JS-6

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SOUTHERN DIVISION

JOHN OF ARC, INC., et al.,

Plaintiffs,

v.

THE JOHNNY ROCKETS GROUP, INC., JOHNNY ROCKETS LICENSING, LLC, THE COCA-COLA COMPANY, INC., REDZONE CAPITAL MANAGEMENT COMPANY, LLC, WFI STADIUM, INC., and DOES 1 THROUGH 100, INCLUSIVE,

Defendants.

Case No.: SACV 16-01325-CJC(DFMx)

ORDER GRANTING DEFENDANTS THE JOHNNY ROCKETS GROUP, INC., AND JOHNNY ROCKETS LICENSING, LLC'S MOTION TO COMPEL ARBITRATION AND ALL DEFENDANTS' MOTIONS FOR STAY

I. INTRODUCTION

Plaintiffs John of Arc, Inc., et al., are current and former franchisees of the Johnny Rockets chain of hamburger restaurants. (Dkt. 1-1 ["Compl."] ¶ 46.) Plaintiffs bring this

class action lawsuit against The Johnny Rockets Group, Inc., Johnny Rockets Licensing, LLC, The Coca-Cola Company, Inc., RedZone Capital Management Company, LLC, WFI Stadium, Inc., and Does 1 through 100, inclusive, for various causes of action arising from Defendants' alleged "secret kickback" scheme in the sale of Coca-Cola soft drinks. (*See generally* Compl.) Before the Court is The Johnny Rockets Group, Inc. and Johnny Rockets Licensing, LLC's (together "Johnny Rockets") motion to compel arbitration and for stay, (Dkt. 11), as well as motions for stay pending the outcome of arbitration filed by The Coca-Cola Company, Inc. ("TCCC"), (Dkt. 16); RedZone Capital Management Company, LLC ("RedZone"), (Dkt. 18); and WFI Stadium, Inc. ("WFI"), (Dkt. 20).

For the following reasons, Defendant Johnny Rockets' motion to compel arbitration and all Defendants' motions for stay are GRANTED.[1]

II. BACKGROUND

Defendant The Johnny Rockets Group is the franchisor of the Johnny Rockets chain of hamburger restaurants. (Compl. ¶ 47.) Defendant Johnny Rockets Licensing, a wholly-owned subsidiary of The Johnny Rockets Group, owns trademarks associated with the Johnny Rockets brand. (*Id.*) Plaintiffs are current and former franchisees of the Johnny Rockets restaurant chain. (*Id.* ¶ 46.) According to the Complaint, many are "small entrepreneurs and retired couples who invest their life savings in the restaurants." (*Id.* ¶ 63.) Defendant Johnny Rockets Licensing entered into franchise agreements with Plaintiffs so that Plaintiffs could operate Johnny Rockets restaurants. (*Id.* ¶ 47.)

[1] Having read and considered the papers presented by the parties, the Court finds this matter appropriate for disposition without a hearing. *See* Fed. R. Civ. P. 78; Local Rule 7-15. Accordingly, the hearing set for September 12, 2016, at 1:30 p.m. is hereby vacated and off calendar.

The parties do not dispute that the agreements contain the following arbitration clause, or a close variation thereof:[2]

> Except as otherwise provided in this Agreement and except for claims of promissory fraud, FRANCHISEE and FRANCHISOR agree that any claim, controversy, or dispute arising out of or relating to this Agreement (and exhibits) including those occurring subsequent to the termination or expiration of this Agreement shall, except as specifically set forth herein and in Section 20.A above, be referred to arbitration in accordance with the rules of arbitration of the American Arbitration Association (or any successor thereto), as amended and The Federal Arbitration Act, 9 U.S.C.A. Section 1-14 shall apply. If such rules are in any way contrary to or in conflict with this Agreement, the terms of this Agreement shall control.

(Compl. Ex. A at 44; Dkt. 11 ("Mot.") at 1–2; Dkt. 12 [Declaration of James Walker] at ¶¶ 5–10.) The franchise agreements also provide that "arbitration shall be final and binding upon the parties and judgment upon an award rendered by the Arbitrator may be entered in any court of competent jurisdiction." (Compl. Ex. A at 45; Mot. at 3.)

As franchisees, Plaintiffs are required to serve Coca-Cola soft drinks, and therefore must purchase Coca-Cola soft drink ingredients from TCCC. (Compl. ¶¶ 48–50.) According to the Complaint, in 2007 Johnny Rockets was negotiating an agreement with Pepsi to replace Coca-Cola products in Johnny Rockets restaurants with Pepsi soft drink products. (*Id.* ¶ 51.) Pepsi was offering a lower price for soft drink products than that which Johnny Rockets was paying for Coca-Cola products and also offered to limit future

[2] Although the Complaint alleges that some of the franchise agreements between Plaintiffs and Johnny Rockets were oral, (Compl. ¶ 47), Johnny Rockets states that there are no oral agreements between the parties, (Mot. at 4). This discrepancy is immaterial in adjudicating this motion, since Plaintiffs do not argue that any alleged oral agreements contained terms that are different from that of the written arbitration clauses at issue. (*See generally* Dkt. 28 ("Opp.").)

price increases, purchase new Pepsi-branded soft drink dispensers for the restaurants, and pay for the cost of substituting Coca-Cola memorabilia with Pepsi memorabilia. (*Id.*)

Around the same time, Defendant RedZone, a private equity fund, purchased Johnny Rockets. (*Id.* ¶¶ 52–53.) RedZone also owned Defendant WFI, which operated a stadium commonly known as "FedEx Field." (*Id.* ¶ 53.) RedZone wanted to purchase Coca-Cola soft-drink ingredients at a lower price than that paid by other buyers, including those of the National Football League ("NFL"), but was apparently prevented from doing so due to a series of most-favored-nation agreements the NFL holds with its member teams. (*Id.* ¶ 55.) RedZone and TCCC both allegedly wanted to circumvent the NFL agreements and therefore negotiated a secret kickback scheme whereby WFI would purchase Coca-Cola products for FedEx Field at the higher price set by the NFL agreements, and would make up the difference via a "syrup tax" on the Johnny Rockets franchisees. (*Id.* ¶ 56.) Whenever a Johnny Rockets franchisee bought a gallon of Coca-Cola soft drink syrup, TCCC would remit $0.50 of the purchase price to either RedZone or one of its wholly-owned subsidiaries. (*Id.*)

As a result of this agreement, RedZone instructed Johnny Rockets to reject Pepsi's offer. (*Id.* ¶ 57.) According to the Complaint, this allowed RedZone to pass the cost of the more expensive deal with TCCC on to the Johnny Rockets franchisees. (*Id.* ¶ 60.) The franchisees must therefore purchase Coca-Cola products at a price higher than they would have paid for Pepsi products, and at a price higher than what their competitors pay for Coca-Cola products. (*Id.* ¶ 61.) This deal was concealed from Plaintiffs, who did not learn about it until December 2014. (*Id.* ¶¶ 62, 66–67, 74.) Before each franchise agreement was signed, Johnny Rockets would provide Plaintiffs with a "standardized, preprinted Franchise Disclosure Document" which disclosed that "certain funds" were paid by TCCC, but not the amount of the kickback, the manner in which the kickback was paid, to whom the kickback was paid, or that franchisees were paying a higher price

for the syrup than other restaurants. (*Id.* ¶¶ 77–78.) The kickback scheme is still in force. (*Id.* ¶ 64.)

Plaintiffs filed this action in Orange County Superior Court on April 29, 2016. (Dkt. 1-1 Ex. A.) Plaintiffs brought the following causes of action against the following defendants:

1. Fraud against Johnny Rockets and RedZone, (Compl. ¶¶ 75–85);
2. Breach of the implied covenant of good faith and fair dealing against Johnny Rockets, (*Id*. ¶¶ 86–93);
3. Breach of fiduciary duty against Johnny Rockets and RedZone, (*Id*. ¶¶ 94–101);
4. Intentional interference with prospective economic relations against TCCC, (*Id*. ¶¶ 102–108);
5. Violations of the California Unfair Practice Act – Business & Professions Code Section 17045 – Secret Rebate against all Defendants, (*Id*. ¶¶ 109–116); and
6. Violations of the California Unfair Practice Act – Business & Professions Code Section 17200 against all Defendants, (*Id*. ¶¶ 117–131).

On July 15, 2016, Defendants removed the action to this Court. (Dkt. 1.) On July 22, 2016, Johnny Rockets moved to compel arbitration and for a stay. (Dkt. 11.) That same day, TCCC, RedZone, and WFI filed motions for stay pending the outcome of arbitration. (Dkt. 16; Dkt. 18; and Dkt. 20, respectively.)

III. DISCUSSION

The parties disagree on two issues. First, they debate whether the arbitration clauses in the franchise agreements apply to Plaintiffs' claims against Johnny Rockets. Defendants appear to concede that the arbitration clause does not apply to claims against RedZone, TCCC, and WFI ("the non-Johnny Rockets Defendants"), because they are not

parties to the franchise agreements. Second, the parties dispute whether the claims against the non-Johnny Rockets Defendants should be stayed pending the outcome of arbitration of the claims against Johnny Rockets. The Court addresses each issue in turn.

A. The Scope of the Arbitration Clauses

The Federal Arbitration Act ("FAA") provides that a "written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of the contract." 9 U.S.C. § 2. The FAA reflects a "liberal federal policy favoring arbitration." *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). Its "overarching purpose is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate informal, streamlined proceedings." *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 344 (2011). Consistent with this purpose, "the Act leaves no place for the exercise of discretion by a district court, but instead mandates that district courts *shall* direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 218 (1985). "The court's role under the Act is therefore limited to determining (1) whether a valid agreement to arbitrate exists and, if it does, (2) whether the agreement encompasses the dispute at issue." *Chiron Corp. v. Ortho Diagnostic Systems, Inc.*, 207 F.3d 1126, 1130 (9th Cir. 2000).

The parties only dispute the scope of the arbitration clause in the franchise agreements—they do not dispute the underlying validity of such clauses. The disagreement centers on whether Plaintiffs have pled promissory fraud, which is the only cause of action that is expressly carved out of the arbitration clauses. (Compl. Ex. A at 44; Mot. at 1–2; Dkt. 12 at ¶¶ 5–10.) Plaintiffs argue that their Complaint, in substance,

pleads promissory fraud, while Defendants contend that it only pleads fraudulent concealment. For the following reasons, the Court finds that Plaintiffs have not sufficiently alleged promissory fraud in their Complaint.

Promissory fraud is a "subspecies of fraud." *UMG Recordings, Inc. v. Glob. Eagle Entm't, Inc.*, 117 F. Supp. 3d 1092, 1109 (C.D. Cal. 2015) (citing *Lazar v. Superior Court*, 12 Cal. 4th 631, 638 (1996)). The essence of the cause of action is that the defendant made a promise to the plaintiff that it had no intention of performing at the time it made the promise. *See id.* Therefore, the complaint must allege "(1) a promise made regarding a material fact without any intention of performing it; (2) the existence of the intent not to perform at the time the promise was made; (3) intent to deceive or induce the promisee to enter into a transaction; (4) reasonable reliance by the promisee; (5) nonperformance by the party making the promise; and (6) resulting damage to the promise[e]." *Rossberg v. Bank of Am., N.A.*, 219 Cal. App. 4th 1481, 1498, *as modified on denial of reh'g* (Sept. 26, 2013). Nonperformance or breach of contract alone will not support a finding of promissory fraud. *UMG Recordings*, 117 F. Supp. 3d at 1110.

By contrast, the elements of fraudulent concealment are "(1) concealment or suppression of a material fact; (2) by a defendant with a duty to disclose the fact to the plaintiff; (3) the defendant intended to defraud the plaintiff by intentionally concealing or suppressing the fact; (4) the plaintiff was unaware of the fact and would not have acted as he or she did if he or she had known of the concealed or suppressed fact; and (5) plaintiff sustained damage as a result of the concealment or suppression of the fact." *Hambrick v. Healthcare Partners Med. Grp., Inc.*, 238 Cal. App. 4th 124, 162 (2015), *reh'g denied* (June 17, 2015), *review denied* (Sept. 30, 2015).

Plaintiffs have not convinced the Court that they have pled the requisite elements of promissory fraud. Plaintiffs insist that although the Complaint does not use words to

the effect of "promissory fraud," "when the Complaint's allegations are read in the context of the Franchise Disclosure Document and the promises made therein, it is clear that promissory fraud has been sufficiently pled." (Opp. at 5.) Among the six causes of action in the Complaint, only the first cause of action for "Fraud" could impliedly encompass promissory fraud. (*See generally* Compl.) However, read most generously, the Complaint is still missing key elements of promissory fraud, including (1) that Defendants made a promise concerning the kickback; (2) that Defendants had no intention of performing said promise at the time the promise was made; (3) that Defendants did so to induce Plaintiffs to enter into the agreement; that (4) Plaintiffs relied on said promise; or that (5) Defendant did not perform the promise. (Compl. ¶¶ 75–85.) *See Rossberg*, 219 Cal. App. 4th at 1498. Therefore, Plaintiffs' allegations cannot even imply a claim of promissory fraud.

However, Plaintiffs' allegations map nicely onto the elements of fraudulent concealment, because they have pled that (1) Defendants concealed or suppressed a material fact (i.e., the existence and details of the kickback scheme); (2) Defendants had a duty to disclose this scheme to the Plaintiffs; (3) Defendants intended to deceive Plaintiffs by intentionally concealing or suppressing the scheme; (4) Plaintiffs were unaware of the scheme and would not have entered into the franchise agreements if they had known about it; and (5) Plaintiff sustained damages and paid higher prices for Coca-Cola products as a result of the concealment. (Compl. ¶¶ 75–85.) *See Hambrick*, 238 Cal. App. 4th at 162.

Plaintiffs attempt to bring their claims within promissory fraud by referencing "a number of promises," including a promise to maintain truth throughout the term of the franchise agreement, to deal with Plaintiffs in good faith, and to choose franchisee suppliers in a manner that "conform[s] to specifications and quality standards reasonably established." (Opp. at 1.) However, references to these "promises" are nowhere in the

Complaint. (*See generally* Compl.) Nor is it clear where these "promises" are in the franchise agreement, since Plaintiffs provide no citation.[3] (*See* Opp. at 1.) In any event, references to such "promises" in the Complaint would not be helpful. As explained above, although the Complaint's first cause of action is merely presented as "fraud," it is in essence a claim of fraudulent concealment. The entire Complaint, and particularly the fraud claim, is premised on injuries to the Plaintiffs based on Defendants' alleged concealment of the kickback scheme. (*See generally* Compl.; *Id.* ¶¶ 75–85 (fraud allegations).) Plaintiffs' references to promises of truthfulness, good faith, and conformity with quality standards in its briefing are too general to be attributed to the kickback scheme.[4] (*See* Opp. at 1.)

Plaintiffs attempt to show Defendants' lack of intent to honor any such "promises" in the Complaint by arguing that the Complaint alleges "even as Defendants were using their franchise agreements and disclosure to pledge loyalty and good faith to their franchisees, *they had already* entered into the secret kickback agreement with Coca-Cola." (Opp. at 8–9 (emphasis in original).) Plaintiffs cite only paragraph 76 of the Complaint, which merely states that from 2007 until the present, Plaintiffs entered into written or oral franchise agreements, pursuant to which they were required to purchase certain products, including Coca-Cola syrup. (Compl. ¶ 76.) That Defendants had already entered into a kickback agreement before signing new franchise agreements does

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[3] In its reply brief, Johnny Rockets points to relevant language in the franchise agreement attached to the Complaint that might contain the "promises" to which Plaintiffs are referring. (Dkt. 32 at 12–15.) Even if Johnny Rockets identified the correct language, Plaintiff still has not established that it pled promissory fraud. The language identified by Johnny Rockets does not provide any language from which it could be inferred that Johnny Rockets was making a promise regarding the kickback scheme. (*See id.*) The cited language only affirms the *licensee's* duty to refrain from making false representations to the licensor, that the parties to the agreement generally acknowledge that they will deal with one another in good faith, and that the franchisor will require that all supplies, equipment, furnishings, and fixtures conform to the franchisor's own specifications and quality standards. (*See* Compl. Ex. A at 1, 19, 46.)

[4] Plaintiffs also fail to adequately explain why, even if the fraud claim was a promissory fraud claim, the rest of the Complaint's allegations should not be decided in arbitration. (*See generally* Opp.)

not evidence an intent not to honor the aforementioned mysterious "promises" in Plaintiffs' briefing. (*See* Opp. at 1.)

Additionally, Plaintiffs maintain that they have properly alleged the element of inducement in paragraphs 80–82 of their Complaint, (Opp. at 11). This defies a plain reading of the Complaint. The paragraphs in question only allege that Plaintiffs would not have entered into the franchise agreements if they had known about the kickback, but nowhere does it say that Defendants made any promises concerning the kickback or that Defendants made such promises to induce Plaintiffs to enter into the franchise agreements. (*See* Compl. ¶¶ 80–82.)

Thus, the Complaint alleges fraudulent concealment. The Complaint does not allege promissory fraud, and therefore is not exempt from the arbitration clause in the franchise agreements. Plaintiffs' claims against Johnny Rockets must be adjudicated in arbitration, so the motion to compel is GRANTED.

B. Stay of Claims Pending Arbitration

All Defendants seek a stay pending the outcome of arbitration of the claims against Johnny Rockets. "[T]he power to stay proceedings is incidental to the power inherent in every court to control disposition of the cases on its docket with economy of time and effort for itself, for counsel, and for litigants." *Landis v. N. Am. Co.*, 299 U.S. 248, 254 (1936). The power to stay a case "calls for an exercise of a sound discretion" and a weighing of "competing interests." *CMAX, Inc. v. Hall*, 300 F.2d 265, 268 (9th Cir. 1962). Among those interests are "the possible damages which may result from the granting of a stay, the hardship or inequity which a party may suffer in being required to go forward, and the orderly course of justice measured in terms of the simplifying or

complicating of issues, proof, and questions of law which could be expected to result from a stay." *Id.*

Furthermore, when "independent proceedings . . . bear upon [a] case," a trial court may, "with propriety, find it efficient for its own docket and the fairest course for the parties to enter a stay" pending resolution of the independent proceedings.[5] *Leyva v. Certified Grocers of Cal., Ltd.*, 593 F.2d 857, 863 (9th Cir. 1979). This rule "does not require that the issues in such proceedings are necessarily controlling of the action before the court." *Id.* at 863–64. Where litigation against one defendant is stayed due to a controlling agreement to submit to arbitration, a court may avoid "a duplication of effort in trying simultaneously, or even successively" the issues in the complaint by staying the claims against defendants who are not bound by the arbitration agreement. *See, e.g., U.S. for Use & Benefit of Newton v. Neumann Caribbean Int'l, Ltd.*, 750 F.2d 1422, 1427 (9th Cir. 1985).

As explained above, the arbitration clause contained in the franchise agreements between Johnny Rockets and Plaintiffs clearly applies to Plaintiffs' claims against Johnny Rockets. Therefore, Johnny Rockets' motion for stay must be granted. 9 U.S.C. § 3 ("Upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, [the Court] shall on application of one of the parties stay the trial of the action until such arbitration has been had . . . .").

Additionally, the non-Johnny Rockets Defendants' motions for stay should be granted because the claims against them are inextricably intertwined with those against

[5] Plaintiffs argue that the non-Johnny Rockets Defendants cannot enforce the arbitration agreement because they may not rely on the theories of incorporation by reference, assumption, agency, alter ego liability, or equitable estoppel. (Dkt. 28 at 13.) This is immaterial, since the non-Johnny Rockets Defendants do not seek to enforce the arbitration clause as to themselves, but rather, seek stays pending the outcome of arbitration against Johnny Rockets. (*See* Dkt. 16; Dkt. 18; and Dkt. 20.)

Johnny Rockets. Plaintiffs agree that the claims against the non-Johnny Rockets Defendants "arise from the same common core of operative facts" as the claims against Johnny Rockets.[6] (Dkt. 28 at 14.) All of the claims in the Complaint, including those against the non-Johnny Rockets Defendants, are based on or closely relate to the franchise agreements between Plaintiffs and Johnny Rockets. (Dkt. 28 at 14.) The first three causes of action arise directly out of the franchise agreements, because Plaintiffs base the claims on Defendants' intentional failure to disclose the kickback scheme in the franchise agreements and similar omissions in negotiating the agreements. (Compl. ¶¶ 78, 92, 97.) Additionally, the claims for intentional interference with prospective economic relations brought against TCCC and violations of the California Unfair Practices Act against all Defendants are all based on the same secret kickback scheme. (*See id.* at ¶¶ 105, 112, 121–131.) Therefore, these claims are all necessarily and inextricably intertwined, and adjudication of the claims will hinge in large part on the alleged existence and intentional concealment or omission of the kickback scheme.

Since the six claims in the Complaint are so closely connected, proceeding with litigation in a piecemeal fashion against the non-Johnny Rockets Defendants will prejudice the arbitration and waste judicial resources. Without a stay of all claims, the arbitration and litigation will adjudicate many of the same questions of law and fact. *See, e.g., U.S. for Use & Benefit of Newton*, 750 F.2d at 1427. The arbitrator's decisions on the claims against Johnny Rockets will very likely reduce the number of issues that will remain in the cases against the non-Johnny Rockets Defendants, strongly indicating the propriety of a stay. *See id.* Furthermore, arbitration will likely be complete before any trial held in this Court, prejudicing outcomes in the case against the non-Johnny Rockets

[6] Plaintiffs argue that the commonality of questions of fact here militates in favor of denying the stay because this simplifies the action and allows "greater resolution of causes and disposition of parties than the proposed arbitration—thus conserving judicial economy." (Dkt. 28 at 15.) Since the arbitration clause is binding as to Johnny Rockets, the Court fails to see how judicial economy is advanced by permitting Plaintiffs to litigate against the non-Johnny Rockets Defendants while a case that is so factually similar is proceeding in arbitration.

Defendants. Therefore, the most efficient resolution of this case is to stay the claims against all Defendants. The Court in its discretion STAYS all claims pending the outcome of arbitration between Plaintiffs and Johnny Rockets.

V. CONCLUSION

For the foregoing reasons, Defendants The Johnny Rockets Group, Inc. and Johnny Rockets Licensing LLC's motion to compel arbitration, (Dkt. 11), is GRANTED. Additionally, all Defendants' motions for stay, (Dkt. 11; Dkt. 16; Dkt. 18; and Dkt. 20), are GRANTED.

DATED: September 7, 2016

CORMAC J. CARNEY
UNITED STATES DISTRICT JUDGE