REASONABLE RELIANCE UNDER THE MINNESOTA FRANCHISE ACT

When a failing or disgruntled franchisee in Minnesota decides to bite the bullet and file a lawsuit against a franchisor, the lawsuit will often include some sort of misrepresentation/fraud claim under the Minnesota Franchise Act (MFA). In fact, it is a good bet that most franchisors that reside in Minnesota have faced, or will at some point face, a fraud/misrepresentation claim under the MFA. However, a franchisor who takes appropriate steps to protect itself at the time the franchise agreement is entered into can often obtain dismissal of those fraud claims before a trial.

One of the key legal issues that arises in those cases is whether or not a fraud claim under the MFA requires a plaintiff to establish reasonable reliance. Most Minnesota courts have held that reasonable reliance is an essential element of a common law fraud claim. The majority of the courts that have addressed this issue in a franchise context have reached a similar conclusion: to succeed on a fraud claim under the MFA a plaintiff must establish that it reasonably relied on the alleged fraudulent statement. Moua v. Jani-King of Minnesota, Inc., 810 F. Supp. 2d 882, 891 (D. Minn. 2011); U-Bake Rochester, LLC v. Utecht, No. Civ. 12-1738 (ADM/SER), 2014 WL 223439, at *8 (D. Minn. Jan. 21, 2014); Ellering v. Sellstate Realty Sys. Network, Inc., 801 F. Supp. 2d 834, 845 n. 12 (D. Minn. 2011). The only published case which appears to suggest a contrary conclusion is Randall v. Lady of Am. Franchise Corp., 532 F. Supp. 2d 1071, 1086 (D. Minn. 2007).

In Randall, Judge Schiltz recognized that some level of reliance is required to prevail on a fraud claim under the MFA. Id. However, Judge Schiltz stated “[T]he Court is not convinced that justifiable or reasonable reliance is an element of a claim for misrepresentation under the Minnesota Franchise Act.” Id. Randall was one of the first decisions by a Minnesota court addressing the reasonable reliance issue under the MFA. At the time, courts in several other states had concluded, contrary to Judge Schiltz, that reasonable reliance was an essential element for a fraud claim under their state’s franchise act. Bonfield v. AAMCO Transmissions, Inc., 708 F. Supp. 867, 876-78 (N.D. Ill. 1989) (fraud claim under Illinois franchise act requires showing of reasonable reliance); Cook v. Little Caesar Enters., Inc., 210 F.3d 653, 659 (6th Cir. 2000) (reasonable reliance required for misrepresentation claim under Michigan franchise law); Hardee’s of Maumelle, Ark, Inc. v.
Hardee’s Food Sys., Inc., 31 F.3d 573, 579 (7th Cir. 1994) (recognizing that Indiana courts have required a showing of reasonable reliance for fraud claims under the Indiana franchise act).

Following the trend in other states, every Minnesota court that has addressed the issue since Randall has concluded that reasonable reliance is an essential element of a fraud/misrepresentation claim under the MFA. In the most recent published case to address the issue, Judge Montgomery left little doubt that reasonable reliance is an essential and necessary element of a fraud/misrepresentation claim under the MFA. U-Bake Rochester, LLC, 2014 WL 223439, at *8 (“To prevail on a misrepresentation claim under the MFA, a plaintiff must prove it reasonably relied on the misrepresentation”). Judge Montgomery had previously reached this same definitive conclusion in her decision in the Moua case when she stated: “the Court is convinced that reasonable reliance is an element of a claim under the MFA.” Moua, 810 F. Supp. at 891-92.

In Moua, Judge Montgomery also addressed Judge Schiltz’s opinion in Randall. Judge Montgomery noted that Judge Schiltz did not actually hold, but merely suggested, that unreasonable reliance could satisfy the requirements of a fraud claim under the MFA. Moua, 810 F. Supp. at 891-92. Judge Schiltz made this suggestion, according to Judge Montgomery, based on the concept that the MFA is a remedial statute and requires broad construction. Id. Judge Montgomery noted that two prior cases that actually addressed the issue of reasonable reliance as an essential part of the case had held that the MFA does require reasonable reliance to state a fraud claim. Id.

In the Ellering case, Judge Kyle, similarly noted that the Randall decision was based primarily on the “anti-waiver” provision of the MFA and the conclusion by Judge Schiltz that the anti-waiver provision should be applied broadly and precluded dismissal of a misrepresentation claim based on a “general disclaimer.” Ellering, 801 F. Supp. 2d at 845. Judge Kyle further noted that even in the Randall decision Judge Schiltz recognized that a plaintiff must show some level of reliance to state a viable misrepresentation claim under the MFA. Id. Judge Kyle concluded by stating:

To the extent Randall suggests that a plaintiff may succeed on an MFA claim with evidence that he unreasonably relied upon the franchisor’s representations, the Court declines to follow it.

Ellering, 801 F. Supp. 2d at 845 n. 13.

Based on the recent decisions by U.S. District Courts in Minnesota, as discussed above, it seems likely that Minnesota courts in the future will similarly conclude that reasonable reliance is an essential element to any fraud claim brought under the MFA. See also Kieland v. Rocky Mountain Chocolate Factory, Inc., No. Civ. 05-150, 2006 WL 2990336, at *8 (D. Minn. Oct. 18, 2006) (dismissing misrepresentation claim under the MFA based on a contractual disclaimer); Long John Silver’s Inc. v. Nickleson, 923 F. Supp. 2d 1004, 1016-17 (W.D. Ky. 2013) (Court held that reasonable reliance was required for fraud claim under the MFA, but concluded that it could not determine as a matter of law whether or not reliance was unreasonable); but see Hanley v. Doctor’s Exp. Franchising, LLC, No. Civ. A. ELH-12-795, 2013 WL 690521 (D. Md. Feb. 25, 2013) (In analyzing a fraud claim under the Maryland franchise law, the Court suggested that approach in Randall was the proper analysis.) However, it is important to note that this issue has not yet been addressed by a Minnesota state court in a published opinion and, as such, the final determination on this issue may still be forthcoming.

Knowing that under Minnesota law a franchisee must prove reasonable reliance to prevail on a fraud claim (common law or statutory), a franchisor can take certain steps at the beginning of the relationship to try to eliminate the argument of reasonable reliance. The most effective manner in which to do so is to require the
franchisee to execute a specific disclaimer, either as part of the franchise agreement, the franchise disclosure document (FDD) or in a separate certification/disclaimer type document. Minnesota courts have held that “[r]eliance is unreasonable as a matter of law where an oral representation is ‘plainly contradicted by the terms of [a] written contract.’” *U-Bake Rochester, LLC*, 2014 WL 223439, at *8, quoting *Crowell v. Campbell Soup Co.*, 264 F.3d 756, 762 (8th Cir. 2001). By inserting the proper language in the relevant documents (the FDD and/or the franchise agreement), including specific disclaimer language, a franchisor can help protect itself from liability on alleged fraud/misrepresentations claims.

Many fraud/misrepresentation claims asserted by disgruntled franchisees involve alleged misrepresentations regarding potential or future earnings. A specific disclaimer stating that no representations regarding future or potential earnings were provided by the franchisor other than those set forth in the FDD and that the franchisee is not relying on any future or potential earnings representations other than those set forth in the FDD, will provide strong evidence of lack of reasonable reliance to help defeat a fraud/misrepresentation claim. Alternatively, some franchisors will actually have a separate document which is executed by the franchisee at the same time as the franchise agreement. This separate document will contain several statements, each of which must be initialed by the franchisee, indicating that the franchisee has not received and is not relying on any representations as to success, potential earnings or future profits, other than those set forth in the FDD.

In *Moua*, Judge Montgomery granted summary judgment for the franchisor, concluding that there was no reasonable reliance to support a fraud/misrepresentation claim as a matter of law because the alleged misrepresentation was directly contradicted by the franchise agreement. *Moua*, 810 F. Supp. 2d at 891. Similarly, in *Ellering*, Judge Kyle granted summary judgment for the franchisor on a fraud/misrepresentation claim regarding future earnings. Judge Kyle held that as a matter of law reasonable reliance did not exist because the franchisees had executed an Area Representative Agreement and a franchise agreement both of which contained an express disclaimer that the franchisee was not relying on any “guarantee, warranty, projection, forecast or earnings claim.” *Ellering*, 801 F. Supp. 2d at 845.

The relatively recent decisions by Minnesota courts regarding the reasonable reliance requirement for fraud claims under the MFA and the willingness of courts to dismiss such claims prior to trial provide a valuable lesson to franchisors. Franchisors should take the extra time and effort at the beginning of the relationship to secure clear and specific disclaimer language from franchisees regarding representations made by the franchisor and representations relied on by the franchisee. By doing so, a franchisor can put itself in a position to potentially avoid the expenditure of significant time and money later if the relationship with a franchisee subsequently falls apart and litigation is pursued.

**FRANCHISORS AS EMPLOYERS/JOINT EMPLOYERS**

A hot topic in the franchise world is the issue of whether or not a franchisor can be considered an employer in regards to its relationship with its franchisees and/or employees of its franchisees. This issue can arise under different circumstances, including: (1) an analysis under the Fair Labor Standards Act (FLSA) and/or similar state laws as to whether or not a franchisor is a joint employer of the employees of the franchisee as it pertains to minimum wage laws, overtime, etc.; (2) an analysis under the National Labor Relations Act (NLRA) as to whether or not a franchisor is a joint employer of the employees of the franchisee in terms of labor relations; and (3) an analysis under the FLSA and/or similar state laws as to whether or not a franchisor is an employer of the franchisee. Several decisions have been issued in the past few months addressing each of these issues. While no definitive decisions or mandates are in place, franchisors should
pay close attention to how these issues are ultimately resolved.

1. Franchisor as Joint Employer under the FLSA

The U.S. District Court for the Southern District of New York recently addressed this issue in the decision *Olvera v. Bareburger Group LLC*, No. 14 Civ. 1372 (PAE), 2014 WL 3388649 (S.D.N.Y. July 10, 2014). In *Olvera*, the plaintiffs were porters, dishwashers, food preparers and cooks who worked for a franchisee at two separate franchise locations. The claims asserted in the complaint were brought under the FLSA and the New York Labor Law (NYLL) regarding the alleged failure to pay minimum wage, overtime and spread-of-hours compensation. The court held that under the FLSA an “employer” is “any person acting directly or indirectly in the interest of an employer in relation to an employee,” noting that the definition was intended to be broad and expansive. *Id.* at *2*. The court stated that when determining employer status under the FLSA “control is the key” and the court must look at the “economic realities” rather than “technical concepts.” *Id.* at *3*.

The court noted that the Second Circuit has articulated two tests for determining whether an employment relationship exists under the FLSA. The “formal control” test looks at whether the alleged employer: (1) had the power to hire and fire employees; (2) supervised and controlled the employee’s work schedules or conditions of employment; (3) determined the rate and method of payment; and (4) maintained employment records. Under the “functional control” test the court looks at various factors, including: (1) whether the alleged employers’ premises and equipment were used for work; (2) could or did business shift as a unit from one alleged employer to another; (3) the extent to which employees performed a discrete line-job integral to alleged employer’s process of production; (4) whether responsibility under contracts could pass from one subcontractor to another without material changes; (5) degree to which alleged employers or their agents supervised work; and (6) whether employees worked exclusively or predominantly for alleged employer.

In the complaint, the plaintiffs alleged that franchisor: (1) guided franchisees on how to hire and train employees; (2) set and enforced requirements for operation of franchises; (3) monitored employee performance; (4) specified methods and procedures used by employees to prepare customer orders; (5) exercised control, directly or indirectly, over the work of employees; (6) required the franchise to employ recordkeeping of operations, including tracking hours and wages and for retaining payroll records; and (7) exercised control over franchisees timekeeping and payroll practices. The complaint also alleged that the franchisor had the right to inspect the facilities and operations of franchises, to audit the franchisee’s financial records and to terminate the franchise agreement of any franchise that violated the FLSA or NYLL.

The court denied the franchisor’s motion to dismiss and held that the plaintiff had adequately pled that the franchisor was a joint employer under the FLSA and the NYLL. In reaching its decision, the court noted that this was a motion to dismiss at the pleading stage and that all but one of cases cited by franchisor were based on a summary judgment motion after the completion of discovery. In the one case relied on by the franchisor that was dismissed on the pleadings (*Chen v. Domino’s Pizza, Inc.*, No. 09-107 (JAP), 2009 WL 3379946 (D.N.J. Oct. 16, 2009)), the plaintiff had simply made the conclusory statement that Domino’s was an employer within meaning of statute and had not pled any facts in the complaint to support the conclusion. The court further noted that it must accept all of the allegations in the complaint as true and that after discovery the decision may be different.
In a similar recent case, the U.S. District Court in New York again denied a franchisor’s motion to dismiss claims under the FLSA and the NYLL brought by employees of a franchisee. Cordova v. SCCF, Inc., No. 13CIV5665-LTS-HP, 2014 WL 3512838 (S.D.N.Y. July 16, 2014). In the decision, the court noted that other circuits have generally held that franchisors are not employers under the FLSA. However, similar to the decision in Olvera, the court distinguished those prior cases by noting that they were all decided after the completion of discovery pursuant to summary judgment motions and the court here was deciding in the context of a motion to dismiss prior to the completion of any discovery. Id. at *4.

These two recent decisions from New York show that the determination of the employer question under the FLSA and state wage laws will be heavily dependent on the facts and how those facts are developed during the discovery process. As the law develops through case decisions, more guidance will be provided to franchisors as to the extent they can interact with their franchisees without facing liability as an employer under the FLSA or similar state laws.

2. Franchisor as Joint Employer under the NLRA

On July 29, 2014 the Office of Public Affairs of the National Labor Relations Board (NLRB) issued a press release indicating that the General Counsel of the NLRB would pursue 43 unfair labor practices cases against both individual McDonald’s franchisees and the franchisor, McDonald’s. The NLRB press release stated that McDonald’s would be “named as a joint employer respondent.” In the wake of this press release, it has been widely reported that the NLRB ruled that franchisors could be liable for the unfair labor practices of their franchisees. This is incorrect - there has been no ruling or decision by the NLRB. What was announced on July 29, however, is the intention of the NLRB’s enforcement arm to assert that McDonald’s has liability as a joint employer for the alleged unfair acts of its franchisees if the cases are not settled.

The NLRB General Counsel office’s decision to litigate indicates a change in direction by that office and if successful, could have significant ramifications for franchisors. The NLRB’s decision to assert liability for unfair labor practices against a franchisor follows positions taken by the office of the General Counsel in an amicus brief submitted in an NLRB action, outside of the franchise context, in late June 2014, Browning-Ferris Industries of California, Inc., d/b/a BFI Newby Island Recyclery & FPR-II, LLC, d/b/a LeadPoint Business Services & Sanitary Truck Drivers and Helpers Local 350, International Brotherhood of Teamsters, Case 32-RC-109684.

In the amicus brief, the General Counsel’s office criticized the existing joint-employer test of “whether a putative joint employer’s control over employment matters is direct and immediate” as inhibiting meaningful collective bargaining. In support of this position, the amicus brief devoted over two pages to a discussion of franchising, stating that “[f]ranchising ... illustrates how the current joint-employer standard undermines meaningful collective bargaining.” The NLRB General Counsel’s office asserted that franchisors “can exert significant control on the day-to-day operations of their franchisees,” including controlling the number of workers and the hours each employer works. It concluded that “some franchisors effectively control such wages” paid by their franchisees. The amicus brief charged that “some scholars have posited that franchisors consider avoidance of unionization and the collective bargaining process to be the ’prime advantage of franchising.’”

At the heart of the amicus brief, the General Counsel’s office urged the NLRB to adopt a new, less restrictive standard for determining joint-employer status. The NLRB proposed a more liberal test for “joint employer” status which asks whether:
Under the totality of the circumstances, including the way the separate entities have structured their commercial relationship, the putative joint employer wields sufficient influence over the working conditions of the other entity’s employees such that meaningful bargaining could not occur in its absence.

This test, if applied in the McDonald’s cases, contains what appears to be a fairly subjective and fact specific test of whether the franchisor “wields sufficient influence … such that meaningful bargaining” could not occur without the franchisor.

Representatives of McDonalds have indicated that they will fight any attempt by the NLRB to classify McDonald’s as a joint employer. The International Franchise Association (IFA) and other business trade groups have similarly stated their opposition to the position taken by the NLRB and have indicated that it could have a devastating impact on the franchise business model. If the cases are not resolved and McDonald’s elects to fight the determination it will be a long process before it is fully resolved. The cases will be tried before an NLRB Administrative Law Judge. Those decisions then could be appealed to the full five member NLRB, whose decision then could be appealed to a Federal Circuit Court of Appeals and possibly the U.S. Supreme Court. As such, an actual, final “decision” on these specific cases is likely several years away. However, if a final decision is made supporting the NLRB’s position it could subject franchisors to laws concerning wages and hours, worker’s compensation, collective bargaining/unions, unemployment benefits and discrimination. In the end, it may ultimately change the franchise business model as we currently know it.

3. Franchisor as an Employer of a Franchisee

In Naik v. 7-Eleven, Inc., No. 13-4578 (RMB/JS), 2014 WL 3844792 (D.N.J. August 5, 2014), the U.S. District Court in New Jersey addressed the third scenario identified above – can a franchisor be held to be an employer of a franchisee. In Naik, the plaintiffs, a group of franchisees, claimed that they were employees of the franchisor and asserted claims under the FLSA and the New Jersey Wage and Hour Law for minimum/unpaid wages and overtime wages, along with various other claims. The primary issue in the case revolved around whether the franchisee should be classified as an independent contractor or as an employee of the franchisor.

In the complaint the franchisees claimed that: (1) the franchisor installed a security system which recorded their conduct to intimidate them; (2) the franchisor controlled the radio volume, television channel, heat and air conditioning at the franchise location; (3) the franchisor harassed them based on their Indian descent; (4) the franchisor had unannounced visits; (5) the franchisor controlled the regulation of vendors and supply, and regulated product pricing, advertising and promotion; (6) payroll was processed through the franchisor’s internal payroll system; (7) the franchisee was required to wear the franchisor’s uniforms; and (8) bookkeeping and accounting was done by franchisor. In response, the franchisor brought a Motion to Dismiss claiming that: (1) under terms of franchise agreement the franchisees were independent contractors; and (2) even if the franchisees are determined to be employees they are exempt from coverage as “managers” and not entitled to overtime pay.

The court noted that generally the employer-employee relationship issue is a question of fact. It then identified six (6) factors to look at to determine if a party is an employee under the FLSA: (1) the degree/ right to control the manner in which work is performed; (2) the employee’s opportunity for profit or loss depending upon his managerial skills; (3) the employee’s investment in equipment required for his task, or
employment of helpers; (4) whether or not the service rendered requires a special skill; (5) the degree of permanence of the working relationship; and (6) is the service being rendered an integral part of alleged employer’s business. In addition to six factors, the court noted that it must review the circumstances as a whole to determine as a matter of economic reality whether the individuals (alleged employees) are dependent upon the business to which they render service.

In reviewing the complaint, the court found that: (1) plaintiffs had adequately pled a high degree of control by the franchisor over the franchisee, which weighed in favor of finding that the franchisees were employees; (2) the factor regarding opportunity for profit was neutral – the franchisee controlled some areas of work that could impact profit or loss, but the franchisor controlled other areas that could impact profit or loss; (3) the franchisees made a substantial investment in the equipment for the store and this factor weighed in favor of finding that the franchisees were independent contractors; (4) the special skill factor weighed in favor of finding of independent contractor; the court noted that there were no allegations in complaint regarding the skill issue and that the franchisees were in-store operators with the ability to hire their own employees under the franchise agreement; (5) the length and conditions of the franchise agreement supported the conclusion that the degree of permanency favored a finding that the franchisees were employees; and (6) the franchisees are critical to, and an integral part of, the franchisor’s business and that this factor weighed in favor of finding that the franchisees were employees. As to the economic reality analysis, the court concluded that the alleged control exercised by the franchisor went well beyond the steps necessary to ensure uniformity among franchisees in the system and that the franchisees had adequately pled facts that depicted an economic reality of dependence on the franchisor.

As a result of its findings, the court denied the motion to dismiss concluding that the plaintiffs/franchisees had adequately pled facts to support a conclusion that the franchisees were employees of the franchisor.

4. Potential Impact on Franchising

Clearly, the courts have not yet established definitive rulings regarding the issue of when a franchisor will be considered an employer and/or the resulting consequences of such a finding. The potential impact of such a conclusion in any one, or all, of the areas addressed above is of some debate. Some commentators believe that if franchisors are held to be employers that it will mean, or lead to, the end of the franchising business model as we currently know it. Others believe that the impact of such a finding will be minimal as the franchise business model will adjust as it has always done in the past.

If franchisors are determined to be joint employers of the franchisee’s employees, they can react in different ways. Some franchisors may seek to have more control over the operations of their franchisees – believing if they are going to be liable anyway as a joint employer, they may as well get more actively involved to prevent mistakes/misconduct. However, increased control may lead to franchisor liability as to other claims based on vicarious liability theories – see the summer edition of our newsletter for a discussion of a franchisors’ potential liability based on vicarious liability theories. Other franchisors may pull back and offer only bare minimum support and limited control so as to try to avoid a finding that they are a joint employer.

Given the potential reactions of franchisors and the potential ultimate impact on the franchising business model, it could be a very important next few months/years as these various issues are resolved and clarified by the courts.
LEGISLATIVE UPDATES

Governor Vetos Bill to Amend Franchise Relations Act

In August 2014, legislators in California passed Senate Bill 610 which would have amended the California Franchise Relations Act (the “Act”) and would have provided additional protections to franchisees. On September 30, 2014, Governor Jerry Brown announced that he had vetoed Senate Bill 610. While the bill goes back to the Senate, it is essentially dead. Governor Brown noted that before such a law is enacted, there must be proof of a systematic problem and a showing that the proposed solution (legislation) will fix the problem and not create new problems.

California Expands Scope of Vehicle Code

On August 25, 2014, the Governor of California signed into law an amendment to the Vehicle Code that subjects recreational off-highway vehicles (ROV) and utility-terrain vehicles (UTV) to the Code’s provisions governing the New Motor Vehicle Board. As a result, ROV/UTV manufacturers: (1) must provide dealers with 60 days written notice for termination and/or non-renewal (and establish good cause for doing so), (2) must repurchase certain inventory upon termination/non-renewal, and (3) are prohibited from establishing new dealers within a 10 mile radius of an existing dealer. The Code also lists manufacturer warranty reimbursement obligations, and several unfair/prohibited actions which manufacturers may not commit. This amendment takes effect on January 1, 2015.

RECENT CASE LAW

Court Addresses Anti-Discrimination Provisions of the Minnesota Franchise Act

A Minnesota federal court recently discussed application of the provision in the Minnesota Franchise Act (MFA) which prohibits discrimination among franchisees located in the state. The regulations under the MFA provide that franchisors may not “discriminate between franchisees in the charges offered or made for royalties, goods, services, equipment, rentals, advertising services, or in any business dealing, unless any classification of or discrimination between franchisees is based on franchises granted at different times, geographic, market, volume, or size differences, costs incurred by the franchisor, or other reasonable grounds considering the purposes of Minnesota Statutes... “ Minn. Rule § 2860.4400(B) (2013). In this recent case, the franchisor, Party City Corp., had terminated a number of franchise agreements and had converted those stores to “supply agreements.” As a result, the remaining Party City franchisees were required to pay royalty fees, and advertising fund fees, while those operating under the supply agreements did not. Defendants argued that the stores with supply agreements “are no longer franchises, and do not fall within the purview of the MFA.” The Court rejected this argument, holding that an agreement need not be labeled a franchise to constitute a franchise under the MFA, and thus these supply agreements could be construed to constitute franchise agreements. The Court then concluded that the differences in terms could constitute a violation of the anti-discrimination provisions of the MFA. This case highlights the dangers of providing varying economic terms to franchisees located in the state of Minnesota. *Newspaper, LLC v. Party City Corp.*, No. 13-1735 ADM/LIB, 2014 WL 2986653 (D. Minn. July 1, 2014).

Court Refuses to Dismiss Robinson-Patman Act Claims Brought by Car Dealer

The U.S. District Court for the Northern District of California recently denied a car manufacturer’s motion to dismiss Robinson-Patman Act (RPA) claims brought by a dealer. The plaintiff dealer had alleged that the...
manufacturer had violated the RPA because it failed to provide the same incentives to existing dealers that were provided to new dealers competing in the same territory. The plaintiff asserted that the manufacturer’s formula for sales incentives discriminated against existing dealers because the formula was based on the prior year’s sales and that new dealers did not have prior year’s sales. Plaintiff also argued that the formula failed to take into account decreased sales due to competition from the new dealer. As a result, plaintiff argued that a new dealer received subsidies during July 2012 despite selling only 60 vehicles, while the plaintiff failed to receive subsidies during the same period despite selling 130 vehicles. The Court held that the plaintiff had alleged sufficient facts in its Complaint to plead functional unavailability by showing that the incentive program was not applied even-handedly; that the applied formula was different for different dealers (one based on prior year’s sales while the other was based on other metrics); and that a competing car dealer qualified for incentives despite lower sales. The Court concluded that the formula set up newly opened dealers as a class of “favored purchasers” while pre-existing dealers were a class of “disfavored purchasers.” The Court also held that the plaintiff had sufficiently pled injury to competition through diverted sales by showing a decrease in sales over two different periods of time totaling 16 months, with a corresponding increase in sales by the “favored purchasers.” The Court also noted that plaintiff had sufficiently pled that a $700 price difference due to vehicle incentives was a significant advantage, especially given the low profit margin that dealers make on automobiles. Mathew Enterprise, Inc. v. Chrysler Group LLC, No. 13-CV-04236-BLF, 2014 WL 3418545 (N.D. Cal. July 11, 2014).

Fifth Circuit Reverses District Court’s Findings Regarding Joint Employer

Our summer edition of the newsletter contained an article regarding the theories pursuant to which a franchisor could be held vicariously liable for actions of its franchisees or employees of its franchisees. The article referenced a decision in Orozco v. Plackis, 952 F. Supp. 2d 819 (W.D. Tex., 2013) in which a U.S. District Court in the Western District of Texas held that there was sufficient evidence to support a jury finding that the franchisor was a joint employer based on language in the franchise agreement and testimony from a representative of the franchisor that he had met with the franchisee and provided advice regarding work schedules. On July 3, 2014, the Fifth Circuit Court of Appeals reversed that decision. The Fifth Circuit held that the plaintiff had failed to submit sufficient evidence for a reasonable jury to conclude under the economic reality test that the defendant franchisor was a joint employer of an employee of the franchisee. As such, the Fifth Circuit concluded that the franchisor’s motion for judgment as a matter of law should have been granted after completion of the trial. The Fifth Circuit held that there was insufficient evidence to support the conclusion that the franchisor had the authority to hire or fire the plaintiff. Moreover, the Fifth Circuit concluded that advice provided by the franchisor regarding scheduling of work shifts was advice to improve the profitability of the franchise location and is typical conduct/advice that a franchisor would engage in to help a struggling franchisee. Finally, the Fifth Circuit noted that the language in the franchise agreement cited by the lower court to support its decision was an innocuous statement in the agreement, insufficient to support a finding that the franchisor was a joint employer. Nothing in the evidence, according to the Fifth Circuit, supported the conclusion that the franchisor supervised or controlled the franchisee’s employees. At best, it simply showed advice and training that the court would expect a franchisor to provide to a franchisee. The Fifth Circuit decision in the Orozco case provides helpful ammunition to franchisors who are faced with a claim of being a joint employer of a franchisee’s employees. Orozco v. Plackis, 757 F.3d 445 (5th Cir. 2014).

Court Upholds Termination of Dealer Without Opportunity to Cure When Cure is Not Possible
The Second Circuit Court of Appeals affirmed a decision by the District Court which held that when it is not possible for a dealer to cure a material breach, an opportunity to cure need not be provided even if required by an applicable dealer statute. In December 2011, a New York state court found that the dealer had engaged in fraudulent, illegal and deceptive business practices. The state court issued injunctive relief against the dealer and civil penalties which ultimately resulted in a $500,000 payment by the dealer. Hyundai Motor America (Hyundai), the manufacturer, upon learning of the state court decision, terminated the dealer based on a clause in the dealer agreement which permitted immediate termination for the violation of a law which adversely affects the operation, management, reputation, business or interests of the dealership or Hyundai. The dealer filed a lawsuit in federal court against Hyundai seeking to enjoin the termination. The dealer argued that Section 463 of New York’s Vehicle and Traffic law required that Hyundai provide notice and an opportunity to cure. The District Court, in granting Hyundai’s Motion for Summary Judgment, declared that the New York statute does not modify the common law principle that a party commits a material breach of the contract when it violates a provision going to the very basis of the agreement. In those situations, the court held, immediate termination is permitted, without an opportunity to cure. The District Court went on to hold that common law does not require an opportunity to cure when there is no possibility of curing the breach. The Second Circuit agreed and upheld the decision concluding that if the state legislators intended to abrogate common law through passage of the New York Vehicle and Traffic law they were required to specifically and expressly do so. Without such express and specific language in the statute, common law would control and providing an opportunity to cure would not be required when doing so would be useless. Giuffre Hyundai, Ltd. v. Hyundai Motor America, 756 F.3d 204 (2d. Cir. 2014).

Court Dismisses Fraud Claims Under New York Franchise Act for Lack of Reasonable Reliance

In this case, a 7-Eleven franchisee claimed that the franchisor had violated Section 683 of the New York Franchise Act (NYFA) by failing to fully disclose the required information relating to protected earnings or income and Section 687 of the NYFA by providing fraudulent oral misrepresentations regarding potential earnings and income. The franchise agreement contained an express disclaimer pursuant to which the franchisee represented and warranted that it had not received and was not relying on any representations regarding future earnings or potential income. The U.S. District Court for the Southern District of New York held that reasonable reliance is an essential element of a fraud/misrepresentation claim under Section 687. The court noted that under common law a party cannot satisfy the reasonable reliance requirement for a fraud claim if it specifically disclaims reliance on a particular representation. While the court noted that some lower courts had held that the anti-wavier provision of the NYFA should create an exception to this common law rule, the court did not agree with those prior decisions. The court held that the disclaimer must be given its full force and effect and, as a result, the franchisee could not establish reasonable reliance as a matter of law, thereby requiring dismissal of the Section 687 claim. The court held that “refusing to enforce non-reliance disclaimers would violate the sanctity of contracts and discourage their use” and would “undermine the goals of the NYFA.” The court, however, did allow the franchisee to proceed with its Section 683 claim, holding that Section 683 of the NYFA only sets forth disclosure requirements and reliance is not an essential element of such a claim. Governara v. 7-Eleven, Inc., No. 13-CV-6094 (LAP), 2014 WL 4476534 (S. D.N.Y. Aug. 20, 2014).

Eighth Circuit Vacates Summary Judgment Award and Remands for Standing Determination Under Lexmark

Our summer newsletter presented an article discussing the recent U.S. Supreme Court decision in Lexmark International, Inc. v. Static Control Components, Inc., 134 S. Ct. 1377, 1385 (2014) which set forth a revised
standing analysis for false advertising claims under the Lanham Act. Based on the Lexmark decision, the Eighth Circuit recently addressed the decision in Lexmark and its impact on a pending case. The Eighth Circuit noted that while the pending case was under advisement with the Eighth Circuit, the Lexmark decision was issued and resolved the circuit split regarding the proper standing analysis for false advertising claims under the Lanham Act. Under Lexmark, courts are now required to apply the zone-of-interests test and proximate causality requirement to determine if standing exists for false advertising claims under the Lanham Act. The Eighth Circuit further noted that the U.S. Supreme Court expressly rejected a requirement that the challenged commercial speech must be made by a competitor – the stated basis upon which the district court in this case had granted summary judgment. As such, the Eighth Circuit remand the case to the district court to determine if the plaintiff has standing to assert the Lanham Act claim under the new standard set forth in Lexmark. Syngenta Seeds, Inc. v. Bunge North America, Inc., 763 F.3d 795 (8th Cir. 2014) (reh’g denied Sept. 15, 2014).