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## Franchise Law

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# FRANCHISE LAW

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## I. INTRODUCTION

Texas courts continue to define the boundaries of franchise law with decisions regarding procedure, enforcement of contractual terms, intellectual property, common law and statutory claims, and remedies. Cases

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during this Survey period address a range of pertinent topics from the field of franchise law, such as Texas courts' willingness to enforce choice-of-law and arbitration provisions in franchise agreements, burdens of proof for parties seeking injunctive relief, hurdles facing claimants under the Texas Deceptive Trade Practices Act (DTPA), and many other important developments. This Survey's selected cases and analyses will provide practitioners with valuable insights into the current state of franchise law in Texas.

## II. PROCEDURE

### A. CHOICE-OF-LAW

Courts in Texas continue to enforce choice-of-law provisions in franchise agreements. In *Gigi's Cupcakes, LLC v. 4 Box LLC*, the U.S. District Court for the Northern District of Texas applied the franchise agreements' Tennessee choice-of-law provision despite certain franchisees' arguments that the provision was invalidated by their respective states' franchise relationship laws.<sup>1</sup> In *Gigi's*, franchisees from Minnesota, North Dakota, Indiana, and Ohio argued that the application of their franchise agreements' Tennessee choice-of-law provision would violate the public policies of those states.<sup>2</sup> Specifically, the franchisees argued that because those states had franchise relationship laws that afforded them greater protection than Tennessee law and because they were deprived of some of the benefits of the application of those franchise relationship laws, the choice-of-law provision must be invalidated.<sup>3</sup>

The district court emphasized that in Texas, choice-of-law agreements are enforceable.<sup>4</sup> In order to render the choice-of-law provision unenforceable, the franchisees had the burden to show that Tennessee law: (1) had no substantial relationship to the parties' transaction or other reasonable basis for application; or (2) that the application of Tennessee law was:

contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of [Restatement (Second) Conflict of Laws] § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.<sup>5</sup>

The franchisees argued that the choice-of-law provision violated the public policies of their respective states.<sup>6</sup> The district court then analyzed whether: (1) the franchisees' states had a more significant relationship

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1. *Gigi's Cupcakes, LLC v. 4 Box LLC*, No. 3:17-CV-3009-B, 2018 WL 6068817, at \*4 (N.D. Tex. Nov. 19, 2018). Deborah S. Coldwell, Iris Gibson, and Sally Dahlstrom represent *Gigi's* and certain of its affiliates in this matter.

2. *Id.* at \*2.

3. *Id.*

4. *Id.* at \*3.

5. *Id.* (citation omitted).

6. *Id.* at \*2.

with the parties' relationship and transaction at issue than Tennessee; (2) the franchisees' states had a materially greater interest than Tennessee in the determination of a particular issue; and (3) whether the franchisees' states had a fundamental policy that would be contravened by the application of Tennessee law.<sup>7</sup> The district court explained that in order to invalidate the choice-of-law provision all three of the questions must be answered affirmatively.<sup>8</sup>

The district court held that the franchisees failed to meet their burden to establish that a state other than Tennessee had a more significant relationship with the parties and transaction at issue.<sup>9</sup> Thus, the district court applied Tennessee law to the parties' claims.<sup>10</sup> On rehearing, the district court withheld ruling on whether the application of Tennessee law barred the franchisees' franchise relationship.<sup>11</sup> The district court explained that it would determine if the claims were barred by the Tennessee choice-of-law following additional discovery and presentation of evidence.<sup>12</sup>

#### B. PRELIMINARY INJUNCTIONS

Obtaining a preliminary injunction may sometimes be difficult in Texas and places a "heavy burden" on the party seeking the preliminary injunction. In *BL Restaurant Franchises LLC v. 510 Park Inc.* in the U.S. District Court for the Northern District of Texas, Bar Louie, franchisor of the Bar Louie restaurant system, sought a preliminary injunction against a franchisee requiring it to comply with pre-termination procedures under the parties' franchise agreement.<sup>13</sup> Specifically, the franchisee claimed that Bar Louie failed to perform under the franchise agreement and the franchisee gave notice that it intended to close its franchised restaurant.<sup>14</sup> The franchisee subsequently closed the franchised restaurant.<sup>15</sup> Under the parties' franchise agreement, the franchisee was required to give the franchisor written notice of any breach and an opportunity to cure.<sup>16</sup> No such notice and opportunity was provided.<sup>17</sup> Thus, the franchisor argued that it was entitled to injunctive relief requiring the franchisee to reopen and comply with pre-closing procedures.<sup>18</sup>

The parties' franchise agreement gave Bar Louie the right to injunctive relief regardless of whether Bar Louie met the applicable standard for

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7. *Id.*

8. *Id.*

9. *Id.* at \*4.

10. *Id.* at \*3.

11. *Id.* at \*4.

12. *Id.*

13. *BL Rest. Franchises LLC v. 510 Park Inc.*, No. 3:18-CV-0971-B, 2018 WL 2363606, at \*1 (N.D. Tex. May 24, 2018).

14. *Id.* at \*2.

15. *Id.* at \*1.

16. *Id.* at \*2.

17. *Id.*

18. *Id.*

obtaining a preliminary injunction in certain circumstances.<sup>19</sup> Bar Louie argued that, under the circumstances, it was entitled to a preliminary injunction under the franchise agreement regardless of whether it met the applicable standard for preliminary injunctions.<sup>20</sup> However, the provision of the franchise agreement related to preliminary injunctions only provided for injunctive relief when a franchisee improperly used proprietary marks, confidential information, or both.<sup>21</sup> The district court held that requiring notice of breach of the franchise agreement and opportunity to cure did not relate to the use of proprietary marks or confidential information.<sup>22</sup> Thus, the franchisee's adherence to pre-closing provisions of the franchise agreement did not fall within the provision of the franchise agreement, and Bar Louie was not entitled to a preliminary injunction on this basis.<sup>23</sup>

Bar Louie also argued that it was able to obtain a preliminary injunction without the franchise agreement provision. The district court emphasized the high burden for obtaining this "extraordinary and drastic remedy" and the high burden on the movant.<sup>24</sup> In order to obtain a preliminary injunction, the movant must show: "(1) a substantial likelihood of success on the merits; (2) a substantial threat that it will suffer irreparable injury absent the injunction; (3) that the threatened injury outweighs any harm the injunction might cause the defendants; and (4) that the injunction will not impair the public interest."<sup>25</sup> The franchisees argued that Bar Louie was unlikely to succeed on the merits because it breached the franchise agreement, the franchisees did not breach the franchise agreement, and Bar Louie could not prove damages.<sup>26</sup> The franchisees alleged Bar Louie breached the franchise agreement by failing to provide adequate training and support and failing to communicate marketing and advertising plans and ideas.<sup>27</sup>

The district court held that Bar Louie did not meet its heavy burden of persuasion that there was a substantial likelihood of success on the mer-

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19. *Id.*

20. *Id.*

21. *Id.* The franchise agreement provided: "Franchisee recognizes the unique value and secondary meaning attached to the System, the Proprietary Marks, standards of operation and Confidential Information (collectively 'Proprietary Property'), and Franchisee agrees that any non-compliance with the terms of this Agreement or any unauthorized or improper use of the Proprietary Property will cause irreparable damage to Franchisor and its franchisees. Franchisee therefore agrees that if it should engage in any such unauthorized or improper use of the Proprietary Property, either during or after the Term, Franchisor shall be entitled to permanent and temporary injunctive relief, without bond, from any court of competent jurisdiction, in addition to any other remedies to which Franchisor may be entitled by law or at equity." *Id.*

22. *Id.*

23. *Id.*

24. *Id.* at \*1 (quoting *Anderson v. Jackson*, 556 F.3d 351, 360 (5th Cir. 2009)).

25. *Id.* (quoting *Enrique Bernat F., S.A. v. Guadalajara, Inc.*, 210 F.3d 439, 442 (5th Cir. 2000)).

26. *Id.* at \*2.

27. *Id.* at \*3.

its.<sup>28</sup> Bar Louie argued that there was no provision of the franchise agreement requiring it to support the franchisees in the ways they alleged.<sup>29</sup> However, at the preliminary injunction stage, the district court held that even without a provision requiring Bar Louie's support, Bar Louie did not refute that it failed to provide such support.<sup>30</sup> The district court also held that Bar Louie did not respond to the argument that the franchisees were not required to comply with the pre-closing conditions.<sup>31</sup>

Thus, the district court denied Bar Louie's request for a preliminary injunction.<sup>32</sup> This case demonstrates the high burden applicable to movants seeking a preliminary injunction. Parties seeking a preliminary injunction must be prepared to provide sufficient evidence to meet the high burden in order to be successful.

### C. PERSONAL JURISDICTION

In *KF Franchising, Ltd. v. Tasone Inc.*, the U.S. District Court for the Western District of Texas held that because a Texas state court had ruled on personal jurisdiction, the plaintiff franchisor could not seek to litigate the case in federal court.<sup>33</sup> In this case the franchisor brought breach of contract, misappropriation of trade secrets, trademark and copyright infringement, violations of the Texas Uniform Trade Secrets Act, unfair competition, and breach of non-compete agreements claims.<sup>34</sup> Prior to this district court case, a Texas state court dismissed all these same claims except the breach of contract claim for "want of jurisdiction."<sup>35</sup> The district court here held that, though the Texas state court dismissal did not use the words "personal jurisdiction," it was a ruling on personal jurisdiction. Thus, the district court did not have personal jurisdiction.<sup>36</sup>

### D. ARBITRATION

Arbitration provisions continue to be enforced in franchise agreements in Texas. In *Charging Bison, LLC v. Interstate Battery Franchising & Development, Inc.*, the U.S. Court of Appeals for the Fifth Circuit held that when a dispute arises over the applicability of an arbitration provision, the dispute should be resolved in favor of arbitration.<sup>37</sup> Here, the parties entered into a franchise agreement that included an arbitration clause.<sup>38</sup>

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28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. *KF Franchising, Ltd. v. Tasone Inc.*, No. H-17-3849, 2018 WL 1865921, at \*2 (S.D. Tex. Apr. 18, 2018). Deborah S. Coldwell and Taylor Rex Robertson represented KF Franchising in this matter.

34. *Id.* at \*1-2.

35. *Id.*

36. *Id.*

37. *Charging Bison, LLC v. Interstate Battery Franchising & Dev., Inc.*, 711 F. App'x 232, 232 (5th Cir. 2018) (per curiam).

38. *Id.*

The arbitration clause had a carveout for disputes involving the propriety of a termination.<sup>39</sup> The franchisee argued it was entitled to termination because the franchise agreement was procured by fraud.<sup>40</sup> The franchisor demanded arbitration.<sup>41</sup> Emphasizing the importance of arbitration agreements, the Fifth Circuit ruled that “the plain meaning of [the carveout provision] does not cover anticipatory termination of the franchise agreement.”<sup>42</sup> Thus, the Fifth Circuit affirmed the district court’s ruling that the arbitration must proceed.<sup>43</sup>

### III. THE FRANCHISE RELATIONSHIP, TERMINATION, AND NONRENEWAL

Failure of a franchisee to abide by pre-termination obligations set forth in its franchise agreement prior to closing a franchised location may not be sufficient to entitle a franchisor to injunctive relief in Texas courts.<sup>44</sup> As noted above in the procedural analysis of *BL Restaurant Franchises LLC v. 510 Park Inc.*,<sup>45</sup> Bar Louie, franchisor of the Bar Louie restaurant system, filed a motion for preliminary injunction in the U.S. District Court for the Northern District of Texas against its franchisee, seeking to require the franchisee to re-open the Bar Louie location it operated in the Uptown neighborhood of Dallas, Texas, because the franchisee closed the location prior to fulfilling the pre-termination requirements in its franchise agreement.<sup>46</sup> The franchisor argued that the franchise agreement expressly authorized injunctive relief, regardless of whether franchisor could show the four elements required to establish a common law right to injunctive relief.<sup>47</sup>

The franchisor argued specifically that two sections of the franchise agreement authorized injunctive relief to compel the franchisee to reopen the restaurant and comply with the pre-termination provisions of the agreement. Section 19.3 of the franchise agreement provided that the franchisee may not terminate the agreement prior to the expiration of its term, except through arbitration, based upon a material breach of the agreement by the franchisor, and, further, that the franchisee must provide the franchisor with written notice of its claim within one year of when it believed the franchisor materially breached the agreement and it must allow the franchisor sixty days to cure.<sup>48</sup> Likewise, section 22.1 provided that, under specific circumstances, the franchisor was entitled to injunctive relief “in addition to any other remedies to which Franchisor

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39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *See* *BL Rest. Franchises LLC v. 510 Park Inc.*, No. 3:18-CV-0971-B, 2018 WL 2363606, at \*1 (N.D. Tex. May 24, 2018).

45. *Id.*

46. *Id.* at \*2.

47. *Id.*

48. *Id.*

[was] entitled by law or at equity.”<sup>49</sup> The franchisor argued that violation of the pre-termination provisions was a circumstance triggering injunctive relief under section 22.1, but the district court disagreed. Rather, the district court held that section 22.1 applied only to “[p]roprietary [p]roperty,” defined as intellectual property, confidential information, and other information and processes related to the systems and methods for operating a Bar Louie franchise.<sup>50</sup> Because the franchisee’s noncompliance with the pre-termination procedures of section 19.3 did not implicate any of the proprietary interests contemplated by the injunction-triggering provisions of section 22.1, the district court concluded that franchisor was required to meet the higher common law standard for injunctive relief to apply.<sup>51</sup>

While ultimately unsuccessful in this case, the franchisor’s argument that its franchise agreement provided an independent basis for injunctive relief could serve as a template for more effective injunctive provisions in future franchise agreements. Pairing an express entitlement to injunctive relief with standard provisions regarding termination rights would provide an easier path to enforcement of contract rights than attempting to meet the general “substantial likelihood of success on the merits” standard.<sup>52</sup>

#### IV. INTELLECTUAL PROPERTY

##### A. TRADEMARK

Courts in Texas continue to take seriously the continued use of a franchisor’s licensed marks post-termination in violation of the Lanham Act. In *Choice Hotels International, Inc. v. Frontier Hotels, Inc.*, the U.S. District Court for the Southern District of Texas awarded \$757,746.75 for lost profits, \$120,996.01 for actual damages, and \$33,395.50 for attorneys’ fees.<sup>53</sup> In *Choice Hotels*, a franchisee continued to use licensed marks after termination in violation of the parties’ franchise agreement.<sup>54</sup> Specifically, the franchisee continued to use road signs and photographs on third-party booking websites with the franchisor’s licensed marks.<sup>55</sup>

The franchisor instructed the franchisee not to use its licensed marks and the district court had permanently enjoined the franchisee from using the licensed marks.<sup>56</sup> Yet, the franchisee continued to use the licensed marks.<sup>57</sup>

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49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.* at \*3.

53. *Choice Hotels Int’l, Inc. v. Frontier Hotels, Inc.*, No. H-15-2355, 2018 WL 2317604, at \*3 (S.D. Tex. May 22, 2018).

54. *Id.* at \*1.

55. *Id.*

56. *Id.*

57. *Id.*



The district court held that the franchisee's use of the licensed marks was a violation of the Lanham Act and that the franchisor was entitled to (1) lost profits; (2) actual damages; and (3) attorneys' fees.<sup>58</sup>

## V. COMMON LAW CLAIMS

### A. FRAUD AND UNFAIR COMPETITION

Fraud claims in the franchising context generally arise in the sales process when a franchisee believes that the value of the franchise was misrepresented by the franchisor's sales agent. But fraud claims can also arise at other stages, for example when a franchisee attempts to transfer its franchise and the transferee believes that it was fraudulently induced into purchasing the franchise. Such was the case in *Saenz v. Gomez*, which involved a franchisee's secret transfer of a franchise without the required written consent of the franchisor.<sup>59</sup>

Saenz entered into a franchise development agreement with Pizza Patrón, which granted him the exclusive right to develop Pizza Patrón restaurants within a defined area in Texas.<sup>60</sup> Saenz owned at least four Pizza Patrón locations, which he financed through three loans that were cross-collateralized and secured by blanket liens over the assets of his four locations, including a location in Rio Grande City.<sup>61</sup> Under the franchise development agreement, Saenz was prohibited from transferring the franchise without Pizza Patrón's written consent.<sup>62</sup> Gomez and Saenz entered in negotiations for Gomez to purchase the Rio Grande City Pizza Patrón franchise.<sup>63</sup> During these negotiations, Saenz represented that he was the corporate representative for Pizza Patrón in the South Texas region, which was untrue, and provided Gomez with various financial documentation, including inaccurate profit and loss income statements.<sup>64</sup> The parties entered into a purchase-sale agreement, whereby Gomez purchased all equipment and inventory for the Rio Grande City location for \$350,000, a purchase price just over the amount Saenz owed the bank.<sup>65</sup> No one obtained consent from Pizza Patrón, and the deal closed.<sup>66</sup> Saenz lied about the actual purchase price to his bank, which allowed Saenz to keep the balance instead of paying off the loans to the bank, and continued to hide the transfer from Pizza Patrón.<sup>67</sup> Gomez operated the store for about a year when he ceased operations due to health concerns and declining sales.<sup>68</sup> Gomez sued Saenz and various others, including

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58. *Id.* at \*3.

59. *Saenz v. Gomez (In re Saenz)*, 899 F.3d 384, 388 (5th Cir. 2018).

60. *Id.* at 387.

61. *Id.*

62. *Id.*

63. *Id.* at 387–88.

64. *Id.*

65. *Id.* at 388.

66. *Id.*

67. *Id.* at 388–89.

68. *Id.* at 389.

franchisor Pizza Patrón, in state court, alleging fraudulent misrepresentation, breach of contract, common law fraud, and conversion.<sup>69</sup> Pizza Patrón was subsequently dismissed and Saenz filed for Chapter 7 bankruptcy.<sup>70</sup> The state lawsuit was removed to bankruptcy court, which held trial and found in favor of Gomez on the fraudulent misrepresentation and common law fraud claims and allowed an exception from the bankruptcy discharge.<sup>71</sup> After the district court affirmed the bankruptcy decision, Saenz appealed, challenging the sufficiency of the evidence supporting the finding of common law fraud and the bankruptcy court's determination that the judgment was nondischargeable. After first determining that the bankruptcy court had jurisdiction to liquidate a state claim from discharge, which is discussed below, the U.S. Court of Appeals for the Fifth Circuit affirmed the bankruptcy court's judgment on the fraud claims.<sup>72</sup>

Saenz argued that there was no evidence of justifiable reliance, a required element for a Texas common law claim, because there were red flags and that the facts presented were insufficient to support a finding of proximate cause.<sup>73</sup> The Fifth Circuit rejected both arguments. First, the Fifth Circuit determined that the reliance element does not require a demonstration of reasonableness, but that a plaintiff cannot rely on a representation if there are red flags that indicate that reliance is not warranted.<sup>74</sup> With respect to the bankruptcy court's finding, the Fifth Circuit found that:

Not only did Saenz make credible representations, he also went to great lengths, including falsifying bank documents, to prevent Gomez from questioning his authority to effectuate the franchise transfer. Without any reason for Gomez to question Saenz, his income statements, and his claim that he worked for Pizza Patrón corporate, the bankruptcy court concluded the weight of the evidence supported justifiable reliance. We do not have a definite and firm conviction that a mistake has been committed in this respect.<sup>75</sup>

The Fifth Circuit next dismissed Saenz's argument that there was no evidence of proximate causation, which requires cause in fact and foreseeability.<sup>76</sup> The Fifth Circuit explained that cause in fact is established if the injury would not have occurred "but for" the wrongful act or omission.<sup>77</sup> Furthermore, foreseeability "requires that the injury [complained of] be of such a general character as might reasonably have been anticipated, and that the injured party should be so situated with relation to the

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69. *Id.*

70. *Id.* at 389 n.7.

71. *Id.* at 389.

72. *Id.* at 391–93.

73. *Id.* at 392–93.

74. *Id.* at 392 (citing *AT&T Universal Card Servs. v. Mercer (In re Mercer)*, 246 F.3d 391, 418 (5th Cir. 2001)).

75. *Id.* at 393.

76. *Id.*

77. *Id.*

wrongful act that injury to him . . . might reasonably have been foreseen.”<sup>78</sup> The Fifth Circuit found that there was no error in the bankruptcy court’s conclusion that Gomez’s injuries were foreseeable and directly attributable to Saenz’s misrepresentations regarding the inflated profits in the income statements and Saenz’s corporate status within the franchisor.<sup>79</sup>

The franchisee’s ability to transfer its franchise rights to a third party is crucial to the franchisee because this enables a franchisee to sell their business, retire, or pass their business on to their family. Most franchisors want control over this process, while most franchisees want to convey their franchises freely. While the facts of *Saenz* are unique in the transferring franchisee’s efforts to keep the transfer secret, this case serves as a useful reminder for franchisors to keep up-to-date records of franchisee ownership and to enforce the franchise agreement provisions that require the franchisor be notified and have the right to approve any transfer.

#### B. VICARIOUS LIABILITY

The distinction between independent contractors and employees continues to be an issue for franchisors, particularly in the cleaning franchise industry. The consequences of misclassifying individuals as independent contractors can be quite severe. For example, being deemed an employee instead of an independent contractor has significant consequences for the franchisor, including the potential for vicarious liability. In addition, employment classification impacts several federal statutes, including the Fair Labor Standards Act (FLSA), Americans with Disabilities Act, Family Medical Leave Act, and National Labor Relations Act. A misclassification claim under the FLSA was at issue in *Fernandez v. Jani-King International, Inc.*<sup>80</sup> In *Fernandez*, individual franchisees filed suit against Jani-King International, Inc., Jani-King, Inc., Jani-King of Houston, Inc., SCT Enterprises, Inc., and Rocket Franchising, Inc. (collectively JaniKing Defendants) under the FLSA for unpaid overtime and minimum wage violations.<sup>81</sup> The JaniKing Defendants filed motions to dismiss for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6), arguing that plaintiffs were franchisees, not employees, and that the FLSA therefore did not apply.<sup>82</sup>

The JaniKing Defendants first argued that franchisees could not state a plausible claim of employer liability under the FLSA, because the complaint grouped all defendants together in a conclusory manner without explaining how an employment relationship existed as to each of the defendants.<sup>83</sup> The U.S. District Court for the Southern District of Texas

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78. *Id.* (quoting *In re Air Crash at Dallas/Fort Worth Airport*, 720 F. Supp. 1258, 1279 (N.D. Tex. 1989), *aff’d*, 919 F.2d 1079 (5th Cir. 1991), *cert. denied*, 502 U.S. 899 (1991)).

79. *Id.*

80. No. H-17-1401, 2018 WL 539364, at \*1 (S.D. Tex. Jan. 8, 2018).

81. *Id.* at \*1.

82. *Id.*

83. *Id.* at \*2.

agreed and determined that franchisees' allegations that "[d]efendants" as a group employed them was insufficient to state a plausible claim for joint-employer liability under the FLSA, which requires that the complaint alleges "some facts at least of the employment relationship" to set forth a "facially plausible claim of multiple employer liability under the FLSA."<sup>84</sup>

The JaniKing Defendants, in reliance on the order of the U.S. District Court for the Western District of Oklahoma, which dismissed the FLSA claims asserted by business entities,<sup>85</sup> next argued that plaintiffs were not "individuals" for purposes of FLSA liability because the franchise agreements with franchisor were entered into by corporate entities, not individual plaintiffs in their individual capacities.<sup>86</sup> The district court rejected this argument, which it considered "convoluted" given plaintiffs' allegations that they, as individuals, were employees of the JaniKing Defendants apart from the existence of the franchise agreement.<sup>87</sup> In addition, plaintiffs alleged that they provided "janitorial cleaning services" for the JaniKing Defendants' customers, which the district court agreed was enough to plausibly state that franchisees were "individuals" under the FLSA.<sup>88</sup>

Next, the JaniKing Defendants argued that the franchisees did not allege sufficient facts to render the franchisor an employer under the FLSA, because the allegations stated nothing more than a franchisor-franchisee relationship.<sup>89</sup> The district court rejected this argument and determined that "[t]he mere fact that parties to an FLSA case are also parties to a franchise agreement does not render a plaintiff's FLSA . . . claims not plausible."<sup>90</sup> Rather, the definition of an employer under the FLSA as "any person acting directly or indirectly in the interest of an employer in relation to an employee"<sup>91</sup> is "an expansive one, with 'striking breadth.'"<sup>92</sup> The district court next applied the U.S. Court of Appeals for the Fifth Circuit's economic reality test to determine a party's status as an employer under the FLSA.<sup>93</sup> Under this test, courts evaluate "whether the alleged employer: (1) possessed the power to hire and fire the employees, (2) supervised and controlled employee work schedules or conditions of employment, (3) determined the rate and method of pay-

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84. *Id.* (quoting *Kaminski v. BMW Sugar Land Partners*, No. H10-551, 2010 WL 4817057, at \*2 (S.D. Tex. Nov. 19, 2010)).

85. The decision of the Western District of Oklahoma was later overruled by the U.S. Court of Appeals for the Tenth Circuit, which held that the fact that some franchisees are LLCs does not preclude their coverage under the FLSA. *See Acosta v. Jani-King of Okla., Inc.*, 905 F.3d 1156, 1160 (10th Cir. 2018).

86. *Fernandez*, 2018 WL 539364, at \*2.

87. *Id.*

88. *Id.*

89. *Id.* at \*3.

90. *Id.*

91. 29 U.S.C. § 203(d) (2019).

92. *Fernandez*, 2018 WL 539364, at \*3 (quoting *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992)).

93. *Id.*

ment, and (4) maintained employment records.”<sup>94</sup> The district court determined that plaintiffs’ allegations were enough to survive a Rule 12(b)(6) motion to dismiss. Plaintiffs alleged that the JaniKing Defendants:

[N]egotiated contracts with customers, retained rights to inspect [p]laintiffs’ work, prohibited [p]laintiffs from engaging in other cleaning business without written authorization, retained rights to require [p]laintiffs to undergo checks and drug testing, required them to wear Jani-King uniforms, retained rights to establish policies and procedures, required [p]laintiffs to undergo training, assigned contracts to the franchisees at their discretion, retained the right to perform all billing and accounting functions, invoiced all cleaning services directly to customers, and paid [p]laintiffs any money owed to them.<sup>95</sup>

The district court determined that these allegations, which must be taken as true for purposes of the 12(b)(6) motion to dismiss, were enough to meet at least two elements (factors two and three) of the economic reality test.<sup>96</sup> Although the district court found that plaintiffs’ allegations had not been found to meet the other two elements per se, the allegations did have some bearing on the power to hire and fire and to supervise and control employee work schedules and conditions of employment.<sup>97</sup> Therefore, the district court determined that plaintiffs’ allegations were enough to plausibly state a claim of employer status under the economic reality test.<sup>98</sup>

Finally, the JaniKing Defendants argued that the franchisees did not sufficiently allege the actual work they did that would entitle them to overtime pay under the FLSA.<sup>99</sup> The district court agreed that the franchisees alleged only generalized, conclusory allegations that they worked more than forty hours a week without overtime pay and that plaintiffs therefore failed to state a plausible FLSA overtime claim.<sup>100</sup> The district court granted plaintiffs leave to amend to allege on a defendant-by-defendant basis a plausible employment relationship, as well as the factual circumstances that support their allegations that give rise to the overtime provisions in the FLSA.<sup>101</sup>

The FLSA requires non-exempt employees to be paid a minimum wage and overtime and requires employers to keep certain pay records. Under *Fernandez*, individuals who create corporate entities that perform work as franchisees can be found to be employees under the FLSA. In addition, calling a worker an independent contractor or a franchisee does not

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94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.* at \*4.

100. *Id.*

101. *Id.*

mean that the worker is not an employee under the FLSA; rather, the legal determination is made using the economic realities test. *Fernandez* also demonstrates that franchisors should consider whether the controls imposed by franchise agreements could create unwanted employment relationships.

## VI. STATUTORY CLAIMS

### A. TEXAS DECEPTIVE TRADE PRACTICES

Franchisees generally qualify as “consumers” under the DTPA, which gives franchisees the ability to assert claims for treble damages and attorneys’ fees.<sup>102</sup> Failure-to-disclose claims under the DTPA’s laundry list often arise in the franchise context, where franchisees contend that they were induced to enter into a franchise agreement based on a franchisor’s omission of material information. But, as *Ferreira v. Russell*<sup>103</sup> demonstrates, this material information must be known by the franchisor at the time of the transaction. *Ferreira* involved an oral agreement for the operation of a “Paw Depot” franchise to sell holistic pet supplies.<sup>104</sup> The only written agreement between the franchisor and franchisee was titled a “noncompete agreement” that referred to a fee for “\$35,000 per one franchise zone.”<sup>105</sup> The parties also orally agreed for franchisor’s construction company to build-out the store, which the parties planned to complete in sixty to ninety days.<sup>106</sup> Franchisee believed that the \$35,000 in the noncompete agreement included “a Paw Depot franchise and a completely built-out store, including shelves stocked with the product.”<sup>107</sup> Franchisor believed that the \$35,000 was for the franchise alone, and that the franchisee would also pay the construction costs.<sup>108</sup> Unexpected construction delays occurred and franchisor requested an additional \$10,000 to complete the build-out.<sup>109</sup> Franchisee refused, hired a new contractor, and opened the store under another name.<sup>110</sup> Franchisee also sued franchisor, franchisor’s wife, and franchisor’s construction company, alleging several “laundry list” DTPA violations based on the construction delays and franchisor’s alleged failure to disclose that surplus and repurposed materials would be used for construction.<sup>111</sup> After the trial court entered judgment against the franchisor for damages and attorneys’ fees based on failure to disclose under Section 17.46(b)(24) of the DTPA, franchisor appealed, arguing that there was not legally sufficient evidence

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102. See *AdvoCare Int’l, L.P. v. Ford*, No. 05-10-00590-CV, 2013 WL 505210, at \*5 (Tex. App.—Dallas Feb. 5, 2013, pet. denied) (mem. op.).

103. No. 05-16-01235-CV, 2018 WL 3829231, at \*1 (Tex. App.—Dallas Aug. 13, 2018, no pet.) (mem. op.).

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.* at \*1–2.

110. *Id.* at \*2.

111. *Id.* at \*2–4.

to support the trial court's finding.<sup>112</sup>

The Dallas Court of Appeals agreed that there was insufficient evidence to establish a DTPA violation. To prevail on a DTPA claim for failure to disclose under Section 17.46(b)(24), a plaintiff must prove the following elements: "(i) a failure to disclose material information concerning goods or services that was (ii) known at the time of the transaction, (iii) intended to induce the consumer into a transaction, and (iv) that the consumer would not have entered had the information been disclosed."<sup>113</sup> The court determined that there was no evidence that franchisor had knowledge at the time of the agreement that the construction delays would occur.<sup>114</sup> The court determined that the fact that construction delays later arose or that franchisor acknowledged to franchisee that the sixty-day estimate was optimistic was not evidence that franchisor had knowledge of the delays at the time the oral franchise agreement was entered into.<sup>115</sup>

As to franchisee's argument regarding nondisclosure that surplus and repurposed materials would be used, the court also found that there was insufficient evidence to establish a DTPA violation under Section 17.46.<sup>116</sup> The court first reiterated that mere nondisclosure of material information is not enough to establish a DTPA claim.<sup>117</sup> Rather, the information must be withheld for the intent of inducing the franchisee into entering into the franchise agreement.<sup>118</sup> Moreover, the court determined that there must be direct evidence of intent to induce, which cannot be presumed.<sup>119</sup> Finding that there was nothing in the parties' testimony or surrounding circumstances that would raise a reasonable inference of intent to induce, the court determined that there was insufficient evidence to support this theory as well.<sup>120</sup>

*Ferreira* is a reminder that mere nondisclosure of material information is not enough to establish an actionable claim under the DTPA. Rather, failure-to-disclose claims must establish that the material information was known at the time of the transaction and that this information was withheld with the intent of inducing the franchisee into entering into the franchise agreement.

## B. BANKRUPTCY

A bankruptcy court has jurisdiction over causes under Title 11, as well as core proceedings that "arise under title 11" or that "arise in a case"

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112. *Id.* at \*2.

113. *Id.*

114. *Id.* at \*3.

115. *Id.*

116. *Id.*

117. *Id.* at \*4.

118. *Id.*

119. *Id.*

120. *Id.*

under Title 11.<sup>121</sup> Bankruptcy judges have jurisdiction to hear and enter final judgment in core matters.<sup>122</sup> Non-core matters, by contrast, are those that could exist outside of bankruptcy that do have some effect on the bankruptcy. A common example of a non-core matter is a franchisor or franchisee's state law claim against the other party for breach of the franchise agreement or fraud, which is a creature of state law. With respect to non-core matters, a bankruptcy judgment may only "submit proposed findings of fact and conclusions of law to the district court," with the judgment entered by the district court.<sup>123</sup> If all parties to the proceeding consent, however, the bankruptcy court may enter a final judgment in a non-core proceeding.<sup>124</sup> *Saenz v. Gomez*, discussed above, considered whether the bankruptcy court had jurisdiction over the transferee franchisee's state law fraud claims.<sup>125</sup> In *Saenz*, the bankruptcy court determined that it had jurisdiction and constitutional authority over the state law claims because the case involved a "core" matter.<sup>126</sup> In the alternative, the bankruptcy court concluded that even if the state law claim was not a core matter, the bankruptcy court had jurisdiction because the parties consented to jurisdiction.<sup>127</sup> The U.S. Court of Appeals for the Fifth Circuit found no error in the bankruptcy court's determination that the parties consented to jurisdiction to enter a final judgment.<sup>128</sup> The Fifth Circuit, however, declined to consider whether the case involved "'core' matters" to "issue a final judgment that liquidates a state law claim excepted from discharge."<sup>129</sup>

In addition to jurisdictional issues, *Saenz* also considered the dischargeability of the state law fraud claim. Chapter seven liquidation is a principal means used by franchisees to discharge their debts. The Bankruptcy Code authorizes a broad discharge with the intent to provide a fresh start to honest but unfortunate debtors. Notwithstanding this broad discharge, Section 523 of the Bankruptcy Code sets forth certain debts that are nondischargeable, including debts obtained by actual fraud.<sup>130</sup> In *Saenz*, Gomez asserted actual fraud as a basis for nondischargeability of the bankruptcy court's judgment under Section 523(a)(2)(A) of the Bankruptcy Code.<sup>131</sup> The Fifth Circuit agreed with the bankruptcy court's finding that all elements of the Section 523(a)(2)(A) claim were satisfied.<sup>132</sup> The Fifth Circuit explained that the elements of "actual fraud" generally correspond with the elements of common law fraud in Texas.<sup>133</sup>

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121. 28 U.S.C. § 157(b)(1) (2019); 28 U.S.C. § 1334(b) (2019).

122. *Id.* § 157(b)(1).

123. *Id.* § 157(c)(1).

124. *Id.* § 157(c)(2).

125. *Saenz v. Gomez (In re Saenz)*, 899 F.3d 384, 390 (5th Cir. 2018).

126. *Id.*

127. *Id.*

128. *Id.* at 391.

129. *Id.* at 390.

130. 11 U.S.C. § 523 (2016).

131. *In re Saenz*, 899 F.3d at 393–94.

132. *Id.* at 395.

133. *Id.* at 394.



For the same reasons that fraud was found, the Fifth Circuit determined that the elements for actual fraud for nondischargeability were also met.<sup>134</sup>

A debtor's litigation claims are often valuable assets of the bankruptcy estate. But if a debtor does not include specific and unequivocal language preserving its claims and causes of action against third parties post-confirmation, standing to pursue these claims will be lost. Whether the plan documents properly preserved a franchisee's post-confirmation claims against its franchisor was at issue in *Lauter v. Citgo Petroleum Corp.*<sup>135</sup> In this case, debtor Gas-Mart USA (Gas-Mart) and Citgo Petroleum Corporation (Citgo) entered into a Marketer Franchise Agreement in September 2013.<sup>136</sup> In July 2015, franchisee Gas-Mart filed Chapter 11 bankruptcy and in March 2016, Gas-Mart rejected all of its executory contracts, including the franchise agreement with Citgo.<sup>137</sup> In September 2016, a liquidation plan was confirmed. The plan provided for establishment of a creditor trust; appointment of the plaintiff as trustee of the creditor trust authorized to pursue causes of action; and transfer of estate assets, including causes of action, to the creditor trust.<sup>138</sup> Plaintiff Lauter, as the creditor-trustee of Gas-Mart, filed suit against Citgo for breach of contract, violation of the automatic stay in the bankruptcy court, and avoidance of a preferential transfer.<sup>139</sup> The trustee contended that Citgo took actions after Gas-Mart declared bankruptcy, which caused Gas-Mart's reorganization attempts to fail.<sup>140</sup>

Citgo argued that the plan documents did not adequately preserve the trustee's breach of contract and stay violation claims.<sup>141</sup> The U.S. District Court for the Southern District of Texas determined that "specific and unequivocal" language is required to preserve a claim under U.S. Court of Appeals for the Fifth Circuit law.<sup>142</sup> The district court also found that the plan documents were sufficiently "specific and unequivocal" to preserve the breach of contract claims against Citgo because the plan documents mentioned contract claims as preserved and identified Citgo as a potential defendant.<sup>143</sup> Although the breach of contract claim was preserved, the district court determined that the trustee did not have standing to assert claims for post-petition breach of contract because of Gas-Mart's rejection of the franchise agreement.<sup>144</sup> The breaches alleged, including Citgo's not supplying fuel, creating unreasonable restrictions of fuel allocation, and failing to comply with the other terms of the franchise

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134. *Id.* at 394–95.

135. No. H-17-2028, 2018 WL 801601, at \*3 (S.D. Tex. Feb. 8, 2018).

136. *Id.* at \*1.

137. *Id.* at \*1–2.

138. *Id.* at \*2.

139. *Id.* at \*3.

140. *Id.*

141. *Id.* at \*11.

142. *Id.* at \*6–9.

143. *Id.* at \*10.

144. *Id.* at \*15.

agreement, all occurred post-termination and after Gas-Mart rejected the franchise agreement.<sup>145</sup> As to plaintiff's claim for violation of the automatic stay, the district court determined that the plan documents did not preserve this claim because the documents did not mention stay violations.<sup>146</sup> The fact that Citgo may have had actual knowledge of a claim for violation of the stay was irrelevant since the issue was governed by the plan documents and what claims the plaintiff preserved on notice to creditors.<sup>147</sup>

### C. LIQUOR LAWS

States take the primary role in regulating the sale and distribution of alcoholic beverages within their borders. Texas has a three-tier system of alcohol regulations. Producers, distributors, and retailers are required to remain independent and without any financial interests in each other. Texas vigorously enforces these regulations. Texas statutes prohibit publicly-traded companies from selling liquor; Texas is the only state in the nation with such a law. In *Wal-Mart Stores, Inc. v. Texas Alcoholic Beverage Commission*, Wal-Mart brought a constitutional challenge against four Texas statutes governing the issuance of package store permits, which allow the retail sale of liquor in Texas.<sup>148</sup> These statutes prohibit public corporations, such as Wal-Mart, from obtaining package store permits and prohibit other companies with diffuse ownership from obtaining more than five of these permits.<sup>149</sup> Wal-Mart argued that these statutes violated the Dormant Commerce Clause and the Equal Protection Clause and sought both a declaration that these statutes were unconstitutional and a permanent injunction against their enforcement.<sup>150</sup> The U.S. District Court for the Western District of Texas agreed and declared that the public corporation ban violated the Commerce Clause and issued a permanent injunction.<sup>151</sup>

Under the public corporation ban at issue, any entity owned or controlled in part by a public corporation is forbidden from holding a package store permit in Texas and therefore cannot sell liquor.<sup>152</sup> Under the statute, a public corporation is defined as a corporation whose shares are on a public stock exchange or in which more than thirty-five persons hold an ownership interest.<sup>153</sup> The Texas Package Store Association argued on behalf of the Texas Alcoholic Beverage Commission that the public corporation ban was necessary to promote "accountability" and to have real humans close to the business who will bear ultimate personal responsibil-

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145. *Id.*

146. *Id.* at \*11.

147. *Id.* at \*12.

148. *Wal-Mart Stores, Inc. v. Texas Alcoholic Beverage Comm'n*, 313 F. Supp. 3d 751, 756 (W.D. Tex. 2018).

149. *Id.*

150. *Id.*

151. *Id.* at 786.

152. *Id.* at 758.

153. *Id.*

ity for the actions of the liquor store.<sup>154</sup> The district court determined that there was no evidence of actual problems with corporate accountability and the public corporation ban had a discriminatory purpose to exclude out-of-state companies in order to benefit locally-owned package stores.<sup>155</sup> The district court determined that while the public corporation ban did not have a discriminatory effect because public corporations are banned from the market whether or not they are based in Texas or owned by Texas,<sup>156</sup> the ban places “burdens on interstate commerce that exceed the burdens on intrastate commerce.”<sup>157</sup> The district court determined that only a very small percentage of in-state companies that wanted to engage in the retail sale of liquor were prevented from doing so by the public corporation ban and that a very large percentage of out-of-state companies were blocked.<sup>158</sup> In determining whether a legitimate local purpose for the public corporate ban existed, the district court agreed that the Texas legislature had an interest in reducing the availability and consumption of liquor.<sup>159</sup> However, the increased prices caused by the public corporation ban could have been achieved by less discriminatory alternative means, including an excise tax.<sup>160</sup>

Pending an appeal to the U.S. Court of Appeals for the Fifth Circuit, liquor in publicly owned stores in Texas, including Wal-Mart, Costco, and other giant retailers could become a reality. If publicly traded companies are allowed to sell liquor, existing law still requires these companies to build separate facilities, although they can be next to existing stores.

## VII. REMEDIES: DAMAGES AND INJUNCTIVE RELIEF

### A. COMPENSATORY DAMAGES AND PUNITIVE DAMAGES

As discussed above, in *Choice Hotels International, Inc. v. Frontier Hotels, Inc.*, Choice Hotels filed suit against a franchisee for continuing to use Choice Hotels’ “COMFORT” family of registered trademarks (i.e., COMFORT INN®) after the franchise agreement was terminated—and even after a court issued a permanent injunction against the franchisee’s use of the trademark.<sup>161</sup> Under the Lanham Act, Choice Hotels was entitled to the franchisee’s profits for the infringement,<sup>162</sup> and it was the franchisee’s burden to prove any elements of costs or deductions—something the franchisee failed to even address.<sup>163</sup> To determine the proper amount of damages, the U.S. District for the Southern District of Texas examined

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154. *Id.* at 761.

155. *Id.* at 768–69.

156. *Id.* at 766.

157. *Id.* at 774 (quoting Nat’l Solid Waste Mgmt. Ass’n v. Pine Belt Reg’l Solid Waste Mgmt. Auth., 389 F.3d 491, 501 (5th Cir. 2004)).

158. *Id.* at 775.

159. *Id.* at 776.

160. *Id.*

161. *Choice Hotels Int’l, Inc. v. Frontier Hotels, Inc.*, No. H-1502355, 2018 WL 2317604, at \*1 (S.D. Tex. May 22, 2018).

162. *Id.* at \*2.

163. *Id.*

the franchisee's profit-loss information from December 2014 through February 2016, and, because the franchisee did not provide the same information from March 2016 through August 2016, the district court relied on Choice Hotels' estimate of the franchisee's profits and loss based on the prior year.<sup>164</sup> The district court accepted franchisor's calculations and stated that franchisor was entitled to \$252,582.25, representing the franchisee's profits from the relevant period.<sup>165</sup> The district court awarded treble damages of \$757,746.75, three times the franchisee's profits, based on the franchisee's continued use of the marks after Choice Hotels issued multiple warnings, sent a termination letter, and filed the lawsuit—which the court concluded was intentional infringement.<sup>166</sup>

Finally, the district court awarded Choice Hotels actual damages in the form of reasonable royalties.<sup>167</sup> The franchise agreement obligated the franchisee to pay Choice Hotels 9.5% of its gross room revenue from the relevant period as a franchise fee,<sup>168</sup> which the court calculated to be \$1,273,642.23 by referencing both the franchisee's actual total income from December 2014 through February 2016 and the estimated income from March 2016 through August 2016.<sup>169</sup> Applying the franchise fee percentage, the district court awarded Choice Hotels \$120,996.01 in actual damages.<sup>170</sup>

## B. INJUNCTIVE RELIEF

Injunctive relief is considered an extraordinary remedy, and courts place a high burden on parties seeking injunctions or restraining orders. As noted in preceding sections of this Survey, the franchisor of the Bar Louie restaurant system sought a temporary restraining order and preliminary injunction to force a franchisee to comply with pre-termination procedures in the franchise agreement.<sup>171</sup> The agreement could only be terminated if an arbitrator found that Bar Louie had materially breached the agreement,<sup>172</sup> and the franchisee was required to provide Bar Louie with written notice within one year of any alleged breach and allow sixty days for Bar Louie to cure.<sup>173</sup> Instead, the franchisee notified Bar Louie that it intended to close the restaurant before the end of the term, and Bar Louie sought an injunction requiring the franchisee to reopen the restaurant and comply with the pre-termination procedures.<sup>174</sup> In response, the franchisee argued Bar Louie had materially breached the

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164. *Id.* at \*1–2.

165. *Id.*

166. *Id.* at \*2–3.

167. *Id.*

168. *Id.* at \*3.

169. *Id.*

170. *Id.*

171. *BL Rest. Franchises LLC v. 510 Park Inc.*, No. 3:18-CV-0971-B, 2018 WL 2363606, at \*1 (N.D. Tex. May 24, 2018).

172. *Id.* at \*2.

173. *Id.*

174. *Id.*

franchise agreement by failing to provide adequate support—an allegation that Bar Louie curiously did not refute.<sup>175</sup> Bar Louie instead made the vague declaration that not every breach warranted repudiation by the other party.<sup>176</sup> The franchisee also argued that it had not technically “terminated” the franchise agreement, noting that it closed the restaurant “simply because it was financially impossible to keep it open”—another argument that Bar Louie inexplicably provided no response to.<sup>177</sup> Since Bar Louie did not dispute that it failed to provide support to the former franchisee, the U.S. District Court for the Northern District of Texas concluded that Bar Louie had failed to show a substantial likelihood of success on the merits and thus was not entitled to injunctive relief.<sup>178</sup>

### C. ATTORNEYS’ FEES

Courts have significant discretion in determining reasonable awards of attorneys’ fees. In addition to awarding Choice Hotels actual damages and three times the franchisee’s profits from the relevant period, the district court in *Choice Hotels International, Inc. v. Frontier Hotels, Inc.* also awarded Choice Hotels its attorneys’ fees under the Lanham Act due to franchisee’s intentional infringement.<sup>179</sup> Excluding the fees that Choice Hotels estimated were “likely to be billed” in the future, the district court found that the rates and number of hours for Choice Hotels’ attorneys were reasonable and awarded \$33,395.50 in attorneys’ fees.<sup>180</sup>

Awards of attorneys’ fees can vary substantially depending on the facts of individual cases and courts’ interpretations of specific language providing for awards of fees under various statutes. After the U.S. District Court for the Western District of Texas denied a franchisor’s request for three types of injunctive relief in *Stockade Companies, LLC v. Kelly Restaurant Group, LLC*, Kelly Restaurant Group (Kelly) filed a motion to dismiss for failure to state a claim.<sup>181</sup> However, before the district court could rule on that motion, the franchisor voluntarily dismissed its claims without prejudice.<sup>182</sup> Kelly then filed a motion with the district court for its attorneys’ fees and costs, arguing that it was the prevailing party and the franchisor had dismissed its claims simply to avoid an unfavorable judgment on the merits.<sup>183</sup> Kelly believed its request for attorneys’ fees was supported by three statutes—Rules 54(d) and 41(d) of the Federal Rules of Civil Procedure and Section 134A.005 of the Texas Civil Prac-

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175. *Id.* at \*3.

176. *Id.*

177. *Id.*

178. *Id.*

179. *Choice Hotels Int’l, Inc. v. Frontier Hotels, Inc.*, No. H-1502355, 2018 WL 2317604, at \*3 (S.D. Tex. May 22, 2018).

180. *Id.*

181. *Stockade Cos., LLC v. Kelly Rest. Grp., LLC*, No. 1:17-CV-143-RP, 2018 WL 3018177, at \*1–2 (W.D. Tex. June 15, 2018).

182. *Id.* at \*2.

183. *Id.*

tices & Remedies Code—and a provision in the franchise agreement.<sup>184</sup>

In response, the franchisor first argued that the franchise agreement required Kelly to submit its claim for attorneys' fees to arbitration and that an arbitrator, not the district court, should determine the threshold question of whether such claim was subject to arbitration.<sup>185</sup> Because the district court had previously found that the franchisor had failed to present clear and unmistakable evidence that the parties agreed to arbitrate the question of arbitrability, the district court concluded it could decide whether the claim was subject to arbitration.<sup>186</sup> Because the claim was collateral to the franchisor's claim for injunctive relief that was excepted from the arbitration clause, the district court decided that the claim was not subject to arbitration.<sup>187</sup>

The district court next addressed whether Kelly was a "prevailing party."<sup>188</sup> To be a prevailing party, a "judicially sanctioned change in the legal relationship of the parties" must have occurred.<sup>189</sup> Looking to U.S. Court of Appeals for the Fifth Circuit precedent, the district court noted that a defendant is generally not a prevailing party when the plaintiff dismisses its claims without prejudice.<sup>190</sup> Kelly argued the Texas Supreme Court had recognized an exception where a plaintiff dismisses its claims "to circumvent unfavorable legal restrictions or rulings."<sup>191</sup> The district court held Kelly did not prove the exception because the denial of the motions for preliminary injunctions did not necessarily mean the court would have granted Kelly's motion to dismiss.<sup>192</sup> Further, the district court recognized it had granted numerous other motions in favor of the franchisor earlier in the case and that the franchisor had not abandoned its claims entirely but chose to pursue them in arbitration instead.<sup>193</sup>

Even if Kelly had shown it was the prevailing party, the district court found that Kelly would not have been entitled to relief under any of the statutes or the language of the franchise agreement.<sup>194</sup> First, Rule 54 only provides the procedure to recover attorneys' fees; it does not supply the substantive prerequisites for recovery, which are instead governed by federal or state law covering the substantive issues in the case.<sup>195</sup> Second, by its own terms, the franchise agreement did not permit Kelly to recover fees because it only applied to a party that "instituted" a legal proceeding.<sup>196</sup> Third, the district court denied recovery under Section

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184. *Id.*

185. *Id.* at \*3.

186. *Id.*

187. *Id.* at \*3–4.

188. *Id.* at \*4.

189. *Id.* (quoting *Buckhannon Bd. & Care Home v. W.V. Dept. of Health & Human Res.*, 532 U.S. 598, 605 (2001)).

190. *Id.* at \*4–5.

191. *Id.* (quoting *Epps v. Fowler*, 351 S.W.3d 862, 870 (Tex. 2011)).

192. *Id.* at \*5.

193. *Id.* at \*6.

194. *Id.*

195. *Id.* at \*2.

196. *Id.* at \*6.

134A.005(1) of the Texas Uniform Trade Secrets Act because Kelly had failed to show the franchisor's trade secret claim was brought in bad faith, which required clear evidence that the claim was entirely without merit and taken for an improper purpose.<sup>197</sup> Finally, the district court held Rule 41(d) did not apply because the rule only applied to two sequential lawsuits—not to a lawsuit and a subsequent arbitration.<sup>198</sup> The district court therefore denied the franchisee's request for attorneys' fees.<sup>199</sup>

## VIII. CONCLUSION

This Survey period includes franchise cases from a range of subject matters, including procedure, franchise-specific contractual relationships, intellectual property, common law claims, statutory claims, and remedies.

Among the procedural cases, *Gigi's Cupcakes* emphasized that Texas courts will enforce choice-of-law agreements unless 1) no substantial relationship exists between the parties or the transaction and the state and no other reasonable basis exists for choosing such a forum; or 2) that enforcement of the agreement contravenes the "fundamental policy of a state which has a materially greater interest than the chosen state" in the determination of the legal issues in dispute.<sup>200</sup> *BL Restaurant Franchises* indicated that a similarly heavy burden of proof exists where a party seeks a preliminary injunction to enforce its rights under a franchise agreement; Texas courts will narrowly construe provisions of a franchise agreement granting a party a right to injunctive relief.<sup>201</sup> In *KF Franchising*, the district court held that a plaintiff franchisor could not seek to litigate in federal court because a Texas state court had already ruled on personal jurisdiction.<sup>202</sup> In *Charging Bison*, the U.S. Court of Appeals for the Fifth Circuit affirmed a district court's enforcement of an arbitration clause, holding that disputes over the applicability of arbitration provisions should be resolved in favor of arbitration.<sup>203</sup>

*BL Restaurant Franchises* surfaced once again in this Survey's analysis of the franchise relationship, termination, and nonrenewal. In that case, a district court held that the franchisor was not entitled to an injunction to reopen the restaurant at issue under separate provisions of the franchise agreement concerning termination requirements and protections for the franchisor's proprietary property.<sup>204</sup> Instead, the district court applied the much higher common law standard for injunctive relief, concluding that

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197. *Id.* at \*6–7.

198. *Id.* at \*7.

199. *Id.*

200. *Gigi's Cupcakes, LLC v. 4 Box LLC*, No. 3:17-CV-3009-B, 2018 WL 6068817, at \*3 (N.D. Tex. Nov. 19, 2018).

201. *BL Rest. Franchises LLC v. 510 Park Inc.*, No. 3:18-CV-0971-B, 2018 WL 2363606, at \*2–3 (N.D. Tex. May 24, 2018).

202. *KF Franchising, Ltd. v. Tasone Inc.*, No. H-17-3849, 2018 WL 1865921, at \*2 (S.D. Tex. Apr. 18, 2018).

203. *Charging Bison, LLC v. Interstate Battery Franchising and Dev., Inc.*, 711 F. App'x 232, 232 (5th Cir. 2018) (per curiam).

204. *BL Rest. Franchises*, 2018 WL 2363606, at \*2–3.

the franchisor could not demonstrate the requisite likelihood of success on the merits.<sup>205</sup>

The district court in *Choice Hotels International* was comparatively more receptive to that franchisor's attempts to enforce its intellectual property rights with injunctions and extensive damages awards. In that case, the district court awarded the franchisor over \$900,000 in lost profits, actual damages, and attorneys' fees, finding that the franchisee violated the Lanham Act by continuing to use the franchisor's licensed trademarks after the franchise agreement had terminated—and even after being enjoined by the court.<sup>206</sup>

This Survey's analysis of common law claims included cases addressing fraud and unfair competition, as well as vicarious liability. In *Saenz*, a franchisee fraudulently sold his pizza franchise to an unwitting buyer by forging the business's income statements and misleading the buyer as to the franchisee's relationship to the franchisor.<sup>207</sup> Although the franchisor was dismissed from the case, the issues addressed by the Fifth Circuit are a useful reminder for franchisors to keep current records of franchisee ownership and to enforce franchise agreement provisions regarding notification of any franchise transfers.<sup>208</sup> In *Fernandez*, a district court probed the distinction between independent contractors and employees in assessing whether franchisors were vicariously liable for a franchisee's wage violations under the FLSA.<sup>209</sup> Though many of the disputed issues remain unresolved, *Fernandez* serves as a prescient warning to franchisors that controls imposed in franchise agreements could create unintended and unwanted employment relationships with franchisees and their employees.<sup>210</sup>

The statutory claims cases probed a broad range of subject matters. In *Ferreira*, the Dallas Court of Appeals demonstrated that the DTPA imposes a heavy burden of proof on plaintiffs claiming a failure to disclose information; the court of appeals affirmed a trial court finding that insufficient evidence existed to establish that the defendant knew at the time of the agreement that construction delays would occur, much less that defendant withheld relevant information with the intent to induce the franchisee to enter into an agreement.<sup>211</sup> In *Saenz*, the Fifth Circuit affirmed a bankruptcy court's conclusion that a franchisee's state law claims involved a "core" matter of the bankruptcy, providing the bankruptcy court with jurisdiction to enter a final judgment on the state law claims.<sup>212</sup>

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205. *Id.* at \*6–7.

206. *Choice Hotels Int'l, Inc. v. Frontier Hotels, Inc.*, No. H-1502355, 2018 WL 2317604, at \*2–3 (S.D. Tex. May 22, 2018).

207. *Saenz v. Gomez (In re Saenz)*, 899 F.3d 384, 393 (5th Cir. 2018).

208. *Id.* at 389 n.7.

209. *Fernandez v. Jani-King Int'l, Inc.*, No. H-17-1401, 2018 WL 539364, at \*1–2 (S.D. Tex. Jan. 8, 2018).

210. *Id.* at \*4.

211. *Ferreira v. Russell*, No. 05-16-01235-CV, 2018 WL 3829231, at \*1–4 (Tex. App.—Dallas Aug. 13, 2018, no pet.) (mem. op.).

212. *In re Saenz*, 899 F.3d at 393–94.



*Lauter*, another bankruptcy case, discussed issues of claim preservation and standing.<sup>213</sup> *Lauter* reiterated that debtors must include specific and unequivocal language preserving claims following confirmation of bankruptcy, or lose standing to pursue those claims.<sup>214</sup> Finally, *Wal-Mart Stores* involved successful constitutional claims by Wal-Mart against the Texas Alcoholic Beverages Commission, specifically that Texas violated the Commerce Clause and the Equal Protection Clause in prohibiting publicly traded companies from selling liquor in the state.<sup>215</sup> Though this case is pending appeal to the Fifth Circuit, the district court's ruling has the potential to dramatically affect the ability of franchises to sell liquor in Texas.

This Survey's discussion of remedies revisited several cases discussed in earlier portions of the Survey, but with particular emphasis on the kinds of remedies available to litigants—including damages, injunctive relief, and attorneys' fees. In *Choice Hotels*, the district court concluded that the defendant intentionally infringed the franchisor plaintiff's trademarks, and awarded over \$900,000 in damages based on estimates of the franchisee's profits during the relevant time period, royalty schedules contained in the franchise agreement, and treble damages available as a remedy for intentional infringement.<sup>216</sup> In *BL Restaurant Franchises*, the district court refused to grant a preliminary injunction requiring the franchisee to keep its restaurant open according to the pre-termination provisions in the franchise agreement, holding that because the franchisor failed to show a likelihood of success on the merits, it was not entitled to injunctive relief.<sup>217</sup> *BL Restaurant Franchises* illustrates the high burden for parties seeking a preliminary injunction—Bar Louie's failure to refute the franchisee's allegations that Bar Louie had failed to provide adequate support and that it was financially impossible for the franchisee to keep the restaurant open ultimately proved fatal to Bar Louie's request for injunctive relief.<sup>218</sup> Finally, *Choice Hotels* and *Stockade Companies* offered contrasting examples of the highly contextual and discretionary analysis through which courts award attorneys' fees; parties seeking fees face a particularly high burden of proof where statutory provisions for attorneys' fees require evidence that the opposing party acted intentionally or in bad faith.<sup>219</sup>

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213. *Lauter v. Citgo Petroleum Corp.*, No. H-17-2028, 2018 WL 801601, at \*3 (S.D. Tex. Feb. 8, 2018).

214. *Id.* at \*10–15.

215. *Wal-Mart Stores, Inc. v. Texas Alcoholic Beverage Comm'n*, 313 F. Supp. 3d 751, 756 (W.D. Tex. Mar. 20, 2018).

216. *Choice Hotels Int'l, Inc. v. Frontier Hotels, Inc.*, No. H-1502355, 2018 WL 2317604, at \*1–3 (S.D. Tex. May 22, 2018).

217. *BL Rest. Franchises, LLC v. 510 Park Inc.*, No. 3:18-CV-0971-B, 2018 WL 2363606, at \*1–3 (N.D. Tex. May 24, 2018).

218. *Id.* at \*3.

219. *Choice Hotels*, 2018 WL 2317604, at \*3; *Stockade Cos., LLC v. Kelly Rest. Grp., LLC*, No. 1:17-CV-143-RP, 2018 WL 3018177, at \*6–7 (W.D. Tex. June 15, 2018).

Taken together, the cases analyzed in this Survey provide a recent account of the most prominent changes occurring in the field of franchise law in Texas. These cases illustrate continuing trends in franchise law jurisprudence and also draw attention to emerging legal issues which franchise law practitioners should continue to monitor in the months and years ahead.

