

E-ALERT: GOLD, ET AL. V. MELT FRANCHISING, LLC, ET AL.

Mulcahy LLP secures an important ruling on behalf of a franchisor in California’s Second Appellate District. The ruling, which upholds the enforceability of a class action waiver in a franchise agreement, provides a roadmap for franchisors attempting to avoid or defeat class action claims by franchisees. Although the opinion is unpublished, and thus cannot be cited as authority, the rationale of the opinion suggests that the rule enunciated in *Discover Bank v. Superior Court* – that class action waivers are often unenforceable in the consumer context – has a more limited application in the franchise context.

Many franchise agreements contain provisions barring class-action suits by franchisees. These prohibitions prevent groups of disgruntled franchisees from combining their resources in a joint suit against the franchisor. But under *Discover Bank v. Superior Court* [36 Cal.4th 148 (2005)], class action waivers are typically found unenforceable in certain contexts. Now, an appellate ruling procured by Mulcahy LLP suggests that the rule enunciated in *Discover Bank* has limited applicability in the franchise context.

In *Gold, et al. v. Melt Franchising, LLC, et al.* (Los Angeles County Superior Court Case No. BC377783), seven Melt franchisees in four states filed a suit alleging, among other things, that Melt defrauded the franchisees and violated state franchise statutes. Mulcahy LLP, acting on behalf of Melt and individual Melt officers named in the suit, moved to dismiss the case, arguing that the class action waiver in the parties’ franchise agreement precluded a class action claim, and that the purported class members did not enjoy a sufficient unity of interest to properly constitute a class.

The trial court accepted both of Mulcahy LLP’s arguments, and the appellate court affirmed on the ground that the class action waiver was enforceable and precluded a class action claim. The appellate court’s decision in *Gold* is not published, so franchisors may not rely on it as authority in pursuing the arguments the court accepted. Nevertheless, as discussed more thoroughly below, a franchisor has a good chance of defeating many class action claims on a motion to dismiss by examining the court’s rationale and advancing similar arguments to those Mulcahy LLP advanced on Melt’s behalf.

In *Gold*, plaintiffs unsuccessfully argued that the class action waiver was unconscionable, and consequently unenforceable. Plaintiffs relied on several California cases that held class action waivers unconscionable in some contexts. In one of the cases cited by plaintiffs, *Discover Bank*, the California Supreme Court determined that class action waivers in so-called “contracts of adhesion” are unconscionable in certain circumstances. In *Discover Bank*, a class of credit-card holders claimed that the defendant, Discover Bank, had misled the cardholders as to when they could make payments without incurring a late fee. Plaintiffs in that case claimed that, although each plaintiff had sustained only minor damage, the aggregate amount of improper fees collected

by Discover Bank was substantial. After successfully compelling arbitration, Discover Bank attempted to dismiss the suit pursuant to a class action waiver contained in the cardholder agreement.

The Court in *Discover Bank* refused to enforce the class action waiver, holding it unconscionable. In particular, the court held that a class action waiver is unconscionable where: (1) it appears in a consumer contract of adhesion, where one party has no ability to negotiate the terms of the contract; and (2) *each individual consumer's claims are necessarily small*, but the class's claims would be large in the aggregate.

Discover Bank demonstrates that class-action waivers are unenforceable when they appear in certain kinds of consumer contracts. But the opinion in *Gold* suggests that the holding in *Discover Bank* is limited to consumer contracts and *suits where an individual plaintiff's claim would necessarily be very small*, and where the class action waiver therefore functions as a so-called "exculpatory clause."

The salient question for franchisees, then, is whether class-action waivers in *franchise agreements* are viable. Under the rationale of *Gold*, it appears that they are unless under the circumstances they function as an exculpatory clause – that is, the rule in *Discover Bank* invalidating certain class actions waivers is extended to franchise agreements only where an individual franchisee's claim would be very small.

The *Gold* Court found that franchise agreements often differ in kind from the type of consumer contracts in which a class-action waiver is unconscionable, because franchise agreements "are not consumer contracts involving large numbers of consumers," and "do not involve small amounts of damages for each of those consumers." **Thus, where the claims brought by individual franchisees would be significant, the franchisor should argue that *Discover Bank* does not apply, and that consequently the class action waiver should be enforced.**

According to the *Gold* court, the rationale behind the holding in *Gold* that class action waivers in certain franchise agreements are not unconscionable under California law likewise applies under the law of Florida and Massachusetts. Accordingly, franchisors should pursue the same arguments that Mulcahy LLP pursued in *Gold* to defeat class actions under California, Florida and/or Massachusetts law.

Franchisors can glean another important lesson from *Gold*: a valid choice of law clause can make it very difficult for franchisees to successfully pursue class or consolidated actions against the franchisor, even in the absence of a class action waiver. The trial court in *Gold* sustained Melt's demurrer on a second ground in addition to the class action waiver – because the franchisees were located in four separate states, and each of the franchise agreements provided that the law of the franchisee's home state applied, "the plaintiffs lacked sufficient unity of interest for a consolidated action . . . **even if the franchise [agreement] did not prohibit class and multi-party actions.**" In other words, franchisees from multiple states were members of the

purported class bringing the action against Melt, and these franchisees' franchise agreements provided that the law of the franchisee's home state would be applied; therefore, the substantive law of many states would apply, and the plaintiffs did not share a "unity of interest" as required to bring a class action in California.

The appellate court did not address the second ground offered by the trial court for sustaining the demurrer. Nonetheless, the trial court's logic provides significant comfort that a franchisor can protect itself from class action suits even in the absence of a class action waiver by providing that the law of the state where franchisees are located will apply.

With Mulcahy LLP's assistance, the final result for the defendant franchisor (and the individual defendants, including several of the franchisor's officers) was dismissal of the franchisees' entire case against them. Mulcahy LLP's defense in *Gold* provides a useful roadmap for franchisors who are worried about the far-reaching effects a class action suit could have on their franchise systems. A franchisor who takes the approach Mulcahy LLP implemented in *Gold* has an excellent chance of obtaining a motion to dismiss a class action claim prior to incurring the substantial cost of conducting and responding to discovery.

This underscores the point that it is important for a franchisor to choose the right litigation counsel early in the process – a successful motion to dismiss can save the franchisor substantial sums of money. Please contact Mulcahy LLP if you would like further information on avoiding or defending class action claims or otherwise require the assistance of experienced franchise counsel.