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**WO**

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF ARIZONA

Zounds Hearing Franchising, LLC, an Arizona limited liability company; and Zounds Hearing Inc., a Delaware corporation,

Plaintiffs,

v.

Edward T. Bower and Barbara Bower, husband and wife; and Lend Me Your Ears, Inc., an Ohio corporation;

Defendants.

Zounds Hearing Franchising, LLC, an Arizona limited liability company; and Zounds Hearing Inc., a Delaware corporation,

Plaintiffs,

v.

Frank R. Graziano and Mary E. Graziano, husband and wife; and FNM Enterprises, Inc., an Ohio corporation,

Defendants.

Zounds Hearing Franchising, LLC, an Arizona limited liability company; and Zounds Hearing Inc., a Delaware corporation,

Plaintiffs,

v.

Glenn Harbold, an individual; and Perfect Clarity LLC, an Ohio limited liability company,

Defendants.

No. CV-16-01462-PHX-NVW  
(Consolidated)

**ORDER**

[Re: No. CV-16-01462-PHX-NVW]

No. CV-16-01465-PHX-NVW

No. CV-16-01467-PHX-NVW

1  
2 Zounds Hearing Franchising, LLC, an Arizona  
3 limited liability company; and Zounds Hearing  
4 Inc., a Delaware corporation,

5  
6 Plaintiffs,

7 v.

8 Lawrence R. Woerner and Nancy Woerner,  
9 husband and wife; Susan Steigerwald and David  
10 Steigerwald, husband and wife; Lawrence W.  
11 Woerner and Rosemarie Woerner, husband and  
12 wife; and WOCO Franchise LLC, an Ohio  
13 limited liability company,

14 Defendants.

No. CV-16-01470-PHX-NVW

15 Edward T. Bower; Lend Me Your Ears, Inc.;  
16 Frank Graziano; FNM Enterprises, Inc.; Glenn  
17 Harbold; Perfect Clarity, LLC; Lawrence  
18 Woerner; WOCO Franchise, LLC,

19 Plaintiffs,

20 v.

21 Zounds Hearing Franchising, LLC; Zounds  
22 Hearing, Inc.; Frannet, LLC; Jose Torres, dba  
23 Frannet of South Florida; Todd Pfister;  
24 FranChoice, Inc.; Chris L. Cynkar

25 Defendants.

No. CV-17-00728-PHX-NVW

26  
27 Statutes in most states protect investors in franchises by, among other things,  
28 requiring certain disclosures, prohibiting certain contract terms in franchise agreements,  
requiring others, and giving certain rights whether or not stated in the franchise  
agreements. *See Mitchell J. Kassoff, Complex of Federal and State Laws Regulates  
Franchise Operations as Their Popularity Grows, 73 N.Y. St. B. J. 48 n.5 (Feb. 2001)*  
(listing 33 states). If an in-state franchisor selling an in-state franchise to an in-state  
franchisee tried to escape those obligations by writing in his franchise agreement that the  
franchisee agrees he does not have to comply with those laws, he would be laughed out  
of court. That is because the very nature of such statutes is to impose obligations on

1 people that override what they might otherwise agree to among themselves. Such statutes  
2 say what you cannot agree to.

3       Indeed, it is in the nature of investor protection statutes generally that they  
4 override the “freedom of contract” of investors to waive their statutory rights in advance.  
5 That is the whole point of such statutes. For example, sellers of securities cannot excuse  
6 themselves from state securities laws by saying in their offering that the buyer agrees the  
7 state’s securities laws do not apply to the seller—or that the laws of some more lenient  
8 state will apply instead of the laws of the state of the offering.

9       A few states like Arizona have no special protections for investors in franchises.  
10 In Arizona any contract term and anything short of fraud will go. It is now common for  
11 franchisors in *laissez faire* states like Arizona to try to immunize themselves from the  
12 investor protection laws of the states in which they do business by saying it is so in their  
13 contracts. They include in the franchise agreement a provision choosing the law of a  
14 state other than the state where the franchise operates, a state with lesser or no franchisee  
15 protections.

16       The question posed in this case is whether such a contract term is valid, whether  
17 an out-of-state franchisor can avoid local investor protection statutes by getting the  
18 investor to agree that local law does not apply and the law of some other state applies  
19 instead. The cases are surprisingly diverse on this question. The diversity—and the error  
20 of some of the cases—arises from courts’ attempts to apply the highly abstract  
21 methodology of the Restatement (Second) of Conflict of Laws § 187 and 188 (1971).

22       The answer is clearly no. Under choice-of-law principles, parties cannot  
23 circumvent by contract the investor protections a state provides to all within its  
24 boundaries, especially for its own residents. The state of the franchise situs is the state  
25 whose laws would apply in the absence of an effective choice of law by the parties—*i.e.*,  
26 the state with the most significant relationship to the transaction and the parties. *See*  
27 Restatement (Second) of Conflict of Laws §§ 187(2)(b), 188 (1971). Under the better  
28 analysis, that is so even if the franchisee being protected is a resident of a different state.

1 But in this case the franchisees are residents of the state of the situs of the franchise, and  
2 the state that has the strongest interest in protecting its own residents. The Restatement  
3 (Second) of Conflicts of Laws does not present a bright line rule, but the Comments do  
4 present an analysis with a clear result. Cases that miss that result are to be forgiven but  
5 not followed.

6 This is an easy case. It is triply easy. First, the franchise and the franchisees are  
7 both located in Ohio. In those circumstances, a foreign-domiciled franchisor may not  
8 “contract” out of the Ohio protections any more than an Ohio-domiciled franchisor could.  
9 There is no scenario in which another state would have a materially greater interest in  
10 having its less protective franchise laws applied than the more protective laws of the state  
11 in which the franchisee resides and the franchise operates. Without that materially  
12 greater interest in another state, it is beyond the power of the parties to contract for  
13 application of the other state’s law.

14 Second, even if the franchisee were out-of-state, the state of location of the  
15 franchise would still have a materially greater interest in having its protective franchise  
16 laws applied than the state of the franchisor with less protective laws.

17 Third, if there were any doubt that the investor protection franchise laws override  
18 parties’ ability to contract out of them, and thus are fundamental state policy, the Ohio  
19 statute says it a second time: that the franchisee protection laws are fundamental policy of  
20 Ohio out of which the parties cannot contract. It is not necessary for a state to say twice  
21 that its law controls whether or not the parties agree. But Ohio did say it twice.

22 Investor protection franchise laws reflect a fundamental policy of a state as to  
23 what contract terms are permitted and legal for investments and businesses in the state.  
24 Franchisors may not exempt themselves from such laws merely by entering into the  
25 forbidden contract terms and adding that the law of some other state will substitute. *See*  
26 Restatement (Second) of Conflict of Laws § 187 cmt. g (“[A] fundamental policy may be  
27 embodied in a statute which makes one or more kinds of contracts illegal or which is  
28 designed to protect a person against the oppressive use of superior bargaining power.”)

1           The cases on validity of franchise choice-of-law clauses call for more extended  
2 review, with harmonization where possible and rejection where necessary.

3  
4 **I.     BACKGROUND**

5           Before the Court is the Zounds Defendants’ Renewed Motion to Dismiss  
6 Amended Complaint or, Alternatively, to Stay Proceedings and Compel Mediation.  
7 (Doc. 43.) Zounds Hearing Franchising, LLC, is an Arizona limited liability company  
8 that franchises third parties to operate hearing aid centers under the Zounds trade name.  
9 Its parent company, Zounds Hearing, Inc., is a Delaware corporation that sells Zounds  
10 approved products. Both companies have their principal place of business in Arizona.  
11 They will be referred to as “Zounds.” In 2013, Zounds entered into franchise agreements  
12 with four Ohio companies and their owners (“the Franchisees”) to operate hearing aid  
13 centers in Ohio.

14           As is common among state franchise laws, the Ohio franchise statutes protect  
15 buyers of franchises and other business opportunity plans by limitations and prohibitions  
16 on the kinds of terms that may be included in franchise agreements. They commonly  
17 track or exceed the disclosures and protections afforded under Federal Trade Commission  
18 Rule, 16 C.F.R. Part 436, which are enforceable only by the FTC and not by private right  
19 of action. *See* 1 W. Michael Garner, *Franchise and Distribution Law and Practice* 6.3-  
20 6.4 (2016) (summarizing state laws). The state franchise disclosure statutes are  
21 enforceable by the wronged franchisees themselves.

22           The franchises fared poorly and two are already out of business. On May 11,  
23 2016, the Franchisees filed an action in Ohio state court alleging Zounds violated the  
24 Ohio Business Opportunity Purchasers Protection Act. They allege specifically that  
25 Zounds’ franchise agreements failed to give a five-day cancellation right as required by  
26 Ohio Rev. Code § 1334.06, and that Zounds made false, misleading, and/or inconsistent  
27 representations in connection with the sale of the franchises in violation of Ohio Rev.  
28 Code § 1334.03. They assert that during a pre-signing “discovery day” agents of Zounds

1 made statements regarding the revenue the Franchisees might expect to receive and  
2 showed them purported monthly financial results of an affiliated Zounds franchise on a  
3 whiteboard, which were not in the mandatory disclosure documents and could not be  
4 substantiated. At oral argument counsel acknowledged that the Franchisees will prevail  
5 under Ohio law and will fail under Arizona law. Zounds responded the next day by filing  
6 four separate declaratory judgment actions in this Court in Arizona.

7 The franchise agreements include identical provisions regarding choice of Arizona  
8 law, exclusive Arizona venue, and mandatory pre-suit mediation in Arizona at the sole  
9 option of Zounds. Section 22(A) provides, “This Agreement shall be governed by and  
10 construed in accordance with the laws of the State of Arizona, without reference to  
11 Arizona’s conflict of law principles.” Section 22(E) provides that “any actions arising  
12 out of or related to this Agreement must be initiated and litigated in the state court of  
13 general jurisdiction closest to Phoenix, Arizona or, if appropriate, the United States  
14 District Court for the District of Arizona.” Section 22(C) provides that, at Zounds’  
15 election, Franchisees must mediate their disputes in Arizona before filing suit. But the  
16 section is more than a mediation clause; it precludes the Franchisees from ending  
17 mediation and suing until either Zounds or the Mediator consents. Zounds is free to  
18 terminate whenever it wants.

19 Zounds’ four actions in this Court seek declarations that the term for pre-suit  
20 mediation in Arizona “is valid and enforceable and that mediation must occur in Phoenix,  
21 Arizona, as a condition precedent to the suit Defendants filed in Ohio.” Zounds burdened  
22 the Franchisees with four lawsuits in this distant forum to have this Court instruct the  
23 Ohio court how to rule on a defense in the Ohio lawsuit. This Court consolidated those  
24 four actions on June 30, 2016, under Rule 42, Federal Rules of Civil Procedure, and  
25 Local Rule LRCiv 42.1, notwithstanding the franchise agreements’ attempt to disable this  
26 Court from using those rules in the administration of its cases.

27 Zounds removed the Ohio action to federal court and then moved to dismiss or  
28 transfer to Arizona, thus presenting for decision in the Ohio court the very issue on which

1 it had sued the Franchisees four times in this Court—whether the Ohio franchise statutes  
2 trump the franchise agreements’ Arizona choice of law and venue provisions or vice  
3 versa. The Ohio Federal court expressly did not decide that question but instead  
4 transferred the Ohio case to this Court solely in its discretion under 28 U.S.C. § 1404(a)  
5 for the convenience of parties and witnesses. All further motions were expressly left to  
6 this Court to decide. By agreement of the parties, the transferred case was consolidated  
7 here with the four Arizona cases.

8 In light of the transferor court’s limited ruling, Zounds filed this Renewed Motion,  
9 which poses the question the Ohio court did not decide, whether the franchise agreements  
10 successfully exempt Zounds from Ohio’s franchise disclosure laws, including the  
11 prohibition of out-of-Ohio venue terms, or the Ohio laws govern and invalidate the  
12 Arizona venue and choice of law clauses. (Doc. 43.) The Ohio statutes govern and the  
13 contrary terms in the franchise agreements are invalid. The Motion will be denied, and  
14 the case originally filed in Ohio will be transferred to the Northern District of Ohio under  
15 the mandatory Ohio venue term of the Ohio statutes.

16 **II. OHIO LAW GOVERNS AND THE ARIZONA VENUE AND CHOICE OF**  
17 **LAW TERMS OF THE FRANCHISE AGREEMENTS ARE INVALID**

18 “A federal court sitting in diversity must apply the forum state’s choice of law  
19 rules.” *Jorgensen v. Cassidy*, 320 F.3d 906, 913 (9th Cir. 2003) (citing *Klaxon Co. v.*  
20 *Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941)). Arizona and Ohio both follow the  
21 Restatement (Second) of Conflict of Laws (1971) (“Restatement”) when deciding  
22 whether a contractual choice of law is valid and enforceable. *Swanson v. Image Bank,*  
23 *Inc.*, 206 Ariz. 264, 266, 77 P.3d 439, 441 (2003); *Schulke Radio Prods., Ltd. v.*  
24 *Midwestern Broad. Co.*, 6 Ohio St. 3d 436, 439, 453 N.E.2d 683, 686 (1983).

25 Under the Restatement as pared down for this case, there are three steps: (1) as a  
26 starting point, the law of the state with the most significant relationship to the transaction  
27 and the parties governs and (2) if the parties chose the law of another state, the law of the  
28 chosen state will govern (3) unless it would be contrary to fundamental policy of the state

1 with the most significant relationship to the transaction and the parties and that state has a  
2 materially greater interest than the chosen state in the determination of the particular  
3 issue.

4  
5 **A. Ohio Is the State with the Most Significant Relationship to the**  
6 **Transaction and the Parties**

7 The rules for finding which state's laws would apply in the first place are found in  
8 the Restatement § 188 and § 6. Section 6 states a non-exclusive list of factors relevant to  
9 choice of the applicable rule of law:

10 (1) A court, subject to constitutional restrictions, will follow a statutory  
11 directive of its own state on choice of law.

12 (2) When there is no such directive, the factors relevant to the choice of the  
13 applicable rule of law include

14 (a) the needs of the interstate and international systems,

15 (b) the relevant policies of the forum,

16 (c) the relevant policies of other interested states and the relative  
17 interests of those states in the determination of the particular issue,

18 (d) the protection of justified expectations,

19 (e) the basic policies underlying the particular field of law,

20 (f) certainty, predictability and uniformity of result, and

21 (g) ease in the determination and application of the law to be  
22 applied.

23 Restatement (Second) of Conflict of Laws § (6).

24 With respect to an issue in contract, the Restatement § 188 states additional  
25 focused rules and contacts to be considered in determining the law applicable to an issue:

26 (1) The rights and duties of the parties with respect to an issue in contract  
27 are determined by the local law of the state which, with respect to that  
28 issue, has the most significant relationship to the transaction and the parties  
under the principles stated in § 6.



1 (2) In the absence of an effective choice of law by the parties (see § 187),  
2 the contacts to be taken into account in applying the principles of § 6 to  
3 determine the law applicable to an issue include:

- 4 (a) the place of contracting,
- 5 (b) the place of negotiation of the contract,
- 6 (c) the place of performance,
- 7 (d) the location of the subject matter of the contract, and
- 8 (e) the domicile, residence, nationality, place of incorporation and  
9 place of business of the parties.

10 These contacts are to be evaluated according to their relative importance  
11 with respect to the particular issue.

12 (3) If the place of negotiating the contract and the place of performance are  
13 in the same state, the local law of this state will usually be applied, except  
14 as otherwise provided in §§ 189-199 and 203.

15 Restatement (Second) of Conflict of Laws § 188.

16 The factors listed in § 188 and § 6 are at a high level of generality and they apply  
17 issue by issue. Many rules of contract are gap-filling rules concerning interpretation or  
18 other matters in which a state has a weak interest in application of its own default rules  
19 and the parties have a strong interest avoiding disputes over which body of rules to look  
20 to.

21 All states have gap-filling rules . . . and indeed such rules comprise the major  
22 content of contract law. What is important for present purposes is that a gap in a  
23 contract usually results from the fact that the parties never gave thought to the  
24 issue involved. In such a situation, the expectations of the parties with respect to  
25 that issue are unlikely to be disappointed by application of the gap-filling rule of  
26 one state rather than of the rule of another state. Hence with respect to issues of  
27 this sort, protection of the justified expectations of the parties is unlikely to play so  
28 significant a role in the choice-of-law process. As a result, greater emphasis in  
fashioning choice-of-law rules in this area must be given to the other choice-of-  
law principles mentioned in the rule of § 6.

Restatement (Second) of Conflict of Laws § 188 cmt. b.

1           However, “[f]ulfillment of the parties’ expectations is not the only value in  
2 contract law; regard must also be had for state interest and for state regulation. The  
3 chosen law should not be applied without regard for the interests of the state which would  
4 be the state of the applicable law with respect to the particular issue involved in the  
5 absence of an effective choice by the parties.” Restatement (Second) of Conflict of Laws  
6 § 187 cmt. g. Some rules, especially regulatory statutes, reflect a strong state policy  
7 about what conduct is forbidden or required within the state. Where people are not  
8 allowed to do things in a state, the chosen exercise of the police power of the state would  
9 be defeated by allowing parties to grant themselves extraterritoriality by contract. On  
10 such issues, the location of the conduct will usually trump all other considerations.

11           Here the issues—mandatory and robust investment disclosures, prohibition of  
12 other financial representations outside the disclosure documents, substantively prohibited  
13 contract terms, five-day cancellation rights stated on the face of the document,  
14 prohibition of out-of-state choice-of-law provisions, prohibition of inconvenient  
15 forums—go to the core of minimum business fairness and honesty Ohio chooses for sales  
16 of franchises in its territory, whether bought by residents or not. They protect Ohio’s  
17 police power over conduct within its boundaries, not just the forms and interpretation of  
18 contracts.

19           A state has an especially strong interest in protecting its residents by such  
20 statutes.<sup>1</sup> In this case the Franchisees all reside and operate their franchises in Ohio. On  
21 the issues in this case, the Ohio statutes protect purchasers of franchises and other types  
22 of business opportunity plans, where Arizona law does not. The Franchisees will prevail  
23 under the Ohio statutory rules of decision, and Zounds will prevail under the Arizona

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25           <sup>1</sup> See, e.g., *Cottman Transmission Sys., LLC v. Kershner*, 492 F. Supp. 2d 461,  
26 468 (E.D. Pa. 2007) (noting the franchise laws of California, New York, and Wisconsin  
27 express strong state policies favoring their application to protect their citizens); *Wright-  
28 Moore Corp. v. Ricoh Corp.*, 908 F.2d 128, 133-34 (7th Cir. 1990) (same with respect to  
the franchise laws of Wisconsin, Minnesota, and Indiana).

Franchise choice of law cases are legion. Only representative cases are cited.

1 regime of no regulation. The Ohio domicile, situs, and statutory purpose of investor  
2 protection outweigh any factors favoring application of any other state's laws. They far  
3 outweigh any theoretical interest of Arizona in enabling its residents, by virtue of their  
4 Arizona domicile and superior bargaining power, to project Arizona *laissez faire*  
5 investment policy into states that protect buyers, wherever domiciled, of investments in  
6 their state through disclosures and prohibition of certain contract terms. The Comment to  
7 the Restatement so states:

8 [T]he state where a party to the contract is domiciled has an obvious  
9 interest in the application of its contract rule designed to protect that party  
10 against the unfair use of superior bargaining. And a state where a contract  
11 provides that a given business practice is to be pursued has an obvious  
12 interest in the application of its rule designed to regulate or to deter that  
13 business practice. . . . And a state may have little interest in the application  
of a statute designed to regulate or deter a certain business practice if the  
conduct complained of is to take place in another state.

14 Restatement (Second) of Conflict of Laws § 188 cmt. c.

15 Indeed, the state where the franchise is located and the franchisee is domiciled will  
16 always have the most significant relationship to the transaction and the parties if that  
17 state's investor protection laws are stronger and there is a conflict between that law and  
18 the law of the chosen state. This Court so holds as a general rule.<sup>2</sup>

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21 <sup>2</sup> See, e.g., *Wright-Moore Corp.*, 908 F.2d at 132-34 (applying Indiana franchise  
22 law despite choice of New York law provision in franchise agreement where potential  
23 franchisee was incorporated and located in Indiana and the principal place of business of  
24 its franchise would be in Indiana); *Ticknor v. Choice Hotels Int'l, Inc.*, 265 F.3d 931 (9th  
25 Cir. 2001) (applying Montana franchise law despite choice of Maryland law provision in  
26 franchise agreement where some but not all franchisees resided in Montana and the  
27 franchise was located there); *Cottman Transmission Sys.*, 492 F. Supp. 2d at 466-71  
28 (allowing claims under franchise laws of California, New York, and Wisconsin despite  
choice of Pennsylvania law in franchise agreements where franchisees resided and  
operated their franchises in those three states); *Pinnacle Pizza Co., Inc. v. Little Caesar  
Enters.*, 395 F. Supp. 2d 891, 898 (D.S.D. 2005) (applying South Dakota franchise laws  
despite choice of Michigan law provision in franchise agreement where franchisees  
resided and operated their franchises in South Dakota).

1  
2 **B. Contractual Choice of the Less Protective Arizona Law for the Issues in**  
3 **this Case Is Contrary to Fundamental Policy of Ohio and Is Therefore**  
4 **Invalid**

5 **1. General Analysis under the Restatement (Second) of Conflict of Laws**  
6 **§ 187**

7 The Restatement § 187 states the test for whether the parties' choice of law is  
8 valid and enforceable:

9 (1) The law of the state chosen by the parties to govern their contractual  
10 rights and duties will be applied if the particular issue is one which the  
11 parties could have resolved by an explicit provision in their agreement  
12 directed to that issue.

13 (2) The law of the state chosen by the parties to govern their contractual  
14 rights and duties will be applied, even if the particular issue is one which  
15 the parties could not have resolved by an explicit provision in their  
16 agreement directed to that issue, *unless* either

17 (a) the chosen state has no substantial relationship to the parties or  
18 the transaction and there is no other reasonable basis for the parties'  
19 choice, or

20 (b) *application of the law of the chosen state would be contrary to a*  
21 *fundamental policy of a state which has a materially greater interest*  
22 *than the chosen state in the determination of the particular issue and*  
23 *which, under the rule of § 188, would be the state of the applicable*  
24 *law in the absence of an effective choice of law by the parties.*

25 (3) In the absence of a contrary indication of intention, the reference is to  
26 the local law of the state of the chosen law.

27 Restatement (Second) of Conflict of Laws § 187 (emphasis added).

28 The factors and considerations on whether the defeated state policy is fundamental  
for purposes of the Restatement § 187(b)(2) overlap the factors of the Restatement § 6  
and § 188 concerning which state has the most significant relationship to the transaction  
and the parties. The Ohio laws here are substantive state policy grounded in prohibited  
and mandatory conduct concerning business and investment integrity. The heightened

1 protections for franchisees are the very ones on which this lawsuit turns: mandatory,  
2 complete, and true written disclosure statements, Ohio Rev. Code § 1334.02; five-day  
3 cancellation right on the face of the franchise agreement, *id.* § 1334.06; prohibition of  
4 false or misleading statements and any representations in addition to or inconsistent with  
5 the disclosures, *id.* § 1334.03; civil and criminal sanctions, *id.* §§ 1334.08, 1334.99;  
6 rescission and treble damages or \$10,000 minimum, plus reasonable attorney fees, *id.*  
7 § 1334.09. It is hard to see how a statute making something a crime is not fundamental  
8 policy, such that a party can commit the crime in the state and contract his way out of the  
9 liability. *See, e.g., MGM Grand Hotel, Inc. v. Imperial Glass Co.*, 65 F.R.D. 624, 632  
10 (D. Nev. 1974), *rev'd on other grounds*, 533 F.2d 486 (9th Cir. 1976) (“[T]he punitive  
11 provisions of [contractor-licensing statute] express a strong public policy of Nevada.  
12 This legislative desire to punish those who ignore the statutory command can even be  
13 termed a fundamental policy.”).

14 We have not examined every statute in every state that provides special  
15 protections for franchise buyers, but it hard to imagine that any such statute will ever be  
16 any less than fundamental policy of the state, in the sense that the state intends that a  
17 franchisor need only enter into the forbidden contract to escape the statute forbidding the  
18 contract. Under this view, it would not matter either that the franchisee is out of state.  
19 As a matter of statutory construction, a state’s declaration of protection of business and  
20 investment integrity within its boundaries is not silently limited to protecting only its own  
21 residents. If a statute said so straight out, it would violate the Privileges and Immunities  
22 Clause of Article IV, Section 2, of the United States Constitution. (“The Citizens of each  
23 State shall be entitled to all Privileges and Immunities of Citizens in the several States.”)

24 The Ohio franchise regulation statutes and those in similar states always reflect  
25 fundamental policy of the state, and a contractual choice of the law of a less protective  
26 state cannot defeat the state’s protection for an in-state franchise and franchisee. The  
27  
28

1 cases to the contrary are unpersuasive and in two states have been overturned by statutory  
2 amendment.<sup>3</sup>

## 3 4 **2. The Ohio Statutes Expressly State They are Fundamental Policy**

5 In 2012 the Ohio legislature amended the Act to state explicitly that it embodies a  
6 fundamental policy of the state in response to an aberrant ruling in *Tele-Save*  
7 *Merchandising Co. v. Consumers Distributing Co.*, 814 F.2d 1120 (6th Cir. 1987), which  
8 held otherwise. That ruling has been criticized by judges and scholars alike.<sup>4</sup> The newly  
9 added language in the amendments is underlined below:

10  
11 \_\_\_\_\_  
12 <sup>3</sup> See, e.g., *Banek Inc. v. Yogurt Ventures U.S.A., Inc.*, 6 F.3d 357 (6th Cir. 1993)  
13 (reasoning the Michigan franchise disclosure statute “is not so strongly worded” as other  
14 states’ laws and, therefore, did not reflect a state policy strong enough to void choice of  
15 Georgia law provision in franchise agreement); *Tele-Save Merch. Co. v. Consumers*  
16 *Distrib. Co.*, 814 F.2d 1120 (6th Cir. 1987) (reasoning the Ohio franchise disclosure  
17 statutes did not invalidate choice of New Jersey law provision in franchise agreement  
18 where contacts were fairly evenly divided between Ohio and New Jersey; the parties  
19 were of similar bargaining strength; and application of New Jersey law would not be  
20 contrary to fundamental policy of Ohio); *Modern Comput. Sys., Inc. v. Modern Banking*  
21 *Sys., Inc.*, 871 F.2d 734 (8th Cir. 1989) (en banc) (applying the *Tele-Save* analysis to  
22 conclude that the Minnesota Franchise Act did not invalidate choice of Nebraska law  
23 provision; concluding further that although the Act “undeniably does evince a policy in  
24 favor of offering franchisees in Minnesota remedies greater than those available under  
25 traditional common law . . . [the state also has] a powerful countervailing policy:  
Minnesota’s traditional willingness to enforce parties’ choice of law agreements”),  
*superseded by statute*, Minn. Stat. § 80C.21, *as amended by* 1989 Minn. Laws 1989 ch.  
26 198, § 2; *Zounds Hearing Franchising, LLC v. Moser*, No. CV-16-00619-PHX-DGC,  
27 2016 WL 6476291 (D. Ariz. Nov. 2, 2016) (reasoning the Florida Franchise  
28 Misrepresentation Act did not invalidate choice of less-protective Arizona law for a  
Florida franchise sold to a Florida domiciliary); *Sherman v. PremierGarage Sys., LLC*,  
No. CV-10-0269-PHX-MHM, 2010 WL 3023320 (D. Ariz. July 30, 2010) (same).

26 <sup>4</sup> See, e.g., George F. Carpinello, *Testing the Limits of Choice of Law Clauses:*  
27 *Franchise Contracts as a Case Study*, 74 Marq. L. Rev. 57, 72-76 (1990) (describing  
28 “several errors in the court’s analysis”); *Modern Comput. Sys., Inc. v. Modern Banking*  
*Sys., Inc.*, 871 F.2d 734, 743 (8th Cir. 1989) (Heaney, J., dissenting) (“In my view, *Tele-*  
*Save* is based on faulty reasoning.”).

1 Section 1334.06(E) provides: “In connection with the sale or lease of a  
2 business opportunity plan, any provision in an agreement restricting  
3 jurisdiction or venue to a forum outside of this state, or requiring the  
4 application of laws of another state, is void with respect to a claim  
5 otherwise enforceable under sections 1334.01 to 1334.15 of the Revised  
6 Code.”

7 Section 1334.15(A) provides: “The general assembly declares that the offer  
8 and sale of business opportunity plans is a matter affected with a public  
9 interest. The general assembly further declares that it is the intent of this  
10 chapter to protect prospective purchasers of business opportunity plans by  
11 requiring that sellers provide the purchasers with the information necessary  
12 to make an intelligent decision about the business opportunity plan being  
13 offered, and that this chapter represents a fundamental public policy for this  
14 state.”

15 Section 1334.15(B) provides: “The remedies of sections 1334.01 to  
16 1334.15 of the Revised Code are in addition to remedies otherwise  
17 available for the same conduct under federal, state, or local law. Any  
18 waiver by a purchaser of sections 1334.01 to 1334.15 of the Revised Code  
19 or any venue or choice of law provision that deprives a purchaser who is an  
20 Ohio resident of the benefit of those sections is contrary to public policy  
21 and is void and unenforceable.”

22 2011 S.B. 196 (adopted June 26, 2012).

23 With the 2012 amendment Ohio is now the franchisee protection state on  
24 steroids. But the amendment was not necessary. It is not necessary under the  
25 Restatement § 187(b)(2) for a statute to recite that its policy is fundamental to fall beyond  
26 the parties’ ability to contract out of it. It only has to *be* fundamental. No thaumaturgic  
27 words are required. The Ohio statutes, like many others, cannot reasonably be construed  
28 any other way.

There should be nothing wrong with a statute saying it is fundamental policy in  
order to blunt a bad court ruling when the statute is already fundamental policy in its very  
nature. Saying the protections cannot be waived is surplusage in a statute that starts out  
saying what must and cannot be in a valid contract. Lawyers and legislators often say the  
same thing twice. Some cases note that a non-waivability term cinches these statutes as

1 fundamental policy that parties cannot contract out of.<sup>5</sup> But regrettably, some cases go  
2 further and hold that a statute is not fundamental because it does not have a non-  
3 waivability term.<sup>6</sup> That is mistaken and should be rejected. It is okay to say it twice but  
4 that does not mean saying once is not saying it at all.

5 Thus, Ohio has a “materially greater interest” than Arizona in the determination of  
6 the issues this case turns on. Ohio has an interest in applying its own laws policing the  
7 sale of franchises and business opportunity plans within the state and protecting its  
8 residents and others from insufficient disclosures and false, misleading, and inconsistent  
9 representations. These interests outweigh any generalized interest Arizona might have in  
10 enabling its residents with superior bargaining power to project Arizona *laissez faire*  
11 policy into states that require heightened business honesty and disclosure instead. *See,*  
12 *e.g., Barnes Grp., Inc. v. C & C Prods., Inc.*, 716 F.2d 1023, 1030 (4th Cir. 1983)  
13 (interest of one state in regulating business relationships within its borders is materially  
14 greater than another state’s generalized interest in protecting the interstate contracts of its  
15 domiciliary); *Stickney v. Smith*, 693 F.2d 563, 565 (5th Cir. 1982) (same).

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16  
17 <sup>5</sup> *See, e.g., Wright-Moore Corp.*, 908 F.2d at 132 (relying in part on non-  
18 waivability term in Indiana’s franchise laws to invalidate choice of New York law  
19 provision in franchise agreement: “The public policy, articulated in the nonwaiver  
20 provisions of the statute is clear: a franchisor, through its superior bargaining power,  
21 should not be permitted to force the franchisee to waive the legislatively provided  
22 protections, whether directly through waiver provisions or indirectly through choice of  
23 law. This public policy is sufficient to render the choice to opt out of Indiana's franchise  
24 law one that cannot be made by agreement.”); *Cottman Transmission Sys., LLC*, 492 F.  
25 Supp. 2d at 467-69 (relying in part on non-waivability terms in franchise laws of  
26 California, New York, and Wisconsin to invalidate choice of Pennsylvania law provision  
27 in franchise agreements).

28 <sup>6</sup> *See, e.g., Banek Inc.*, 6 F.3d at 359-61 (reasoning the non-waivability term in  
Michigan franchise laws “is not so strongly worded” as other states’ laws and, therefore,  
does not reflect a strong enough state policy to void the choice of Georgia law provision  
in franchise agreement); *Moser*, 2016 WL 6476291, at \*6 (concluding the Florida  
Franchise Misrepresentation Act did not invalidate choice of Arizona law provision in  
franchise agreement in part because “Florida did not include an anti-waiver provision in  
the FFMA”); *Sherman*, 2010 WL 3023320, at \*6 (same).



1 Ohio, the state with the most significant relationship to the transaction and the  
2 parties, has a fundamental policy of providing protections to purchasers of franchises.  
3 Applying Arizona law instead would defeat that fundamental Ohio policy about what  
4 happens in Ohio. Ohio has a materially greater interest than Arizona in the resolution of  
5 this issue of investor protection for buyers of franchises in Ohio, especially for Ohio  
6 residents.

7  
8 **C. The Choice of Law and Venue Provisions Are Invalid as to the  
9 Issues in this Case**

10 The Arizona choice of law and venue provisions in Zounds' franchise agreement  
11 are expressly invalid under Ohio Rev. Code § 1334.06(E), which provides that "any  
12 provision in an agreement restricting jurisdiction or venue to a forum outside of this state,  
13 or requiring the application of laws of another state, is void . . . ." Therefore, these  
14 actions must be transferred to Ohio in accordance with the exclusive Ohio venue  
15 provision of the Ohio statute to decide them in accordance with Ohio law.

16 Thus, the Ohio 2012 Amendment requiring Ohio law to be applied takes this case  
17 back to the beginning of the Restatement analysis. The Restatement § 6(1) says, "A  
18 court, subject to constitutional restrictions, will follow a statutory directive of its own  
19 state on choice of law." An Ohio court has to apply the Ohio law. A federal court in  
20 Ohio sitting in diversity jurisdiction also has to apply the forum state's choice of law  
21 rules, *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941), and the Ohio  
22 legislature said exactly what that choice of law rule is in franchise cases. The  
23 Restatement does not reconcile how any court in Ohio has to apply the Ohio statute,  
24 notwithstanding the parties' attempt to contract out of it, but a court in a different forum  
25 could not find the Ohio law anything less than fundamental Ohio policy for Ohio  
26 franchises.

27 **III. THE FRANCHISE AGREEMENTS' ARIZONA VENUE REQUIREMENT  
28 FOR PRE-SUIT MEDIATION VIOLATES THE FRANCHISEES' RIGHT  
TO OHIO VENUE**

1           Section 22(C) provides that, at Zounds’ election, the Franchisees must mediate  
2 their disputes in Arizona before commencing litigation. The Franchisees argue that the  
3 pre-suit mediation requirement is enough of a part of the litigation to come within the  
4 Ohio prohibition of non-Ohio venue clauses. *See* Ohio Rev. Code § 1334.06(E). The  
5 mediation term is intimately bound up with the Franchisees’ right to sue. The  
6 Franchisees are forbidden to bring suit until “such mediation proceedings have been  
7 terminated either: (i) as the result of a written declaration of the mediator(s) that further  
8 mediation efforts are not worthwhile; or (ii) as a result of a written declaration by  
9 Franchisor.” Thus, unlike real mediation, the Franchisees may not decide further  
10 mediation is not worth it. They are bound to continue mediating and forbidden to bring  
11 suit until the mediator or Zounds allows it.

12           The Section 22(C) pre-suit mediation requirement is integral to any litigation  
13 against Zounds. By tying the litigation to the mediation in this manner, Subsection 22(C)  
14 brings itself within the prohibition of Ohio Rev. Code § 1334.06(E), which voids *any*  
15 provision in an agreement restricting venue to a forum outside of Ohio. As such, the pre-  
16 suit mediation provision is void to the extent it requires the parties to mediate in Arizona  
17 as a precondition to suit.

18           This invalidity of venue may void the “mediation” clause entirely. However, the  
19 Franchisees stated in open court that they will mediate, but only in Ohio due to the extra  
20 expense of mediating in Arizona. The parties also stipulated in open court to mediation  
21 before a United States Magistrate Judge in lieu of the procedure in Section 22(C). The  
22 Court holds the parties to that stipulation. Upon transfer of the case to Ohio, mediation  
23 before a United States Magistrate Judge will satisfy the Franchisees’ obligations.

24           The parties also dispute whether mediation must be separate for each Franchisee  
25 or may be done together. Section 22(C), the mediation clause, does not directly forbid  
26 joint mediations of similar disputes involving the same attorneys. Rather, Zounds relies  
27 on Section 22(K), which provides in part that “all proceedings arising out of or related to  
28 this Agreement . . . will be conducted on an individual, not a class-wide basis, and that

1 any proceeding between Franchisee, Franchisee’s guarantors and Franchisor or its  
2 affiliates/officers/employees may not be consolidated with any other proceeding between  
3 Franchisor and any other third party.”

4 Zounds contends the mediation is a “proceeding[] arising out of or related to this  
5 Agreement” and thus limited to an individual basis with no consolidation. But in so  
6 arguing, Zounds hooks itself on the horns of its own dilemma concerning venue. If  
7 Section 22(K) applies to the mediation because it is a “proceeding,” then the Ohio  
8 prohibition of non-Ohio venue terms also applies to the mediation, as this Court  
9 otherwise finds. In truth, Zounds has hooked itself on both horns of its dilemma,  
10 impaling its venue argument and its non-joinder of mediations argument.

11 Ohio Rev. Code § 1334.09 voids the class action prohibition in Section 22(K).  
12 That section also fairly voids the prohibition on joinder of individual actions, in court or  
13 in mediation. The statutory validation of the greater includes the lesser. Zounds’  
14 assertion that they will be prejudiced by group mediation is not credible. The  
15 Franchisees would be prejudiced by paying their attorneys four times to do the same  
16 mediation. Requiring the Franchisees to participate on an individual basis would  
17 unjustifiably raise the costs of mediation and further delay resolution of this action by  
18 settlement or by adjudication.

19 Finally, the Magistrate Judge who will conduct the mediation has control over his  
20 own docket and proceedings, control of which the franchise agreement cannot strip him.  
21 He may decide to do individual mediations, or he may decide to do a joint mediation.  
22 This Court cannot and will not direct him how he must proceed.

23 Accordingly, Zounds’ request that individual mediations be ordered is denied.

24  
25 **IV. TRANSFER OF THE OHIO CASE AND JUDGMENT AGAINST ZOUNDS**  
26 **IN THE ARIZONA CASES**

27 As discussed above, the Northern District of Ohio transferred its case to this Court  
28 solely under 28 U.S.C. § 1404(a), which states, “For the convenience of parties and  
witnesses, in the interest of justice, a district court may transfer any civil action to any

1 other district or division where it might have been brought or to any district or division to  
2 which all parties have consented.” In so doing, the court gave weight to the Arizona  
3 venue clause, which would have been valid unless it defeated a fundamental policy of the  
4 Ohio Business Opportunity Purchasers Protection Act, which that court did not decide.  
5 As the Ohio district court stated, “further adjudication of all pending matters” has now  
6 fallen to this Court. (Doc. 33, No. CV-17-00782.)

7 This Court has taken the next step and answered the question the Ohio court did  
8 not reach. The Ohio statutes apply, invalidate the Arizona choice of law and venue  
9 clauses, and allow the action to be brought only in Ohio. The Ohio case must be  
10 transferred back to Ohio, not because the Ohio court erred in transferring under § 1404(a)  
11 in the sequence in which it decided the motions. Rather, it must be transferred back  
12 because under these later rulings the substantive Ohio law that binds the parties allows  
13 that action to be brought only in Ohio. There is no “other district . . . where it might have  
14 been brought.” 28 U.S.C. § 1404(a).

15 This order rules on the merits of Zounds’ four declaratory judgment actions filed  
16 in this Court. In each Zounds sought a declaration “that Section 22.C of the Franchise  
17 Agreement is valid and enforceable and that mediation must occur in Phoenix, Arizona as  
18 a condition precedent to the suit Defendants filed in Ohio.” (Doc. 1, No. CV-16-01462,  
19 at 7; Doc. 1, No. CV-16-01465, at 7; Doc. 1, No. CV-16-0167, at 7; Doc. 1, No. CV-16-  
20 01470, at 8.) This order has ruled on that as well and determined that:

21 1. Section 22.C of the Franchise Agreement is invalid and  
22 unenforceable to the extent it requires that mediation occur in Phoenix, Arizona as  
23 a condition precedent to the suit Defendants filed in Ohio because

24 2. The Ohio Business Opportunity Purchasers Protection Act, Ohio  
25 Rev. Code § 1334.06(e), provides that “any provision in an agreement restricting  
26 jurisdiction or venue to a forum outside of this state, or requiring the application of  
27 laws of another state, is void with respect to a claim otherwise enforceable under  
28 [the Act]” and the claims Defendants filed in Ohio are claims under the Act, and

1           3.     Section 22.A of the Franchise Agreement providing that “[t]his  
2 agreement shall be governed by and construed in accordance with the laws of the  
3 State of Arizona” is invalid and unenforceable with respect to the claims and  
4 issues under the Ohio Business Opportunity Purchasers Protection Act that the  
5 Franchisees filed in Ohio.

6           Declaratory judgment shall be entered accordingly against Zounds in the four  
7 Arizona actions.

8  
9     **V.     ATTORNEY FEES**

10           In each of the declaratory actions file in this Court, Zounds prayed for award of  
11 costs and attorney fees against each of the Franchisees “pursuant to Section 20(D) of the  
12 Franchise Agreement and A.R.S. § 12-341.01.” Section 20(D) is an odious one-way fee-  
13 shifting term for the benefit of Zounds if it wins in litigation, but not for the Franchisees  
14 if they win. Zounds lost in the declaratory actions.

15           Zounds also prayed for attorney fees under A.R.S. § 12-341.01, which states in  
16 part:

17           A. In any contested action arising out of a contract, express or implied, the  
18 court may award the successful party reasonable attorney fees. . . .

19           B. The award of reasonable attorney fees pursuant to this section should be  
20 made to mitigate the burden of the expense of litigation to establish a just  
21 claim or a just defense. It need not equal or relate to the attorney fees  
22 actually paid or contracted, but the award may not exceed the amount paid  
or agreed to be paid.

23     A.R.S. § 12-341.01(A)-(B).

24           Zounds brought these declaratory contract actions under Arizona law and sought a  
25 fee award under A.R.S. § 12-341.01. It turns out they fail because Arizona law does not  
26 validly apply, but the fee-shifting authority of the statute applies in favor of the  
27 successful party whether the contract claim succeeded or failed. *See Fulton Homes Corp.*  
28 *v. BBP Concrete*, 214 Ariz. 566, 572, 155 P.3d 1090, 1096 (App. 2007) (“An

1 adjudication on the merits is not a prerequisite to recovering attorneys' fees under A.R.S.  
2 § 12-341.01."); *Nat'l Union Fire Ins. Co. v. Aero Jet Servs., LLC*, No. CV-11-1212-PHX-  
3 DGC, 2012 WL 510490 (D. Ariz. Feb. 16, 2012) (defendant who obtained dismissal of  
4 declaratory judgment action in federal court was "successful party" in "contested action"  
5 as required for award of attorney fees under Arizona fee-shifting statute governing  
6 contracts), *aff'd sub nom. Nat'l Union Fire Ins. Co. v. 757BD, LLC*, 560 F. App'x 657  
7 (9th Cir. 2014). The assertion of an Arizona contract claim and request for fees under the  
8 statute leaves Zounds open to assessment of fees under the statute upon the failure of the  
9 Arizona contract claim. *ZB, N.A. v. Hoeller*, 242 Ariz. 315, 395 P.3d 704, 709 (App.  
10 2017) ("When a provision allows for awarding fees only to one party and is silent on  
11 awarding fees to the other parties to a contract, fees may be awarded to the other parties  
12 pursuant to A.R.S. § 12-341.01.").

13 An award is in the discretion of the court. *Associated Indem. Corp. v. Warner*,  
14 143 Ariz. 567, 570, 694 P.2d 1181, 1184 (1985) (giving non-exclusive list of factors to  
15 consider in exercising discretion). The circumstance that Zounds gave itself, but only  
16 itself, a right to award of attorney fees will powerfully favor discretion to equalize and  
17 deodorize that odious term. Indeed, it should be a presumptive abuse of discretion not to  
18 award attorney fees against an unsuccessful party who used its superior bargaining power  
19 to impose such a term.

20 The Ohio statute also permits award of attorney fees in the circumstances of this  
21 case. Ohio Rev. Code § 1334.09 provides that a purchaser may have various remedies  
22 for a violation of the Ohio Act, including:

23 (B) The court may award to the prevailing party a reasonable attorney fee  
24 limited to the work reasonably performed, if either of the following apply:

25 . . .

26 (2) The seller or broker committed an act or practice that violates  
27 sections 1334.01 to 1334.15 of the Revised Code.

28 Ohio Rev. Code § 1334.09(B)(2).

1 The declaratory adjudication in these cases is that Zounds violated Ohio Rev.  
2 Code § 1334.06(e) by contracting for venue outside of Ohio and for application of the  
3 law of another state.

4 It is efficient for this Court to conclude the attorney fees aspects of the four  
5 Arizona cases because they are reduced to final judgment here, this Court is familiar with  
6 the services rendered, and the Franchisees should be paid for those services promptly  
7 without having to await adjudication in the Ohio case. Zounds burdened the Franchisees  
8 with a multiplicity of actions in a distant forum. Compensation is appropriate.

9 All of the services rendered in the five cases, except those in the Ohio case before  
10 the four actions were filed in this Court on May 12, 2016, are pertinent to all the cases.  
11 Therefore, all the fees incurred in all the cases to date are recoverable in every case, but  
12 recoverable only once. What is awarded and paid here will not be recoverable again  
upon conclusion of the Ohio case, unless it has not yet been paid in these actions.

13 The Franchisees may submit their bills of costs and applications for award of  
14 attorney fees under Federal Rule of Civil Procedure 54(d) and Local Rules LRCiv 54.1  
15 and 54.2.

16  
17 IT IS THEREFORE ORDERED that the Zounds Defendants' Renewed Motion to  
18 Dismiss Amended Complaint or, Alternatively, to Stay Proceedings and Compel  
Mediation (Doc. 43) is denied.

19 IT IS FURTHER ORDERED that Case No. CV-17-00728 is deconsolidated and  
20 the Clerk shall transfer the case to the United States District Court for the Northern  
21 District of Ohio.

22 IT IS FURTHER ORDERED that the Clerk enter judgment in consolidated Cases  
23 No. CV-16-01462, No. CV-16-01465, No. CV-16-01467, and No. CV-16-01470  
24 declaring and adjudging as follows:

- 25 1. Section 22.C of the Franchise Agreement is invalid and  
26 unenforceable to the extent it requires that mediation occur in Phoenix, Arizona as  
27 a condition precedent to the suit Defendants filed in Ohio because  
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2. The Ohio Business Opportunity Purchasers Protection Act, Ohio Rev. Code § 1334.06(e), provides that “any provision in an agreement restricting jurisdiction or venue to a forum outside of this state, or requiring the application of laws of another state, is void with respect to a claim otherwise enforceable under [the Act]” and the claims Defendants filed in Ohio are claims under the Act, and

3. Section 22.A of the Franchise Agreement providing that “[t]his agreement shall be governed by and construed in accordance with the laws of the State of Arizona” is invalid and unenforceable with respect to the claims and issues under the Ohio Business Opportunity Purchasers Protection Act that the Franchisees filed in Ohio.

The Clerk shall terminate these cases in this Court.

Dated this 15th day of September, 2017.

  
\_\_\_\_\_  
Neil V. Wake  
Senior United States District Judge