LADR Case Notes (December 2023–February 2024) and FLJ Currents (Fall 2023)

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LADR CASE NOTES

JANUARY 2024 LADR CASE NOTES

***Breadeaux's Pisa, LLC v. Beckman Bros.*, 83 F.4th 1113 (8th Cir. 2023)**[1]

Franchisor filed a lawsuit in court against its franchisee seeking injunctive and declaratory relief related to violation of a non-compete. Franchisee operated a pizza restaurant in Iowa. After the franchise agreement was not renewed in 2021, the franchisee continued to operate a pizza restaurant in the same location. The franchise agreement allowed the franchisor to enforce the franchise agreement's non-compete provisions by filing for equitable relief in court or initiating mediation and arbitration.

The franchisee asserted counterclaims against the franchisor for declaratory relief, as well as breach of contract. The franchisor moved to compel mediation and arbitration of the franchisee's counterclaims, which the district court granted.

The franchisor then moved for a preliminary injunction on its original claims, but the court denied the request for preliminary injunction. The franchisee sought

1. Andrew M. Malzahn and his firm represented the franchisee in this matter.

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discovery, which the franchisor objected to as frivolous because the franchise agreement provided that the parties consented to equitable relief. But the district court disagreed, explaining that denial of the preliminary injunction meant that discovery on damages and enforceability of the non-compete was necessary.

The next day, the franchisor filed a demand for arbitration seeking injunctive and declaratory relief (the same relief originally sought in court). The franchisor also moved to stay the court action pending arbitration.

Lower court decision: The district court denied the franchisor's request to stay all proceedings pending arbitration and again rejected the franchisor's objections to discovery. The franchisor sought an interlocutory appeal of the denial of the stay.

Eighth Circuit's decision: The Eighth Circuit agreed with the district court and refused to stay the case for arbitration, highlighting that the franchisor, as the plaintiff, elected to litigate in court. It only sought to move to arbitration after receiving adverse rulings. After litigating the preliminary injunction request, mediating, and participating in discovery, the franchisor filed a demand for arbitration. The court viewed this as the franchisor trying to re-litigate the preliminary injunctive relief in arbitration and avoid adverse discovery rulings.

The Federal Arbitration Act, Section 3, is typically applicable to defendants for purposes of staying litigation pending arbitration (not plaintiffs). The Eighth Circuit disagreed that the arbitration provision in the franchise agreement required all claims to be arbitrated other than the franchisor's equitable claims. The franchisor elected to enforce the franchise agreement through judicial process. In fact, the Eighth Circuit concluded that the franchisor's request for declaratory relief invited the court to examine whether the franchisee was in breach of the non-compete provision—thus inviting the court to "peek" at arbitrable issues.

Focusing on the franchisor's actions, the Eighth Circuit held the franchisor waived its right to arbitrate. The franchisor knew of its right to arbitrate but acted inconsistently with that right by seeking relief that would "require a determination of arbitrable issues" and by failing to seek arbitration after its preliminary injunctive request was denied. Notably, the Eighth Circuit acknowledged that if arbitration had been sought at that earlier point—after denial of preliminary injunction but before the other steps taken in the case—it very well may have been allowed.

***Pioneer Hotel Group, Inc. v. Choice Hotels International, Inc.*, No. 1:23-CV-00173-REP, 2023 WL 7135059 (D. Idaho Oct. 30, 2023)**

Franchisor filed a demand for arbitration against the plaintiffs for breach of a franchise agreement. The franchise agreement contained an arbitration provision.

The plaintiffs, however, disputed that they ever entered into a franchise agreement with the franchisor. Specifically, the plaintiffs claimed that they

had no record of the franchise agreement and that one of the plaintiffs was confident that he never signed it. The plaintiffs claimed they did not operate a hotel under franchisor's brand—one operated a hotel under a competing brand and the other never ran a hotel. They submitted declarations on their role as passive investors that had nothing to do with operations. Accordingly, the plaintiffs filed an objection and moved to dismiss the arbitration, as well as filed this lawsuit in court seeking relief based on plaintiffs' contention that they cannot be compelled to arbitrate based on a non-existent agreement.

Franchisor moved to dismiss the plaintiffs' complaint for improper venue because the claims should be arbitrated. Franchisor submitted evidence that one plaintiff signed a franchise agreement via DocuSign and that the other plaintiff signed a related guaranty via DocuSign. Plaintiffs disputed the authenticity of these documents.

District Court's decision: The district court denied the franchisor's motion. The court found that there was a dispute whether the parties entered a franchise agreement and, without a franchise agreement that included an arbitration provision, there was no arbitration provision to enforce.

Arbitration is a matter of contract, which requires agreement by the parties. Because the plaintiffs disputed the very existence of a franchise agreement (or guaranty), arbitrability was not the issue—the issue was whether there was an arbitration agreement at all. Construing the contested facts in the plaintiffs' favor, the court was not in a position to conclude as a matter of law that the parties entered into the franchise agreement (and guaranty). As such, whether an agreement exists between the parties was an issue that the court must resolve upfront, and discovery would be necessary to determine the answer to that question.

SEPTEMBER 2023 LADR CASE NOTE

Sasoro 13, LLC v. 7-Eleven, Inc. No. 3:22-cv-2313, 2023 WL 2290788 (N.D. Tex. Feb. 27, 2023)

A recent decision from the Northern District of Texas rejects a franchisee's efforts to allege a breach of the duty of good faith and fair dealing by a franchisor and vindicates a franchisor's right to enforce the terms of its franchise agreement. In *Sasoro 13, LLC v. 7-Eleven, Inc.*, the court dismissed claims for declaratory judgment, breach of contract, violations of the Texas Uniform Commercial Code (UCC), violations of the Petroleum Marketing Practices Act (PMPA), and violations of the Texas Deceptive Trade Practices Act (DTPA) as asserted by franchisee Sasoro 13, LLC (Sasoro) against franchisor 7-Eleven, Inc. (7-Eleven).

Sasoro and 7-Eleven were parties to a franchise agreement (Franchise Agreement) that allowed Sasoro to operate a 7-Eleven gas station franchise in Las Vegas, Nevada. The parties agreed that Texas law applied to all disputes arising out of the Franchise Agreement. The Franchise Agreement included a termination right under which 7-Eleven could terminate the Franchise Agreement upon the occurrence of four instances of any noncompliance

in a two-year period. The Franchise Agreement explicitly stated that any four instances of noncompliance in a two-year period constitute a material breach of the Franchise Agreement without regard to any post-notification corrections made by Sasoro. In October 2022, 7-Eleven notified Sasoro that it was exercising its termination right after Sasoro failed to comply with the Franchise Agreement on at least four occasions in a two-year period. Notably, Sasoro admitted that at least four instances of non-compliance occurred in the relevant time period. Sasoro nonetheless alleged that 7-Eleven's termination breached the terms of the Franchise Agreement and violated the duty of good faith and fair dealing.

Texas law generally refuses to imply a duty of good faith and fair dealing in a contract that is not governed by the UCC. Tex. Bus. & Com. Code § 1.304. Texas courts recognize a duty of good faith and fair dealing in non-UCC contracts only when the agreement expressly incorporates the duty or "a special relationship of trust and confidence exists between the parties to the contract." *TBK Consulting, Inc. v. Dex Media, Inc.*, No. 4:17-cv-924, 2018 WL 11434567, at *4 (N.D. Tex. Aug. 17, 2018). In this case, the court dismissed Sasoro's claims brought under the UCC for breach of the duty of good faith and fair dealing because the Franchise Agreement was not a contract for goods. The court explained that "the heart of the [franchise] transaction is Sasoro's use of 7-Eleven's trademark. Though Sasoro purchases branded goods from 7-Eleven under the [Franchise] Agreement . . . it does so in connection with its contractual rights to use the 7-Eleven name." The court also refused to imply a duty of good faith and fair dealing because the Franchise Agreement did not expressly incorporate such a duty and because Texas courts including the Texas Supreme Court have regularly denied to extend "special relationship" status to the franchisor-franchisee relationship. *See, e.g.*, *Subaru of Am., Inc. v. David McDavid Nissan, Inc.*, 84 S.W.3d 212, 225 (Tex. 2002).

The court ultimately determined that Sasoro's remaining claims must also be dismissed. First, the court looked to the language of the Franchise Agreement and found that Sasoro failed to allege any facts that alleged breach. Sasoro's primary theory of breach was that instances of its noncompliance were not material and that 7-Eleven would be "excused from performing under a contract only if the other party commits a material breach." *Greene v. Farmers Ins. Exch.*, 446 S.W.3d, 761, 767 (Tex. 2014). Because the Franchise Agreement explicitly set forth that four instances of noncompliance with the Franchise Agreement in a two-year period constituted a material breach, the court rejected Sasoro's argument and dismissed Sasoro's claim for breach of contract. The court also dismissed Sasoro's claim for violation of the PMPA because Sasoro did not meet the definition of a retailer or distributor under the PMPA. In dismissing Sasoro's PMPA claim, the court cited the consignment structure of gasoline sales from 7-Eleven to consumers at Sasoro's franchise location and held that such transactions did not constitute purchase of gasoline by Sasoro from 7-Eleven, which was in turn

necessary to trigger application of the PMPA. *See* 15 U.S.C. §§ 2801(1)(A), 2801(6)(A)–(B), 2801(7). Sasoro further conceded that its remaining claims for declaratory judgment and violation of the DTPA were duplicative of its other claims and accordingly withdrew them.

In having its claims dismissed, Sasoro joins the many franchisees who have failed to convince courts applying Texas law that franchisors' conduct must adhere to a standard of good faith and fair dealing. And, as with other cases, the court refused to look beyond plain and unambiguous language of a franchise agreement to resolve a franchisee's allegations of breach of contract by the franchisor.

CURRENTS

ANTITRUST

***Deslandes v. McDonald's US, LLC*, Bus. Franchise Guide (CCH) ¶ 17,357, 81 F.4th 699 (7th Cir. 2023)**

In a case examining the antitrust implications of anti-poaching provisions in franchise agreements, the Seventh Circuit unanimously revived a claim by two McDonald's workers alleging that anti-poaching provisions in McDonald's franchise agreements violated Section 1 of the Sherman Antitrust Act.

One plaintiff, Leinani Deslandes, worked for a McDonald's franchisee near Orlando, Florida. The second plaintiff, Stephanie Turner, worked for an affiliate-owned, non-franchised McDonald's restaurant near Covington, Kentucky. In their complaint, the employees alleged that every McDonald's franchise agreement contained no-poaching provisions restricting franchisees from soliciting or employing anyone who was employed by a different McDonald's restaurant within the previous six months. The employees contended these provisions prevented them from taking higher paying jobs with other McDonald's franchisees. The employees filed a putative class-action complaint against McDonald's Corporation and McDonald's USA, LLC, alleging the anti-poaching provisions violated Section 1 of the Sherman Antitrust Act.

The U.S. District Court for the Northern District of Illinois dismissed the employees' claims, finding that they did not sufficiently plead a violation of Section 1 under either available theory: that the anti-poaching provisions were naked restraints and therefore *per se* unlawful, or that the anti-poaching provisions were unlawful under a Rule of Reason theory.

In rejecting the employees' *per se* unlawful theory, the district court reasoned the anti-poaching provisions were ancillary to the success of a cooperative venture, namely, the franchise agreements, which increase output of burgers and fries. The district court held the anti-poaching provisions were therefore not *per se* unlawful naked restraints and dismissed that claim pursuant to Federal Rule of Civil Procedure 12(b)(6). But the Seventh Circuit disagreed, finding the district court's approach incorrectly "treats benefits

to consumers (increased output) as justifying detriments to workers (monopsony pricing)." The Seventh Circuit questioned whether anti-poaching provisions truly promoted the production of restaurant food. The Seventh Circuit reasoned that it was possible that the provisions helped the restaurants increase their profits "without adding to output," in which case the anti-poaching restrictions could not be considered "ancillary" in the antitrust law sense. On the other hand, the court suggested it could be possible that the anti-poaching clauses helped the restaurants recover training costs, thereby making "training worthwhile to both franchise and worker." In that case, the provisions would be ancillary to the success of a cooperative venture between worker and employer and would therefore be justified. Ultimately, the court concluded these "complex questions" required "careful economic analysis" and could not be resolved on the face of the pleadings. The workers' complaint plausibly alleged a *per se* violation of Section 1, and the Seventh Circuit reversed the trial court's dismissal of that claim.

The workers' second theory, relying on the Rule of Reason, fared worse. The district court dismissed that claim pursuant to Federal Rule of Civil Procedure 12(c) because the workers failed to allege McDonald's and its franchisees had sufficient power in the relevant labor market. The district court invited the workers to amend their complaint to allege the requisite market power, but they failed to do so. On appeal, the workers argued no amendment was necessary because McDonald's power in the market for "workers at McDonald's" was obvious. The Seventh Circuit rejected this argument, reasoning that this proposed market was too narrow. The court could not "treat employment for a single enterprise as a market all its own." The workers were free to choose to work for other restaurants. And there were dozens of quick-serve restaurants within three miles of one of the plaintiff's homes and hundreds of similar restaurants within ten miles. Absent any allegations of market power in this broader labor market, "the Rule of Reason is out of this suit."

The Seventh Circuit remanded the action for further proceedings on the workers' *per se* theory. The trial court's earlier ruling denying class certification was not before the Seventh Circuit. However, because the denial of class certification was based, at least in part, on the district court's belief that the *per se* theory was not viable, the appellate court suggested the trial court "may think it wise to reconsider" that decision.

Circuit Judge Kenneth F. Ripple issued a concurring opinion to clarify the scope of the Seventh Circuit's reasoning. He suggested that the court's analysis should "be helpful to the district court" in determining whether the anti-poaching provisions were ancillary to a cooperative venture, but that the Seventh Circuit did not decide the merits of that question. Rather, the Seventh Circuit remanded the question to the district court to make that decision, subject to the district court's own determination as to the "relative usefulness of the various considerations" affecting that decision.

McDonald's appealed the Seventh Circuit's decision to the United States Supreme Court, which denied certiorari.

ARBITRATION

***Munoz v. Earthgrains Distribution, LLC*, Bus. Franchise Guide (CCH) ¶17,370, 2023 WL 5986129 (S.D. Cal. Sept. 13, 2023)**

Former baked goods distributors brought a class action lawsuit against the producers of baked goods (Earthgrains), alleging California Labor Code violations due to Earthgrains' misclassification of the former distributors as independent contractors rather than employees. The U.S. District Court for the Southern District of California held that the arbitration provisions in the distribution agreement were unenforceable for lack of mutual consent and because they were unconscionable.

Each individual distributor entered into a thirty-four page agreement (Distribution Agreement) to purchase exclusive rights to sell and distribute baked goods within specified geographic areas in California. Each agreement contained a Dispute Resolution Provision (DRP) providing for binding arbitration "governed by the Federal Arbitration Act and the law of the Commonwealth of Pennsylvania to the extent that Pennsylvania law is not inconsistent with the FAA." Each agreement included a waiver of the right to bring any class action in any forum. Along with the Distribution Agreement, the plaintiffs received Franchise Disclosure Documents (FDDs), which contained an addendum for the state of California (California Addendum). The California Addendum stated, "The Distribution (Franchise) Agreement requires that all disagreements be resolved by binding arbitration . . . . This provision may not be enforceable under California law."

Earthgrains filed a motion to compel arbitration, citing terms of the Distribution Agreement. The plaintiff distributors contested the validity of the arbitration provision. The distributors argued there was no mutual assent to the DRP due to a discrepancy between the Distribution Agreement and the California Addendum. Although there was an integration clause and the California Addendum was not part of the agreement, the court determined that extrinsic evidence could be considered where the validity of the agreement was in dispute.

The court relied on *Laxmi Investments, LLC v. Golf USA*, 193 F.3d 1095, 1096 (9th Cir. 1999), where the franchise agreement was preceded by an offering circular which read: "The Franchise Agreement also requires binding arbitration . . . [in the] State of Oklahoma. This provision may not be enforceable under California law." Due to the contradictory terms in the offering circular and franchise agreement, the *Laxmi* court held that the franchisees had no reasonable expectation that it had agreed to a forum other than California. In this case, the Distribution Agreement and addendum were presented to the distributors together and were contradictory. For this reason, the court held there was no meeting of the minds as to the DRP. As California residents, the distributors had no reasonable expectation that they agreed to arbitrate.

The court distinguished *Meadows v. Dickey's Barbeque Restaurants Inc.*, 144 F. Supp. 3d 1069 (N.D. Cal. 2015), which was cited by Earthgrains. In that

case the plaintiffs signed a franchise agreement with a Texas choice-of-law provision, and the FDD accompanying the franchise agreement contained a disclaimer that read: "The franchise agreement requires application of the laws of Texas. This provision may not be enforceable under California law." Immediately preceding the FDD in *Meadows* was a table listing the important provisions of the franchise agreement and a State Cover Page, both of which reiterated the franchisor's intention to apply Texas law. In enforcing the choice-of-law provision, the *Meadows* court explained that the two additional representations made clear that the franchisor would insist on the application of Texas law. Unlike the plaintiffs in *Meadows*, the distributors were not provided with a separate table identifying the arbitration provision as important to the Distribution Agreement. Moreover, in Earthgrains' FDD, the disclosure regarding binding arbitration in the State Cover Page was not readily identifiable from the rest of the text that was also in all capital letters. The disclosure regarding arbitration also appeared in the middle of the page without distinguishable font style or size from the surrounding text. The court found that the producers did not present the distributors with additional and clear representations that the producers would insist on applying the arbitration clause.

The court also found that the DRP, as a whole, was unconscionable. It was a contract of adhesion where the drafting party, a sophisticated and multi-billion-dollar enterprise, had superior bargaining power to individual distributors of limited means and education. Nothing distinguished the arbitration provision itself from any other provision in the thirty-four page agreement. There was no further clarification on the applicability of the arbitration agreement in light of the inconsistencies between the Distribution Agreement and the California Addendum.

In addition, the Distribution Agreement required sixty days' written notice of a dispute or there would be full and complete waiver of the disagreement. The court found this to be substantively unconscionable given that the plaintiffs alleged unwaivable California Labor Code violations that had limitations periods of up to four years. The Distribution Agreement also contained a $10,000 liquidated damages provision for individuals attempting to circumvent arbitration.

To discourage future exploitation of weaker parties, the court refused to sever the unconscionable provisions from the Distribution Agreement and found the DRP unenforceable in its entirety. The DRP contained multiple unconscionable provisions that significantly hindered the distributors' ability to bring claims, imposed a hefty financial burden on the distributors alone, and excluded from arbitration those claims the producers were most likely to bring.

***Fuentes v. Jiffy Lube International, Inc.*, Bus. Franchise Guide (CCH) ¶ 17, 368, 2023 WL 5984284 (E.D. Pa. Sept. 14, 2023)**

The U.S. District Court for the Eastern District of Pennsylvania enforced a mandatory arbitration agreement (Arbitration Agreement) contained within

the paperwork given to newly hired employees of the Jiffy Lube® franchisee. The court held that the plaintiff-intervenor's electronic acknowledgment of receiving the Arbitration Agreement and his continued employment after said acknowledgment were sufficient to create an enforceable agreement to arbitrate.

Jiffy Lube International, Inc. (Jiffy Lube) is the largest chain of quick oil change and automotive repair services in the United States. Over 2,000 franchises exist across the country. Each Jiffy Lube location is owned and operated by an independent business that entered into a franchise agreement with Jiffy Lube. From 2014 until December 2018, Jiffy Lube's franchise agreement contained a "no-poach" clause that prohibited franchisees from soliciting or hiring employees from other Jiffy Lube franchises.

In November 2018, former Jiffy Lube franchisee employee Victor Fuentes sued Jiffy Lube on behalf of a nationwide class. The complaint asserted that the no-poach provision restricted competition between Jiffy Lube franchises and depressed employees' wages. The Fuentes matter settled in July 2022.

Following the announcement of this settlement, Oscar Jimenez, a former employee of a California-based Jiffy Lube franchisee, Alamitos Enterprises, LLC (Alamitos), moved to intervene as a representative of the nationwide class or, at a minimum, a California subclass. In support of his motion, Jimenez attached a new complaint against Jiffy Lube that alleged violations of antitrust laws on behalf of himself and a class of former Jiffy Lube employees. Jimenez and the purported class alleged that the no-poach agreement placed severe limitations on individual Jiffy Lube franchisees and restricted an employee's ability to obtain better compensation and benefits. The court granted Jimenez's motion to intervene. Jiffy Lube subsequently moved to compel Jimenez to arbitration and to dismiss the complaint for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6).

The court analyzed Jiffy Lube's motions under the motion to dismiss standard. The court, citing a Third Circuit opinion, stated that "when it is apparent, based on the face of a complaint, and documents relied upon in the complaint, that certain of a party's claims are subject to an enforceable arbitration clause, a motion to compel arbitration should be considered under a Rule 12(b)(6) standard without discovery's delay." Here, the court determined that the arbitration agreement was integral to Jimenez's claims and applied the Rule 12(b)(6) standard.

Jiffy Lube's motions were based on the mandatory arbitration provision in the agreement, which contained the aforementioned Arbitration Agreement, on Alamitos's employee electric on-boarding platform (ADP platform or account). Jiffy Lube argued that Jimenez was subject to arbitration because: (1) the Arbitration Agreement became binding after thirty days of employment; and (2) Jiminez's claims fell within the scope of the Arbitration Agreement. Although Jiminez did not sign the agreement containing the Arbitration Agreement, Jiffy Lube submitted screenshots, along with a franchisee affidavit, of Jimenez's ADP account to demonstrate that the user

account associated with Jimenez "acknowledged" receipt of the agreement containing the Arbitration Agreement.

Jimenez submitted an affidavit stating that he was unaware of the existence of the Arbitration Agreement and that he would have opted out had he known of its existence. He further argued that the Arbitration Agreement did not bind him because he did not sign it and was not given sufficient notice that his continued employment would constitute acceptance.

The court determined that California law clearly established that continued employment, following notice of an employer's arbitration agreement, constitutes implied consent to arbitrate (under a preponderance of the evidence standard). The court also noted that California courts "routinely" uphold arbitration agreements despite a party's protest that they do not recall agreeing to them.

The court then held that, even if Jiminez did not sign the agreement containing the Arbitration Agreement, Jiminez's acknowledgment that he received and read the agreement containing the Arbitration Agreement followed by his continued employment constituted acceptance of the Arbitration Agreement. Despite these arguments, the court could not overlook Jimenez's failure to dispute the validity or scope of the arbitration provision, his failure to opt out, his receipt of acknowledgment of the Agreement through his ADP account, or his continued employment for over thirty days after the acknowledgment. These facts weighed in favor of enforcing the Agreement.

Consequently, the court granted Jiffy Lube's motion to compel arbitration and resolved Jimenez's other claims as moot.

BANKRUPTCY

In re Thornhill Brothers Fitness, L.L.C., Bus. Franchise Guide (CCH) ¶ 17,392, 85 F.4th 321 (5th Cir. 2023)

The Fifth Circuit reversed and remanded the bankruptcy court's ruling authorizing the partial assignment of an executory contract under Chapter 11. A franchisee-debtor filed for Chapter 11 bankruptcy because of a personal injury action brought in Louisiana state court. The tort victim in the underlying action was allegedly injured while using an inversion machine at the franchisee-debtor's fitness facility. The franchisee debtor and the tort victim reached a settlement of the underlying tort claim. The settlement included partial assignment of an executory contract between the franchisor and franchisee to the tort victim. Contrary to the requirements of Chapter 11, the bankruptcy court approved the settlement and partial assignment of the franchise agreement.

The underlying tort claim was filed by William Flynn in Louisiana state court against the fitness facility franchise owner—Thornhill Brothers Fitness, LLC (Thornhill)—and franchisor—Anytime Fitness, LLC (Anytime)—for injuries sustained while using an inversion machine at the fitness facility

owned and operated by Thornhill. Anytime disputed its involvement in the matter, arguing that the inversion machine's presence at the fitness facility was not authorized by the franchise agreement between Thornhill and Anytime. Anytime filed a motion to dismiss, arguing that it was not liable for injuries resulting from an unauthorized piece of fitness equipment. A Louisiana trial court dismissed Anytime with prejudice. An intermediate Louisiana appellate court affirmed. The tort claim matter proceeded between Flynn and Thornhill.

Before trial, Thornhill filed a voluntary petition for bankruptcy. The bankruptcy petition disclosed the Flynn litigation as the only significant non-insider liability for an amount above $1 million. Less than forty-eight hours after filing the bankruptcy petition, Thornhill's counsel emailed the bankruptcy court, informing it that the parties had reached a settlement. Counsel requested a "wet signature" from the court approving the settlement. The court sent counsel a photograph of the signed draft order approving the settlement.

The settlement between Flynn and Thornhill awarded Flynn $1 million plus judicial interest—the maximum amount allowed by Thornhill's insurance policy. Notwithstanding the Louisiana state court's order dismissing Anytime with prejudice, the Flynn settlement allowed Flynn to sue Anytime. The settlement documents also contained an admission by Thornhill to $7 million in total liability to Flynn. Thornhill further agreed to assign all rights it had against Anytime—including those arising from the indemnity provision contained in the franchise agreement. Thornhill would retain all other obligations and benefits associated with the franchise agreement. The settlement further required that Thornhill remain listed as a defendant in name only. Flynn waived his right to pursue any claims against Thornhill. Anytime became aware of the settlement two weeks after the bankruptcy court approved the settlement.

As a result of the settlement, Flynn filed a new lawsuit (New Suit) against Anytime in Louisiana court. The New Suit alleged that Thornhill's admission in the settlement documents, the assignment of Thornhill's rights against Anytime, the indemnity provision of the Agreement, and the bankruptcy court's approval, supported a finding that Anytime was liable to Flynn for $7 million in damages.

Anytime contested the bankruptcy court's approval of the settlement, claiming that it violated Anytime's notice and hearing rights pursuant to Federal Rule of Bankruptcy Procedure 9109(a). The bankruptcy court withdrew its approval and permitted Anytime to contest the settlement. The bankruptcy court entered a new order reaffirming its prior decision. Anytime appealed this order, and the district court affirmed.

On appeal, the Fifth Circuit reviewed the bankruptcy court's ruling relating to the application of 11 U.S.C § 365 and the assignment of executory contracts. There was no dispute that the franchise agreement between Thornhill and Anytime was an executory contract (a contract that neither

party has finished performing). The court agreed that a franchise agreement—in a general sense—could be considered an executory contract because it specifies ongoing obligations between the franchisee and franchisor. 11 U.S.C. § 365(a) addresses executory contracts and states that a trustee in control of a post-petition debtor may, "subject to the court's approval," "assume or reject any executory contract" of the pre-petition debtor. A debtor must clear various statutory hurdles before a trustee can assume an executory contract. For example, if there is a default under the contract, the debtor must either cure the default or provide adequate assurances that the trustee will promptly cure the default. 11 U.S.C. § 365(b)(1). The debtor must also provide adequate assurances of future performance under such a contract. *Id*. An executory contract that is assumed will remain in effect on the assuming party. A debtor may also assign its rights and obligations under an executory contract to others. However, the debtor must assume the contract in accordance with statutory requirements of 11 U.S.C. § 365(f), and the non-bankruptcy party to the contract must be given adequate assurance of the assignee's future performance.

The Fifth Circuit observed that an executory contract must be assumed or rejected in its entirety. A debtor may not choose, or piecemeal, the parts of the agreement to be assumed, especially when the contract contains several agreements. Assignment under 11 U.S.C. § 365(f) is only intended to change who performs the obligations under the contract, not the contract itself. The Fifth Circuit acknowledged that the Bankruptcy Code contains various catch-all provisions but explained that such provisions do not provide the bankruptcy court with the ability to create rights or actions that are otherwise unavailable. The Fifth Circuit noted that if a debtor could sever an agreement and assign specific provisions, the trustee or debtor could assume property that it did not have before the petition, and it would "derogate the counterparty's contractual rights that would have existed outside of bankruptcy." A debtor cannot use 11 U.S.C. § 365 to create an entirely different contract.

Thus, the Fifth Circuit concluded that Thornhill impermissibly used Chapter 11 to partially assign specific rights to Flynn. Thornhill did not assign the entirety of the Agreement to Flynn. What is more, the Agreement forbade assignment without Anytime's consent, which Thornhill did not receive, as evidenced by Anytime's opposition to the assignment and terms of the settlement. The Fifth Circuit found that the bankruptcy court erroneously permitted the partial assignment of an executory contract and failed to discern whether Thornhill assigned nonexistent rights.

Finally, the Fifth Circuit stated that Thornhill's reliance on *In re Jackson Brewing Co.*, 624 F.2d 599 (5th Cir. 1980), in support of its argument that any defect in the bankruptcy court's order was cured by its order approving the settlement was unavailing. *In re Jackson* prescribed a balancing test to govern the court's approval of a Federal Rule of Bankruptcy Procedure 9109

compromise, not a Chapter 11 assignment of an executory contract. The Fifth Circuit further stated that compliance with the holding in *In re Jackson* is not a substitute for compliance with Chapter 11. A bankruptcy court's rulings must comply with legal precedent and the applicable Bankruptcy Code provisions—compliance with one hurdle does not immediately clear another. The court held that since the bankruptcy court did not satisfy 11 U.S.C. § 365, it did not matter whether they satisfied the rule from *In re Jackson*.

The Fifth Circuit reversed the bankruptcy court's order approving the settlement between Flynn and Thornhill and remanded for further proceedings.

BREAKAWAY FRANCHISEES

***JTH Tax LLC v. Foster*, Bus. Franchise Guide (CCH) ¶17,371, 2023 U.S. Dist. LEXIS 161631 (W.D. Pa. Sept. 12, 2023)**

This case is discussed under the topic heading "Non-Compete Agreements."

CHOICE OF FORUM

***Munoz v. Earthgrains Distribution, LLC*, Bus. Franchise Guide (CCH) ¶17,370, 2023 WL 5986129 (S.D. Cal. Sept. 13, 2023)**

This case is discussed under the topic heading "Arbitration."

CHOICE OF LAW

***Functional Hiit Fitness, LLC v. F45 Training Inc.*, Bus. Franchise Guide (CCH) ¶ 17,379, 2023 WL 6367691 (E.D. Mich. Sept. 28, 2023)**

This case is discussed under the topic heading "Fraud."

CLASS ACTIONS

***Munoz v. Earthgrains Distribution, LLC*, Bus. Franchise Guide (CCH) ¶ 17,370, 2023 WL 5986129 (S.D. Cal. Sept. 13, 2023)**

This case is discussed under the topic heading "Arbitration."

CONTRACT ISSUES

***Functional Hiit Fitness, LLC v. F45 Training Inc.*, Bus. Franchise Guide (CCH) ¶ 17,379, 2023 WL 6367691 (E.D. Mich. Sep. 28, 2023)**

This case is discussed under the topic heading "Fraud."

***Massage Heights Franchising, LLC, v. Hagman*, Bus. Franchise Guide (CCH) ¶ 17,393, 679 S.W.3d 298 (Tex. App. 2023)**

This case is discussed under the topic heading "Vicarious Liability."

***JTH Tax LLC v. Foster*, W.D. Pa., Bus. Franchise Guide (CCH) ¶ 17,371, 2023 U.S. Dist. LEXIS 161631 (W.D. Pa. Sept. 12, 2023)**
This case is discussed under the topic heading "Non-Compete Agreements."

DAMAGES

***Massage Heights Franchising, LLC, v. Hagman*, Bus. Franchise Guide (CCH) ¶ 17,393, 679 S.W.3d 298 (Tex. App. Ct. 2023)**
This case is discussed under the topic heading "Vicarious Liability."

DEFINITION OF FRANCHISE

***Cognex Corp. v. Air Hydro Power, LLC*, Bus. Franchise Guide (CCH) ¶ 17,363, F. Supp. 3d , 2023 WL 5833112 (D. Mass. Sept. 8, 2023)**
In a multi-jurisdiction dispute over the non-renewal of a distribution agreement, the U.S. District Court for the District of Massachusetts dismissed all of the distributor's claims, holding, among other things, that the manufacturer and its distributor had no franchise relationship.

The plaintiff, Cognex, manufactures products used in automated manufacturing. It had a distribution agreement with the defendant, Air Hydro, that was scheduled to expire on December 1, 2021, unless the parties jointly agreed in writing to extend its term. On November 1, 2021, Cognex notified Air Hydro that it would not renew the distribution agreement.

Air Hydro then sued Cognex in Florida state court for breach of the distribution agreement. Before Air Hydro served Cognex with the Florida complaint, Cognex sued Air Hydro in the U.S. District Court for the District of Massachusetts. In the Massachusetts action, Cognex alleged Air Hydro breached the distribution agreement's forum-selection clause, which required all claims to be brought in Massachusetts, and breached the implied covenant of good faith and fair dealing. Air Hydro then dismissed the Florida action and asserted its counterclaims in the Massachusetts action. Cognex moved to dismiss each of Air Hydro's counterclaims, and the court granted Cognex's motion in its entirety.

The district court dismissed Air Hydro's counterclaim for violation of the Florida Franchise Act (FFA) because the distribution agreement contained a choice of law provision providing the agreement would be governed by Massachusetts law, which barred the FFA claim. The court observed that Massachusetts courts give effect to choice of law provisions unless that provision is contrary to a fundamental policy of a state. Reasoning that, unlike several other Florida statutes with explicit anti-waiver provisions, the FFA conspicuously lacked an anti-waiver provision, which could have prohibited the parties from contractually waiving application of the statute. Therefore, consistent with other federal district courts reaching the same conclusion, the Massachusetts choice of law provision barred the FFA claim.

The district court next dismissed Air Hydro's counterclaims for violation of the Florida Deceptive and Unfair Trade Practices Act, the Indiana Franchise Act, and the Indiana Deceptive Franchise Practices Act because each of those claims required Air Hydro to establish that it had a franchise relationship with Cognex. Whether a franchise relationship existed rested on whether the parties' contract required Air Hydro to make a "required payment" to Cognex or a "franchise fee," which is defined as "all consideration that the franchisee must pay to the franchisor or an affiliate, either by contract or by practical necessity, as a condition of obtaining or commencing operation of the franchise."

Air Hydro identified four purported "franchise fees" or "required payments" that it contended, but the district court found none of them qualified. First, Air Hydro claimed its contract required it to purchase demonstration equipment. But the plain language of the contract showed that these purchases were not mandatory, but were instead optional incentives that, if purchased, entitled Air Hydro to discounts on other items. Thus, these payments were not a "condition of obtaining or commencing operation of the franchise."

Second, Air Hydro claimed it was required to pay licensing fees for a software product that facilitated resale of Cognex's products. But the parties' contract did not include this requirement. At most, it required Air Hydro to notify customers that the products for sale included copyrighted software. Under the contract, this was a notice requirement, not a required payment.

Third, without identifying any specific payments, Air Hydro contended it incurred costs in the form of hiring and training employees. It asked the district court to infer that these costs were mandatory payments to Cognex. But because Air Hydro never alleged that it was required to pay Cognex for this training, the district court was unwilling to infer that these payments were mandatory.

Fourth, Air Hydro argued that its costs to build demonstration facilities constituted a required payment. But Air Hydro never alleged it paid these costs to Cognex. The district court viewed these costs, as well as the training and hiring costs, as mere costs of doing business, and not any required payments to Cognex.

Because Air Hydro could not plausibly allege it made a required payment to Cognex, the district court dismissed its claims brought under each of these statutes.

The district court next addressed Air Hydro's claim for breach of the implied covenant of good faith and fair dealing. Air Hydro argued Cognex breached the implied covenant by not compensating Air Hydro for the value of unsold demonstration equipment. However, in the contract, Air Hydro expressly waived any right to "seek indemnity from Cognex for any unsold or unusable inventory." Even if the demonstration equipment was not inventory, Air Hydro pleaded no facts establishing it had any reasonable

expectation that it would be compensated for unused equipment. Thus, the district court dismissed its claim for breach of the implied covenant.

Air Hydro's claims for tortious interference with business relationship and promissory estoppel were both barred by the express terms of the parties' contracts. Cognex did not wrongfully divert customers away from Air Hydro because the contract expressly stated that Air Hydro's rights were "nonexclusive" and that Cognex had the right to "sell or license any of the Products within [Air Hydro's] Territory." Similarly, Air Hydro's promissory estoppel claim was not supported by Cognex's alleged oral representations that it intended to renew the distribution agreement. Air Hydro could not have reasonably relied on any such oral representation because the contract required all renewals to be in writing. Thus, the district court dismissed both of these claims.

Air Hydro's final counterclaim for unjust enrichment, which alleged that Cognex received the benefit of Air Hydro's purchase of demonstration equipment and general investment in the Cognex brand, also failed. In dismissing this counterclaim, the district court cited the well-established principle that a claim for unjust enrichment cannot survive when a valid express contract covers the same subject matter.

EARNINGS CLAIMS

***Functional Hiit Fitness, LLC v. F45 Training Inc.*, Bus. Franchise Guide (CCH) ¶ 17,379, 2023 WL 6367691 (E.D. Mich. Sept. 28, 2023)**

This case is discussed under the topic heading "Fraud."

FRAUD

***Functional Hiit Fitness, LLC v. F45 Training Inc.*, Bus. Franchise Guide (CCH) ¶ 17,379, 2023 WL 6367691 (E.D. Mich. Sept. 28, 2023)**

The U.S. District Court for the Eastern District of Michigan dismissed several of a franchisee's claims against its franchisor and several individuals responsible for negotiating its franchise agreements, while allowing several other of the franchisee's claims to proceed. Specifically, the court dismissed the franchisee's claims for breach of the implied covenant of good faith and fair dealing, unjust enrichment, violations of the California Franchise Investment Law (CFIL), and violations of the Delaware Uniform Deceptive Trade Practices Act. Holding that Michigan, not Delaware, law applied to the dispute, the franchisee's claims for breach of contract, fraud and misrepresentation, negligent misrepresentation, and violations of the Michigan Franchise Investment Law (MFIL) survived the franchisor's motion to dismiss.

F45 Training Inc. (F45), a franchisor of fitness studios, entered into three franchise agreements for the operation of three F45 studios in Michigan with the franchisee, Functional HIIT Fitness (FHF). FHF alleged that it

received and relied on an outdated Franchise Disclosure Document (FDD) when entering into the first two agreements, and did not receive any FDD before entering into the third agreement. FHF also alleged that individual defendants made written and oral financial performance representations at various times that were not included in the FDD, and inaccurately inflated the profitability of F45 studios.

In its breach of contract claim, FHF alleged that F45 charged fees and costs that were not identified in the applicable franchise agreements. In particular, F45 allegedly breached by overcharging for heart rate monitors, failing to disclose the cost of music licensing fees, and incorrectly listing the costs of leasehold improvements in the FDD as being substantially less than the amount FHF paid at one of its studios.

F45 and the individual defendants moved to dismiss all claims, and four of the five individual defendants brought a motion to dismiss the complaint for lack of personal jurisdiction.

The court first determined whether personal jurisdiction existed over the individual defendants. Four of the defendants involved in the franchise sales process were not Michigan residents; instead, they were each Australian citizens. One defendant lived in Australia, two lived in Texas, and one lived in California. The court found that being officers of the franchisor was insufficient to create personal jurisdiction. Rather, FHF needed, and failed to present, evidence that the individual defendants were actively and personally involved in the conduct giving rise to the claims for the court to exercise personal jurisdiction.

Regarding FHF's claims under California, Delaware, and Michigan law, the court proceeded to analyze which state's law applied. Although the franchise agreements provided for Delaware law and would govern all disputes under the franchise agreement, the court concluded that applying Delaware law would be contrary to a "fundamental public policy" of Michigan, and the MFIL applied and Michigan law governed the dispute in its entirety. Unlike Delaware law, which the court noted does not require pre-contractual notice or disclosure, Michigan law expressly provides for protecting franchisees from "superior bargaining power" of franchisors under the MFIL.

Having determined that Michigan law applied, the court held that the franchisee had sufficiently stated a claim for fraud, fraudulent inducement, and misrepresentation. The franchisee also alleged sufficient facts to state a claim for breach of contract. The court declined to determine whether the franchisee's contract claims over music licensing and leasehold improvement amounts in the FDD should proceed. The issue of whether the franchise agreements fully incorporated the FDDs was better addressed at a later stage of the litigation, not on a motion to dismiss.

Finally, the court dismissed the franchisee's claims under the CFIL and Delaware Uniform Deceptive Trade Practices Act simply because Michigan law governed the dispute.

GOOD FAITH AND FAIR DEALING

***Cognex Corp. v. Air Hydro Power, LLC*, Bus. Franchise Guide (CCH) ¶ 17,363, F. Supp. 3d , 2023 WL 5833112 (D. Mass. Sept. 8, 2023)**
This case is discussed under the topic heading "Definition of a Franchise."

INJUNCTIVE RELIEF

***JTH Tax LLC v. Foster*, W.D. Pa., Bus. Franchise Guide (CCH) ¶ 17,371, 2023 U.S. Dist. LEXIS 161631 (W.D. Pa. Sept. 12, 2023)**
This case is discussed under the topic heading "Non-Compete Agreements."

JURISDICTION

***Functional Hiit Fitness, LLC v. F45 Training Inc.*, Bus. Franchise Guide (CCH) ¶ 17,379, 2023 WL 6367691 (E.D. Mich. Sept. 28, 2023)**
This case is discussed under the topic heading "Fraud."

LABOR AND EMPLOYMENT

National Labor Relations Board—Rule on Joint-Employer Status and Potential Effects on the American Franchise Model
On October 26, 2023, the National Labor Relations Board (NLRB) issued its Final Rule (Rule) addressing the standard for determining Joint-Employer Status under the National Labor Relations Act (NLRA). The Rule went into effect on December 26, 2023. The new standard will only apply to cases filed after December 26, 2023.

Under the Rule, Joint-Employer Status can be established if each entity has an employment relationship with a group of employees and they share, or jointly influence, one or more of an employee's essential terms or conditions of employment. The Rule identifies "essential terms or conditions" as:

(1) Wages, benefits, and other compensation;
(2) Hours of working and scheduling;
(3) The assignment of duties to be performed;
(4) The supervision of the performance of duties;
(5) Work rules and directions governing the manner, means, and methods of the performance of duties and the grounds for discipline;
(6) The tenure of employment, including hiring and discharge; and
(7) Working conditions related to the safety and health of employees.

See 29 CFR 103.40(c).

The key aspect of the Rule's "share" or "codetermine" requirement means that the employer possesses the "authority to control (whether directly, indirectly, or both), or to exercise the power to control (whether directly,

indirectly, or both) one or more of the employees' essential terms and conditions of employment." This provision subsequently raises the question of whether *indirect* or *reserved* control is sufficient, on its own, to establish joint-employer status.

Separately, an entity that is considered a joint employer due to its control over essential employment terms will be required to bargain over those terms and conditions in addition to other areas it exercises control over. Opponents of the Rule argue that it is overbroad and expands a franchisor's liability exposure to claims typically handled by franchisees. Many fear that the Rule seeks to alter the American franchise model for the worse. Proponents of the Rule argue that it is a pragmatic approach to ensure that employers who exercise control over an employee's "essential terms or conditions" of employment respect its obligations and bargaining requirements under the NLRA. Nonetheless, the Rule is undergoing congressional review and will (and already has been) subjected to legal challenges.

***Munoz v. Earthgrains Distribution, LLC*, Bus. Franchise Guide (CCH) ¶ 17,370, 2023 WL 5986129 (S.D. Cal. Sept. 13, 2023)**
This case is discussed under the topic heading "Arbitration."

***Massage Heights Franchising, LLC, v. Hagman*, Bus. Franchise Guide (CCH) ¶ 17,393, 679 S.W.3d 298 (Tex. App. Ct. 2023)**
This case is discussed under the topic heading "Vicarious Liability."

NON-COMPETE AGREEMENTS

***JTH Tax LLC v. Foster*, W.D. Pa., Bus. Franchise Guide (CCH) ¶ 17,371, 2023 U.S. Dist. LEXIS 161631 (W.D. Pa. Sept. 12, 2023)**
The U.S. District Court for the Western District of Pennsylvania held that a tax return preparation franchisor could not enforce non-competition and non-solicitation covenants of its franchise agreement with a Pennsylvania franchisee after the time restriction in the covenant had passed. The court concluded that the franchisor's claims of recent discovery of covenant violations that occurred years earlier reflected a lack of diligence in monitoring and enforcing its contractual rights. Despite the franchisor's delay, the equities relating to its request for return of the operations manual, customer lists and contact information, customer tax returns and files, could still support the franchisor overcoming a laches defense raised by the franchisee.

In September 2015 JTH Tax/Liberty Tax Service (Liberty) entered into a franchise agreement with the franchisee (Foster) for the operation of a tax preparation business in Pennsylvania. In May 2020, Liberty issued notice of breaches, including failure to pay monies owed, failure to open a franchise for business pursuant to the franchise agreement's schedule, and failing to actively operate her office. In June 2020, after Foster failed to cure, Liberty terminated the franchise agreement. In January 2023, Liberty filed suit

against Foster for breach of the franchise agreement and promissory notes, violations of the Defend Trade Secrets Act (DTSA), conversion, and unjust enrichment. Liberty sought injunctive relief to prevent Foster's operation of a tax service business in Foster's former territory and diverting or attempting to divert Liberty's customers for two years following entry of injunctive relief. Liberty alleged that it only recently discovered that Foster was operating a separate tax company since at least January 2020, that Foster had solicited Liberty's clients during the 2020 tax season, and that Foster created a website for the separate company while still a franchisee.

In response to Liberty's motion to dismiss, Foster argued Liberty's claims for breach of the notes and for conversion were barred by the statute of limitations, and that the doctrine of laches barred the injunctive relief sought.

The district court determined it had subject matter jurisdiction due to Liberty's DTSA claim. Liberty's assertions surrounding its tax service system and its franchised income tax preparation centers located throughout the United States were sufficient to support the necessary nexus between its tax preparation services and interstate commerce, therefore supporting federal question jurisdiction.

The court then exercised supplemental jurisdiction over Liberty's state law claims. However, the court had to decide which state's law to apply. The franchise agreement and promissory notes contained a Virginia choice of law provision, but did not contain an express statement of intent to apply Virginia's statutes of limitation. In accordance with Pennsylvania's choice of law rules, the court looked to Pennsylvania law to resolve Foster's statute of limitations defense.

The court denied Foster's motion to dismiss Liberty's claim for breach of the promissory notes. The court determined that, whether the notes were under seal, and therefore subject to a potential twenty-year limitations period, was a question of fact, not law, and therefore not appropriate to determine at the dismissal stage. The court could not determine from Foster's complaint whether Foster's assertion that Foster rejected Liberty's request to include a seal with a signature was sufficient to rebut a presumption under Pennsylvania law that Foster adopted the seal. However, Pennsylvania's two-year statute of limitations for conversion barred that claim.

With respect to Liberty's claims for injunctive relief, the court refused to enforce the non-competition and non-solicitation clauses beyond their contractual expiration date. Under Virginia law, which governed the franchise agreement, a prospective injunction may issue beyond the expiration date only where the party seeking the injunction did not contribute unnecessarily to the delay that led to the expiration of the original non-compete covenant. The court found no such narrow exception applied in this case, because there was no delay outside of Liberty's control in filing the action.

In response to Foster's laches defense, and notwithstanding the court finding that Liberty lacked diligence in enforcing its rights, it drew a distinction from Liberty's request for return of property. The court found it to be

a relatively simple and straightforward request that was not certain to affect matters of proof.

STATUTE OF LIMITATIONS

***JTH Tax LLC v. Foster*, Bus. Franchise Guide (CCH) ¶ 17,371, 2023 U.S. Dist. LEXIS 161631 (W.D. Pa. Sept. 12, 2023)**

This case is discussed under the topic heading "Non-Compete Agreements."

STATUTORY CLAIMS

***Cambria Co., LLC v. M&M Creative Laminates, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,351, 995 N.W.2d 426 (Minn. Ct. App. 2023)**

After a buyer (M&M) of quartz countertops failed to timely pay the manufacturer's (Cambria) invoices, Cambria terminated the parties' contracts (a series of "business-partner agreements" or "BPAs") and sued for damages. M&M counterclaimed, alleging among other things that the termination violated the Minnesota Franchise Act (MFA). The Minnesota Court of Appeals affirmed Cambria's victories at summary judgment and trial, holding the parties' relationship was not a "franchise" under the MFA.

Cambria, manufactures and sells quartz countertops. Under its contracts with M&M, Cambria agreed to fabricate and polish countertops based on M&M's purchase orders, which M&M would then install in homes and commercial buildings. M&M regularly failed to timely pay Cambria's invoices. Eight years into the parties' relationship, M&M was more than $150,000 in arrears. Cambria terminated the parties' contracts and sued for the outstanding balance.

M&M asserted counterclaims premised on its relationship with Cambria constituting a "franchise" under the MFA. M&M alleged that Cambria violated the MFA because it did not have the requisite "good cause" to terminate the parties' relationship and because Cambria failed to provide ninety days' notice of the termination.

In its motion for summary judgment, Cambria argued the MFA did not apply because the parties' relationship did not meet the statutory definition of a "franchise." Cambria's argument turned on whether M&M paid a "franchise fee" to Cambria. The MFA defines a "franchise fee" as "any payment for goods or services," but expressly excludes "the purchase of goods or agreement to purchase goods at a bona fide wholesale price." M&M argued its payments to Cambria did not fall within the exclusion because the payments were not only for goods (countertops), but also for services (fabrication). According to M&M, because every payment included, in part, a payment for services, the exception did not apply.

The appellate court found minimal case law on whether the purported "fee" constituted a "franchise fee" under the MFA and, therefore, looked to Uniform Commercial Code cases. Reasoning that paying for a product with

some added service "does not transform a contract of sale into a contract for services," the appellate court concluded the predominant purpose of M&M's payments to Cambria was to purchase goods, i.e., countertops. The inclusion of ancillary fabrication services did not convert the payment into one for services. Thus, the payments fell within the exception and did not constitute a "franchise fee." The appellate court therefore affirmed the trial court's entry of summary judgment against M&M on its claim for violation of the MFA.

The Minnesota Court of Appeals decided several other issues in Cambria's favor. First, M&M brought claims against Cambria for tortious interference with contract and unfair competition, alleging Cambria's improper termination of the contracts caused it to lose customers. The trial court granted summary judgment on these claims, ruling they were barred by a contractual limitation of liability provision stating Cambria would not be liable for "lost profits . . . however caused and on any theory of liability arising out of this agreement, or this termination," whether based in contract or tort. The appellate court affirmed that ruling, finding as a matter of contract interpretation that the plain language of the limitation of liability provision covered these two claims.

Next, the court affirmed the trial court's award of more than $75,000 in costs to Cambria. After filing suit, Cambria served M&M with an offer of judgment under Minnesota Rule of Civil Procedure 68.01(d). The offer of judgment proposed the parties would dismiss all claims and counterclaims with prejudice with no exchange of money. At the resulting trial, the jury awarded Cambria damages that, after accounting for offset, exceeded $200,000. Because that award was less favorable to M&M than the offer of judgment, the trial court ordered M&M to reimburse Cambria for its costs. M&M appealed, arguing a confession of judgment with no dollar figure was ineffective. The appellate court swiftly rejected this theory and affirmed the trial court, reasoning that the confession of judgment was the equivalent of a "zero-dollar offer."

Finally, the Minnesota Court of Appeals affirmed a sanctions award against M&M's attorney for violating a protective order. The protective order stated that all confidential information would be used "solely for the purpose of this action" and should not be communicated to any person other than the parties, attorneys, or court staff. M&M's counsel disclosed a summary of a witness's confidential testimony to another law firm, which then published that information to the International Trade Commission. Both a special master and the district court found that the attorney violated the protective order "for whatever benefit he could get for his client." The appellate court, under a deferential abuse of discretion standard of review, affirmed the sanctions award against the attorney.

***Functional Hiit Fitness, LLC v. F45 Training Inc.*, Bus. Franchise Guide (CCH) ¶ 17,379, 2023 WL 6367691 (E.D. Mich. Sept. 28, 2023)**
This case is discussed under the topic heading "Fraud."

TERMINATION AND NONRENEWAL

***Cognex Corp. v. Air Hydro Power, LLC*, Bus. Franchise Guide (CCH) ¶ 17,363, F. Supp. 3d , 2023 WL 5833112 (D. Mass. Sept. 8, 2023)**
This case is discussed under the topic heading “Definition of a Franchise.”

TORTIOUS INTERFERENCE

***Cambria Co., LLC v. M&M Creative Laminates, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,351, 995 N.W.2d 426 (Minn. Ct. App. 2023)**
This case is discussed under the topic heading “Statutory Claims.”

***Cognex Corp. v. Air Hydro Power, LLC*, Bus. Franchise Guide (CCH) ¶ 17,363, F. Supp. 3d , 2023 WL 5833112 (D. Mass. Sept. 8, 2023)**
This case is discussed under the topic heading “Definition of a Franchise.”

UNFAIR COMPETITION/UNFAIR AND DECEPTIVE PRACTICES

***Cognex Corp. v. Air Hydro Power, LLC*, Bus. Franchise Guide (CCH) ¶ 17,363, F. Supp. 3d , 2023 WL 5833112 (D. Mass. Sept. 8, 2023)**
This case is discussed under the topic heading “Definition of a Franchise.”

VICARIOUS LIABILITY

***Massage Heights Franchising, LLC, v. Hagman*, Bus. Franchise Guide (CCH) ¶ 17,393, 679 S.W.3d 298 (Tex. App. Ct. 2023)**
In a lawsuit brought by the customer of a franchised massage parlor, the Houston division of the Texas Court of Appeals upheld a compensatory damages award against the franchisor, finding that a franchisor can be vicariously liable for the negligent actions of the franchisee in hiring an individual with a known violent criminal record. However, the court held that an individual cannot recover punitive damages from a franchisor when the cause of such damages is rooted in the criminal actions of another individual.

Appellant Massage Heights Franchising, LLC (MH Franchising) licenses its trademarks, service marks, and business systems to franchisees, who subsequently operate businesses offering massage and professional therapeutic services to the public. These businesses operate under the name “Massage Heights.” The relationship between MH Franchising and its franchisees is governed by the franchise agreement and MH Franchising’s operations manual (Manual). The franchisee involved in this case, MH Alden Bridge, LLC (MH Alden Bridge) is located in The Woodlands, Texas, and is owned by OMG MH Holdings, LLC (OMG Holdings). Eric Oliver is the president of OMG Holdings.

Appellee Danette Hagman initiated suit against her masseuse, Mario Rubio (who had a criminal record for assault and robbery), MH Franchising,

Oliver, and OMG Holdings alleging negligence, premises liability, respondeat superior, violations of the Texas Deceptive Trade Practices Act, and gross negligence. Hagman alleged that Rubio sexually assaulted her during a massage and prevailed at trial. The jury ultimately found MH Franchising to be fifteen percent at fault. The jury awarded Hagman $1.5 million in damages and $1.8 million in punitive damages. MH Franchising appealed the jury verdict and award.

MH Franchising argued that it was not liable to Hagman under a negligence cause of action because (1) it did not retain control over MH Alden Bridge's employment practices (e.g., hiring, firing, and supervision); (2) MH Franchising was unaware of any complaints regarding Rubio; (3) Texas required that Rubio be licensed by the state, undergo professional training, and submit a background check; (4) MH Alden Bridge's supplemental background check failed to reveal any sexually motivated crimes; (5) Rubio's criminal act was a superseding cause of Hagman's damages, and, as such, the chain of causation was broken; and (6) there was no evidence of breach and causation.

The appellate court upheld the jury's finding that MH Franchising breached its duty owed to Hagman. In support of this finding, the appellate court reasoned that although MH Franchising did not exert direct control over the hiring process implemented by MH Alden Bridge, the MH Franchising franchise agreement provided an avenue by which MH Franchising could have exercised such control, and MH Franchising failed to exercise such control. Specifically, the franchise agreement and Manual contained various provisions controlling the work performed by masseuses and client interactions. Notably, the franchise agreement and Manual did not contain any provisions addressing the employment of individuals with a criminal record. Despite this, the court determined that the franchise agreement and Manual granted MH Franchising the contractual right to exercise control over the "means, methods, and details of the massages provided by masseuses in its franchisees' locations as well as the interactions between the masseuses and clients." The court further stated that the franchise agreement's authorization for a franchisee to make independent decisions regarding the hiring, firing, and training of the franchisee's staff did not excuse "MH Franchising from the duty to act reasonably with regard to the detail over which it did retain control—providing massages to customers by masseuses."

According to the *Hagman* court, Texas law supports the existence of such a duty. Specifically, employers have a duty to investigate potential employees who would be given access to individuals in vulnerable positions. Here, the court reiterated that an individual who removes all—or most—of her clothes to receive a service (such as a massage) is placed in a vulnerable position—a point that MH Alden Bridge and MH Franchising did not dispute during trial. Based on the above, the court determined that MH Franchising had the ability to exert control to protect the franchisee's customers from foreseeable harm but failed to do so.

As to causation, the court found that MH Franchising's negligence was the proximate cause of Hagman's injuries. The court reiterated that MH Alden Bridge hired Rubio *because* MH Franchising permitted the hiring of masseuses with any kind of criminal record. Even though Rubio's past criminal offenses were not sexual in nature, the court found sufficient evidence to support the argument that, had MH Franchising exercised its control and prevented individuals with "violent offenses" (like Rubio) from obtaining employment, then Hagman would not have been assaulted. Finally, the court concluded that placing "a violent criminal with a history of poor impulse control in a position of power over an undressed and trusting customer behind a closed door poses a foreseeable risk of harm to the customer." The danger of a sexual assault by a masseuse is a foreseeable harm.

Despite MH Franchising's arguments that Rubio's criminal action was a "new and independent cause," the court rejected MH Franchising's superseding cause argument. A superseding cause is one that "intervenes between the original wrong and the final injury so that the injury is attributed to the new cause rather than the original and more remote cause." "To be a new and independent cause, the intervening cause must be both unforeseeable and a superseding cause of the injury." The court held that Rubio's act arose from MH Franchising's negligence in permitting the placement of a violent criminal in a position of power. Furthermore, the court held that the danger of a sexual assault by a masseuse was, and is, a foreseeable risk. The court rejected MH Franchising's superseding cause argument.

Finally, the court reversed the trial court's award of punitive damages to Hagman. Texas Civil Practice and Remedies Code § 41.005(a) prohibits the award of punitive damages for negligence occurring concurrently with a criminal act (or in matters involving harm caused by a criminal act). The court found that her injuries were indivisible to Rubio's criminal act. Accordingly, the court reversed the award of exemplary damages.

***Matter of Thornhill Brothers Fitness, L.L.C.*, Bus. Franchise Guide (CCH) ¶ 17,392, 85 F.4th 321 (5th Cir. 2023)**

This case is discussed under the topic heading "Bankruptcy."