LADR Case Notes April 2023–June 2023 and FLJ Currents (Summer 2023)

*David Harford, Melanie C. Kalmanson & Sawan S. Patel**

APRIL 2023 LADR CASE NOTE

Mr. Harford

Ms. Kalmanson

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***JTH Tax, LLC v. Agnant*, 62 F.4th 658 (2d Cir. 2023)**
A former tax-preparation franchisee defeated the franchisor's motion for a preliminary injunction to enforce post-term non-compete, when the franchisee de-branded and continued to operate after franchise termination.

In March 2022, franchisor JTH Tax, LLC, d/b/a/ Liberty Tax Service (Liberty) terminated franchisee Alexia Agnant's (Agnant) franchise agreements, claiming that Agnant and her staff had committed material violations of federal tax laws and regulations in providing tax preparation services. Liberty also demanded that Agnant comply with various post-termination obligations, including her non-compete and non-solicitation covenants. Agnant refused, stopped using Liberty's marks, but continued to operate.

In April 2022, Agnant sued Liberty, asserting claims for violation of the New York Franchise Sales Act, fraud in the inducement, unjust enrichment, and disputed Liberty's terminating the franchise agreement. The following day, Liberty sued Agnant for breach of franchise agreements, violation of the Defend Trade Secrets Act of 2016, trademark infringement, false designation and misrepresentation of origin, federal trademark dilution, unjust enrichment, and common-law conversion, alleging that the former franchisee refused to

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comply with various post-termination obligations, including non-compete and non-solicitation covenants.

Liberty moved for preliminary injunctive relief, and the district court denied. The Second Circuit Court of Appeals affirmed the district court's ruling.

The Court of Appeals first held that the heightened standard applies and that Liberty must show a "clear or substantial" likelihood of success on the merits, and a "strong" irreparable harm. "[A] plaintiff must meet that standard if he seeks an injunction that provides him substantially all the relief he seeks in the litigation, and that cannot be meaningfully undone in the event that the enjoined party prevails at trial on the merits." *JTH Tax*, 2023 WL 2467363, at *6. Liberty failed to explain "how a court could undo the effect of a wrongfully imposed injunction that would effectively put Agnant out of business." *Id*. The Court of Appeals cited multiple franchise termination cases and analyzed the effect to defendants, "the right to continue a business . . . is not measurable entirely in monetary terms, especially when that business is essential to the defendant's manner of living." *Id*. "Like the family-owned businesses in those cases, Agnant would suffer irreparable harm if she were wrongfully put out of business," when Agnant provided testimony that she used her home as collateral for the business loan, had been in business only for two years, and did not have a track record, and she would be unable to provide for her family and pay for the legal fees if her business were closed. *Id*. at 7.

The Court of Appeals next reviewed the district court's rulings that Agnant's evidence and competing testimony "neutralized" Liberty's declarations, and held that Liberty did not meet the standard of a clear or substantial likelihood of success on the merits. On the one hand, Agnant testified that she did not violate federal tax laws and that "Liberty would pick on little things." On the other hand, Liberty's pre-termination communications with Agnant consistently offered her only boilerplate and non-specific guidance, and lacked specificity as to what exactly she was doing wrong. *Id*. at 8. Liberty's declaration was also conclusory and did not provide any example of a tax return prepared by Agnant that violated federal law.

Finally, the Court of Appeals examined the "strong irreparable harm" element and upheld the district court's ruling that Liberty failed to meet its burden. In this case, the district court found, although Agnant did not stop operating, she was no longer using Liberty's name, confidential information, or proprietary information and resources. The Court of Appeals reasoned, there is no "automatic assumption" that "irreparable harm must inevitably be assumed in breach of covenant cases," and "a plaintiff must present the district court with actual evidence." *Id*. at 11.

The facts and rulings in this case provide insights on franchisees' potential arguments either against a similar preliminary injunction, or to support a preliminary injunction against termination.

MAY 2023 LADR CASE NOTE

Hyundai Subaru of Nashville, Inc. v. Hyundai Motor America, Inc., 2023 WL 2201015 (M.D. Tenn. Feb. 24, 2023)

A car dealership defeated the manufacturer's motion to dismiss on violation of Automobile Dealer's Day in Court Act (ADDCA), constructive termination, breach of contract, and breach of implied covenant of good faith and fair dealing arising from manufacturer's refusal to approve the dealership relocation.

Hyundai Subaru of Nashville, Inc. d/b/a Downtown Hyundai (Downtown) alleged the following in its complaint: it has sales and services agreements with Hyundai Motor America, Inc. and Genesis Motor America, LLC (collectively "HMA") to sell Hyundai and Genesis vehicles out of its dealership located at a certain address in Nashville, Tennessee. The lease on that property will expire at the end of 2023. After Downtown informed HMA of its intention to relocate in 2021, HMA attempted to coerce Downtown into selling the dealership so HMA can replace Downtown with its preferred operator. Downtown submitted two potential sites for relocation, both located in primarily African American neighborhoods. HMA denied both locations. Downtown alleged HMA's conduct as discriminatory and coercive. Count I alleged violation of ADDCA, 15 U.S.C. § 1222 *et seq.*, and constructive termination. Count II alleged breach of contract and breach of the implied covenant of good faith and fair dealing.

HMA's Rule 12(b)(6) motion to dismiss, made two main arguments: Downtown is still opening and operating so there can be no constructive termination claim; this relocation dispute, like many others, should be dismissed for lacking an actional "wrongful demand" under ADDCA.

The ADDCA provides that an "automobile dealer may bring suit against any automobile manufacturer engaged in commerce . . . [to] recover the damages by him sustained and the cost of suit by reason of the failure of said automobile manufacturer to act in good faith in performing or complying with any of the terms or provisions of the franchise, or in terminating, canceling, or not renewing the franchise with said dealer." 15 U.S.C. § 1222. Under the statute, "[t]he term 'good faith' [means] the duty of each party to any franchise, and all officers, employees, or agents thereof to act in a fair and equitable manner toward each other so as to guarantee the one party freedom from coercion, intimidation, or threats of coercion or intimidation from the other party." 15 U.S.C. § 1221. "In order to succeed on a Dealers' Act claim, the dealer must demonstrate that the manufacturer exercised coercion or intimidation or made threats against the dealer . . . to achieve an improper or wrongful objective . . . ." *Adkins v. Gen. Motors Corp.*, 170 F. App'x 184, 188 (2d Cir. 2006).

The court rejected HMA's first argument and held ADDCA's language was not limited solely to termination; it instead allowed recovery for a dealership that had been injured by manufacturer's failure to act in good faith.

HMA cited cases where the courts found a business still in operation could not sustain a constructive termination claim. However, these cases were decided under entirely different laws (Petroleum Marketing Practices Act, contract, and New York Franchise Motor Vehicle Dealer Act). Unlike the Petroleum Marketing Practices Act, ADDCA's focus is not solely on termination; it allows recovery for a plaintiff that has been "injured by the defendant's failure to act in god faith."

The court also rejected HMA's second argument and found that "Downtown paints a sufficiently detailed picture to open the door of discovery" that "manufacturer makes a wrongful demand which will result in sanctions if not complied with." According to the allegations in the Amended Complaint, HMA began its coercion tactics by presenting Downtown with an already written sales agreement that would place the dealership in the hands of HMA's preferred operator. Downtown refused HMA's demands and looked to relocate, only to be stopped at every turn. It began when Downtown proposed a site only minutes from its present location but, on the eve of closing, HMA rejected the proposal based on reasons that had never previously been mentioned to Downtown. It continued when Downtown presented a seemingly appropriate second site, but this option was rejected when HMA claimed it lacked enough details, even though Downtown had provided extensive information and included a market study. Next, HMA proposed a site to Downtown, but the price for the parcel was more than what any reasonable dealer would pay and was not even large enough to meet HMA's guidelines. In addition, Downtown also alleged that HMA has a history of redlining dealerships away from African American neighborhoods. Even after the court considered the notion that a "distributor acting honestly is entitled to latitude in making commercial judgments," based on the allegations in the complaint, the court found that Downtown sufficiently pled that HMA failed to act in good faith.

JUNE 2023 LADR CASE NOTE

Lunt v. Frost Shades Franchising, LLC, No. 3:22-cv-00775, 2023 WL 3484202 (M.D. Tenn May 16, 2023)

Bob Lunt was a franchisee of Frost Shades Franchising, LLC (Frost Shades) and operated his location in South Carolina. Frost Shades franchises businesses that sell and install residential and commercial window tinting and window films.

Lunt claimed that Frost Shades provided little support and never provided him with an operating manual for him to operate his business. He also claimed that the initial training Frost Shades provided was inadequate, and, as a result, he had to learn how to operate his business on his own. These issues led to a breakdown of the relationship.

The owners of Frost Shades had an internal dispute. As a result of this dispute, Lunt learned that some of the owners were parties to litigation and subject to orders issued by state agencies that were not disclosed to Lunt in the FDD that Frost Shades provided him.

In October 2022, Lunt filed a complaint in the United States District Court for the Middle District of Tennessee against Frost Shades and two of its owners, Leiby Goldberger and Curt Swanson. Lunt asserted three counts: one for fraudulent misrepresentation, one for fraudulent concealment, and one for injunctive relief. Lunt sought restitution and rescission of all agreements between him and Frost Shades.

Lunt's fraud claim was based on Frost Shades' failure to include litigation and agency actions in Item 3 involving Goldberger and Swanson, who were previously involved in another franchisor, Patch Boys Franchising, LLC (Patch Boys). Patch Boys was subject to two civil actions in Minnesota, an investigation and consent order by the Minnesota Department of Commerce, and an investigation and Assurance of Discontinuance (consent order) by the Attorney General of New York involving Patch Boys' franchising practices. In its Item 3, Frost Shades stated that it had no litigation to disclose.

In response to Lunt's lawsuit, Frost Shades filed a motion to compel arbitration. Lunt, in turn, filed a motion for preliminary injunction, seeking an order enjoining Frost Shades from enforcing the non-compete provision in the franchise agreement and from interfering with Lunt's operation of a competing business. Lunt wanted the injunction because he was negotiating with a competitor of Frost Shades to operate a business for the competitor.

The court's ruling on each of these motions is discussed below.

Motion to Compel Arbitration

Lunt argued that under older Tennessee cases, which prohibited arbitration of fraudulent inducement claims, Frost Shades' motion should be denied. Frost Shades responded by pointing to the New Jersey choice of law provision in the franchise agreement. Lunt claimed that the court should find the choice of law was impermissible given the lack of connection between New Jersey and the underlying transaction.

The court concluded that the parties' arguments about the choice of law provision were beside the point because the Federal Arbitration Act and the terms of the agreement dictate the scope of the arbitration provision. The court pointed out that the FAA governs if the contract relates to interstate commerce. Moreover, because the franchise agreement did not exclude fraudulent inducement claims, Lunt could not rely on outdated and displaced Tennessee law. The court ultimately compelled arbitration and stayed the action pending the arbitration.

Motion for Preliminary Injunction

To analyze Lunt's request for a preliminary injunction, the court analyzed the traditional elements: (1) whether the moving party is facing immediate, irreparable harm, (2) the likelihood of success on the merits, (3) the balance of the equities, and (4) the public interest.

Preliminarily, the court addressed the parties' disagreement about which state's laws governed the claims. Contradicting his position on the motion to compel arbitration, Lunt argued that Georgia law governed the interpretation of the contract and that South Carolina law governed the claims of fraudulent inducement.

Lunt repeated his argument that New Jersey had no relationship with the underlying transaction. The court noted that one of the owners and defendants, Goldberger, lives in New Jersey and that Frost Shades moved to New Jersey, albeit one year after Lunt signed his franchise agreement. The court ultimately enforced the New Jersey choice of law provision, after noting no substantive difference between the relevant states' law on fraudulent inducement.

Likelihood of Success on the Merits

Citing New Jersey and South Carolina case law, the court noted that nondisclosure is fraudulent where a party has a duty to disclose as a matter of law. As the court explained, "[T]he federal duty to make certain disclosures in an FDD may form part of the foundation of state fraud claim . . . because the Franchise Rule, like any binding disclosure obligation, changes the landscape of which omissions can be considered false or misleading." *Lunt*, 2023 WL 3484202, at *8 (citing *TC Tech Mgt. Co. v. Geeks on Call Am., Inc.*, No. 2:03-CV-714-RAJ, 2004 WL 5154906, at *5 (E.D. Va. Mar. 24, 2004)).

Frost Shades admitted that it "inadvertently" omitted one of the civil actions but explained that the omission was because the suit was filed against Patch Boys after Swanson and Goldberger had sold their interest in Patch Boys. The court discounted this argument because Swanson and Goldberger were named defendants in the lawsuit.

Frost Shades also argued that, because the second civil action and consent order that resulted from the Minnesota investigation were part and parcel of the civil action, it was not a separate litigation subject to the Item 3 disclosure obligation. The court noted that the argument may have carried some weight if the civil actions were disclosed. Indeed, the court held this argument against Frost Shades because it admitted the civil action should have been disclosed. This was a tacit admission that the investigation and consent order by the Minnesota attorney general should have also been disclosed.

On the New York Assurance of Discontinuance, Frost Shades argued that it was not obligated to disclose this because it related to the New York Franchise Sales Act and not the FTC Franchise Rule. The court cited to the language of the Franchise Rule that requires disclosure of currently effective injunctive or restrictive orders relating to federal or state franchise laws.

Given Goldberger's experience with franchising, the court held that Frost Shades should have understood why a potential franchisee would expect to receive information about past litigation. Moreover, the court disagreed with Frost Shades' contention that if it substantially complied with the FTC Rule, then it could not be held liable for fraudulent inducement.

After finding that Lunt provided evidence to support the conclusion that he was likely to prove that he relied on the deficient FDD, the court analyzed Lunt's claimed damages. Lunt explained that the non-compete provision restricts his rights to engage in the window film industry and that this restriction is itself a form of injury. The court found this undeniable.

The court found that Lunt established a "significant likelihood of success" on each element of his claim for fraudulent inducement.

Irreparable Harm

Lunt argued that he was suffering irreparable harm because of his inability to pursue other opportunities with the Frost Shades competitor. If he had to wait for the litigation to release him from the non-compete provision, Lunt claimed, then he was in danger of losing the money that he invested in his business.

The court noted that monetary or economic harm, alone, typically does not constitute irreparable harm, because monetary injury can be remedied by an award of damages. The court agreed with Lunt's argument, however, that his claims are only incidentally about the money he would lose and are really about his right to operate his business in the field of his choosing. The court found that the value of that right was "unknowable." The court noted that Lunt's showing of irreparable harm, while not overwhelming, was sufficient to support an award of preliminary relief.

Balance of Equities and Public Interest

The court explained that the only harm Frost Shades would suffer if the injunction was issued was that Lunt would be able to compete immediately, rather than after the expiration of the non-compete term. It found that this harm was not worse than the harm Lunt would suffer from having the non-compete provision wrongly enforced against him. This was particularly true because Frost Shades would remain capable of selling franchises within Lunt's territory.

Allowing Frost Shades to enforce the non-compete provision during the litigation, the court found, "would amount to locking Lunt out of the industry unless he was willing to serve as a franchisee for the company that, he has plausibly alleged, defrauded him." The court found the equities favored Lunt.

The court also found that the public interest factor favored Lunt, citing to cases finding that the public interest disfavors restraints on trade and interference with a person's livelihood. While the public interest also supports enforcement of *valid* non-compete provisions, the court noted that this analysis directly implicated the merits of Lunt's claim for fraudulent inducement.

The court found that the record suggested that Lunt had a significant likelihood of establishing that he was not subject to a lawfully obtained and enforceable non-compete provision. As a result, the court found that each preliminary injunction factor favored granting Lunt's request.

The court entered an order enjoining Frost Shades from enforcing the non-compete provision. However, the court denied Lunt's request for an order enjoining Frost Shades from interfering with his operation of a competing business.

The court noted that Frost Shades may not unlawfully interfere with Lunt's business, as a matter of law, but it was allowed to compete lawfully with Lunt. Ordering Frost Shades to not interfere with Lunt's business would, therefore, place an unnecessary and vague restriction on Frost Shades' ability to compete with him.

After granting the injunction, the court required Lunt to post a bond of $500.

CURRENTS

ARBITRATION

***Lunt v. Frost Shades Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 17,323, 2023 WL 3484202 (M.D. Tenn. May 16, 2023)**
This case is discussed in the LADR Case Notes.

***NuVasive, Inc. v. Absolute Medical, LLC*, Bus. Franchise Guide (CCH) ¶ 17,323, 71 F.4th 861 (11th Cir. 2023)**
The Eleventh Circuit affirmed a district court order tolling the deadline to vacate an arbitration award and vacating the award because that prevailing party in the arbitration—a medical products distributor—had procured the award through fraud.

The plaintiff, NuVasive, a medical products distributor, entered into a five-year exclusive distribution agreement with the defendant, Absolute Medical, to market and sell NuVasive products in central Florida. Absolute Medical, which was owned by Greg Soufleris, utilized independent contractor sales representatives to market and sell NuVasive products to doctors and medical practices. As part of the exclusive distribution agreement, NuVasive provided training to Absolute Medical and its independent sales representatives. In exchange, Absolute Medical agreed to a non-compete and non-solicitation provision for the term of the agreement and one additional year following the end of the five-year term of the agreement. Absolute Medical also agreed to have its independent sales representatives sign "compliance agreements" regarding their adherence to the non-compete provisions of the distribution agreement.

Less than one year into the five-year term, Soufleris gave notice of his termination of the distribution agreement. Three days later, Soufleris formed a new company called Absolute Medical Systems that employed the same independent sales representatives and sold similar medical devices manufactured by one of Nuvasive's competitors, Alphatec.

NuVasive filed a federal lawsuit in the U.S. District Court for the Middle District of Florida against Absolute Medical, Soufleris, and Absolute Medical's sales representatives asserting nine counts against the defendants. NuVasive claimed that the defendants had violated the non-compete provisions of the distribution agreement and converted NuVasive's trade secrets and proprietary information. After filing the case, NuVasive moved to compel arbitration of its breach of contract claim. The district court granted the motion and stayed the non-contractual claims pending the completion of arbitration. Absolute Medical prevailed on the breach of contract claim brought by NuVasive in the arbitration. The arbitration panel held that NuVasive had not met its burden of establishing that its alleged damages were caused by Absolute Medical's breach of contract.

After the completion of arbitration, the parties resumed litigation of the remaining claims in the district court. The district court permitted limited discovery and set the matter for trial. During the limited discovery period—but more than ninety days after the issuance of the arbitration award—Absolute Medical produced text messages among the defendants indicating that Greg Soufleris was texting answers to a witness while that witness was testifying under oath during the arbitration hearing. The witness was testifying remotely, and NuVasive was able to line up the timing of texts sent to the witness by Soufleris with questions asked during cross-examination.

Despite the expiration of the deadline to move to vacate under the Federal Arbitration Act (FAA), NuVasive moved to vacate the arbitration award asserting that the award was procured by fraud and that it could not have discovered the fraud before the statutory deadline. The district court agreed to vacate the award and retained jurisdiction to decide the breach of contract claim.

Absolute Medical appealed. It argued that equitable tolling cannot be applied to motions to vacate under the FAA, that the fraud did not impact the award, and that the district court should have remanded the matter to the arbitration panel to decide the breach of contract claim again.

The Eleventh Circuit upheld the district court's order. First, the court joined the Ninth Circuit in holding that the deadline to move to vacate an arbitration award under the FAA is subject to equitable tolling. The court reasoned that the statutory text of the FAA does not create a statutory deadline. It also held that permitting equitable tolling of the deadline to move to vacate an arbitration award would not be disruptive because the law places a "heavy burden" on a party seeking the tolling to prove both extraordinary circumstances and diligence.

The Eleventh Circuit found no error in the district court's decision to grant equitable tolling, holding that NuVasive had met the heavy burden of showing a basis for equitable tolling. Describing defendants' conduct as "shocking," the court held that it was an extraordinary circumstance that NuVasive moved quickly to address following its discovery.

The Eleventh Circuit also upheld the district court's decision to vacate the award and retain jurisdiction to decide the breach of contract claim instead of sending it back to arbitration. The Eleventh Circuit held that NuVasive had satisfied the three-part test required to show that an arbitration award should be vacated for fraud under the FAA. First, NuVasive showed clear and convincing evidence that defendants had engaged in improperly supplying testimony to witnesses during the hearing; it established that it could not have discovered the fraud during the arbitration; and it established that the testimony of the witness was materially related to an issue in the arbitration. Further, in light of the shocking conduct by defendants, along with other evidence of discovery misconduct, the Eleventh Circuit found no error in the district court's decision to retain jurisdiction over the entire case.

CONTRACT ISSUES

***Cookie Dough Bliss Franchising, LLC v. Feed Your Soul Minnesota, LLC*, Bus. Franchise Guide (CCH) ¶ 17,342, 2023 WL 4901292 (D. Minn. Aug. 1, 2023)**

This case is discussed under the heading "Injunctive Relief."

***D.Q.S.A. LLC, dba Dairy Queen of Southern Arizona v. American Dairy Queen Corp.*, Bus. Franchise Guide (CCH) ¶ 17,326, 2023 WL 4365332 (D. Ariz. July 6, 2023)**

On cross summary judgment motions, the U.S. District Court for the District of Arizona granted a motion for summary judgment by Dairy Queen's master franchisor, requiring Dairy Queen's Arizona subfranchisor to enforce its subfranchisees' immediate installation of a new point-of-sale systems under certain subfranchise agreements.

The Arizona subfranchise relationship between American Dairy Queen Corporation (Master Franchisor) and DQSA LLC (Subfranchisor) dates back to the 1940s, through each of their predecessors. During this time, agreements were changed, updated, and amended in various ways as the Dairy Queen system grew. One such way that Dairy Queen grew was through two different offerings: the dairy products-only stores and the quick-service food restaurants. The controlling agreements at play between the Master Franchisor and its Arizona subfranchisor are (1) 1960 Territory Agreements (TA), which gave the subfranchisor the right to sublicense the "Dairy Queen" mark for the sale of frozen dairy product within the territory (similar to DQ Treat stores); and (2) a 1985 Food Service Agreement (FSA), which gave the subfranchisor the right to subfranchise quick-service "Dairy Queen" restaurants throughout most of Arizona (similar to DQ Grill and Chill). According to the terms of the FSA, in the event of any inconsistency between the agreements, the TA controls the dairy products only, and the FSA controls the food service of subfranchisees' business.

In January 2019, the Master Franchisor designated the ITP system as the only approved point-of-sale system for use in all of its stores throughout the United States. The Master Franchisor requires any subfranchisee operating under a newer form Operating Agreement, or who is authorized to serve food, to use the ITP system. The subfranchisor's quick-service food restaurant subfranchisees operate two different categories of Operating Agreements. Some operate under a newer form Operating Agreement, which is similar to the Master Franchisor's current form operating agreement, while others operate under an older form Operating Agreement with a Food Service Addendum.

The subfranchisor filed a lawsuit against the Master Franchisor asking the court to determine when subfranchisees must adopt the new point-of-sale, and when the subfranchisor must enforce adaptation of the new point-of-sale system. For clarity, the parties agreed that the Master Franchisor can enforce a new point-of-sale system on the subfranchisees under either subfranchise agreement, but disagreed as to *when* the subfranchisees are required to adopt this system. The Master Franchisor argued that the subfranchisees must immediately adopt the ITP system, whereas the subfranchisor argued that the subfranchisees need only adopt the ITP system when modernization of their store is required. The parties agreed that there were no issues of material fact, that the case hinged on interpretation of contracts, and that the case could be resolved on cross motions for summary judgment, which the parties filed.

The two different types of subfranchise agreements required individual analysis. The newer form Operating Agreement requires modernization of various aspects of the store, including equipment (and thus point-of-sale systems) at least every ten years, but also provides the subfranchisees may only use a point-of-sale system that is approved by the Master Franchisor. The subfranchisor argued that the provision on modernization set a limit to when subfranchisees are required to adopt changes in various aspects of the store, including the building, equipment, and grounds. However, when applying this logic to the whole agreement, the court found the modernization provision to be a baseline of when subfranchisees are required to update the point-of-sale system, rather than a limit on when the Master Franchisor can require updates to the point-of-sale system.

The court further noted that this conflict between the provisions was an example of the contract interpretation principle that the specific governs the general. The modernization provisions mentioned various categories, include the building, grounds, signage, premises, and equipment generally, whereas the approved equipment provisions specifically enumerate the point-of-sale system and the requirement that subfranchisees must purchase, install, and maintain Master Franchisor's designated point-of-sale system. Put another way, the specific requirement that the subfranchisees must use only an approved point-of-sale system was an immediate duty, and it was not overridden by the more general duty to update or modernize the store periodically.

The subfranchisor further pointed to the Master Franchisor's FDD, noting that it stated that subfranchisees are only required to modernize approximately every ten years. However, the court noted that the FDD was consistent with the newer form operating agreements and stated that subfranchisees may only use equipment, including the point-of-sale system, that are approved by the Master Franchisor, and that the Master Franchisor has the right to periodically change its list of approved equipment.

The subfranchisor asserted three other arguments regarding the Operation Manual to support its position. First, it argued that when the Master Franchisor required installation of the ITP system, it did not identify or define it in the Operations Manual. However, the Operations Manual now does so, and thus this argument failed. Next, the subfranchisor pointed to the fact that the Operations Manual states, "If your agreement does not contain a modernization provision, you will not be required to modernize." The court rejected this argument too, holding that the approved equipment is identified in a different provision and states that subfranchisees must use the ITP system. Finally, the subfranchisor asserted that the requirement to install the ITP system would be contrary to the terms of the newer form Operating Agreement and thus is an impermissible unilateral modification. The court rejected this too, finding, as stated previously, that the newer form Operating Agreement allows the Master Franchisor to change the approved point-of-sale system and require subfranchisees to immediately install the approved system.

The newer form Operating Agreement and the FDD were consistent, and the court found that subfranchisees operating under the newer form Operating Agreement would be required to update the point-of-sale system immediately, and the subfranchisor would be required to enforce the standard immediately.

For subfranchisees operating under the older form Operating Agreements, the same provisions would not apply. However, the FSA requires the subfranchisor to enforce Master Franchisor's standards of operations, including using only approved equipment, on the subfranchisor's subfranchisees, and permits the Master Franchisor to modify what equipment is approved on a reasonably periodic basis. The subfranchisor argued that these provisions are general and vague, and they do not include any modernization provision, unlike the newer form Operating Agreements. However, the court found that the plain language of the FSA required the subfranchisor to enforce system standards, and included the standard that subfranchisees only use approved equipment. The subfranchisor argued that the TA should control, and the TA did not give Master Franchisor authority to control the point-of-sale system. However, the FSA stated that, in the case of any inconsistency, the FSA controls on aspects of food service; thus, where subfranchisee quick-service stores are involved, the FSA controls.

The court thus concluded that under the newer form Operating Agreement and the FSA the subfranchisor is required to immediately enforce adoption of the ITP system by its subfranchisees that operate "Dairy Queen" quick-service restaurants, can give dates certain by when subfranchisees must sign participation agreements, and when subfranchisees must complete installation of the ITP system.

***NuVasive, Inc. v. Absolute Medical, LLC*, Bus. Franchise Guide (CCH) ¶ 17,323, 71 F.4th 861 (11th Cir. 2023)**
This case is discussed under the heading "Arbitration."

DAMAGES

***Little Caesar Enterprises, Inc. v. S&S Pizza Enterprises, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,354, No. 21-1176, 2023 WL 5489021 (E.D. Mich. Aug. 24, 2023)**
The U.S. District Court for the District of Michigan granted summary judgment to a franchisor seeking damages for breach of contract against terminated franchisees. Defendants (franchisees) owned and operated two Little Caesars franchise locations under separate franchise agreements, which (a) placed terms on franchisees' ability to use Plaintiffs' (franchisors) trademarks, (b) contained a non-compete clause, and (c) outlined liquidated damages for premature termination of the agreement.

Franchisor sent franchisees notices of default under the franchise agreements for failing to submit required financial statements and for abandoning one of the franchise locations. Ultimately, after providing franchisees with an opportunity to cure, franchisor terminated the franchise agreements. Franchisees contested the termination.

Franchisor and its affiliate that owned the system's trademarks filed suit against franchisees for breach of contract, trademark infringement, unfair competition, and trade dress infringement. The plaintiffs' claims were based on franchisees' actions discussed above as well as post-termination defaults.

Franchisor filed a motion for summary judgment on Count I (breach of contract), to which franchisees did not respond. The court found that franchisees committed several breaches of the franchise agreements and continued to do so after the franchisor filed suit. Due to the franchisees' failure to cure, the court determined the franchisor had "good cause to terminate the Franchise Agreements." As to damages, the court enforced the liquidated damages provision in the franchise agreements, finding that the amount presented in the affidavit attached to the motion for summary judgment could be awarded by a reasonable juror. The court also referenced its prior enforcement of the same liquidated damages provision in another case. Further, the court enforced the attorneys' fees provision in the Franchise Agreements, requiring the franchisees to pay franchisor's attorneys' fees and costs "incurred during litigation."

ENCROACHMENT

Zubair Kazi et al. v. KFC US, LLC, Bus. Franchise Guide (CHH) ¶ 17,343, 76 F.4th 993 (10th Cir. 2023)

The Tenth Circuit overturned a jury verdict awarding a franchisee of Kentucky Fried Chicken (KFC) damages for breach of the implied covenant of good faith and fair dealing arising out of KFC's decision to allow another franchisee to open a new location about 4.5 miles away from the plaintiff-franchisee.

The plaintiff, Zubair Kazi, was an experienced KFC franchisee who had owned over eighty locations over a period of forty years. In 2019, when KFC decided it wanted to open a new location in Pueblo, Colorado, the plaintiff owned the only KFC restaurant in Pueblo.

Before opening the new location, KFC followed procedures that it had developed with KFC's National Council and Advertising Cooperative—an organization controlled by a board of KFC franchisees. These procedures required KFC to give the plaintiff thirty days' notice and an opportunity to apply to own the new location or to ask for an impact study performed by pre-approved vendors. If the impact study found that the new location would impact the closest existing store's sales by fifteen percent or more, the new location would not be approved; if the impact was between ten and fifteen percent, KFC would conduct further studies before placing the location; if the impact was less than ten percent, the new store would be approved.

The plaintiff requested a study, which was performed by one of the pre-approved vendors, and found that the proposed new location would impact the sales of the plaintiff's location by about thirteen percent. The plaintiff hired his own vendor that assessed the impact at thirty-five percent. KFC conducted additional study and determined to grant the franchise; however, the new franchisee encountered difficulties opening a store at the original location. The new franchisee selected a different location slightly further away from the plaintiff's store. KFC did not provide plaintiff with additional notice and did not perform a new impact study, relying upon their pre-approved vendor's opinion that the impact of the new location would be less than the original location. The plaintiff responded with a suit for breach of contract, breach of the implied covenant of good faith and fair dealing, promissory estoppel, and unjust enrichment claiming that KFC acted in bad faith.

In the trial court, the district court dismissed all but one of the plaintiff's claims. It reasoned that the plaintiff had no breach of contract claim because the franchise agreement only provided for a protected territory within a 1.5-mile radius of the plaintiff's store and the guidelines developed with the National Council and Advertising Cooperative did not create new contractual obligations. The district court also dismissed the promissory estoppel and unjust enrichment claims because they were duplicative of the implied covenant claim, which the court found was plausible based upon the existence of the guidelines created to determine the impact of the locations of new KFC stores. KFC renewed its objections to the plaintiff's legal theory on summary judgment, which was denied. The case then proceeded to trial where a jury awarded the plaintiff about $790,000 in damages. KFC appealed the judgment to the Tenth Circuit.

The Tenth Circuit overturned the award reasoning that Kentucky law, which governed the agreement, would not have authorized the plaintiff to proceed to trial on an implied covenant claim that seeks to establish liability for conduct that was expressly authorized by the agreement. Because the Kentucky Supreme Court had not previously addressed an encroachment claim on all fours with this case, the Tenth Circuit had to predict how the Kentucky Supreme Court would handle the claim. Looking at Kentucky appellate court decisions and other federal court decisions applying Kentucky law, the court decided that Kentucky law did not authorize the plaintiff to proceed on his theory of breach of the implied covenant. The court reasoned that the agreement placed only a prohibition on authorizing a new franchise within 1.5 miles of an existing location and said nothing to imply that KFC is limited in any way in locating new franchises outside of that area. The court also noted that, because the agreement only gave the franchisee an opportunity to negotiate for the new location, the franchisee had no reasonable expectations of any other rights stemming out of the location of new franchises outside of 1.5 miles from an existing location. The court then overturned the award and ordered the district court to enter judgment for KFC on all the franchisee's claims.

FRAUD

***Lunt v. Frost Shades Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 17,323, 2023 WL 3484202 (M.D. Tenn. May 16, 2023)**

This case is discussed in the LADR Case Notes.

IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

***Zubair Kazi et al. v. KFC US, LLC*, Bus. Franchise Guide (CHH) ¶ 17,343, 76 F.4th 993 (10th Cir. 2023)**

This case is discussed under the heading "Encroachment."

INJUNCTIVE RELIEF

Cookie Dough Bliss Franchising, LLC v. Feed Your Soul Minnesota, LLC, Bus. Franchise Guide (CCH) ¶17,342, 2023 WL 4901292 (D. Minn. Aug. 1, 2023)

The U.S. District Court for the District of Minnesota denied a motion for a preliminary injunction filed by a cookie-dough franchisor seeking to enjoin its former franchisee, Feed Your Soul Minnesota, from operating a competing business in its former franchise territory.

In November 2021, Cookie Dough Bliss and Feed Your Soul Minnesota entered into a franchise agreement granting Feed Your Soul the right to operate a Cookie Dough Bliss franchise business in Minnesota, including the right to operate a retail location and a food truck within a protected territory. Over the course of the next year, the parties accused one another of material breaches of the agreement. The agreement was terminated—it appears by mutual assent—in May 2023. Following the termination, the franchisee rebranded its retail location and food truck and began selling similar cookie-dough products in a similar territory as "UnBakeable."

Cookie Dough Bliss responded by filing a lawsuit for breach of the franchise agreement's post-termination covenant not to compete for two years and within a thirty-mile radius of the franchise territory. Cookie Dough Bliss alleged that Feed Your Soul's actions violated the terms of the non-compete agreement, created customer confusion, and illicitly utilized Cookie Dough Bliss's trade secrets and confusingly similar logos. Cookie Dough Bliss filed a motion for a temporary restraining order and preliminary injunction.

In considering Cookie Dough Bliss's request for a preliminary injunction, the district court considered all four factors relevant to the issuance of preliminary injunctions in federal court: the threat of irreparable harm; the likelihood of success on the merits of the claim; the balance of the harms; and the public interest.

The district court concluded that the first factor—the threat of irreparable harm—was dispositive because Cookie Dough Bliss could not meet its burden to demonstrate any prospect of irreparable harm. Cookie Dough Bliss asserted that the injunction was necessary to avoid customer confusion in the local market, to ensure that it could refranchise the area, and to discourage other franchisees from disregarding the terms of their franchise agreements. The district court rejected each of these arguments. There was no significant evidence of customer confusion because the former franchisee was operating under a distinct trade name, and, if there was any confusion, it arose out of the fact that Cookie Dough Bliss's own website mistakenly stated that it had a franchisee in Minnesota. The court held that the risk of other franchisees disregarding their franchise agreements was uncertain and speculative. And, finally, the court determined that there was no risk of harm arising out of the alleged need to refranchise because Cookie Dough Bliss was not currently registered to sell franchises in Minnesota and, therefore, had no lawful ability to refranchise the territory.

The district court also assessed the three other preliminary injunction factors, finding none weighed in favor of granting an injunction to the franchisor. The court first found that Cookie Dough Bliss had not shown a likelihood of success on the merits of its breach of contract claim. The court found that the non-compete provision was likely unenforceable under Minnesota law because it was too broad in scope and might not serve a legitimate purpose in light of the fact that Cookie Dough Bliss did not have the capacity to sell new franchises in Minnesota.

The court found that the balance of the harms also weighed against the injunction because the alleged harm to Cookie Dough Bliss was uncertain and speculative, whereas the harm to former franchisee—if the injunction was issued—was definite and certain. The court found that the public interest factor was neutral because the public had an equally strong interest in both upholding contracts and unrestrained competition.

***Lunt v. Frost Shades Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 17,323, 2023 WL 3484202 (M.D. Tenn. May 16, 2023)**

This case is discussed in the LADR Case Notes.

LABOR AND EMPLOYMENT

***Carpenter v. Pepperidge Farm, Inc.*, Bus. Franchise Guide (CCH) ¶ 17,329, 2023 WL 4552291 (E.D. Penn. July 14, 2023)**

The U.S. District Court for the Eastern District of Pennsylvania granted summary judgment against a Pepperidge Farm distributor representing a putative class of distributors claiming to have been misclassified as independent contractors instead of employees.

The plaintiffs were "independent direct-store-delivery partners" of Pepperidge Farm that had each entered into a distribution agreement with Pepperidge Farm providing for the sale and delivery of Pepperidge Farm baked goods in an exclusive territory. The distributors filed a wage and hour class action against Pepperidge Farm alleging that their relationship with Pepperidge Farm was not an employment relationship under which they had not been paid according to the dictates of Pennsylvania's Wage Payment and Collection law.

The district granted summary judgment to Pepperidge Farm, holding that Pepperidge Farm had established that no material fact was in dispute regarding whether the relationship was employer-employee. In reaching its conclusion, the district court applied a multifactor test used under Pennsylvania law to determine the existence of an employment relationship. The factors considered include the right to control of the manner that work is to be done; the worker's responsibility for the result only; the terms of the agreement between the parties; the nature of the work or occupation; the skill required for performance of the work; whether the worker is engaged in a distinct occupation or business as the hiring party; which party supplies the tools; whether payment is by time or by job; whether the work is part of the regular business of the employer; and the right to terminate the employment at any time.

The court identified the right to control the time, place, and manner of the work as the preeminent factor and held that Pepperidge Farm did not have a significant right to control because Pepperidge Farm controlled only the results of the work rather than the way in which the work was performed. The court found that Pepperidge Farm did not set a schedule for the distributors, did not dictate which stores to visit or in what order, when to take breaks or vacations, how much product to order, or who performs the work. Distributors even had the freedom to hire other individuals to perform the work that they had contracted to do with Pepperidge Farm.

The court did not accept the distributors' argument that Pepperidge Farm exercised control by dictating promotions offered to chain stores or detailed the placement of products on shelfs through "planograms." The court held that such controls were just the work product and that the distributors had freedom to complete the work in the manner of their choosing.

Because the parties' contract identified the distributors as independent contractors and they were paid on commission, the terms of the agreement favored a finding that there was no employment relationship.

The court found that the distributors had special skills and owned the essential tools for carrying on their business. The plaintiffs each testified that they were more than mere drivers and had utilized their own personal experience in the industry to make their sales routes more profitable. As a result, these factors weighed in favor of an independent contractor finding.

The court also found that Pepperidge Farm had no right to terminate the relationship at will and had to pay an "above-market" value for the sales routes, which indicated an independent contractor relationship.

Finally, while the court found that the distributors were engaged in the same business as Pepperidge Farm—a finding typical of an employment relationship—this sole factor did not outweigh all the others.

NON-COMPETE AGREEMENTS

***Cookie Dough Bliss Franchising, LLC v. Feed Your Soul Minnesota, LLC*, Bus. Franchise Guide (CCH) ¶ 17,342, 2023 WL 4901292 (D. Minn. Aug. 1, 2023)**

This case is discussed under the heading "Injunctive Relief."

***Lunt v. Frost Shades Franchising, LLC*, Bus. Franchise Guide (CCH) ¶ 17,323, 2023 WL 3484202 (M.D. Tenn. May 16, 2023)**

This case is discussed in the LADR Case Notes.

***NuVasive, Inc. v. Absolute Medical, LLC,* Bus. Franchise Guide (CCH) ¶17,323, 71 F.4th 861 (11th Cir. 2023)**
This case is discussed under the heading "Arbitration."

TERMINATION AND NONRENEWAL

***Little Caesar Enterprises, Inc. v. S&S Pizza Enterprises, Inc.*, Bus. Franchise Guide (CHH) ¶17,354, No. 21-1176, 2023 WL 5489021 (E.D. Mich. Aug. 24, 2023)**
This case is discussed under the heading "Damages."

***Star Houston, Inc. v. Volvo Cars of North America, LLC,* Bus. Franchise Guide (CHH) ¶17,313, 673 S.W.3d 644 (Tex. Ct. App. 2023)**
A Texas appellate court affirmed the decision of the Texas Motor Vehicle Board denying a motor vehicle dealer's challenges to the supplier's termination notice. Star Houston, Inc. (Star) was a long-time dealer (franchisee) for Volvo Car USA, LLC (Volvo)—the distributor of Volvo vehicles in the United States. However, its performance had been "lagg[ing] behind . . . virtually every other Volvo dealer in the same region" for some time. While Star and Volvo attempted to develop a plan to improve Star's performance, "the two sides never settled on a mutually agreed approach."

In 2016, Volvo notified Star that it was terminating their franchise relationship. As a result, Star protested the termination to the Motor Vehicle Board (Board). In addition, Star alleged that several Volvo Dealer Incentive Programs violated various Texas statutes. After a "six-day contested-case hearing," two administrative-law judges (ALJs) issued a Proposal for Decision (PFD) in which the ALJs (a) rejected Star's protest of Volvo's termination; (b) rejected most of Star's claims regarding the Volvo Dealer Incentive Programs; but (c) agreed with Star's claims that two of the Volvo Dealer Incentive Programs violated certain Texas statutes. Specifically, the ALJs concluded that the programs violated (1) a Texas statute that bars distributors from "requir[ing] adherence to unreasonable sales or service standards," and (2) a Texas statute that bars distributors from treating "franchised dealers of the same line-make differently" based on performance-based measures that treat the franchised dealers "unfairly or inequitably." Despite this determination, the ALJs concluded that Star was not entitled to relief.

After accepting and reviewing the parties' exceptions to the PFD, the ALJs' PFD was submitted to the Board for review. Upon review, the Board issued its Final Order, adopting the findings of fact and conclusions of law in the PFD.

Both parties then sought judicial review of the Board's Final Order in a Texas trial court. The Board appeared as a defendant to answer each petition as well. Before a trial occurred in the trial court, "Volvo removed the parties' appeal and cross-appeal of the Final Order" to the Texas Court of Appeals. The Court of Appeals reviewed the Board's Final Order to determine whether it was supported by substantial evidence in the record.

Before addressing the parties' claims on appeal, the appellate court addressed the issue of constitutional standing, which was raised "by the Board as cross-appellee." Specifically, the Board argued that Volvo lacked standing to appeal the Final Order given that "the Final Order did not injure Volvo because the Board did not take any action or accord anyone any relief." Volvo responded that, despite the Board not granting relief to Star, the Final Order caused harm to Volvo because the rulings that certain Volvo Dealer Incentive Programs violated Texas Statutes "could let other dealers 'seek damages that resulted from the violation' of applying the programs to those dealers." In other words, Volvo invoked an exception to the standard rule for standing, where the ruling below "would operate as res judicata or collateral estoppel in a subsequent proceeding." The appellate court agreed with Volvo and rejected the Board's standing argument. Thus, the court proceeded to review Volvo's cross-appeal on the merits.

In its two issues on cross-appeal, Volvo challenged the Board's determinations that its Dealer Incentive Programs violated Texas statutes, as discussed above. After reviewing the record, the court rejected Volvo's claims, holding that the Board's determinations were supported by substantial evidence in the record.

Star raised several issues on appeal, focusing on the Board's determinations that the other Dealer Incentive Programs at issue did *not* violate Texas statutes. The court began with Star's second issue on appeal, in which Star argued that the record supported a finding that each program at issue treated Star unfairly or inequitably and, therefore, violated the Texas statute at issue. In other words, the Board erred in determining that most of the Volvo Dealer Incentive Programs did not violate the statute. The appellate court disagreed, finding that "there was a reasonable basis in the record for the Board to . . . conclude[] that the program[s]," save the two discussed above, were "not unfair or inequitable." Rather, the court determined that "the evidence instead suggested that the thresholds for dealers to benefit from the programs applied equally across Volvo's dealer community."

Next, Star argued that the Dealer Incentive Programs were unreasonable because they were not part of Star's franchise agreement with Volvo and, therefore, violated Texas statutes. The court disagreed, finding no authority to support this argument. Otherwise, for the programs that the Board determined did not violate the statute, the court agreed.

Further, Star raised various other claims that the Board erred in determining the Dealer Incentive Programs did not violate other Texas statutes. The court rejected each argument. As to Star's first issue, the appellate court summarily resolved the claim in light of its conclusions on the other issues.

Ultimately, the appellate court affirmed the Board's Final Order. Justice Triana filed a concurring opinion expressing her disagreement with the majority's "analysis of why Volvo has standing to challenge the Board's rulings that the CSI and SSI programs violated the two statutory provisions." Specifically, she argued that the more appropriate analysis of Volvo's standing is "under the APA as an aggrieved party, rather than [under] the common-law standing analysis advocated by the Board."

A petition for review is pending with the Texas Supreme Court as of the time of publication.