and advertising fees, and moved for a preliminary injunction to prevent Miramar from continuing to operate the restaurants, infringing on Little Caesar's trademarks, and violating its post-termination obligations. The district court granted Little Caesar's motion.

Miramar appealed, first claiming that the district court erred in granting the injunction because Little Caesar failed to prove by clear and convincing evidence that Miramar violated the franchise agreement. The appellate court easily disposed of this argument noting that the clear and convincing standard would not apply to a breach of contract claim even at trial, let alone at the preliminary injunction stage, and finding that the declarations and exhibits Little Caesar submitted in support of its motion provided ample evidence of Miramar's violations. Miramar next argued that the district court erred in granting the injunction because Little Caesar allegedly violated the implied covenant of good faith and fair dealing by terminating its franchise agreement in a retaliatory manner. In dismissing this argument, the Sixth Circuit cited well-established case law providing that because Miramar had breached the franchise agreements, Little Caesar could terminate the agreements regardless of its alleged motivation. Finally, Miramar argued that Little Caesar had waived its right to an injunction by allowing it to operate for a year after the initial termination before seeking injunctive relief. The Sixth Circuit found that Miramar had forfeited this argument by failing to raise it before the district court. But it also determined that the argument would fail because the termination notices demanded that Miramar cease operations and cease using Little Caesar's marks, but stated that Little Caesar's election to seek judicial enforcement of the termination and its acceptance of amounts paid by Miramar did not constitute acquiescence in Miramar's continued operations and use of Little Caesar's marks.

Arbitration

Sixth Circuit Holds that AAA Rules Provide for an Arbitrator to Decide the Question of Arbitrability

In another recent decision from the Sixth Circuit Court of Appeals, the court affirmed a ruling that incorporation of the AAA Rules into an arbitration agreement provides the "clear and unmistakable" evidence required under Supreme Court precedent that the parties agreed to arbitrate the question of arbitrability. *Blanton v. Domino's Pizza Franchising LLC*, 2020 WL 3263002 (6th Cir. June 17, 2020). The AAA Rules provide, in part, that "[t]he arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement." Domino's is a large pizza franchisor whose franchise agreements formerly included "anti-poaching" provisions restricting franchisees from hiring the employees of other franchisees. Harley Blanton and Derek Piercing are former employees of Domino's franchisees and the lead plaintiffs in a putative class action against Domino's alleging that the anti-poaching provisions violate antitrust law. The district court compelled arbitration of their claims based on employment agreements Blanton and Piercing signed with their franchisee employers. Piercing appealed, urging that a court should decide whether Domino's could enforce an arbitration provision to which it is not a party. He argued that incorporating the AAA Rules does not provide the required "clear and unmistakable" evidence of an agreement to arbitrate the question of arbitrability and that the arbitrator's authority to determine jurisdiction is limited to determining the "existence, scope, or validity" of the arbitration agreement—and therefore excludes the questions of whether a non-party can enforce an arbitration provision and whether a particular dispute falls within the agreement's scope.

The Sixth Circuit based its ruling primarily on nearly universal precedent showing that incorporating the AAA Rules into an agreement does provide "clear and unmistakable" evidence that the parties agreed to arbitrate arbitrability. From there, the court turned to the language of the rule itself. As it remarked, "[a]rbitration agreements may be less fun than a night out with friends. But the same rules of English apply" to determine their meaning. The authority of the arbitrator to determine issues of jurisdiction "including" those listed in the rule extends beyond the particular examples to other issues of jurisdiction—including the questions of whether a non-party can enforce an arbitration provision and whether a particular dispute falls within the agreement's scope. In the remainder of its opinion, the court held that the "clear and unmistakable" standard established by the Supreme Court is a question of federal, rather than state law, affirmed the district court's denial of Piercing's request to amend his complaint where he had not filed a motion for leave to amend, and declined to vacate certain portions of the district court's opinion holding that Domino's is entitled to enforce the arbitration agreement under state law.

Venue

Pennsylvania Federal Court Enforces Forum Selection Clause Against Both Contracting and Noncontracting Parties

A federal court in Pennsylvania recently transferred a franchise dispute to Delaware pursuant to the franchise agreement's forum selection clause, even though some defendants were not party to the agreement. *Sweet Charlie's Franchising, LLC v. Sweet Moo's Rolled Ice Cream, LLC*, 2020 WL 3405769 (E.D. Pa. June 19, 2020). Franchisor Sweet Charlie's brought an action against a franchisee, Peter Aguib, and other third-parties (collectively, "Aguib"), alleging misappropriation of confidential information that Aguib gained while attending a training program for Sweet Charlie's franchisees in Philadelphia. While Aguib and another defendant were both party to the franchise agreement, three other defendants were not. The franchise agreement's forum selection clause named Delaware courts as the exclusive venue, but Aguib filed the motion to transfer the action to Tennessee, where the defendants are located and where a bankruptcy action was commenced for one of the noncontracting parties.

The court denied Aguib's motion to transfer, and despite neither party requesting it, the court transferred the case to Delaware based upon the franchise agreement's forum selection clause and balancing the equities. The court acknowledged that the property at issue was situated in Pennsylvania, but determined that Tennessee would be the most convenient forum for the noncontracting defendants. However, the court concluded that based upon the interest of efficiency, and the strong public interest in upholding the contracting parties' forum selection clause, justice was best served by transferring the matter to Delaware pursuant to the franchise agreement. The court noted that there may be issues of personal jurisdiction for the noncontracting parties by transferring the case to Delaware, but because the noncontracting parties did not raise such questions, the court chose not to consider them.

Vicarious Liability

New Jersey Federal Court Concludes Franchisor Lacked Sufficient Control over Franchisee to Establish Duty of Care to Franchisee's Employees

A federal Court in New Jersey granted summary judgment after finding that the franchisor did not owe a duty of care to the plaintiff, who was shot in an armed robbery at a 7-Eleven store operated by a franchisee. *Boutahli v. 7-Eleven, Inc.*, 2020 WL 3287127 (D.N.J. June 18, 2020). On January 10, 2014, Boutahli was the only employee working at a 7-Eleven store in Pennsauken, New Jersey. Just after midnight, two men walked into the store, demanded the contents of the cash register, and pistol-whipped and shot Boutahli four times before fleeing the scene. While Boutahli survived the attack, he suffered permanent injuries for which he was seeking compensation from various parties, including 7-Eleven. Boutahli argued that 7-Eleven had acted negligently when it failed to protect him adequately from the attack. 7-Eleven moved for summary judgment, arguing that it did not owe any duty of care to Boutahli.

While New Jersey law usually relies on the Restatement (Second) of Torts for determining the duty of care, the court acknowledged that prior decisions regarding this issue in the franchising context had instead relied on a theory of agency and control to determine if the franchisor should be held liable for tortious acts that occurred on the franchised premises. The court reviewed three cases where the franchisor was found not liable for such acts because the franchisor did not exert day-to-day control of the franchisee, the franchisees retained control over personnel decisions, each location was independently owned and operated, and the language in the franchise agreements clearly stated the parties were not agents of the other. In reviewing the facts at issue, the court found that while 7-Eleven did have certain controls over the store (for example, maintaining certain bookkeeping records, required training, and the right to convert the store into a gas station and to require the store to carry certain products), those controls did not amount to the day-to-day control that would result in 7-Eleven's control over the store. Additionally, the franchise agreement clearly stated the parties were not agents of the other. Therefore, the court held that 7-Eleven did not exert such control over that franchised premises such that it should be held liable for the injuries Boutahli sustained at the franchisee-operated premises. The court thus granted 7-Eleven's motion for summary judgement.

Employment

Illinois Federal Court Finds Franchisor's Distribution of Shared Profits to Franchisee Is Not the Same as Payment of Wages to an Employee

In another case analyzing the amount of control exerted by 7-Eleven over its franchisees, a federal court in Illinois dismissed a franchisee's putative class action seeking relief under Illinois' Wage Payment and Collection Act (IWPCA). *Patel v. 7-Eleven, Inc.*, 2020 WL 3303003 (N.D. Ill. June 18, 2020). In his complaint, plaintiff Niral Patel contended that 7-Eleven's franchise agreements, including the franchise agreement between 7-Eleven and Shanti 11, Inc. (a corporation wholly owned by Patel), constituted agreements to pay wages governed by the IWPCA. Under the franchise agreement, Shanti 11 was required to deposit daily revenue into an account controlled by 7-Eleven and, after 7-Eleven deducted certain franchise fees, a share of the profits was distributed to Shanti 11 and Patel. Patel argued that these distributions constituted wages and that the franchise fees that were withheld constituted improper deductions under the IWPCA. The court disagreed.

Patel's arguments centered around the control 7-Eleven exerted over the day-to-day operations of its franchisees (including their finances), claiming that the franchise agreements acted as agreements to pay wages and Patel and others similarly situated were essentially acting as employees of 7-Eleven. The court acknowledged the extensive control 7-Eleven exerts over its franchisees; however, relying on the dependency of the profit distribution payments on customer sales, the court rejected Patel's notion that the funds paid to its franchisees constituted wages under the IWPCA. Patel attempted to rebut this reasoning by arguing that "the key inquiry . . . is not the 'origin point' of the payment, but rather, which party bears the obligation to pay the Plaintiff." The court found this argument unconvincing, holding, "In consideration for being allowed to own and operate a store under 7-Eleven's brand, Patel agreed to share profits with 7-Eleven, which are dependent on the amount of customer sales. That is not a wage-payment arrangement." As a result, Patel's class action complaint was dismissed with prejudice.

Trademarks and Trade Dress Issues

Court Enjoins Franchisees from Infringing Trademarks but Declines to Enforce Noncompete Because the Parties Had No Signed Franchise Agreement

A federal court in Florida granted a franchisor preliminary injunctive relief for trademark infringement claims, but denied the franchisor's request to enforce a noncompete against defendants who had not signed a franchise agreement. *Interim Healthcare, Inc. v. Interim Healthcare of Se. La., Inc.*, 2020 WL 3078531 (S.D. Fla. June 10, 2020). Interim is the franchisor of a system that provides nursing, therapy and non-medical home care, hospice, and healthcare staffing. Defendants operated Interim franchises in and around New Orleans and Livingston Parish, Louisiana. The defendants began operating the franchise in the Livingston Parish area after the original franchisee had its charter revoked. However, the defendants never signed a franchise agreement for that location. After the defendants failed to pay amounts owed to Interim, Interim terminated the franchises. After termination, the defendants continued to offer services under Interim's name and business system, and Interim brought suit.

The court granted Interim a preliminary injunction with respect to trademark infringement, holding the defendants' continued use of Interim's trademarks after termination was likely to cause the customer confusion necessary to succeed an infringement claim. The court also found that Interim was likely to suffer immediate and irreparable injury in the absence of a preliminary injunction, since, due to the trademark infringement, Interim had lost the ability to control the quality of the hospice services administered under its brand and proprietary marks. But the court declined to enforce the non-compete in the franchise agreement for the Livingston Parish franchise because, under Florida law, which governed the agreement, a restrictive covenant cannot be enforced unless it is set forth in a writing signed by the person against whom enforcement is sought. Although the defendants had "held themselves out as the successors of the Livingston Parish area franchise and . . . performed under, and enjoyed the benefits of, the Livingston Franchise Agreement." Interim could not overcome the signed writing requirement where they had not signed the agreement. On the other hand, the court did find that the defendants were bound to other post-termination obligations as successors in interest to the agreement, including Interim's right to step-in and operate the franchise, regardless of whether the Franchisees had signed the agreement.

Michigan Federal Court Denies Preliminary Injunction for Trademark and Trade Dress Infringement Because of Lack of Consumer Confusion

A federal court in Michigan has denied a restaurant chain's motion for preliminary injunction because it failed to demonstrate likelihood of success on its claim that a competing franchisor was infringing trademarks and trade dress. *Eastpointe DWC, LLC v. Wing Snob Inc.*, 2020 WL 3412266 (E.D. Mich. June 22, 2020). Detroit Wing Company has been operating restaurants primarily selling chicken wings since 2015. Wing Snob Inc. subsequently opened its first restaurant and rapidly expanded, opening locations in near proximity to other Detroit Wing Company locations. Detroit Wing Company sued, alleging that Wing Snob's owner intended to copy Detroit Wing Company's business and did so by locating Wing Snob restaurants near Detroit Wing Company restaurants, using the same colors in the restaurant, using the same wood slats on the walls, having a similar logo, copying Detroit Wing Company's menus and menu trade dress, utilizing the same online ordering method, and implementing a similar social media strategy, which altogether triggered consumer confusion.

The court held that Detroit Wing Company's arguments failed to establish that there was a likelihood of success on the merits. The court addressed the trade dress and trademark infringement claims together as the legal requirement of consumer confusion overlaps for both causes of action. Detroit Wing Company argued that elements of its restaurant design and logo were arbitrary and therefore distinctive, but the court found that consumers were unlikely to associate any aspect of the design or logo as unique or distinctive to Detroit Wing Company. For example, the mere fact that Detroit Wing Company utilizes a chicken in its logo did not distinguish it from any number of chicken restaurants who also use a chicken in their logos. Similarly, neither the design nor logo had acquired a secondary meaning based on evidence submitted to the court. Then the court determined that the claims of customer confusion lacked particularity as to what was confusing, and the logos and restaurant designs were sufficiently different so that confusion was unlikely. As to the copyright claim, Wing Snob presented testimony that it was unaware of Detroit Wing Company's copyrighted work and had no access to it, that a third party created

Wing Snob's logo, and that any use of Detroit Wing Company's copyrighted work had ended. Therefore, Detroit Wing Company had not met its high burden to show entitlement to a preliminary injunction.

COVID-19 Pandemic

CARES Act Increases Debt Limit under Small Business Reorganization Act

A recent change related to the Coronavirus Aid, Relief, and Economic Security (CARES) Act may increase the number of small business bankruptcy filings in coming months. The Small Business Reorganization Act (SBRA) went into effect on February 19, 2020, aiming to streamline small business reorganizations by modifying or eliminating certain traditional Chapter 11 requirements and creating an easier path for small business debtors to confirm plans of reorganization. Under the SBRA, a small business debtor, whether an individual or legal entity, is the only party permitted to file a plan of reorganization, but must do so within ninety (90) days of the petition date.

Under the original provisions of the SBRA, a small business debtor filing under the SBRA could not have more than $2,725,625.00 in secured and unsecured debt as of the petition date. However, the CARES Act recently raised this debt limit to $7.5 million dollars. This higher debt limit will remain in effect through March 27, 2021 (unless extended by Congress). The expansion of the debt limit by the CARES Act creates the opportunity for many more businesses to be eligible for protection under the SBRA. Given recent economic disruptions related to the COVID-19 pandemic, it seems reasonable to expect this increase in eligibility will lead to a wave of small business bankruptcies.

Paycheck Protection Program Continues to Evolve

On June 5, 2020, the President signed the Paycheck Protection Program Flexibility Act of 2020 (Flexibility Act) (Pub. L. 116–142), which changes key provisions of the Paycheck Protection Program (PPP), including provisions relating to the maturity of PPP loans, the deferral of PPP loan payments, and the forgiveness of PPP loans. Section 3(d) of the Flexibility Act provides that the amendments relating to PPP loan forgiveness and extension of the deferral period for PPP loans shall be effective as if included in the CARES Act, which means that they are retroactive to March 27, 2020.

In announcing its "Third Interim Final Rule," interpreting the Flexibility Act, the Department of Treasury stated that the Small Business Administration (SBA) was decreasing from 75% to 60% the portion of loan proceeds that must be used for payroll costs for loans to be 100% forgiven. The Rule also clarifies that the maturity date for PPP loans may be extended by agreement of the borrower and lender beyond the 5-year period specified in the CARES Act. The full Forgiveness Application may be found here.

On June 17, the Department of Treasury and SBA published "EZ and Revised Full Forgiveness Applications for the Paycheck Protection Program (PPP)" for loans issued pursuant to the CARES Act. Section 1106 of the Act provides for forgiveness of up to the full principal amount of qualifying loans guaranteed under the Paycheck Protection Program.

On July 6, SBA published a report summarizing lending under the PPP program, stating that 4,885,388 loans, worth $521,483,817,756 had been made by 5461 lenders as of June 30. As of that date, $131,914,229,876 of PPP funding remained available.

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

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