

COURT OF APPEALS OF TENNESSEE
AT KNOXVILLE

FILED
April 29, 1998
Cecil Crowson, Jr.
Appellate Court Clerk

ELIZABETH BRIGHT)
and THOMAS C. BRIGHT, III) HAMILTON COUNTY
) 03A01-9708-CV-00377
)
Plaintiffs-Appellants)
)
v.) HON. SAMUEL H. PAYNE,
) JUDGE
)
)
SPAGHETTI WAREHOUSE, INC.)
)
Defendant-Appellee) AFFIRMED AND REMANDED

ROGER W. DICKSON OF CHATTANOOGA FOR APPELLANT

F. FERBER TRACY OF CHATTANOOGA FOR APPELLEE

O P I N I O N

Goddard, P.J.

Elizabeth Bright and Thomas C. Bright, III, appeal the dismissal of their case from the Circuit Court of Hamilton County. The Brights filed their lawsuit on August 11, 1995, claiming, *inter alia*, that Spaghetti Warehouse, Inc., had fraudulently induced them to form a corporation and purchase a Spaghetti Warehouse franchise. The Brights requested relief in the form of damages not to exceed \$2.5 million, the trebling of

actual damages in accordance with the Texas Deceptive Trade Practices - Consumer Protection Act, and attorney fees plus court costs and costs of collection.

Spaghetti Warehouse filed a motion to dismiss or stay the proceedings pending the outcome of an arbitration claim in Dallas, Texas. On January 3, 1996, the Circuit Court granted the motion to stay the proceedings. An award was rendered by the arbitrators, denying all relief sought by the Brights' corporation. Spaghetti Warehouse then filed a motion to confirm the Arbitration Award and to dismiss the Circuit Court action. The Honorable Samuel H. Payne granted both the motion to confirm and to dismiss on June 10, 1997. The Brights have filed this appeal contesting that decision.

Elizabeth Bright, a real estate developer, began her relationship with Spaghetti Warehouse in 1990 helping locate proposed restaurant sites. In 1991, Spaghetti Warehouse sent Mrs. Bright promotional documents regarding the Spaghetti Warehouse franchising program. Mrs. Bright had no experience in restaurant operations or management and it was proposed by Ken Vaughn, Vice-President of Franchising and Purchasing for Spaghetti Warehouse, that she act only as an investor and possibly assist the management team with financial matters.

Spaghetti Warehouse introduced Tim Moore and Art Kaplan to Mrs. Bright as restaurant professionals that could help manage

a franchise if she decided to invest. The agreement negotiated had the Brights giving at least 50% of the equity ownership in the franchise to Mr. Kaplan and Mr. Moore and contributing equity capital of at least \$300,000. On November 25, 1991, Mrs. Bright sent Spaghetti Warehouse a completed franchise application and the franchise fee.

In December 1991 the Brights, together with Mr. Kaplan and Mr. Moore, formed the initial franchise entity, named Bright-Moore-Kaplan International Corporation ("BMK"). Mr. Kaplan and Mr. Moore were each given 30% ownership as the "operators" and the Brights had 20% ownership each as the "investors." Before all the papers were finalized Mrs. Bright claimed she observed poor judgment and irrational behavior on the part of Mr. Moore. Mrs. Bright expressed her concerns to Mr. Kaplan and stated that she did not want to go forward with the investment if Mr. Moore was involved. The issue was resolved by removing Mr. Moore as an equity owner but keeping him as an employee. Shortly thereafter, on May 1, 1992, a new corporation was formed under the name Bright-Kaplan International Corporation ("BK"). BK was created with the Brights owning 500 shares of stock and Mr. Kaplan owning 500 shares of stock.

BK obtained construction financing and proceeded with construction of the restaurant. On December 5, 1992, the day prior to the opening of the restaurant, Mrs. Bright, after talking with Mr. Kaplan and Spaghetti Warehouse, terminated Mr.

Moore's employment. After the opening of the restaurant Mrs. Bright claimed that Mr. Kaplan then began causing problems. As a result, in July 1993, Mrs. Bright bought out Mr. Kaplan for approximately \$75,000, his contribution to BK. Mrs. Bright claimed that once Mr. Kaplan and Mr. Moore were removed Spaghetti Warehouse became adversarial, and the restaurant operations deteriorated. The Brights' franchise finally closed in March 1996.

Pursuant to contract, BK and Spaghetti Warehouse had all disputed issues heard in an arbitration proceeding in Dallas, Texas. BK sought relief on several counts in the arbitration proceeding including misrepresentation, fraudulent inducement, violation of the Texas Deceptive Trade Practices - Consumer Protection Act, violation of FTC Disclosure Requirements Concerning Franchising, and breach of contract. The arbitration panel unanimously found all matters in controversy in favor of Spaghetti Warehouse denying BK any relief.

The Circuit Court action brought by the Brights, in their individual capacity, sought relief claiming fraudulent inducement and Texas Deceptive Trade Practices - Consumer Protection Act violations on the part of Spaghetti Warehouse. Upon motion, as already noted, the Circuit Court confirmed the arbitration award and dismissed the Brights' case.

The following issue is presented by the Brights in this appeal:

I. Whether The Circuit Court Erred In Dismissing The Plaintiffs' Lawsuit Based Upon A Decision To Confirm A Texas Arbitration Award Pursuant To T.C.A. § 29-5-301, 9 U.S.C § 16, and Tex. Civ. Prac. & Rem. Code § 171.013.

The Brights first argue that the Circuit Court erred in dismissing their lawsuit because it is a separate and distinct action from the arbitration proceeding, and the arbitration award is not applicable to their individual claims of fraudulent inducement and violations of the Texas Deceptive Trade Practices - Consumer Protection Act. The Brights claim that they are not parties to the Franchise Agreement between BK Corporation and Spaghetti Warehouse, and therefore are not bound by the arbitration provision. Furthermore, the Brights claim they were not involved as individuals in the arbitration proceeding in Texas and have been wrongly precluded from bringing a lawsuit based on a proceeding in which they were not individually involved.

Even if these claims were correct they do not help the Brights in this appeal. Collateral estoppel, which is the principle that would bind the Brights to the arbitration decision, does not require that the parties be the same, but only that the parties be privies. *Harrison v. Bloomfield Building Industries, Inc.*, 435 F.2d 1192 (6th Cir.1970). Therefore,

whether the Brights were parties to the arbitration agreement or proceeding is irrelevant as long as they were privies under the doctrine of collateral estoppel.

The Brights argue that collateral estoppel does not apply in this case. There are four factors that are relevant in determining the application of collateral estoppel: (1) whether the issues in the prior proceeding are the same as the issues presented in the present action, (2) whether the prior proceeding resulted in a judgment on the merits, (3) whether the party in the present action was a party or in privity with a party to the present proceeding, and (4) whether there was full and fair opportunity to litigate the issue in the prior litigation. *Morris v. Esmark Apparel, Inc.*, 832 S.W.2d 563 (Tenn.App.1991). We shall look at each factor in turn.

The Brights argue that the issues in the Circuit Court action are not identical to the issues adjudicated in the arbitration proceeding. Their argument suggests that because the arbitration proceeding included six counts and the Circuit Court action only included two that this was somehow enough to distinguish the issues. This is a misguided argument. The Circuit Court action sought relief for fraudulent inducement and violations of the Texas Deceptive Trade Practices - Consumer Protection Act. The arbitration proceeding adjudicated these same two issues as well as others. Simply changing the packaging of a claim and the names attached to it does not create different

issues. *Turpin v. Love*, an unreported opinion of this Court, filed in Knoxville on August 14, 1973. In fact, this is exactly the type of action that collateral estoppel is designed to prevent. We hold the issues presented in the Brights' lawsuit are identical to those adjudicated in the Texas arbitration proceeding.

The Brights also argue that the Texas arbitration proceeding is not a judgment on the merits because no reasons were given by the arbitration panel for denying the claims made by BK Corporation. The Brights cite *Dickerson v. Godfrey*, 825 S.W.2d 692 (Tenn.1992), to support their claim. However, *Dickerson* does not hold that a reasoned decision must be given in order to have a judgment on the merits only that the issues determined must be clear from the record. The Award of Arbitration states that "[t]he Panel reviewed all the evidence and considered each claim." The document even specifically stated each issue presented before the Panel and the Panel's decision on each issue. We hold that the arbitration proceeding was a judgment on the merits.

The Brights further argue that there is no collateral estoppel because they are not privies to the arbitration decision. "The Tennessee rule holds that privity as used in the context of *res judicata* [and collateral estoppel] does not embrace relationships between persons or entities, but rather to the subject matter of the litigation." *Phillips v. General*

Motors Corp., 669 S.W.2d 665 (Tenn.App.1984), citing *Cantrell v. Burnett & Henderson Co.*, 187 Tenn. 552, 216 S.W.2d 307 (1948). Texas law adheres to the same principle. *Olivarez v. Broadway Hardware, Inc.*, 564 S.W.2d 195 (Tex.Civ.App.1978). The subject matter of the arbitration, which included, among other claims, fraudulent inducement and a violation of the Texas Deceptive Trade Practices - Consumer Protection Act, is identical to that alleged in the Circuit Court action.

Tennessee, as well as the majority of other jurisdictions, has found that the application of privity is clear when a corporation's owner or stockholders attempt to relitigate the same questions litigated previously by the corporation. *Bean v. Commercial Securities Co.*, 25 Tenn.App. 254, 156 S.W.2d 338 (1941); *In re Shea's Will*, 132 N.E.2d 864 (N.Y.Ct.App.1956); *Hofsommer v. Hofsommer Excavating, Inc.*, 488 N.W.2d 380 (N.D. 1992). The Brights rely on *Hadden v. City of Gatlinburg*, 746 S.W.2d 687 (Tenn.1988), for their claim that they may bring an individual action against Spaghetti Warehouse as stockholders of BK. "Stockholders may bring an action individually to recover for an injury done directly to them distinct from that incurred by the corporation and arising out of a special duty owed to the shareholders by the wrongdoer." *Hadden*. The injury claimed by the Brights is in no way distinct from the injury claimed by BK in the arbitration proceeding. Therefore, we hold the Brights' claim that they as sole shareholders of BK Corporation were not in privity to the Texas arbitration proceeding is without merit.

The Brights finally argue that they have not had a full and fair opportunity to present their evidence and arguments on the Circuit Court action claims and, thus, collateral estoppel should not apply. The Brights again argue that because BK Corporation was the party to the arbitration proceeding, which was initiated by Spaghetti Warehouse, they were never given an opportunity to have their individual claims heard. Although the Brights may not have initiated the arbitration proceedings, they did participate and elected to include the same claims as they asserted in the Circuit Court action. BK Corporation was given a full and fair opportunity to promote and defend its interest, which are identical to the Brights' interests as sole shareholders, in the arbitration proceeding. We cannot conceive of any evidence or arguments that would support the Brights' claims of fraudulent inducement and violation of the Texas Deceptive Practices - Consumer Protection Act that would not have been presented on behalf of BK Corporation in the arbitration proceeding. The Brights had a full and fair opportunity to prove their claims against Spaghetti Warehouse through their privy, BK Corporation, but failed in that effort. Therefore, we hold the Brights should not be permitted to go to trial on the merits of those claims a second time.

Aside from arguing that collateral estoppel does not apply to this case, the Brights also argue that the Circuit Court erred in confirming the Texas Arbitration Award and dismissing their individual lawsuit because under Tennessee law their claim

of fraudulent inducement should be decided by a court and not by arbitration. The Brights do not make that same argument, however, for their individual claim of Texas Deceptive Trade Practice - Consumer Protection Act violations. Therefore, we hold that the Texas Arbitration Award concerning that issue is binding upon the Brights, as individuals, under the doctrine of collateral estoppel as discussed above.

The only remaining question then is whether the claim of fraudulent inducement was an issue that could properly be decided by the Texas arbitration proceeding. The Brights argue that under Tennessee law, as set out in *City of Blaine v. John Coleman Hayes Assoc., Inc.*, 818 S.W.2d 33 (Tenn.App.1991), the claim of fraudulent inducement is an issue that should be decided by a court, not an arbitrator. We hold the Brights' argument is without merit for several reasons.

First, *City of Blaine* is distinguishable from the case at hand. Most apparent is the fact that *City of Blaine* involves a broad arbitration clause that allows for enforcement under the prevailing arbitration law of any court having jurisdiction. The contract between BK Corporation and Spaghetti Warehouse specifically requires that all disputes be settled according to the laws of the State of Texas. The United States Supreme Court has held that where the parties have agreed that their arbitration agreement will be governed by the laws of a particular state then the laws of that state shall apply. *Volt*

Info. Sciences v. Bd. of Trustees, 489 U.S. 466, 109 S.Ct. 1248 (1989). The Supreme Court held that enforcing the arbitration under other rules would be contrary to the policies behind state and federal arbitration law "because it would 'force the parties to arbitrate in a manner contrary to their agreement.'" Under Texas law it is clear that a claim of fraudulent inducement is subject to arbitration. *Palm Harbor Homes, Inc. v. McCoy*, 944 S.W.2d 716 (Tex.Ct.App.1997).

City of Blaine is also distinguishable because the plaintiff in that case filed an interlocutory appeal objecting to the fraudulent inducement claim ever going to arbitration. The *City of Blaine* decision is unclear as to whether it holds that a claim of fraudulent inducement can never be arbitrated in Tennessee or just that an arbitration provision cannot require a party to do so. Although the arbitration proceeding in this case was initiated by Spaghetti Warehouse, the Brights never objected to the fraudulent inducement claim going to arbitration. Therefore, even if Tennessee law did apply in this case it is unclear that the rule in *City of Blaine* would apply.

In order to be clear that Texas law applies in this case we must determine if the choice of law clause in the contract is valid. Tennessee will honor a choice of law clause if the state whose law is chosen bears a reasonable relation to the transaction and absent a violation of the forum state's public policy. *Arcata Graphics v. Heidelberg Harris*, 874 S.W.2d

15 (Tenn.App.1993). Spaghetti Warehouse is a Texas Corporation and a majority of the contractual negotiations took place in Texas so there is no doubt Texas bears a reasonable relation to the transaction. Furthermore, we are not inclined to hold that allowing a claim of fraudulent inducement to be arbitrated is in violation of Tennessee's public policy. See *Hotel Ramada of Nevada, Inc. v. Thakkar*, an unreported opinion of this Court filed in Knoxville on July 25, 1991 (Nevada law enforcing gambling debt was not seen to violate Tennessee public policy). Therefore, we hold the choice of law provision is valid.

Under the valid choice of law provision, Texas law is to apply to any and all controversies between Spaghetti Warehouse and BK Corporation. Texas law provides that claims of fraudulent inducement are subject to arbitration. The arbitration proceeding allowed a full and fair opportunity for the issues involved in this case to be litigated. Under the doctrine of collateral estoppel and the public policy of judicial economy the Brights are bound by the Texas Arbitration Award.

For the reasons stated above, the judgment of the Circuit Court confirming the Texas Arbitration Award and dismissing the Brights' case is affirmed and the cause remanded for collection of costs below. Costs of appeal are adjudged against the Brights and their surety.

Houston M. Goddard, P.J.

CONCUR:

Don T. McMurray, J.

Charles D. Susano, Jr., J.