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NEWSLETTER

Equitable Estoppel: Enforcing Franchise Agreements against Non-Signatories

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Generally, the terms of a franchise agreement will only be enforced against a person who has signed the agreement. A number of courts, however, have relied on the doctrine of equitable estoppel to enforce franchise agreement provisions against non-signatories. The principle underlying the doctrine of equitable estoppel is that "it is unfair for a party to rely on a contract when it works to its advantage, and repudiate it when it works to its disadvantage." *Am. Bankers Ins. Group Inc. v. Long*, 453 F.3d 623, 627 (4th Cir. 2006). When determining whether equitable estoppel applies, courts will typically look to see if the claims at issue arise from the franchise agreement or if the non-signatory has an especially close relationship with the signatory.

In *Noble Drilling Services Inc. v. Certex USA, Inc.,* 620 F.3d 469 (5th Cir. Sept. 15, 2010), the Fifth Circuit, in a non-franchise context, in considering whether an arbitration clause was enforceable against a non-signatory, outlined the terms under which the equitable estoppel doctrine could apply. The court explained that the equitable estoppel doctrine could apply if a non-signatory "embraced" the contract, which occurs if the non-signatory: (1) knowingly sought and obtained direct benefits from the contract; or (2) sought to enforce the terms of the contract or asserted claims that had to be determined by reference to the contract.

In the franchise context, the Southern District of Illinois, in *Southern Illinois Beverage, Inc. v. Hansen Beverage Co.,* Bus. Franchise Guide ¶ 13,743 (S.D. Ill. Oct. 15, 2007), conducted a detailed review of the relevant case law and concluded that the doctrine of equitable estoppel could be used to enforce an arbitration provision against a non-signatory if the non-signatory seeks the benefits of the franchise

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agreement. In *Hansen,* a beverage distribution sub-franchisee brought claims against a beverage manufacturer under the Illinois Franchise Disclosure Act. The court compelled arbitration even though the arbitration clause was contained in the franchise agreement between the franchisor and sub-franchisor and did not include the sub-franchisee. In reaching its decision, the court found that the sub-franchisee had sought benefits under the franchise agreement because its claims were "fundamentally rooted in" rights and conditions described in the franchise agreement.

Similarly, in another franchise case, the wife of a distributor was forced to arbitrate her claims against the manufacturer. *Mac Tools v. Diaz,* Bus. Franchise Guide ¶14,820 (S.D. Ohio Apr. 23, 2012). In *Mac Tools,* an individual had entered into a distribution agreement with the tools manufacturer. After mediation failed to resolve that individual's claims against the manufacturer, that individual's wife brought claims against the manufacturer. The wife had invested in the business and was involved with the acquisition of the distributorship business but had not signed the distribution agreement. The wife asserted that, as an investor, she had losses stemming from the manufacturer's violations of franchise regulations as well as the manufacturer's misrepresentations. In opposing a motion to compel arbitration based on an arbitration provision in the distribution agreement, the wife noted she was not a signatory to the agreement and further pointed to language in the agreement stating that the "Agreement is personal to the Undersigned Individual." The court rejected this argument and stated that the wife was involved in the acquisition of the distributorship business and that she clearly expected to benefit from her husband's distribution agreement. The court accordingly found that the doctrine of equitable estoppel applied and granted the motion to compel arbitration.

In a slightly different scenario, the question for the Southern District of Ohio was whether a non-signatory to a franchise agreement could compel arbitration against the signatory franchisee. *Geo Vantage of Ohio v. Geovantage, Inc.,* Bus. Franchise Guide ¶13,436 (S.D. Ohio Sept. 6, 2006). In *Geovantage*, an airborne imaging services franchisee brought claims against its franchisor and the parent company of its franchisor. The parent company sought to compel arbitration pursuant to the arbitration provision in the franchise agreement even though the parent company was not a signatory to the franchise agreement. Relying on the doctrine of equitable estoppel, the court held that the franchisee could not avoid arbitration because its claims arose from and directly related to obligations contained in the franchise agreement.

While the doctrine of equitable estoppel has most often been used to enforce arbitration clauses, a recent case has relied on the doctrine to enforce a jury waiver provision in a franchise agreement. In *Novus Franchising, Inc. v. Superior Entrance Systems, Inc.,* Bus. Franchise Guide ¶ 14,902 (W.D. Wis. Aug. 16, 2012), a non-signatory to a franchise agreement argued that the jury waiver in the franchise agreement was not applicable to the claims against it. In *Novus*, a franchisee executed an automotive glass business franchise agreement. The franchisee's affiliate operated a competing automotive glass business. The franchisee ceased paying royalties and other fees to the franchisor and claimed no longer to be in the automotive glass business. The franchisor then brought claims against the franchisee and its affiliate, alleging that the franchisee had violated the non-compete provisions of its franchise agreement and improperly diverted business to the franchisee's affiliate. An initial issue for the district court was whether the jury waiver provision in the franchise agreement applied to the franchisee's affiliate since the affiliate was not a signatory to the franchise agreement.

Relying on the reasoning used in the arbitration cases, the *Novus* court ultimately held that under an equitable estoppel theory, the jury waiver did apply to the affiliate. The court found that the doctrine could apply in these circumstances because Novus' claims hinged upon the terms of the franchise agreement, and the affiliate's conduct was intertwined with that of the franchisee. The court then reviewed the facts of the case and found that the franchisee's affiliate did receive benefits under the franchise agreement such that it could not deny the jury waiver. In reaching this conclusion, the court noted that the affiliate advertised itself as the franchisor's franchisee and benefited from the training provided by the franchisor. The court also noted that the same manager controlled "both the nominal signatory (the franchisee) and the de facto party to the contract (the franchisee's affiliate)."

While the law in this area is still developing, as made clear in *Novus*, franchisors should keep the equitable estoppel doctrine in mind whenever potential claims arise involving a non-signatory, particularly where the claims involve a corporate affiliate of the franchisee or the franchisee's spouse.