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Interesting Developments in Franchising

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Franchisor Defeats California Franchisee's Attempt to Force Litigation in California

Just because a forum selection clause may be void under an applicable state franchise law doesn't mean that litigation between the franchisor and its franchisee must be brought in the franchisee's home state. A recent decision of the federal district court in Arizona shows that careful pre-litigation planning can secure for a franchisor an important home court advantage.

Introduction

Franchisors frequently include in their franchise agreements mandatory forum selection clauses. These typically require that litigation be brought in a particular court, usually one located in the franchisor's home state. Forum selection clauses lend some predictability and uniformity to the litigation process, and can minimize the expense and business disruption litigation often entails.

Several states' franchise laws render these forum selection clauses void or unenforceable, however. The California Franchise Relations Act ("CFRA"), for example, provides that "[a] provision in a franchise agreement restricting venue to a forum outside [California] is void with respect to any claim arising under or relating to a franchise agreement involving a franchise business operating within this state." Application of state franchise laws like the CFRA to forum selection clauses raises several interesting questions.

First of all, what exactly is the impact of these laws? Just because a forum selection clause is 'void' doesn't mean venue in the franchisor's home state is necessarily 'improper.' In seeking an advantageous forum for a client, franchisor litigation counsel will argue that venue is proper in the franchisor's home state under applicable state or federal venue statutes, even where a state's franchise law invalidates the forum selection provision specifying that venue.

Historically this argument has gained little traction. In *Jones v. GNC Franchising*, the Ninth Circuit Court of Appeals held that the CFRA not only renders void an offending forum selection clause, it prohibits entirely out-of-state litigation against a franchisee. "By voiding any clause in a franchise agreement limiting venue to a non-California forum for claims arising under or relating to a franchise located in [California, the CFRA] *ensures that California franchisees may litigate disputes regarding their franchise agreement in California courts,"* the court held.

Another question concerns the impact these state laws might have on federal litigation in particular. In federal litigation, will a state's pro-franchisee law or policy trump federal venue statutes? *Jones* suggested they may, and the numerous decisions following *Jones* suggest that most courts agree. But a recent franchisor victory in the federal court in Arizona suggests that not all hope for enforcing franchisors' rights is lost.

The Tilted Kilt Case

In *Tilted Kilt Franchise Operating LLC v. Helper,* Tilted Kilt, a Wyoming limited liability company headquartered in Tempe, Arizona sued its former franchisee, a California resident, for fraud and breach of contract in state court in Arizona. The former franchisee removed the case to the federal court in Phoenix and then moved to dismiss for lack of personal jurisdiction and improper venue or, in the alternative, to transfer the case to California. As in *Jones* and numerous similar cases, the franchisee argued the CFRA superseded the franchise agreement's Arizona forum selection clause and rendered it void.

In opposition to the motion to dismiss Tilted Kilt contended that the federal removal statute, 28 U.S.C. § 1441(a), not the CFRA or any other state law, controlled venue of a removed action. That statute specifies that a removed case shall be removed "to the district court of the United States for the district and division embracing the place where such action is pending." Since the case had been removed from Arizona state court, under § 1441(a) venue was proper in the Arizona federal court independent of the void forum selection clause, Tilted Kilt argued.

The Arizona federal court agreed and denied the motion to dismiss for improper venue based on the CFRA. The Ninth Circuit acknowledged that under *Jones* the CFRA "would appear to void the venue-restriction clause of the franchise agreement." Nevertheless, "venue is still proper in [the Arizona federal court] under § 1441 because the case was removed to that court," the court held. The court also denied the franchisee's motion to dismiss for lack of personal jurisdiction and motion to transfer the case to California.

The *Tilted Kilt* decision shows that the CFRA and similar statutes will not in every instance force franchisors to forfeit an advantageous litigation forum. The statutes, rules and legal principles that determine where lawsuits will proceed can be complicated and conflicting. But that very complexity presents franchisor counsel with opportunities for overcoming procedural obstacles through careful pre-litigation planning. Here, because the California franchisee removed to federal court the case that Tilted Kilt originally filed in state court, Tilted Kilt was able to invoke the federal removal statute's venue provisions, which it otherwise would not have been able to do had it filed the case in federal court in the first instance.

Cheng Cohen LLC is counsel for the franchisor in Tilted Kilt Franchise Operating LLC v. Helper, No. CV10-1951-PHX-DGC (U.S. Dist. Ct., D. Ariz.)