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Franchisor Competency, Video 4

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Are They Franchisees or Employees? Court Not Impressed with Inability to Speak English

Sanchez v. CleanNet USA, Inc., 2015 WL 231450 (N.D. Ill. 2015)

This putative class action arises out of Plaintiff Jose Sanchez's participation as a franchisee in a nationwide network of commercial cleaning franchise businesses. Initially, on March 26, 2014, Plaintiff filed an 8-count complaint alleging that the franchisor Defendants CleanNet U.S.A., Inc. ("CleanNet USA") and CleanNet of Illinois, Inc. ("CleanNet IL," and collectively, "Defendants") improperly classified him and other franchisees as independent contractors instead of employees, thereby depriving them of the benefits of an employment relationship under the Fair Labor Standards Act, the Illinois Minimum Wage Law, and the Illinois Wage Payment and Collection Act. Plaintiff also alleged that Defendants engaged in fraud in the inducement to entice him to enter into the franchise agreement, and that Defendants violated the Illinois Franchise Disclosure Act.

This case was before the court on Defendants' motion to dismiss or, in the alternative, motion to stay Sanchez's complaint pursuant to the Federal Arbitration Act, ("FAA"), on the ground that his individual claims were subject to final and binding arbitration pursuant to the dispute resolution provisions in his franchise agreement. Under the

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Franchise Discrimination - Video 1 of 2

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Franchise Law: Fraud and Good Faith in Franchise Law

Franchise Law – Franchisees' Franchise Termination Damages

terms of the Franchise Agreement, the franchisee waived his rights to collect punitive damages, consequential damages, loss of profits, and attorneys' fees and costs. Instead, under the franchise agreement, the franchisor was only liable for "the percentage of total account lacking, multiplied by the initial franchise fee multiplied by 80%" in the event that CleanNet provided at least one customer, but failed to meet its guaranteed monthly billing quota."

Sanchez argued that the Defendants' misguided take-it-or-leave-it negotiation approach, Defendants' failure to explain every term in Spanish, and the length and presentation of the arbitration provisions within the Franchise Agreement were grounds for procedural unconscionability. The court easily rejected these arguments explaining that it is expected that modern contracts will contain terms that are "nonnegotiable and presented in fine print in language that the average consumer might not fully understand," that "driving a hard bargain is not a wrongful act," and that the "disparity in size of the parties entering into an agreement ... without the wrongful use of that power" is insufficient to render an arbitration agreement unenforceable.

Similarly, the Court held that the franchisor's failure to translate the entire Franchise Agreement into Spanish or explain every provision of the Franchise Agreement in Spanish did not render the agreement unenforceable. The court concluded its rejection of the procedural unconscionability argument concluding that "Although the language barrier presented in this case combined with the length and complexity of the Franchise Agreement creates a degree of procedural unconscionability, this is not enough on its own to render the arbitration provision unenforceable."

The Court next examined the franchisee's argument that the arbitration clause within the Franchise Agreement was substantively unconscionable. The court explained that "Indicative of substantive unconscionability are contract terms so one-sided as to oppress or unfairly surprise an innocent party, an overall imbalance in the obligations and rights imposed by the bargain, and significant cost-price disparity." In this regard, Sanchez had argued that the Franchise Agreement's dispute resolution provision contained four substantively unconscionable terms: (1) requiring mediation first, with the filing party paying the filing fee and the remainder costs being borne by the parties equally; (2) requiring arbitration if mediation is not successful with the filing party paying the filing fee and the remainder costs being borne by the parties equally; (3) waiving of punitive damages; and (4) limiting remedies to the actual damages sustained except as otherwise provided in the Franchise Agreement and barring recovery of attorneys' fees. Refusing to find the first two terms substantively unconscionable, the court did void the latter terms reasoning that "Because the Illinois Franchise Disclosure Act makes franchisors liable to franchisees for damages and attorneys' fees, the remedial limitations in the Franchise Agreement -- which includes Sanchez's waiver of punitive damages and recovery of attorneys' fees and costs -- are unenforceable."

Franchisor's Alleged Fraud Regarding Competing Hotel Permissible Under Franchise Agreement Disclaimer

G6 Hospitality v. HI Hotel Group, LLC, Slip Copy, 2015 WL 224679 (M.D. Pa. 2015)

In G6 Hospitality, the United States Court for the Middle District of Pennsylvania came down heavy on a franchisee which tried to introduce evidence of fraud by its franchisor. In essence, the Court granted the franchisor's motion in *limine* to preclude Defendants' fraudulent inducement of contract defense. The franchisor had requested that the Court bar the franchisees from introducing evidence concerning alleged promises that were not specifically included in writing in the parties' written franchise agreement.

Specifically, the franchisor Plaintiffs objected to the franchisee's proposed presentation of evidence setting forth that: (1) the Plaintiffs allegedly promised these Defendants that a competing Motel 6 would close down, and (2) the Defendants would have a right of first refusal to buy the competing motel. Neither of these promises was memorialized in the written franchise contract. Plaintiffs argued that this fraudulent inducement defense was not available under Texas law because the franchise agreement between the parties contained a disclaimer-of-reliance provision.

Interestingly, the franchisees unexplainably mischaracterized the defense as a "breach of the duty of good faith and fair dealing" rather than a "fraudulent misrepresentation." After re-characterizing the affirmative defense, the court proceeded to reject it: "to the extent that any Defendants contend that they relied on extra-contractual statements by the Plaintiffs concerning the franchise agreement, the

Laser Light Distributor Fails to Light-Up the Court

Wave Form Systems, Inc. v. AMS Sales Corporation and American Medical Systems, Inc., U.S. District Court, D. Minnesota, ¶15,430, (Dec. 22, 2014)

American Medical Systems (AMS) is a manufacturer and distributor of medical devices, including the GreenLight brand laser equipment used in the treatment of certain prostate afflictions. Through its subsidiary, AMS Sales Corporation, AMS sold the lasers either directly to health care providers or through a network of Mobile Service Providers (MSPs).

In 2012, Wave Form Systems, an Oregon supplier of laser equipment to health care providers, entered into a Mobile Provider Agreement (MPA) with AMS to become part of its distribution network. The MPA required Wave Form to purchase a post-warranty service plan, established non-competition obligations, and provided a termination date of December 31, 2014. The MPA also included a choice of law provision designating Minnesota as the governing law.

After a rocky relationship, Wave Form was informed that it would not be authorized to offer GreenLight laser services after the termination date of December 31, 2014. In response, in an effort to forestall the termination, Wave Form filed suit, seeking a preliminary injunction and a declaratory judgment that: (1) it was a franchisee under the Minnesota Franchise Act (MFA), (2) the termination of the MPA would violate the MFA, and (3) the AMS violated the non-competition provision of the MPA.

The court ruled against the claimed franchisee and refused to enter the preliminary injunction. According to the court, AMS was exempt from the MFA's registration requirement, since the alleged offer or sale of a franchise to Wave Form was to a resident that was not domiciled, actually present, or operating in Minnesota, and the sale did not violate Oregon law. Further, any harm resulting from lost profits due to Wave Form's inability to offer GreenLight services was not irreparable and could be readily compensated with money damages. In this regard, evidence of harm to Wave Form's reputation, goodwill, and customer relationships was insufficient to warrant injunctive relief because Wave Form was able to continue to provide top quality service in its non-Green Light laser treatment services, which constituted 80 percent of the procedures Wave Form provided. The court also found it important that Wave Form was aware for months

Court finds that Plaintiffs are correct that such a defense is barred under Texas law." Relying upon prior case law from the Texas Supreme Court, the Pennsylvania federal court noted that "after-the-fact protests of misrepresentation are easily lodged, and parties who contractually promise not to rely on extra-contractual statements ... should be held to their word." Thus, the Court concluded that clearly worded disclaimer-of-reliance provisions may preclude fraudulent inducement claims.

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that the MPA would terminate according to its own terms and accordingly had sufficient time to adjust to a business environment that did not include its agreement with AMS.

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