

At Your Service? Customer Account Ownership and Its Impact on Non-Competes, Control Determinations for Vicarious Liability, and Franchise Goodwill

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I. Introduction

The 2010s have been a decade of greatly increased scrutiny regarding the level of control that franchisors exert over their franchisees. While much of that scrutiny has been exerted by parties outside of the franchise relationship, that spotlight has forced franchisors to examine more carefully the controls they wield over franchisees.

However, this willingness to “pull back” on mandates has its limits, and no franchisor wants to be so permissive that it will not obtain a full return on its investment in recruiting and training franchisees. For service businesses, as distinguished from restaurants and most storefront retail, maintaining a hold over the customer lists and contact information developed by a franchisee is a crucial factor for a franchisor, both to gain a return on investment and to create a franchise system that survives for decades rather than years.

Yet a principal goal of all franchisees is to develop a business that it can sell, not just for the value of the physical assets (which may be very modest, especially in a service business) but also for the goodwill that the business has developed with its customers. And it is a legitimate concern of each franchisee that its franchisor not use the customer data that the franchisee developed, at least at the local level, to compete against the franchise. So each franchisee has a vested interest in making sure that it has control over the customer list that it develops in operating the franchise, at least as long as it remains loyal to the franchise system.



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This article wrestles with this issue, using a relatively sparse body of case law to describe the factors that courts have used to determine who “owns” the customer list of a franchised business; analyzing how different levels of control may expose a franchisor to liability for claims of either customers or employees of the franchised business; and finally proposing a framework for protecting both the franchisor’s ability to establish long-term, productive franchises while also allowing franchise owners to capitalize on the goodwill that they are instrumental in developing in those businesses.

Insofar as the analysis of this article concerns issues related to (and determined by) customer lists, it is focused on service-based franchised businesses in which customer lists, subscriptions, and relationships are critical to the success of the franchise. Examples include fitness,¹ massage spas,² lawn care,³ in-home senior care,⁴ “handyman” services,⁵ and child care centers.⁶ Customer lists, to the extent that they are compiled by non-service-based franchisees, such as restaurants and retail operations, are beyond the focus of the analysis presented in this article.

1. See, e.g., ANYTIME FITNESS, <https://www.anytimefitnessfranchise.com/why-anytime-fitness> (last visited May 10, 2019) (“Building strong personal relationships with our members is at the core of what we do”); PLANET FITNESS, <https://www.planetfitness.com/franchising/become-a-franchisee> (last visited May 10, 2019) (“We have more than 12 million members (that doesn’t happen by accident!).”).

2. See, e.g., MESSAGE ENVY, <https://www.messageenvy.com/own-a-franchise> (last visited May 10, 2019) (“Message Envy has a consistent, predictable, and recurring revenue through its membership model.”); LAVIDA MASSAGE, <https://www.lavidamassagefranchise.com> (last visited May 10, 2019) (“Thanks to our loyal guests, LaVida Massage has built a strong reputation for offering exceptional care. Guests can share their experiences giving insight into how to conduct better business.”).

3. See, e.g., U.S. LAWN, <https://uslawnsfranchise.com/the-opportunity> (last visited May 10, 2019) (“How are you going to make a living as a landscaping franchise owner? By landing contracts with the right clients!”); LAWN DOCTOR, <https://lawndoctorfranchise.com/franchise-opportunity/customer-service> (last visited May 10, 2019) (“Because we help [franchisees] achieve a high customer retention rate, they can focus on gaining new customers, growing their business and planning for the future with a more dependable income stream.”).

4. See, e.g., VISITING ANGELS, <https://www.visitingangels.com/knowledge-center/why-in-home-care/what-owning-a-visiting-angels-franchise-means-to-me/254> (last visited May 10, 2019) (“Lydia explains, ‘What a wonderful group of people supporting the franchisees . . . I get many leads a week [from Visiting Angels Corp.] and they are converted into clients for us . . . [T]hese are clients that are truly interested in home care. I just ended my second year [as a Visiting Angels franchise owner] and we have had tremendous growth; . . . the support of the franchise is amazing.’”).

5. See, e.g., HANDYMAN MATTERS, <http://handymanmattersfranchising.com> (last visited May 10, 2019) (“Acceleration Matters. Build your profit base with lead generation and new customer development programs!”).

6. See, e.g., PRIMROSE SCHOOLS, <https://franchise.primroseschools.com/advantage> (last visited May 10, 2019) (“[Franchisor provides] automated CRM system for tracking, measuring and continually improving prospect-to-parent sales processes for enrollment.”).

II. Who Owns Customer Lists in the Absence of a Contractual Provision Addressing Them?

During the franchise relationship, certain legal regimes may limit the use of customer data. For example, in certain circumstances, trade secret laws may protect client lists.⁷ Under the Uniform Trade Secrets Act (UTSA), enacted in almost every U.S. jurisdiction,⁸ a customer list constitutes a trade secret if it “(i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.”⁹ While the interests of the franchisee and franchisor are aligned, the key for both parties is to make reasonable efforts to maintain secrecy of the information, for example, through nondisclosure agreements or confidentiality provisions.

Privacy law presents another legal overlay to the use of client information. Under the European Union General Data Protection Regulation, if a company collects personal data for a particular purpose (e.g., in connection with the service contracts), that personal data can be used for another purpose only if the new purpose is compatible with the original purpose.¹⁰ Some U.S. states have enacted, or are considering, similar legal restrictions on the use of data collected from consumers.¹¹ As a consequence, the use of the client data during the franchise’s existence is likely limited, whether due to legal obligation or to maintain a positive public appearance of not sharing information.

The franchise agreement itself may also restrict the use of customer information by the franchisor, even if the agreement is silent as to client lists specifically. If a franchisee is granted an exclusive territory, and the franchisor shares that franchisee’s in-territory client list with another franchised business in the system, the franchisee would appear to have a colorable claim that the franchisor breached the franchise agreement.

Further, during the term of the franchise agreement, the franchise’s relationship with its customers is one part of the business’s goodwill that can be transferred to successor franchisees. In *BellSouth Telecommunications, Inc. v.*

7. See *Welenco, Inc. v. Corbell*, 126 F. Supp. 3d 1154, 1173 (E.D. Cal. 2015); *Alliantgroup, LP v. Feingold*, 803 F. Supp. 2d 610, 625 (S.D. Tex. 2011); *Holland Ins. Grp., LLC v. Senior Life Ins. Co.*, 766 S.E.2d 187, 192 (Ga. App. 2014); *Calisi v. Unified Fin. Servs., LLC*, 302 P.3d 628, 632 (Ariz. 2013).

8. Trade Secrets Act, Uniform Law Commission, <https://www.uniformlaws.org/committees/community-home?CommunityKey=3a2538fb-e030-4e2d-a9e2-90373dc05792> (last visited May 10, 2019) [hereinafter UTSA].

9. *Id.* § 1(4).

10. See *Can We Use Data for Another Purpose?*, EUROPEAN COMMISSION, https://ec.europa.eu/info/law/law-topic/data-protection/reform/rules-business-and-organisations/principles-gdpr/purpose-data-processing/can-we-use-data-another-purpose_en (last visited May 10, 2019).

11. See, e.g., California Consumer Privacy Act of 2018, CAL. CIV. CODE § 1798 *et seq.*; H.R. 764, Act 171, Gen. Assemb., Reg. Sess. (Vt. 2018) (described as “[a]n act relating to data brokers and consumer protection”).

MCIMetro Access Transmission Services., LLC,¹² for example, the Eleventh Circuit upheld the lower court's finding that BellSouth's loss of about 3,200 customers per week amounted to an irreparable harm to its goodwill. Likewise, Florida goes so far as to express in its Florida Antitrust Act of 1980 that a business has a "legitimate business interest" in customer or client goodwill.¹³ When goodwill is maintained as part of the franchise, it can be transferred to subsequent purchasers for value.¹⁴

At the end of the franchise term, the lack of a contractual provision addressing client lists leads to uncertainty, and likely unfettered use by either party, to the extent of any restrictive covenants. Under current franchising models it is the rule, and not the exception, that the franchisor will have access to the client data of the franchisee, whether because of a centralized client relationship management system, or simply for ongoing auditing purposes. At the same time, it is reasonable to expect that, in the absence of any restriction from doing so, the departing franchisee will take steps to ensure that its client lists and other client information are preserved in a form that the franchisee can access after departure.

The franchisee departing with client information will likely argue that it developed such information through its marketing expenditures, and, as a result, the client information is not the franchisor's trade secret and the franchisee is entitled to retain it. This was the case in *Scott v. Snelling & Snelling, Inc.*¹⁵ In *Scott*, the former franchisee argued that the franchisor's non-compete provision was invalid under California law, notwithstanding the exception under such law permitting enforcement of a non-compete provision when it prevents the unauthorized use of trade secrets or confidential information. The former franchisee based its argument on an assertion that the client information developed by the franchisee did not constitute a trade secret.¹⁶

Under California legal principles, the *Scott* court was required to "determine for itself whether the information allegedly used constitute[d] a trade secret subject to judicial protection at all."¹⁷ Like most other U.S. jurisdictions, California had adopted the UTSA and the court relied upon the UTSA to analyze whether customer lists are trade secrets.¹⁸ The court opined that the customer lists at issue were generated from generally available public information, such that they did not meet the requirement under the UTSA that the value of the putative trade secret is derived from it not being generally known to the public.¹⁹ The court further observed that, when the

12. *BellSouth Telecomm., Inc. v. MCIMetro Access Transmission Servs., LLC*, 425 F.3d 964, 970 (11th Cir. 2005).

13. FLA. STAT. § 542.335.

14. *See, e.g., Dallas & Lashmi, Inc. v. 7-Eleven, Inc.*, 112 F. Supp. 3d 1048, 1060 (C.D. Cal. 2015) (holding that the defendant breached an oral contract for the sale of the franchisee's goodwill).

15. *Scott v. Snelling & Snelling, Inc.*, 732 F. Supp. 1034 (N.D. Cal. 1990).

16. *Id.* at 1038.

17. *Id.* at 1043.

18. *Id.*

19. *Id.*

restrained party has developed a customer list through its own efforts, it is generally accepted under California law that such a list does not constitute a trade secret “because equity has no power to compel a man who changes employers to wipe clean the slate of his memory.”²⁰

At this point it is apparent that, absent clear language regarding the treatment of customer data, the proper use and possession of that information after the end of a franchise relationship are unclear.

III. Using Franchise Agreement Language to Provide Clarity About Client List Ownership

The franchise agreement gives the franchisor the first and best opportunity to establish with specificity that any and all customer data is solely to be used in connection with the franchised business and remains the franchisor’s confidential information after the end of the franchise relationship. In *American Express Financial Advisors, Inc. v. Yantis*,²¹ the franchisee terminated the franchise agreement and attempted to take the clients of American Express Financial Advisors (AEFA) to a competitor. Among other claims, AEFA contended that the franchisee “misappropriated confidential information by keeping client names, addresses and data.”²²

The *Yantis* court engaged in the usual two-pronged analysis under the UTSA. First, the court determined that the client information fell within the definition of a “trade secret” because such information was not generally disclosed to the public and provided AEFA with an economic advantage over its competitors.²³ Second, the court found that AEFA took reasonable steps to maintain the secrecy of that information.

In reaching its conclusion that AEFA reasonably safeguarded client information, the court in *Yantis* observed that the franchisee was required to sign a franchise agreement which specified:²⁴

Except as otherwise permitted in Section 19, [the franchisee] agrees that, without limitation, Client names, addresses, data and other personal and financial information recorded in Client records are confidential. Confidential information includes compilations and lists of such Client information even if of otherwise public information if such compilations or lists were the result of substantial effort, time and/or money expended pursuant to the System. [The franchisee] further agrees to use this confidential information only in furtherance of this Agreement or in accordance with the Manuals and for no other purpose. Confidential information does not include information which is generally known outside of AEFA other than as a result of a disclosure by [the franchisee], [the franchisee’s] agents or representatives or any other person or entity in breach of any contractual, legal or fiduciary obligation of confidentiality to AEFA or to any other person or entity with respect to such information.

20. *Id.* (internal quotation marks and citations omitted).

21. *Am. Express Financial Advisors, Inc. v. Yantis*, 358 F. Supp. 2d 818 (N.D. Iowa 2005).

22. *Id.* at 830.

23. *Id.* at 831.

24. *Id.*

Moreover, the franchisee had agreed in the franchise agreement to require its staff who had access to client lists, and potential leads, to sign a similar confidentiality agreement.

The franchise agreement also restricted the franchisee's use of confidential information, whereby the franchisee agreed to:²⁵

not, during the term of this Agreement or thereafter, except as permitted under Section 14 regarding transfers of the [franchised business], communicate, divulge, or use for himself . . . except pursuant to the System, or for the benefit of any other person, partnership, association, or corporation any confidential information, or trade secrets, including, without limitation, Client names, addresses and data and know-how concerning the methods of operation of the System and the business franchised under which may be communicated to [the franchisee] or of which [the franchisee] may be apprised by virtue of [the franchisee's] operation under the terms of this Agreement.

Finally, the court noted that the franchise agreement contained post-term non-solicit covenants and a perpetual restraint from using, directly or indirectly, any confidential information.

Having satisfied itself that the client information was a trade secret, the *Yantis* court analyzed whether the franchisee misappropriated the information under the UTSA. AEFA argued, and the court agreed, that the franchisee (1) had agreed under the franchise agreement that client records are confidential information not to be disclosed for personal use; (2) was obligated to require its staff who came into contact with confidential information to enter into confidentiality agreements; and (3) "misappropriated AEFA's client files by refusing to return those files when [the franchisee] was contractually obligated to do so."²⁶

Properly addressing client lists in the franchise agreement also enhances the franchisor's ability to enforce a non-compete provision. In *NaturaLawn of America, Inc. v. West Group, LLC*,²⁷ the franchisor brought a claim under Maryland's UTSA seeking injunctive relief due to the misappropriation of trade secrets. In that case, the franchisee used the franchisor's proprietary computer software to gain access to customer lists, which the district court found were trade secrets. According to the court, "The identity of [the franchisor's] customer is not widely known outside [the franchise] and that the lists of those customers *are* well known among [the franchisor's] employees and franchisees." Furthermore, "the customer lists and how they [were] maintained [had] been carefully guarded."²⁸ Finally, the franchisor developed its customer lists over time which "clearly takes effort (establishing goodwill) and money (advertising)," and, therefore, franchisor's lists were trade secrets misappropriated by the franchisee.²⁹

25. *Id.*

26. *Id.* at 833.

27. *NaturaLawn of Am., Inc. v. West Grp., LLC* 484 F. Supp. 2d 392, 398 (D. Md. 2007)

28. *Id.* at 399.

29. *Id.*

The franchisor in *NaturaLawn* also sought an injunction to enforce its non-compete. Among other things, it argued that it suffered irreparable harm by the franchisee's misappropriation of the client lists. The court agreed, finding that the franchisee used the franchisor's proprietary information to compete directly with the franchisor, blatantly ignoring the non-compete provisions of the franchise agreement.³⁰ In other words, by clearly establishing that the client lists were proprietary information in the franchise agreement, the franchisor was able to demonstrate that the franchisee's use of that information was a clear violation of the non-compete.

The lesson to be taken from *Yantis*, *NaturaLawn*, and other similar cases³¹ is that the franchisor is in the best position to draft the franchise agreement in such a way that customer data will be deemed a trade secret of the franchisor and form the basis of an enforceable non-compete clause. The franchise agreement should specifically include client lists among the confidential information of the franchise and include an acknowledgment and undertaking from the franchisee to further protect such information with respect to its employees and agents. However, as observed earlier in *Scott*, even when language in the franchise agreement states that customer lists constitute trade secrets, it is not enough to simply state as much if there is no additional effort to generate information that is not "easily discoverable through public sources."³²

Nonetheless, courts ultimately must also decide if the franchisor has a legitimate business interest that needs to be protected by enforcing the covenant not to compete. If the franchisor is not ready and able to put new a new franchisee in the territory or otherwise provide services in the territory, then language in the franchise agreement defining the protection and ownership of client lists may be irrelevant.³³

IV. Client Lists and Their Relevancy to Joint Employer and Vicarious Liability Claims

Because joint employer claims can significantly impact a franchisor, a franchise agreement is typically drafted with joint-employer issues in mind. However, there is no single joint employer standard, and the tests involved vary between jurisdictions, and even within jurisdictions depending on the law being applied. On September 13, 2018, the National Labor Relations

30. *Id.* at 401.

31. *See, e.g., MarbleLife, Inc. v. Stone Res., Inc.*, 759 F. Supp. 2d 552 (E.D. Pa. 2010).

32. *Scott v. Snelling & Snelling, Inc.*, 732 F. Supp. 1034, 1044 (N.D. Cal. 1990).

33. *See Pirtek USA, LLC v. Wilcox*, 2006 WL 1722346, at *3 (M.D. Fla. June 21, 2006) (determining that franchisor did not have legitimate business interest in enforcing non-compete against former franchisee when franchisor did not operate a franchise within 200 miles of former franchisee's territory) (citing FLA. STAT. § 542.335(1)(g)(2) ("In determining the enforceability of a restrictive covenant, a court [] may consider as a defense the fact that the [party] seeking enforcement no longer continues business in the area [] that is the subject of the action.")).

Board (NLRB) proposed a rule change to its joint-employer standard.³⁴ Under the proposed rule, “an employer may be found to be a joint employer of another employer’s employees only if it possesses and exercises substantial, direct and immediate control over the essential terms and conditions of employment and has done so in a manner that is not limited and routine.” Unless and until that rule goes into effect, the current standard for NLRB claims is a “right-to-control” standard, including direct and immediate control, as well as an employer’s indirect control over employees, so long as the indirect control inquiry is confined to “essential terms and conditions of the workers’ employment.”³⁵

Different joint employer standards apply depending on the federal statute at issue or the jurisdiction. For example, California’s standard was fully articulated and applied by the California Supreme Court in *Patterson v. Domino’s Pizza, LLC*.³⁶ In that case, the franchisor imposed general marketing and operating standards on its franchisee, but reserved to the franchisee “autonomy as a manager and employer,” and making it the franchisee’s responsibility to implement the franchise’s operational standards, hire and fire employees, and regulate workplace behavior.³⁷

In that case, one of the franchisee’s employees complained to the franchisee that she was regularly sexually harassed by one of the franchisee’s assistant managers. Subsequently, the employee resigned and filed a lawsuit against the franchisee, the franchisor, and the assistant manager alleging sexual harassment, among other claims.³⁸ The employee included the franchisor as a defendant under the theory that the franchisor was the legal employer of the employee and the assistant manager. The employee argued that the franchisee was the agent of the franchisor “because business-format franchisors wield detailed control over their franchisees’ general operations,” and, as a consequence, “liability for personal harm sustained in the course of a franchisee’s business should be borne by the franchisor.”³⁹

The franchisor moved for summary judgment and urged the court to acknowledge that the realities of modern franchising are incompatible with a traditional “agency” analysis because modern franchising imposes “a meaningful division of autonomous authority between franchisor and

34. BOARD PROPOSES RULE TO CHANGE ITS JOINT-EMPLOYER STANDARD, NATIONAL LABOR RELATIONS BOARD, <https://www.nlr.gov/news-outreach/news-story/board-proposes-rule-change-its-joint-employer-standard> (September 13, 2018) (last visited May 10, 2019). The comment period ended on February 11, 2019. See <https://www.nlr.gov/news-outreach/news-story/nlr-further-extends-time-submitting-comments-proposed-joint-employer-1> (last visited May 10, 2019). No further action has been reported since that time. See <https://www.federalregister.gov/documents/2018/09/14/2018-19930/the-standard-for-determining-joint-employer-status> (last visited May 10, 2019).

35. *Browning-Ferris Indus. of Cal., Inc. v. Nat’l Lab. Relations Bd.*, 911 F.3d 1195, 1209 (D.C. Cir. 2018).

36. *Patterson v. Domino’s Pizza, LLC*, 333 P.3d 723 (Cal. 2014).

37. *Id.* at 726.

38. *Id.* at 727.

39. *Id.* at 735.

franchisee.”⁴⁰ Rather, proposed the franchisor, the critical factor should be “whether the franchisor had day-to-day control over the specific ‘instrumentality’ that caused the alleged harm.”⁴¹

The California Supreme Court rejected the employee’s argument that “a comprehensive operating system alone constitutes the ‘control’ needed to support vicarious liability claims.”⁴² Instead, the court analyzed the relationship between the franchisor and the franchisee, observing that, under the franchise agreement, the franchisee was “solely responsible for managing its employees”;⁴³ the franchisor had no authority to establish a training program or sexual harassment policy for the franchisee’s employees;⁴⁴ and there was no procedure for the employees to report complaints to the franchisor.⁴⁵ Further, the parties’ conduct established that the franchisee exercised sole control over hiring;⁴⁶ although the franchisor provided general new employee orientation material, such material was to supplement training the franchisee was required to provide, and the franchisor did not provide any direct training assistance;⁴⁷ the franchisee was solely in control of training related to sexual harassment and implemented, on his own, a zero tolerance sexual harassment policy;⁴⁸ no franchisor representative ever approved or even reviewed franchisee’s sexual harassment policy and training program;⁴⁹ “of particular relevance, that [the franchisee’s] sexual harassment policy and training program came with the authority to impose discipline for any violations,” and not the franchisor.⁵⁰ Based upon the foregoing, the court concluded that there was no reasonable inference that the franchisor retained a right as a traditional “principal” and, therefore, there was “no basis on which to find a triable issue of fact that an employment or agency relationship existed between [the franchisor] and [the franchisee] and its employees.”⁵¹

Another enunciated joint employer test can be found in *Salinas v. Commercial Interiors, Inc.*⁵² There, the court set out six factors used by the Fourth Circuit in Fair Labor Standards Act claims:

- (1) Whether, formally or as a matter of practice, the putative joint employers jointly determine, share, or allocate the power to direct, control, or supervise the worker, whether by direct or indirect means;
- (2) Whether, formally or as a matter of practice, the putative joint employers jointly determine, share, or allocate the power to—directly or indirectly—hire or fire the worker or modify the terms or conditions of the worker’s employment;

40. *Id.*

41. *Id.*

42. *Id.* at 738.

43. *Id.* at 741.

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.* at 742.

50. *Id.*

51. *Id.*

52. *Salinas v. Commercial Interiors, Inc.*, 848 F.3d 125, 141 (4th Cir. 2017).

(3) The degree of permanency and duration of the relationship between the putative joint employers;

(4) Whether, through shared management or a direct or indirect ownership interest, one putative joint employer controls, is controlled by, or is under common control with the other putative joint employer;

(5) Whether the work is performed on a premises owned or controlled by one or more of the putative joint employers, independently or in connection with one another; and

(6) Whether, formally or as a matter of practice, the putative joint employers jointly determine, share, or allocate responsibility over functions ordinarily carried out by an employer, such as handling payroll; providing workers' compensation insurance; paying payroll taxes; or providing the facilities, equipment, tools, or materials necessary to complete the work.⁵³

It would appear that maintaining ownership of a client list is not, by itself, a factor in determining whether a franchisor exercises control over the instrumentalities of its franchisee's employment practices.⁵⁴ However, some have urged that the instrumentality test minimizes the economic reality for many franchisees and that they "will rarely risk going against its franchisor's wishes and interests."⁵⁵ By way of example, commentator Tayler Jones noted that in 2016, McDonald's called for increased hourly wages, and its franchisees "begrudgingly acquiesced, though not without considerable friction."⁵⁶ A court may also take the position that, when the entire client list of a service franchisee is the franchisor's trade secret, the economic reality is that the franchisee will align its employment practices with the franchisor's wishes and interests.

Client list ownership may be more important, however, in the context of a customer's (not an employee's) vicarious liability claim. In *Agne v. Papa John's International, Inc.*,⁵⁷ the plaintiff, a customer, filed a motion for class certification for a putative class action claim against, among others, the franchisor on the grounds that the franchisor was vicariously liable for the franchisees' actions in sending unsolicited text messages to their customers. The court rejected the franchisor's argument that the plaintiff lacked standing to bring a suit against it, because, among other things, the franchisor encouraged its franchisees to share their customer information with a third party text messaging provider.⁵⁸ The franchisor had also intervened with the third party text messaging provider to have all customer data deleted from its system.⁵⁹ As a consequence of the franchisor's involvement and exertion of control

53. *Id.* at 141–42.

54. *See also* Cruz v. MM 879, Inc., 2019 WL 266458, at *4 (E.D. Cal. Jan. 18, 2019) (addressing the franchisor's control over wages, hours, and working conditions).

55. Tyler Jones, *Keeping the Entire Pie and the Dog Fed: Why the Modern Instrumentality Test Fails to Reflect the Realities of the Franchisor-Franchisee Relationship*, 36 FRANCHISE L.J. 341, 364 (2016).

56. *Id.* at 359 n.155 (citing Phil Wahba, *McDonalds Says Its Wage Hikes Are Improving Service*, *FORTUNE*, <http://fortune.com/2016/03/09/mcdonalds-wages> (last visited Mar. 27, 2019)).

57. *Agne v. Papa John's Int'l, Inc.*, 286 F.R.D. 559, 563 (W.D. Wash. 2012).

58. *Id.* at 564.

59. *Id.* at 563.

over the use of customer information, the court determined that the plaintiff “alleged an injury that is fairly traceable to [the franchisor].”⁶⁰ The franchisor, Papa John’s International Inc., agreed to a \$16.5 million settlement to resolve the alleged Telephone Consumer Protection Act violations.⁶¹

*Bayhille v. Jiffy Lube International, Inc.*⁶² demonstrates how not maintaining a centralized customer information database can cut against a request to hold the franchisees liable for the actions of the franchisor. In *Bayhille*, plaintiffs in a class action sued the franchisor alleging unjust enrichment, among other things, based on a constant practice among all Jiffy Lube Oil Change locations.⁶³ The plaintiffs consisted of two classes, a class of customers to the company stores, and a franchisee class, who were customers of the franchisees’ stores.⁶⁴ The franchisor class settled and, as part of the settlement, agreed to provide the company store customer class plaintiffs a five-dollar coupon for future service. But the settlement did not include the same coupon for franchisee store customers.⁶⁵ Certain class members objected to the settlement because it failed to offer franchisee store customers any relief.⁶⁶ The trial court had approved the settlement without coupons for franchisee store customers based on, in part, that the franchisees were independent contractors of the franchisor.⁶⁷

The Oklahoma Court of Civil Appeals affirmed the settlement agreement and agreed that the franchisor had no authority to require remedial action from its franchisees.⁶⁸ The court also addressed the argument that the notice of settlement did not satisfy due process because individual notice should have been provided to franchisee store customers (in addition to the notice provided to the company store customers).⁶⁹ Observing that “the record does not indicate that all franchise stores kept detailed customer records or that [the franchisor] could otherwise easily determine which franchise customers were charged the fee,” the court held that the trial court did not abuse its discretion by not requiring the franchisor to send individual notices to the franchise store customers.⁷⁰

Finally, the court in *FTC v. Wyndham Worldwide Corp.*⁷¹ determined that the franchisor could be held liable for a data breach when it held itself out as having authority over customer data collection practices. In general

60. *Id.* at 564.

61. Kenneth Momanyi, *Papa John’s Settles \$16.5 Million for Text SPAM Class Action TCPA Lawsuit*, KENNETH MOMANYI SMS MARKETING SPECIALISTS, <http://smsmarketingspecialist.com/service/content-management-for-animo-2> (last visited May 10, 2019).

62. *Bayhille v. Jiffy Lube Int’l, Inc.*, 146 P.3d 856 (Okla. Civ. App. 2006).

63. *Id.* at 858.

64. *Id.*

65. *Id.*

66. *Id.*

67. *Id.* at 859.

68. *Id.* at 860.

69. *Id.* at 861.

70. *Id.*

71. *FTC v. Wyndham Worldwide Corp.*, 10 F. Supp. 3d 602, 629 (D. N.J. 2014), *aff’d*, 799 F.3d 236 (3d Cir. 2015).

summary, the Federal Trade Commission brought action against Wyndham Worldwide Corporation, Wyndham Hotel Group, LLC, Wyndham Hotel and Resorts, LLC, and Wyndham Hotel Management, Inc. (collectively referred to as Wyndham), alleging that Wyndham committed unfair acts or practices.⁷² Wyndham Hotel and Resorts, LLC is a wholly owned subsidiary of Wyndham Worldwide Corporation that licensed the “Wyndham” name to its franchisees under franchise agreements.⁷³

As part of the franchise agreement, the franchisees were required to purchase and use a property management system that handled reservations and payment card transactions and stored personal information of the customers.⁷⁴ The property management system, which was used for all Wyndham branded hotels (whether or not they were operated as part of the franchise network), included a central reservation system, such that customers making reservations for any Wyndham branded hotel were always directed to the Wyndham Hotel and Resorts, LLC, website to complete the transaction.⁷⁵ The FTC alleged that Wyndham failed to provide adequate security for the personal information it collected about its customers. Consequently, alleged the FTC, on three separate occasions hackers obtained access to Wyndham’s central reservation system and collected personal information about Wyndham’s customers, resulting in more than \$10.6 million in fraud losses.⁷⁶

Wyndham Hotel and Resorts, LLC, argued that it was an entity separate from Wyndham-branded hotels.⁷⁷ The court found that, drawing inferences in favor of the FTC (i.e., the non-moving party in this motion to dismiss), the FTC’s allegations supported including all Wyndham-branded hotels as defendants, and not just Wyndham Hotel and Resorts, LLC. The court’s rationale included a finding that Wyndham Hotel and Resorts, LLC, did not adequately ensure that hotels connecting to its network had implemented sufficient security standards. As such, the court reasoned, a reasonable consumer would have considered the allegedly deficient and misleading Wyndham Hotel and Resorts, LLC, privacy policy as applying to data collected by all Wyndham-branded hotels.⁷⁸

Based on *Agne*, *Bayhille* and *Wyndham*, it is apparent that control over customer information becomes relevant when a customer claim is in issue. In each case where the franchisor exerted control over collection or use of customer information the franchisor was held liable for damages to the customers. These cases are cautionary to the franchisors who wish to control customer information, especially in lieu of specific contract provisions assigning the right of ownership to the franchisors.⁷⁹

72. *Id.* at 606.

73. *Id.* at 608.

74. *Id.*

75. *Id.*

76. *Id.* at 609.

77. *Id.* at 629.

78. *Id.*

79. *Id.*

The foregoing cases demonstrate further that ownership of a customer list may be one factor in the determination of actual or apparent authority between a franchisor and a franchisee. In either event, however, for a plaintiff to succeed, it generally must demonstrate that the plaintiff's harm was a consequence of the control exercised by the franchisor. So, for example, in the case of a data breach, à la *Wyndham*, the franchisor's control over all scheduling and customer data collection sufficiently opened itself up to vicarious liability. So, too, was the case in *Agne*, where the franchisor took steps to control the use of customer information by its franchisees by instructing them to use a third-party text messaging solicitor. Presumably other indicia of control would also support imposing vicarious liability, such as the franchisor sending and collecting invoices or the franchisor communicating directly with clients via a national call center.

V. Client Lists and Franchisee Goodwill

The question of whether goodwill in a particular franchised business is owned by the franchisor or the franchisee (particularly at the termination of the franchise agreement) has been the subject of numerous articles,⁸⁰ though it is still relatively underdeveloped.⁸¹ Professor Robert Emerson, in his award-winning article on the topic of goodwill compensation at franchise termination,⁸² summarized the dual issues. On the one hand, the goodwill associated with the trademark under which the franchise operates belongs to the franchisor under federal law in accordance with the Lanham Act. But, on the other hand, state law may require the franchisor to compensate the franchisee under certain circumstances for local goodwill the franchisee developed.⁸³ Such was the case in *Computer Currents Publishing Corp. v. Jayne Communications, Inc.*⁸⁴ There, the licensor licensed to the licensee the right to publish a local copy of the licensor's magazine.⁸⁵ In alleged violation of the license agreement, the licensee also published Internet-based versions of the magazine.⁸⁶ After eight years of operations,⁸⁷ the licensor sought to terminate the license agreement and moved for a preliminary judgment to pre-

80. See, e.g., Robert W. Emerson, *Thanks for the Memories: Compensating Franchisee Goodwill After Franchise Termination*, 20 J. Bus. L. 286 (2017); Robert W. Emerson, *Franchise Goodwill: "Take a Sad Song and Make It Better,"* 46 U. MICH. J.L. REFORM 349 (2013); Gaylen L. Knack & Ann K. Bloodhart, *Do Franchisors Need to Rechart the Course to Internet Success?*, 20 FRANCHISE L.J. 101, 140 (2001); Benjamin A. Levin & Richard S. Morrison, *Who Owns Goodwill at the Franchised Location?*, 18 FRANCHISE L.J. 85 (1999); Clay A. Tillack & Mark E. Ashton, *Who Takes What: The Parties' Rights to Franchise Materials at the Relationship's End*, 28 FRANCHISE L.J. 88 (2008).

81. Emerson, *supra* note 80, at 286.

82. *Best Paper Selection Process and History*, INTERNATIONAL SOCIETY OF FRANCHISING, <http://franchisesociety.com/isof-best-paper-awards> (last visited May 10, 2019).

83. Emerson, *supra* note 80, at 292–93.

84. *Computer Currents Publ'g Corp. v. Jayne Comm'ns, Inc.*, 968 F. Supp. 684 (N.D. Ga. 1997).

85. *Id.* at 686.

86. *Id.*

87. *Id.* at 690.

vent the licensee from publishing a magazine under the licensor's trademark either online or in hard copy in licensee's locality.⁸⁸

While the licensee agreed to remove the licensor's trademark from its websites, the licensee urged that immediately enjoining it from using the trademark in its print edition (as the licensee agreed to launch a new publication to replace its publication under the licensor's trademark) would impose a tremendous hardship.⁸⁹ The court agreed with the licensee, finding that, because it would not be able to release a new publication for several months, it was "likely to lose many of the readers and advertisers it [had] attracted . . . as well as the good will [it had] cultivated," which would be detrimental to its future business.⁹⁰ Consequently, the court denied the motion for preliminary injunction to the extent that it sought to deny the former franchisee a reasonable transition period.

The *Computer Currents* court, then, clearly recognized that the efforts of the licensee generated goodwill independent of the trademark, with which it would have been inequitable for the court to interfere. However, when the franchisor reserves for itself the right to transfer clients, the franchisee may be in the unfortunate position of having its goodwill effectively valued at nothing as the franchisor unilaterally assigns its client to another franchisee.⁹¹ It appears, therefore, that when the franchise agreement is unclear about ownership of the customer list, or even explicitly reserves its ownership to the franchisor, the franchisor could force a drastic price reduction in the transfer of a service franchise; that is, without also buying the goodwill of the business, the business of the franchise amounts to little more than its assets, likely at a depreciated value.

For some balance, three states have franchise laws that explicitly require the franchisor to compensate the franchisee at termination of the franchise agreement for the goodwill the franchisee developed, though these are limited in their application.⁹² This outcome appears to leave most franchisees at the mercy of the franchise agreement. Indeed, Professor Emerson called for a "presumption favoring goodwill compensation in the franchisee's favor when the franchise relationship is terminated," subject to rebuttal in the event of for-cause termination pursuant to a franchise agreement.⁹³

88. *Id.* at 686.

89. *Id.* at 690.

90. *Id.*

91. *See, e.g.,* *Teng Moua v. Jani-King of Minn., Inc.*, 810 F. Supp. 2d 882, 896–97 (D. Minn. 2011) ("[The Franchisor] has the contractual right to transfer accounts immediately if clients so request or if the client states an intent to cancel its account.").

92. HAW. REV. STAT. § 482E-6(3); 815 ILL. COMP. STAT. 705/20; WASH. REV. CODE § 19.100.180(2)(i). The California Amended Franchise Relations Act also suggests that a franchisor should compensate a franchisee for the local goodwill it has developed, although this is not explicit. *See* CAL. BUS. & PROF. CODE § 20035; *see also* Elizabeth M. Weldon & Nicole Liguori Micklich, *Strange Weather: California's Amended Franchise Relations Act*, *AB 525*, 35 *FRANCHISE L.J.* 577 (2016) (opining regarding Section 20035 that "[g]oodwill seems like a likely area of contention here in that the franchisee will seek personal goodwill for its business, but the franchisor will argue that it owns the institutional, corporate, and national goodwill.").

93. Emerson, *supra* note 80, at 337.

VI. Suggested Framework—Room to Protect Everyone in the Franchise Agreement?

The authors of this article propose approaching this issue through the franchise agreement, rather than leaving it to the whims of the court,⁹⁴ by providing in-term protection for the franchisee while also reserving to the franchisor its right to the continued goodwill in the brand and its connection with consumers after termination. During the term, customer data collected through the franchisee's operation should be deemed owned by the franchisee and subject to use and protection by the franchisee. Further, the franchisor should have read-only access to the client list, for purposes of audits and ensuring any territorial limitations. Finally, during the term, the franchisee and the franchisor would be restricted to using customer data only to advance the franchised business.

If, prior to termination of the franchise agreement, the franchisee intends to sell its business to a new franchisee, the franchisor may not unreasonably withhold approval, and the franchisee has the right to transfer goodwill inherent in the customer list it has developed. Absent a transfer, the franchisee is otherwise afforded a continuous and meaningful renewal right so long as it is current on all of its obligations under the franchise agreement.

At the end of the franchise term, or upon a lawful termination or a franchisee's decision not to renew, the franchisee must surrender all use of customer data and ownership thereof, and its inherent goodwill, automatically transfers to the franchisor. However, if the franchisor terminates the franchise relationship without cause, either during or at expiration of the term, the customer list would remain an asset of the franchisee to use in continuing to operate a similar business in the territory of its former franchise.

VII. Conclusion

Unfortunately, relatively few cases directly address whether a customer list developed in a franchised business is "owned" by a franchisor and franchisees. Those cases that exist are highly colored by the circumstances in which the issue is being addressed, as well as peculiarities of state law, such as California's hostility to post-termination competitive restrictions.⁹⁵

However, it is fair to say existing cases demonstrate that, if a franchise owner remains loyal to a franchise system, most courts will be reluctant to allow a franchisor to deny that franchise owner the ability to capitalize on the local goodwill that it has developed by operating the franchise. For businesses that regularly provide services to repeat customers, such as handyman

94. This also saves the pragmatic franchisor attorney from the necessity of preparing state-specific addenda for the idiosyncrasies in each state with respect to the ownership of client lists and goodwill.

95. See CAL. BUS. & PROF. CODE § 16600 ("Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.").

services or massage spas, the customer list is the critical asset to transfer to a buyer of the franchise. In addition, courts are generally loath to permit franchisors to use customer data in a manner that materially harms the business of the franchisee who developed the customer relationship.

But, absent exceptional circumstances sufficient to justify rescission of the franchise agreement or termination due to a franchisor's default, courts are reluctant to allow a franchise owner to abandon a franchise, operate the same business as an independent, and continue to serve customers developed under the franchisor's trademark. In addition, if a franchise owner is offered a bona-fide opportunity to renew the franchise and chooses not to do so, then courts are similarly unsympathetic to the franchise owner who attempts to recreate the same business as an independent, using the customer data from the closed business to do so. In either circumstance, use of the customer data by the former franchisee also raises important concerns about protecting consumers from unintended use of their personal data.

Finally, the third-party customer cases in the context of data privacy and marketing to a brand's consumers demonstrate that the franchisor's control over the use of customer data during the franchise relationship may generate significant liability risks.

Therefore, it behooves franchisors to recognize these trends in case law and place "ownership" of the customer list in the franchise owner for as long as the franchise continues, including the right to transfer "ownership" of that customer list to a bona fide, approved transferee, but require that the franchisee only use customer list and data in the franchised business. Such a clear contractual provision will protect franchise owners who are loyal to the brand, while also furthering the franchisor's objective of demonstrating that each franchise is an independently operated, separate business, solely liable for any and all claims made by employees and customers of that business.