GRAY PLANT MOOTY

# The GPMemorandum

**TO:** OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS

**FROM:** GRAY PLANT MOOTY'S FRANCHISE AND DISTRIBUTION PRACTICE GROUP

**Quentin R. Wittrock, Editor of *The GPMemorandum***

**Maisa Jean Frank, Assistant Editor**

**DATE:** March 10, 2014—No. 178

Below are summaries of recent case decisions of interest to franchisors.

## POST-TERMINATION INJUNCTIONS: NONCOMPETE COVENANTS

### APPELLATE COURT VACATES ORDER DENYING FRANCHISOR'S MOTION FOR PRELIMINARY INJUNCTION; DISTRICT COURT THEN GRANTS SUMMARY JUDGMENT TO FRANCHISOR AND ENTERS FINAL INJUNCTION

In *H&R Block Tax Services LLC v. Acevedo-López*, 2014 U.S. App. LEXIS 2602 (8th Cir. Feb. 12, 2014), the United States Court of Appeals for the Eighth Circuit vacated the order of a district court in Missouri, which had denied a motion by H&R Block for a preliminary injunction prohibiting breach by a former franchisee of his covenants against competition. Shortly thereafter, the district court granted summary judgment to H&R Block on all of the claims and counterclaims in the case, awarding H&R Block approximately $1.5 million in damages, entering a final injunction enforcing the franchisee's post-termination obligations, and holding that H&R Block was entitled to its attorneys' fees. *H&R Block Tax Servs. LLC v. Acevedo-López*, No. 4:12-cv-01320-SOW (W.D. Mo. Mar. 5, 2014). Gray Plant Mooty represents H&R Block in the action.

In 2007, H&R Block purchased the client records of the franchisee's tax return preparation firm and contemporaneously entered into a franchise agreement providing for his continued operation of the business. In 2012, the franchisee, who was operating franchised locations in eleven cities in Puerto Rico, failed to pay over $530,000 in royalties, claiming that Block's executives had orally agreed that he did not have to pay royalties until various offsets were applied. When the franchisee failed to cure his default, H&R Block terminated his franchise agreement and sued him for amounts owed and for enforcement of his post-termination obligations. H&R Block moved for a preliminary injunction requiring delivery to it of its client records and prohibiting the franchisee from operating a tax business for a period of time in his former territory. The district court denied the motion in a brief order, summarily stating that H&R Block had failed to establish that it would be irreparably harmed in the absence of an injunction, and H&R Block filed an interlocutory appeal. On February 12, 2014, the Eighth Circuit vacated the district court's order, agreeing with H&R Block that the district court failed to properly state the findings and conclusions that supported its denial of H&R Block's motion. The court of appeals then remanded the case for further proceedings.

While H&R Block's interlocutory appeal was pending, the parties completed discovery and briefed cross-motions for summary judgment. On March 5, 2014, shortly after receiving the mandate of the court of appeals, the district court issued its decision on the parties' cross-motions. First, the court held that although the franchisee had asserted a lack of personal jurisdiction as an affirmative defense, he had nonetheless waived that issue by failing to challenge the court's jurisdiction by motion for eleven months. Second, the court held that although Puerto Rico Law 75 provided that forum selection provisions obligating a franchisee to litigate outside of Puerto Rico were not enforceable, the statute did not say that a claim filed outside of Puerto Rico by a franchisor could not be litigated where it was filed. Finally, the court held that the franchisee's claim that his agreement had been orally modified to provide for a setoff was barred by a provision of the franchise agreement stating that the agreement could not be modified except in writing. The franchisee's argument that Missouri law did not enforce such clauses where there was a valid oral agreement was unavailing because the alleged oral agreement lacked consideration.

## CONTRACTS

### COURT GRANTS SUMMARY TO HOTEL MANAGEMENT COMPANY

In a case in which Gray Plant Mooty represented the defendant hotel management company, the federal court in North Dakota recently granted it summary judgment with respect to claims asserted by the owner of a franchised hotel. *Ivesdal v. Three Rivers Hospitality, LLC,* No. 1:12-cv-00073-DLH-CSM (D.N.D. Feb. 7, 2014). Hotel owner Ivesdal engaged Three Rivers to manage operations of his franchised AmericInn hotel in Dickinson, North Dakota. The parties entered into a Management Agreement governed by Minnesota law. After declining to renew the Management Agreement following several years of operations, Ivesdal sued, claiming that the hotel had been mismanaged during the term of the agreement causing him significant financial damage. He brought claims for breach of contract, breach of the implied covenant of good faith and fair dealing, negligence, gross negligence, and breach of fiduciary duty. Most of Ivesdal's claims were dismissed previously upon Three Rivers' motion, which was primarily based on the operation of an exculpatory clause in the Management Agreement requiring Ivesdal to indemnify and hold Three Rivers harmless for all damages arising from any cause other than fraud, gross negligence or intentional conduct. Until now, however, the court did allow the suit to proceed on Ivesdal's theories of gross negligence and breach of fiduciary duty—as they were not barred by the exculpatory clause.

Following discovery, Three Rivers moved for summary judgment on these remaining claims. Although Minnesota law recognizes the existence of a fiduciary relationship between a principal and its agent, the court found that the language of the Management Agreement itself did not support Ivesdal's contention that a separate and distinct fiduciary relationship existed between the parties. Since Three River's representation of Ivesdal under the Management Agreement was explicitly limited to the scope of authority granted in the agreement itself—which specifically disclaimed the existence of a principal/agent relationship or the ability of the parties to bind one another—the court found that Three Rivers was not Ivesdal's agent and thus owed no fiduciary duty. The court also found that Ivesdal's gross negligence claim failed because under Minnesota law, a plaintiff cannot recover tort damages for breach of a contract unless an independent duty exists outside of the duties imposed by the contract itself. Finding no evidence that any independent duty existed, as all of Ivesdal's gross negligence claims related to specific duties imposed by the Management Agreement, the claim was dismissed.

## FEDERAL COURT DISMISSES RESCISSION CLAIM AGAINST FRANCHISOR

A federal district court in Pennsylvania recently held that a franchisor was entitled to summary judgment on a franchisee's equitable rescission claim because the franchisee did not act promptly in bringing suit after discovering the franchisor's alleged misrepresentations. In *Al-Barqawi v. 7-Eleven, Inc.*, 2014 U.S. Dist. LEXIS 19601 (E.D. Pa. Feb. 18, 2014), the franchisee, Al-Barqawi, alleged that 7-Eleven representatives falsely represented to him before he signed his franchise agreement that the particular store he was purchasing did not have problems with crime. Al-Barqawi was robbed at gunpoint during his first week operating the store and learned that the store had been robbed on several prior occasions. Nevertheless, he continued to operate the store for two years until 7-Eleven terminated his franchise agreement. Al-Barqawi then brought suit and raised claims for breach of contract, misrepresentation, rescission, and promissory estoppel. 7-Eleven moved for partial summary judgment, arguing that (1) Al-Barqawi waived his right to equitable rescission by failing to pursue the claim within a reasonable amount of time, (2) Al-Barqawi's claims for intentional and negligent misrepresentation were barred by the applicable statute of limitations, and (3) the existence of the franchise agreement defeated the promissory estoppel claim as a matter of law.

In granting the motion, the court held that Al-Barqawi's rescission claim could not survive summary judgment because he continued to perform under the contract long after learning that 7-Eleven's alleged statements regarding the safety of his store may have been misleading or fraudulent. Applying Pennsylvania law, the court explained that when a nonbreaching party discovers facts that warrant rescission of his contract, he must act promptly to rescind the contract while the parties can still be restored to their precontract positions. The court determined that Al-Barqawi was on notice during his first week operating the store that 7-Eleven may have misrepresented the safety of the store and failed to disclose prior criminal activity on the premises, and his inexcusable delay in seeking to rescind the franchise agreement made it too difficult to return the parties to their original positions. Likewise, the court rejected Al-Barqawi's claim for misrepresentation because the statute of limitations had run and no tolling exception applied. The court also dismissed the promissory estoppel cause of action because Al-Barqawi did not oppose summary judgment for 7-Eleven on that claim.

## BANKRUPTCY

### SEVENTH CIRCUIT GRANTS STAY PENDING APPEAL TO DECIDE WHETHER FRANCHISE AGREEMENT AND RELATED REAL PROPERTY LEASE SHOULD BE TREATED AS A SINGLE EXECUTORY CONTRACT UNDER BANKRUPTCY LAW

In *In re A&F Enterprises, Inc. v. IHOP Franchising LLC,* 2014 U.S. App. LEXIS 2408 (7th Cir. Feb. 7, 2014), the Seventh Circuit reversed the district court and the bankruptcy court and stayed the enforcement of the bankruptcy court orders that were on appeal. The dispute in the bankruptcy case involved when a debtor-franchisee must assume or reject a real property lease for a leased franchise location. Under bankruptcy law, a debtor must assume or reject a commercial real property lease within 120 days after the bankruptcy case is filed or the lease is deemed rejected. In contrast, a debtor may assume or reject an executory contract such as a franchise agreement at any time prior to, or by means of, the confirmation of a chapter 11 plan. In this case, the leases and the franchise agreements for the franchisee's restaurants were cross-defaulted. When the franchisee did not assume the real property leases within the 120-day time period, IHOP took the position that the real property leases could not be assumed because they were deemed rejected and, as a result, the franchisee also lost the opportunity to assume the franchise agreements. The bankruptcy court agreed with IHOP's position and the franchisee appealed to the district court. The franchisee also sought a stay pending appeal from first the bankruptcy court and then the district court. Both of those courts denied the stay request.

The Seventh Circuit reversed, applying a standard similar to that used for granting a preliminary injunction. Noting that the franchisee might permanently lose its franchises absent a stay, the court determined that the potential harms weighed in favor of the stay. The potential harm to the franchisee, according to the court, outweighed any damage to IHOP's good will and trademark resulting from the franchisee's continued operation, because the franchisee's use of the trademark would be improper due only to bankruptcy time limits and not as a result of breaches of the franchise agreement. The court also found that the franchisee's claim had substantial merit.

The underlying bankruptcy court decision regarding the assumption period applicable to the franchise agreements and related leases remains on appeal to the district court. We will provide an update when the court issues a final decision on that issue.

## FRANCHISE SALES

### COURT ALLOWS CLAIM FOR FTC FRANCHISE RULE VIOLATION TO PROCEED UNDER "NEGLIGENCE PER SE" THEORY

In responding to a motion to dismiss, the United States District Court for the Western District of Virginia recently permitted a "negligence per se" claim based on a franchisor's FTC disclosure violation to proceed under Georgia law. *Bans Pasta, LLC v. Mirko Franchising, LLC*, 2014 U.S. Dist. LEXIS 19953 (W.D. Va. Feb. 12, 2014). Mirko, an Italian restaurant franchisee, alleged that the franchisor, Bans Pasta, violated the FTC Rule's disclosure requirements by providing financial performance representations outside the context of Item 19 of the FDD. Bans Pasta filed a motion to dismiss arguing that because neither the FTC Act nor the FTC Franchise Rule gives rise to a private cause of action, as numerous courts have held, the court should not create a private right of action under a tort theory. Bans Pasta implored the court not to "open the door to such claims since it would be tantamount to allowing private rights of action that have been universally barred since the inception of the FTC Act."

Mirko countered that it was not bringing a direct claim for a violation of the FTC Rule, but instead pled the violation as the basis for its negligence per se claim. In analyzing whether to grant the franchisor's motion to dismiss the claim, the court first acknowledged that no cases could be found directly addressing the viability of a negligence per se claim based upon a violation of the FTC Act. Next, the court reviewed state law and determined that both Georgia and Virginia law expressly allow negligence per se claims to be premised on statutes and regulations that do not give rise to a private cause of action. Georgia case law indicated that its statute must dictate a "standard of care" and not "merely impose an administrative requirement," and the plaintiff must still prove the additional elements of duty, proximate causation, and injury to establish liability. Examining whether a standard of care existed, the court concluded that the FTC Franchise Rule supplies a clear legal duty requiring specific actions and thus supplies the standard of care necessary to support a negligence claim.

GRAY PLANT MOOTY

## NEW YORK FRANCHISE SALES ACT CLAIMS WITHSTAND SUMMARY JUDGMENT

In *Solanki v. 7-Eleven, Inc.*, 2014 U.S. Dist. LEXIS 11183 (S.D.N.Y. Jan. 29, 2014), a franchisee's claims under the New York Franchise Sales Act have survived a franchisor's motion for summary judgment. Solanski alleged that 7-Eleven's presale revenue estimates should have been included in the FDD, and that its earnings estimates were false. At or shortly after the parties' initial meeting to discuss the store, 7-Eleven provided Solanski with an FDD and a business plan outline to complete. At a subsequent meeting, Solanski presented his completed business plan, which was approved by 7-Eleven. 7-Eleven never provided Solanski with any sales projections that it had created, and no projections prepared by either party ever were included in the FDD. During its first year of operation, the third store failed to achieve the business plan's projected sales levels, and 7-Eleven terminated the related franchise agreement at Solanski's request. Solanski filed suit.

In its motion for summary judgment, 7-Eleven argued that Solanski had admitted to making up his mind that he wanted to buy the specific store at issue before he ever received the FDD. Therefore, according to 7-Eleven, Solanski could not have relied on any alleged financial representations by 7-Eleven. The court held, however, that the distinction between *wanting* to buy a franchise and conclusively *deciding* to do so based on information received was a disputed issue of material fact for trial. 7-Eleven further argued that even if Solanski could be found to have relied on any such representations in making his decision, he had disclaimed such reliance. In response, the court noted that a disclaimer can only be upheld as to common law fraud claims. In this case, Solanski's claims were made under the Franchise Sales Act, which prohibits the waiver of any duty or liability imposed by the Act. Therefore, the court dismissed 7-Eleven's motion for summary judgment, holding that disputed issues of material fact remained.

## TRADEMARKS

## FORMER FRANCHISEE'S FAILURE TO FULLY DEIDENTIFY DEEMED INFRINGEMENT

The United States District Court for the Northern District of Texas held that the failure of a terminated franchisee and its successor to fully deidentify a hotel and remove all signage related to its former franchise system, even signage that is difficult to access and costly to remove, constituted trademark infringement. *Choice Hotels Int'l, Inc. v. Goldmark Hospitality, LLC*, 2014 U.S. Dist. LEXIS 20666 (N.D. Tex. Feb. 19, 2014). The franchisee, Goldmark, acquired a former Choice Hotels franchisee's property through bankruptcy and foreclosure and converted it from Choice's Quality Suites brand into a rebranded hotel focusing on extended stay guests. Although Goldmark did paint or cover some signage, changed its business cards, took out advertising in the new name, ceased using the Quality Suites online reservation system, and instructed its employees to answer the phone using the new name, it failed to remove two signs bearing the Quality Suites marks. Goldmark claimed that it could not afford to remove the signs, one of which required the use of a crane, but it offered to allow Choice access to the property to do so. Instead, Choice sued for trademark infringement, false designation of origin, and unfair competition. Choice then brought a motion for summary judgment. The court granted the motion as to liability, finding that continued presence of the marks on the two signs constituted use of the marks in commerce and created a likelihood of confusion. It declined to grant summary judgment as to damages, holding instead that Choice needed to submit evidence at trial regarding its damages.

## ARBITRATION

### FEDERAL COURT CONFIRMS ARBITRATION AWARD AGAINST ALTER-EGO

In *Doctor's Associates Inc. v. White*, 2014 U.S. Dist. LEXIS 11433 (D.N.J. Jan. 30, 2014), the federal court in New Jersey granted partial reconsideration of an order refusing to confirm an arbitration award. Doctor's Associates, Inc. ("DAI") had initiated arbitration against franchisee White for breach of his Subway franchise agreement. After DAI won the arbitration, it filed a lawsuit in federal court to confirm the award against both White and Coach Investments & Developers. Although Coach was not party to the arbitration, DAI argued that Coach was the alter ego of the franchisee.

After originally refusing to extend the award to Coach, the court concluded on reconsideration that confirmation was required to prevent injustice. The court reasoned that White's refusal to appear in the case suggested that it was hoping to avoid having to pay a judgment by hiding behind Coach—a company owned and created by White solely to administer his obligations under the franchise agreement. The evidence suggested that White was insolvent and living off the income from Coach.

## STATE FRANCHISE LAWS

### FEDERAL COURT REQUIRES FRANCHISEE TO PLEAD PLACE OF BUSINESS TO SUCCEED ON A NEW JERSEY FRANCHISE PRACTICES ACT CLAIM

In *Ocean City Express Co., Inc. v. Atlas Van Lines, Inc.*, 2014 U.S. Dist. LEXIS 20885 (D.N.J. Feb. 19, 2014), the United States District Court for the District of New Jersey denied the plaintiff's motion to amend its complaint and dismissed without prejudice its claim under the New Jersey Franchise Practices Act. Ocean City Express, which was a party to an agency agreement with Atlas Van Lines, failed to plead that that it had a qualifying place of business in New Jersey. It merely pled that it had a principal place of business within the state of New Jersey.

To qualify for protection under the Act, a party must demonstrate that, among other things, the agreement contemplates or requires the franchisee to establish or maintain a place of business in New Jersey. A place of business is defined as a fixed geographic location at which the franchisee displays or offers for sale, and sells, the franchisor's goods or services. Because Ocean City failed to plead that it engaged in sales and marketing activities and interacted with customers from its place of business in New Jersey, the court dismissed Ocean City's Franchise Practices Act claim and gave it fourteen days in which to amend.

## CHOICE OF FORUM

### TEXAS COURT ENFORCES FORUM-SELECTION CLAUSE AGAINST GUARANTOR

The Texas Court of Appeals recently affirmed a trial court's ruling that a franchise agreement's forum-selection clause was enforceable against a guarantor who had not signed the agreement. *Pritchett v. Gold's Gym Franchising, LLC*, 2014 Tex. App. LEXIS 1281 (Tex. Ct. App. Feb. 4, 2014). The forum-selection clause at issue designated Texas as the exclusive venue for disputes. Pritchett, a guarantor to the franchise agreement who owned a 50% interest in the corporate franchisee, argued that the Texas court lacked personal jurisdiction over him because he did not conduct business in Texas and because he did not sign the franchise agreement containing the forum-selection clause. The trial court rejected Pritchett's argument and the Texas Court of Appeals affirmed.

The appellate court ruled that the guaranty's language providing, "Guarantors do hereby agree to be personally bound by . . . each and every provision in the [Franchise] Agreement" incorporated by reference the franchise agreement's forum-selection clause into the guaranty. Consequently, the mandatory forum-selection clause was enforceable against the agreement's guarantors and barred Pritchett from contesting personal jurisdiction. Furthermore, despite Pritchett's contention that he did not sign the guaranty, the court concluded that the trial court's ruling necessarily implied a finding that he signed the guaranty and, therefore, affirmed his obligations.

## Minneapolis, MN Office

**John W. Fitzgerald, cochair (612.632.3064)**
Megan L. Anderson (612.632.3004)
* Sandy Y. Bodeau (612.632.3211)
* Phillip W. Bohl (612.632.3019)
Jennifer C. Debrow (612.632.3357)
Danell Olson Caron (612.632.3383)
Elizabeth S. Dillon (612.632.3284)
* Ashley Bennett Ewald (612.632.3449)
* Michael R. Gray (612.632.3078)
Kelly W. Hoversten (612.632.3203)
Franklin C. Jesse, Jr. (612.632.3205)
Jeremy L. Johnson (612.632.3035)
* Richard C. Landon (612.632.3429)
Gaylen L. Knack (612.632.3217)
* **Kirk W. Reilly, cochair (612.632.3305)**
Craig P. Miller (612.632.3258)
Bruce W. Mooty (612.632.3333)
John W. Mooty (612.632.3200)
* Kevin J. Moran (612.632.3269)
Kate G. Nilan (612.632.3419)
* Karli B. Peterson (612.632.3278)
Matthew G. Plowman (612.632.3425)
* Max J. Schott II (612.632.3327)
Michael P. Sullivan, Jr. (612.632.3350)
Michael P. Sullivan, Sr. (612.632.3351)
* Henry T. Wang (612.632.3370)
Lori L. Wiese-Parks (612.632.3375)
* Quentin R. Wittrock (612.632.3382)

## Washington, DC Office

**Robert L. Zisk, cochair (202.295.2202)**
* Julia C. Colarusso (202.295.2217)
* Maisa Jean Frank (202.295.2209)
* Jan S. Gilbert (202.295.2230)
* Jeffrey L. Karlin (202.295.2207)
Mark A. Kirsch (202.295.2229)
Peter J. Klarfeld (202.295.2226)
* Sheldon H. Klein (202.295.2215)
* Janaki J. Parmar (202.295.2235)
* Iris F. Rosario (202.295.2204)
* Justin L. Sallis (202.295.2223)
* Stephen J. Vaughan (202.295.2208)
* David E. Worthen (202.295.2203)
Eric L. Yaffe (202.295.2222)
* Carl E. Zwisler (202.295.2225)

**** Wrote or edited articles for this issue.***

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 www.gpmlaw.com/practices/franchise-and-distribution.aspx.


**GRAY PLANT MOOTY**

**500 IDS Center**
**80 South Eighth Street**
**Minneapolis, MN 55402-3796**
**Phone: 612.632.3000**

**Suite 700, The Watergate**
**600 New Hampshire Avenue, N.W.**
**Washington, DC 20037-1905**
**Phone: 202.295.2200**

franchise@gpmlaw.com