Restoring the Status Quo Ante:
Rescission and Restitution

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It is the purpose of rescission is to restore both parties to their former position as far as possible and to bring about substantial justice by adjusting the equities between the parties despite the fact that the status quo cannot be exactly reproduced.¹

Humpty Dumpty sat on a wall
Humpty Dumpty had a great fall
All the King’s horses and all the King’s men
Couldn’t put Humpty together again²

In 1872, a franchisee sought rescission of an agreement granting him a franchise to operate a ferry service in Illinois. The rescission was effective, according to the court, when the deed was tendered in exchange for return of a $300 promissory note. Fitch v. Conyne, 65 Ill. 83 (Ill. 1872). Of course, in 1872, “franchise” meant something much more narrow and different than its current meaning, but the court encountered some tricky issues. The legal history of rescission reflects development over time, as one would expect. Yet the practical problems associated with rescission and its fraternal twin restitution – in particular, how to restore the status quo ante – have not abated, in part due to the ever increasing complexity and multifaceted nature of the modern franchise agreement and relationship.³

In franchising, rescission and restitution remain viable remedies, but their usefulness may be overwhelmed by practical problems associated with the doctrines. This paper⁴ will explore the statutory and common law basis for rescission, the elements of restitution, and the legal and practical issues associated with both. The use of rescission/restitution in governmental enforcement proceedings is not discussed.⁵

I. STATUTORY RESCISSION

A. Summary of Franchise Rescission Statutes

Fourteen states have franchise specific statutes that describe the grounds on and other requirements under which a franchisee may seek to rescind a franchise agreement and obtain restitution or other damages. While the statutes have some similarities, no two are identical.

For example, in five of the fourteen states, California, Maryland, Michigan, New York, and Oregon, the state administrator or other official has the authority to seek rescission on behalf of a franchisee. In Virginia, the commission may impose a fine of up to $25,000 for franchise law violations, but may request that the franchisor offer rescission, and then take that offer into account in deciding the amount of the penalty, if any.

⁴ The authors wish to thank Trey Ingram, University of South Carolina School of Law, and David J. Meretta, an associate with Witmer, Karp, Warner and Ryan, LLP, for their extensive and invaluable contributions to this paper.
⁵ These issues are addressed by our colleagues Martin Cordell, Joseph Punturo, and Mary Beth Trice in “A Basic Guide to Handling Disclosure and Registration Violations,” elsewhere in these Forum materials.
Multiple damages may be awarded under the franchise statutes of Hawaii, South Dakota and Washington.

Reasonable counsel fees may be recovered by the successful plaintiff in an action brought under the rescission statutes in Hawaii, Illinois, Michigan, Minnesota, New York, North Dakota, South Dakota and Virginia. In Oregon and Washington, the prevailing party may recover such fees, raising the possibility that an unsuccessful franchisee may be assessed the reasonable counsel fees of the franchisor.

Interest on a judgment is recoverable at the rate of 6% in New York and 12% in Michigan. None of the other franchise statutes specify a recovery of interest, although the general laws of these states may provide an applicable rate of interest.6

The statute of limitations for claims vary widely as well, with a wide assortment of events that toll the statute, including (a) the act or transaction constituting a violation of law, (b) the date the plaintiff discovered the violation, (c) the date the plaintiff knew or should have known of the facts that are the basis of the violation, (d) the date of the grant or sale of the franchise, (e) the date the plaintiff was notified of the violation of law, (f) the date of a rescission offer from the franchisor, or (g) the date on which the cause of action arose or accrued.

Thus, the rights and responsibilities of both franchisee and franchisor may vary widely based on the state law that applies.7 To aid the practitioner, following is a summary of eight material elements of each such statute, presented in a format that allows comparison of each statute to the other.

1. California Franchise Investment Law
   a. Grounds for Rescission

      The offer or sale of a franchise (a) which is not registered and not exempt from registration, (b) violates the terms or conditions of an exemption from registration, (c) where the disclosure document was not furnished in when required, or (d) involves a false or misleading statement in any filing or disclosure nod where the violation is willful.8

   b. Rescission Offer as Bar to Civil Action

      No such specific provision in the statute.

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6 For example, see Mich. Comp. Laws Serv. §6013, 735 Ill. Comp. Stat. 5/2-1303 and Va. Code Ann § 6.1-330.54..

7 These statutes allow the remedy of rescission in all cases based on violation of franchise disclosure or registration laws. However, not every state with a franchise disclosure law permits rescission for a violation of those laws. See Continental Basketball Ass’n v. Ellenstein Enterprises, Inc., 669 N.E.2d 134 (Ind. 1996) (violation of disclosure/registration law does not warrant rescission). State Business Opportunity statutes may also provide a rescission remedy.

c. **Agency Action**

The commissioner may bring an action, or may request the Attorney General to bring an action including a claim for restitution or disgorgement or damages on behalf of the persons injured by the act or practice constituting the subject matter of the action.\(^9\)

The commissioner may include in any administrative action a claim for rescission, restitution or disgorgement or damages on behalf of the persons injured by the act or practice constituting the subject matter of the action.\(^{10}\)

d. **Defenses**

In the case of a false or misleading statement in any filing or disclosure, the defendant proves that the plaintiff knew the facts concerning the untruth or omission, or that the defendant exercised reasonable care and did not know, or, if he or she had exercised reasonable care, would not have known, of the untruth or omission.\(^{11}\)

It is a defense to any action based upon joint and several liability that the defendant did had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist.

e. **Damages**

No provision in the statute specifies the measure of restitution or disgorgement damages.

f. **Counsel Fees and Interest**

No such specific provision in the statute.

g. **Limitations of Actions**

Any action must be brought before the expiration of (a) four years after the act or transaction constituting the violation, (b) the expiration of one year after the discovery by the plaintiff of the fact constituting the violation, or (c) ninety (90) days after delivery to the franchisee of a written notice disclosing any violation involving a false or misleading statement in any filing or disclosure, which notice shall be approved as to form by the commissioner, whichever shall first expire.\(^{12}\)

h. **Waivers**

Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of the law or any rule or order under the statute is void.\(^{13}\)

\(^{9}\) *Id.*  
\(^{10}\) *Id.* § 31408.  
\(^{11}\) *Id.* § 31400.  
\(^{12}\) *Id.* § 31303.  
\(^{13}\) *Id.* § 31512.
i. **Cumulative Remedies**

Nothing in the statute limits any liability which may exist by virtue of any other statute or under common law if the law were not in effect.\(^{14}\)

2. **Hawaii Franchise Investment Law**

a. **Grounds for Rescission**

Any person who sells or offers to sell a franchise in violation of the Hawaii Franchise Investment law is liable to the franchisee or subfranchisor who may sue for damages caused thereby or for rescission or other relief as the court may deem appropriate.\(^{15}\)

b. **Rescission Offer as Bar to Civil Action**

No such specific provision in the statute.

c. **Agency Action**

No such specific provision in the statute.

d. **Defenses**

In the case of a claims based on acts which (a) constitute an untrue statement of a material fact in any offering circular or report filed, (b) constitute a device, scheme, or artifice to defraud, (c) operate or would operate as a fraud or deceit upon any person, or (d) violated an order of the Director, rescission is not available to the plaintiff if the defendant proves that the plaintiff knew the facts concerning the untruth or admission or that the defendant exercised reasonable care and did not know or if the defendant had exercised reasonable care would not have known of the untruth or admission.\(^{16}\)

e. **Damages**

Suit may be brought to recover the actual damages sustained by the plaintiff; the court may in its discretion increase the award of damages to an amount not to exceed three times the actual damages sustained.\(^{17}\) No provision in the statute specifies the measure of such damages.

f. **Counsel Fees and Interest**

Plaintiff may recover reasonable attorneys' fees.\(^{18}\) No provision in the statute addresses interest on any recovery.

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\(^{14}\) Id. § 31306.

\(^{15}\) Haw. Rev. Stat. § 482E-9 (b).

\(^{16}\) Id.

\(^{17}\) Haw. Rev. Stat. § 482E-9 (c).

\(^{18}\) Id. § 482E-9 (c).
g. **Limitations of Actions**

No civil action may be brought later than five (5) years subsequent to the date of the violation or two years subsequent to the discovery of facts constituting the violation, but in no event later than seven (7) years subsequent to the date of the violation.\(^\text{19}\)

h. **Waivers**

No such specific provision in the statute.

i. **Cumulative Remedies**

No such specific provision in the statute.

3. **Illinois Franchise Disclosure Act of 1987**

a. **Grounds for Rescission**

The offer or sale of a franchise (a) which is not registered and not exempt from registration, (b) where the disclosure document was not furnished in when required, (c) which involved a false or misleading statement in any filing or disclosure, (d) which employed any device, scheme, or artifice to defraud, (e) which operated as a fraud or deceit upon any person, (f) where there was a failure to amend the disclosure document upon a material change in any facts required to be disclosed, or (g) where the franchisor violated an escrow or impound order.\(^\text{20}\)

b. **Rescission Offer as Bar to Civil Action**

No franchisee may sue for rescission who shall fail, within thirty (30) days from the date of receipt thereof, to accept an offer to return the consideration paid or to repurchase the franchise purchased by such person. The offer shall be in writing, shall be delivered to the franchisee or sent by certified mail addressed to the franchisee at such person’s last known address, shall offer to return any consideration paid or to repurchase the franchise for a price equal to the full amount paid less any net income received by the franchisee, plus the legal rate of interest thereon, and may require the franchisee to return to the person making such offer all unsold goods, equipment, fixtures, leases and similar items received from such person. Such offer shall continue in force for thirty (30) days from the date on which it was received by the franchisee and shall advise the franchisee of such rights and the period of time limited for acceptance thereof. Any agreement not to accept or refusing or waiving any such offer made during or prior to the expiration of said thirty (30) days shall be void.\(^\text{21}\)

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\(^{19}\) *Id.* § 482E-10.5 (b).


c. **Agency Action**

No such specific provision in the statute.

d. **Defenses**

It shall be a defense to any action based upon joint and several liability that a person who otherwise is liable had no knowledge or reasonable basis to have knowledge of the facts, acts or transactions constituting the alleged violation.\(^{22}\)

e. **Damages**

No provision in the statute specifies the measure of restitution or disgorgement damages. However, the formula specified in the rescission offer described in the statute may provide some guidance.

f. **Counsel Fees and Interest**

A franchisee in whose favor judgment is entered shall be entitled to the costs of the action including, without limitation, reasonable attorney's fees. No provision in the statute addresses interest on any recovery.\(^{23}\)

g. **Limitations of Actions**

A civil action must be brought before the expiration of three (3) years after the act or transaction constituting the violation upon which it is based, the expiration of one (1) year after the franchisee becomes aware of facts or circumstances reasonably indicating that he may have a claim for relief, or ninety (90) days after delivery to the franchisee of a written notice disclosing the violation, whichever shall first expire.\(^{24}\)

h. **Waivers**

Any condition, stipulation, or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of the statute or any other law of Illinois is void.\(^{25}\)

i. **Cumulative Remedies**

Nothing in the statute shall limit any liability which may exist by virtue of any other statute or under common law if the statute were not in effect.\(^{26}\)

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\(^{22}\) *Id.*
\(^{23}\) *Id.*
\(^{24}\) *Id.* at 705/27.
\(^{25}\) *Id.* at 705/41.
4. **Maryland Franchise Law**

   a. **Grounds for Rescission**

      The sale or grant of a franchise (a) without the offer of the franchise being registered, (b) by means of an untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, if the person who buys or is granted a franchise does not know of the untruth or omission.  

   b. **Rescission Offer as Bar to Civil Action**

      No such specific provision in the statute

   c. **Agency Action**

      Maryland has the power to seek restitution and frequently requires a franchisor to offer rescission and restitution to a franchisee in its Consent Orders.

   d. **Defenses**

      The person who sells or grants a franchise has the burden of proving that the person who sells or grants a franchise did not know and, in the exercise of reasonable care, could not have known of the untruth or omission.

      Joint and several liability does not extend to a person who did not have knowledge of or reasonable grounds to believe in the existence of the facts by which the liability is alleged to exist.

   e. **Damages**

      No provision in the statute specifies the measure of restitution or disgorgement damages.

   f. **Counsel Fees and Interest**

      No such specific provisions in the statute.

   g. **Limitations of Actions**

      An action must be brought within three (3) years after the grant of the franchise.

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28 Id. § 14-210.
29 Id. § 14-227(a)(2).
30 Id. § 14-227(d)(2).
31 Id. § 14-227(e).
h. Waivers

As a condition of the sale of a franchise, a franchisor may not require a prospective franchisee to agree to a release, assignment, novation, waiver, or estoppel that would relieve a person from liability under the statute.32

i. Cumulative Remedies

The powers, remedies, procedures, and penalties of the statute are in addition to and not in limitation of any other powers, remedies, procedures, and penalties provided by law.33

5. Michigan Franchise Investment Law

a. Grounds for Rescission

The filing, offer, sale, or purchase of any franchise (a) which involved a false or misleading statement, (b) which employed any device, scheme, or artifice to defraud, (c) operated as a fraud or deceit upon any person, or (d) the failure, prior to offering for sale or selling a franchise without first providing to the prospective franchisee, at least ten (10) business days before the execution by the prospective franchisee of any binding franchise or other agreement or at least ten (10) business days before the receipt of any consideration, whichever occurs first, a copy of a disclosure statement, the notice required to be filed with the state, and a copy of all proposed agreements relating to the sale of the franchise.34

b. Rescission Offer as Bar to Civil Action

A person may not file or maintain suit for rescission if the franchisee received a written offer before suit and at a time when the franchisee owned the franchise to refund the consideration paid together with interest from the date of purchase at 1 percentage point above the rate that may be recovered in a civil action, less the amount of income received on the franchise, conditioned only upon tender by the person of all items received by the franchisee for the consideration and not sold, and failed to accept the offer within thirty (30) days of its receipt, or if the franchisee received the offer before suit and at a time when the franchisee did not own the franchise, unless the franchisee rejected the offer in writing within thirty (30) days of its receipt. If the franchise involves substantial building or substantial equipment and a significant period of time has elapsed since the sale of the franchise to the franchisee, the rescission offer may recognize depreciation, amortization, and other factors which bear upon the value of the franchise being returned to the franchisor.35

c. Agency Action

Whenever it appears to the department that a person has engaged, is engaged, or is about to engage in an act or practice constituting a violation of a provision of this act or a rule or order hereunder, the department may bring an action in the name of the people in the circuit

31 Id. § 14-204.
35 Id. § 445.1531(2).
court to obtain restitution on behalf of the franchisee. The court may award costs, including reasonable costs of investigation, to the prevailing party.\(^{36}\)

d. **Defenses**

It is a defense to any action based upon joint and several liability that the other person who is so liable had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist.\(^{37}\)

e. **Damages**

No provision in the statute specifies the measure of restitution damages. However, the formula specified in the rescission offer described in the statute may provide some guidance. The statute specifies that damages may be based on reasonable approximations, but not on speculation.\(^{38}\)

f. **Counsel Fees and Interest**

Interest at 6% per year from the date of purchase until June 20, 1984 and 12% per year thereafter and reasonable attorney fees and court costs may be recovered by the plaintiff.\(^{39}\)

g. **Limitations of Actions**

An action shall not be maintained to enforce a civil liability created under the act unless brought before the expiration of four (4) years after the act or transaction constituting the violation.\(^{40}\)

h. **Waivers**

A requirement that a franchisee assent to a release, assignment, novation, waiver, or estoppel which deprives a franchisee of rights and protections provided in the act is void and unenforceable.\(^{41}\)

i. **Cumulative Remedies**

Nothing in the statute limits a liability which may exist by virtue of any other statute or under common law if this act were not in effect.\(^{42}\)

\(^{37}\) Id. § 445.1532.
\(^{38}\) Id. § 445.1531(4).
\(^{39}\) Id. § 445.1531(1).
\(^{40}\) Id. § 445.1533.
\(^{41}\) Id. § 445.1537(b).
\(^{42}\) Id. § 445.1534.
6. **Minnesota Franchise Law**

   a. **Grounds for Rescission**

      A person who violates any provision of the Minnesota Franchise Act or any rule or order thereunder shall be liable to the franchisee or subfranchisor who may sue for damages caused thereby, for rescission, or other relief as the court may deem appropriate.\(^{43}\)

   b. **Rescission Offer as Bar to Civil Action**

      No such specific provision in the statute.

   c. **Agency Action**

      No such specific provision in the statute.

   d. **Defenses**

      It shall be a defense to any action based upon joint and several liability that the person who would otherwise be liable hereunder had no knowledge of or reasonable grounds to know of the existence of the facts by reason of which the liability is alleged to exist.\(^{44}\)

   e. **Damages**

      No provision in the statute specifies the measure of restitution damages. The statute states only that suit may be brought to recover the actual damages sustained by the plaintiff, together with costs and disbursements.\(^{45}\)

   f. **Counsel Fees and Interest**

      Reasonable attorney's fees may be recovered by the plaintiff.\(^{46}\) No provision in the statute addresses interest on any recovery.

   g. **Limitations of Actions**

      No action may be commenced more than three (3) years after the cause of action accrues.\(^{47}\)

   h. **Waivers**

      Any condition, stipulation or provision, including any choice of law provision, purporting to bind any person who, at the time of acquiring a franchise is a resident of Minnesota, or, in the case of a partnership or corporation, organized or incorporated under the laws of Minnesota, or purporting to bind a person acquiring any franchise to be operated in Minnesota to waive

\(^{44}\) Id. § 80C.17(2).  
\(^{45}\) Id.  
\(^{46}\) Id.  
\(^{47}\) Id. § 80C.17(5).
compliance or which has the effect of waiving compliance with any provision of the statute or any rule or order thereunder is void.\textsuperscript{48}

i. **Cumulative Remedies**

   Nothing in the statute limits any liability which may exist by virtue of any other statute or under common law if the act were not in effect.\textsuperscript{49}

7. **New York Franchise Law**

a. **Grounds for Rescission**

   The sale of a franchise (a) which is not registered, (b) which does not comply with the terms and conditions of an exemption, (c) where the disclosure document was not furnished when required, (c) which involved a false or misleading statement in any filing or disclosure, (d) which employed any device, scheme, or artifice to defraud, or (e) which operated as a fraud or deceit upon any person, and where the violation is willful and material.\textsuperscript{50}

b. **Rescission Offer as Bar to Civil Action**

   A person may not file or maintain suit if the franchisee or such person received a written offer before suit, and at a time when he owned the franchise, to refund the consideration paid together with interest at six percent per year from the date of payment, less the amount of income earned by the franchisee from the franchise, conditioned only upon tender by the person of all items received by him for the consideration and not sold, and failed to accept the offer within thirty (30) days of its receipt, provided that the offering documents are submitted to the department for approval at least ten (10) business days prior to submission to the franchisee. The rescission offer shall recite the provisions of this section. If the franchise involves a substantial building or substantial equipment or fixtures and a significant period of time has elapsed since the sale of the franchise to the franchisee, the department in approving a rescission offer may approve an equitable offer recognizing depreciation, amortization, and other factors which bear upon the value of the franchise being returned to the franchisor. Nothing prohibits settlement of any dispute arising under or involving claims, with or without approval of the department.\textsuperscript{51}

c. **Agency Action**

   Upon a showing by the department that a fraudulent practice as defined by the statute has occurred, the department may include in an action an application to direct restitution of any moneys or property obtained directly or indirectly by any such fraudulent practice.\textsuperscript{52}

d. **Defenses**

   It is a defense to any action based upon joint and several liability that the defendant did not know or could not have known by the exercise of due diligence the facts upon which the action is predicated.\textsuperscript{53}

\textsuperscript{48} Id. § 80C.21.
\textsuperscript{49} Minn. Stat. § 80C.17(4).
\textsuperscript{51} Id. § 691(2).
\textsuperscript{52} Id. § 692(2).
e. **Damages**

No provision in the statute specifies the measure of restitution damages. However, the formula specified in the rescission offer described in the statute may provide some guidance.

f. **Counsel Fees and Interest**

Interest at 6% per year and reasonable attorney's fees may be recovered by the plaintiff.\(^{54}\)

g. **Limitations of Actions**

An action shall not be maintained to enforce a liability created under the statute unless brought before the expiration of three (3) years after the act or transaction constituting the violation.\(^{55}\)

h. **Waivers**

Any condition, stipulation, or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of the law, or rule promulgated thereunder, shall be void.\(^{56}\) It is unlawful to require a franchisee to assent to a release, assignment, novation, waiver or estoppel which would relieve a person from any duty or liability imposed by this article.\(^{57}\)

i. **Cumulative Remedies**

Nothing in the statute limits a liability which may exist by virtue of any other statute or under common law if the statute were not in effect.\(^{58}\)

8. **North Dakota Franchise Investment Law**

a. **Grounds for Rescission**

Any person who violates any provision of the statute or any rule or order issued by the commissioner thereunder is liable to the franchisee or subfranchisor who may bring an action for damages, for rescission, or for such other relief as the court may deem appropriate.\(^{59}\)

b. **Rescission Offer as Bar to Civil Action**

No franchisee or subfranchisor may file or maintain an action under this section if he received a written offer before the action was commenced and at a time when he owned the franchise to refund the consideration paid together with interest at the rate of seven percent per annum from the date of purchase, less the amount of income received on the franchise.

\(^{53}\) Id. § 691(3).  
\(^{54}\) N.Y. Gen. Bus. Law § 691(1).  
\(^{55}\) Id. § 691(4).  
\(^{56}\) Id. § 688(4).  
\(^{57}\) Id. § 687(5).  
\(^{58}\) Id. § 691(5).  
conditioned only upon tender by the franchisee or subfranchisor of all items received by the person for the consideration and not sold, and failed to accept the offer within thirty (30) days of its receipt or if the franchisee received the offer before the action was commenced and at a time when the person did not own the franchise, unless the person rejected the offer in writing within thirty (30) days of its receipt; provided, that in either instance the offering documents and rescission prospectus must be submitted to the commissioner for approval at least fifteen (15) days prior to submission to the franchisee or subfranchisor. The rescission offer must recite the provisions of this section. If the franchise involves a substantial building or substantial equipment and a significant period of time has elapsed since the sale of the franchise, the commissioner, in approving a rescission offer, may approve an equitable offer recognizing depreciation, amortization, and other factors which bear upon the value of the franchise being returned to the franchisor.\(^60\)

c. **Agency Action**

No such specific provision in the statute.

d. **Defenses**

It is a defense to any action based upon joint and several liability that the defendant had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist.\(^61\)

e. **Damages**

No provision in the statute specifies the measure of restitution damages. However, the formula specified in the rescission offer described in the statute may provide some guidance.

f. **Counsel Fees and Interest**

The franchisee or subfranchisor, if successful, is entitled to costs and disbursements plus reasonable attorney’s fees.\(^62\) No provision in the statute addresses interest on any recovery.

g. **Limitations of Actions**

No action may be brought after five years from the date that the aggrieved party knew or reasonably should have known about the facts that are the basis for the alleged violation. This limitation does not apply to any action under those sections of the statute relating to (a) denial, suspension, or revocation of registration or exemption, in which case the period is ten (10) years, or (b) fraudulent and prohibited practices in which case the period is six (6) years.\(^63\)

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\(^{60}\) N.D. Cent. Code § 51-19-12(4).

\(^{61}\) Id. § 51-19-12(2).

\(^{62}\) Id. § 51-19-12(3).

\(^{63}\) Id. § 51-19-12(5).
h. Waivers

Any condition, stipulation, or provision purporting to bind any person acquiring any franchisee to waive compliance with any provision of the statute or any rule or order thereunder is void.\textsuperscript{64}

i. Cumulative Remedies

Nothing in the statute limits any liability which may exist by virtue of any other statute or under common law if it were not in effect.\textsuperscript{65}

9. Oregon Franchise Transactions Law

a. Grounds for Rescission

If the seller (a) employs any device, scheme or artifice to defraud, or (b) makes any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.\textsuperscript{66}

b. Rescission Offer as Bar to Civil Action

No such specific provision in the statute

c. Agency Action

The director may bring in any suit a claim for rescission and damages on behalf of other persons injured by any act or practice against which an injunction or restraining order is sought. The court may award appropriate relief to the franchisee or such other persons if the court finds that enforcement of the right of the franchisee or other persons by private civil action or suit, whether by class action or otherwise, would be so burdensome or expensive as to be impractical.\textsuperscript{67}

d. Defenses

It is an affirmative defense to any action for legal or equitable remedies if the franchisee knew of the untruth or omission.\textsuperscript{68}

It is a defense to any action based upon joint and several liability that the nonseller did not know, and, in the exercise of reasonable care, could not have known, of the existence of the facts on which the liability is based.\textsuperscript{69}

\textsuperscript{64} Id. § 51-19-16(7).
\textsuperscript{65} N.D. Cent. Code § 51-19-12(6).
\textsuperscript{67} Id. § 650.065(2).
\textsuperscript{68} Id. § 650.020(2).
\textsuperscript{69} Id. § 650.020(5).
e. **Damages**

The franchisee may recover any amounts to which the franchisee would be entitled upon an action for a rescission.\(^{70}\) No provision in the statute specifies the measure of restitution damages.

f. **Counsel Fees and Interest**

The court may award reasonable attorney fees to the prevailing party.\(^{71}\) The court may not award attorney fees to a prevailing defendant if the action is maintained as a class action.\(^{72}\) No provision in the statute addresses interest on any recovery.

g. **Limitations of Actions**

An action may not be commenced more than three (3) years after the sale.\(^{73}\)

h. **Waivers**

No such specific provision in the statute.

i. **Cumulative Remedies**

Nothing in the statute limits any statutory or common-law rights of a person to bring an action in any court for an act involved in the sale of franchises, or the right of the state to punish a person for a violation of any law.\(^{74}\)

10. **Rhode Island Franchise Investment Act**

a. **Grounds for Rescission**

A person (a) offers or sells a franchise that is not registered or not exempt from registration, (b) fails to provide a disclosure document as and when required, or (c) in connection with the offer or sale a person (i) employs a device, scheme, or artifice to defraud; (ii) makes an untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; (iii) engages in an act, practice, or course of business which operates or would operate as a fraud or deceit on a person; (iv) represent to an offeree of a franchise that the filing of a franchise registration application or the registration of a franchise constitutes a finding by the director that a document filed under the Act is true, complete, and not misleading or that the director has passed upon the merits of the franchise; or (v) misrepresents that a franchise is registered or exempted from registration.\(^{75}\)

b. **Rescission Offer as Bar to Civil Action**

No such specific provision in the statute.

\(^{70}\) *Id.* § 650.020(3).

\(^{71}\) *Or. Rev. Stat.* § 650.020(3).

\(^{72}\) *Id.* § 650.020(4).

\(^{73}\) *Id.* § 650.020(6).

\(^{74}\) *Id.* § 650.085.

c. **Agency Action**

No such specific provision in the statute.

d. **Defenses**

No person will be liable if the defendant proves that the plaintiff knew the facts concerning the violation.\(^{76}\)

It is a defense to any action based upon joint and several liability that the person liable proves he or she did not know, and in the exercise of reasonable care could not have known, of the existence of the fact by reason of which the liability is alleged to exist.\(^{77}\)

e. **Damages**

No provision in the statute specifies the measure of restitution damages.

f. **Counsel Fees and Interest**

No such specific provisions in the statute.

g. **Limitations of Actions**

An action must be commenced not later than the earlier of (a) four (4) years after the act or transaction constituting the violation, or (b) ninety (90) days after the receipt by the franchisee of a rescission offer in a form approved by the director.\(^{78}\)

h. **Waivers**

A condition, stipulation or provision requiring a franchisee to waive compliance with or relieving a person of a duty of liability imposed by or a right provided by this statute or a rule or order under the statute is void. An acknowledgement provision, disclaimer or integration clause or a provision having a similar effect in a franchise agreement does not negate or act to remove from judicial review any statement, misrepresentations or action that would violate this statute or a rule or order under this statute.\(^{79}\)

i. **Cumulative Remedies**

Nothing in the statute limits liability that may exist under another statute or at common law.\(^{80}\)

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\(^{77}\) Id. § 19-28.1-21(b).

\(^{78}\) Id. § 19-28.1-22.

\(^{79}\) Id. § 19-28.1-15.

\(^{80}\) Id. § 19-28.1-23.
11. **South Dakota Franchise Law**

   a. **Grounds for Rescission**

      If in connection with the sale of a franchise a disclosure statement is not furnished to a prospective franchisee or subfranchisor at least seven (7) days in advance of the signing of a franchise or other agreement, or at least seven (7) days prior to the receipt of any consideration, whichever occurs first, the franchise or other agreement shall be voidable at the option of the franchisee or subfranchisor within ninety (90) days of the date of the franchise or other agreement or within seven (7) days after a disclosure statement that meets the requirements of this statute is furnished to the franchisee, whichever expires first.\(^{81}\)

      A person who violates any provision of this statute, or any rule or order thereunder shall be liable to the franchisee or subfranchisor who may sue for damages caused thereby, for rescission, or other relief as the court may deem appropriate.\(^{82}\)

   b. **Rescission Offer as Bar to Civil Action**

      No such specific provision in the statute.

   c. **Agency Action**

      No such specific provision in the statute.

   d. **Defenses**

      It is a defense to any action based upon joint and several liability that the person who would otherwise be liable had no knowledge of or reasonable grounds to know of the existence of the facts by reason of which the liability is alleged to exist.\(^{83}\)

   e. **Damages**

      A suit for rescission may be brought to recover the actual damages sustained by the plaintiff together with costs and disbursements, and the court may in its discretion increase the award of damages to an amount not to exceed three times the actual damage sustained. No provision in the statute specifies the measure of restitution damages.\(^{84}\)

   f. **Counsel Fees and Interest**

      Reasonable attorney's fees may be recovered by the plaintiff.\(^{85}\) No provision in the statute addresses interest on any recovery.

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\(^{82}\) Id. § 37-5A-83.
\(^{83}\) Id. § 37-5A-84.
\(^{84}\) Id. § 37-5A-85.
\(^{85}\) Id.
g. **Limitations of Actions**

No such specific provision in the statute. However, the franchisee must exercise the right to void the franchise agreement within ninety (90) days of the date of the franchise or other agreement or within seven (7) days after a disclosure statement that meets the requirements of this statute is furnished to the franchisee, whichever expires first.  

h. **Waivers**

Any condition, stipulation or provision purporting to waive compliance with any provision of the statute or any rule or order thereunder is void. Any acknowledgement provision, disclaimer or integration clause or a provision having a similar effect in a franchise agreement does not negate or act to remove from judicial review any statement, misrepresentation or action that would violate this chapter or a rule or order under this chapter.

i. **Cumulative Remedies**

Nothing in the statute limits any liability which would exist by virtue of any other statute or under common law if the statute were not in effect.

12. **Virginia Retail Franchising Act**

a. **Grounds for Rescission**

Any franchise may be declared void by the franchisee at his option by sending a written declaration of that fact and the reasons therefor to the franchisor by registered or certified mail if:

(a) The franchisor's offer to grant a franchise was unlawful, provided that the franchisee send such written declaration within seventy-two hours after discovery thereof but not more than ninety (90) days after execution of the franchise; unlawful means that (i) the franchise was not registered, (ii) the offer or grant employed any device, scheme, or artifice to defraud, involved any untrue statement of a material fact or omitted to state a material fact necessary in order to avoid misleading the offeree, or operated as a fraud or deceit upon the franchisee, or (iii) the disclosure document was not furnished in the form and when required;

(b) The franchisee was not afforded the opportunity to negotiate with the franchisor on all provisions within the franchise, except that such negotiations shall not result in the impairment of the uniform image and quality standards of the franchise, provided that the franchisee send such written declaration within thirty (30) days after execution of the franchise; or

(c) The franchisee was not furnished a copy of the franchise agreement and disclosure documents at least seventy-two hours prior to execution of the franchise, provided that the franchisee send such written declaration within thirty (30) days after execution of the franchise.

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86 Id. § 37-5A-49.
87 S.D. Codified Laws § 37-5A-86.
88 Id. § 37-5A-82.
90 Id. § 13.1-565.
b. **Rescission Offer as Bar to Civil Action**

No such specific provision in the statute.

c. **Agency Action**

The Commission may, by judgment entered after a hearing on thirty (30) days’ notice to the defendant, if it be proved that the defendant has knowingly made any misrepresentation of a material fact for the purpose of inducing the Commission to take any action or to refrain from taking action, or has violated any provision of this chapter or any order, rule, or regulation of the Commission issued pursuant to this chapter, impose a civil penalty not exceeding $25,000, which shall be collectible by the process of the Commission as provided by law.

Each franchise entered into contrary to the provisions of this chapter shall constitute a separate violation. The Commission may request the franchisor to rescind any franchise and to make restitution to the franchisee. If the franchisor complies with the request, the Commission shall consider such compliance in determining whether a penalty should be imposed on him on account of that illegal franchise, and if so, the amount of such penalty.91

d. **Defenses**

No such specific provision in the statute.

e. **Damages**

Any franchisee who has declared the franchise void may bring an action against its franchisor to recover the damages sustained by reason thereof.92 No provision in the statute specifies the measure of restitution damages.

f. **Counsel Fees and Interest**

If successful the franchisee shall also be entitled to the costs of the action, including reasonable attorney’s fees.93 No provision in the statute addresses interest on any recovery.

g. **Limitations of Actions**

No suit shall be maintained to enforce any liability created under the statute unless brought within four (4) years after the cause of action upon which it is based arose.94

h. **Waivers**

Any condition, stipulation or provision binding any person to waive compliance with any provision of the statute or of any rule or order thereunder shall be void; provided, however, that

92 Id. § 13.1-571(a). See *Sterling Vision DKM, Inc. v Gordon*, 976v F. Supp. 1194 (E.D.Wis. 1997) and the discussion at Section III.A., infra.
93 Id.
94 Id. § 13.1-571(b).
nothing in the statute bars the right of a franchisor and franchisee to agree to binding arbitration of disputes consistent with the provisions of the statute.\textsuperscript{95}

i. **Cumulative Remedies**

The rights and remedies provided by the statute shall be in addition to any and all other rights and remedies that may exist at law or in equity.\textsuperscript{96}

13. **Washington Franchise Investment Protection Act**

a. **Grounds for Rescission**

Any person who sells or offers to sell a franchise in violation of the statute shall be liable to the franchisee or subfranchisor who may sue at law or in equity for damages caused thereby for rescission or other relief as the court may deem appropriate.\textsuperscript{97}

b. **Rescission Offer as Bar to Civil Action**

No such specific provision in the statute.

c. **Agency Action**

No such specific provision in the statute.

d. **Defenses**

In the case of a violation of the section of the statute that prohibits false or misleading statements or fraud, rescission is not available to the plaintiff if the defendant proves that the plaintiff knew the facts concerning the untruth or omission or that the defendant exercised reasonable care and did not know or if he had exercised reasonable care would not have known of the untruth or omission.\textsuperscript{98}

e. **Damages**

The suit may be brought to recover the actual damages sustained by the plaintiff and the court may in its discretion increase the award of damages to an amount not to exceed three times the actual damages sustained.\textsuperscript{99} No provision in the statute specifies the measure of restitution damages.

f. **Counsel Fees and Interest**

The prevailing party may in the discretion of the court recover the costs of action including a reasonable attorneys’ fee.\textsuperscript{100}

\textsuperscript{95} *Id.* § 13.1-571(c).
\textsuperscript{96} *Id.* § 13.1-571(d).
\textsuperscript{98} *Id.*
\textsuperscript{99} *Id.* § 19.100.190(3).
\textsuperscript{100} *Id.*
g. Limitations of Actions

The Washington Franchise Investment Protection Act does not contain a specific statute of limitation applicable to recession or restitution claims. Accordingly the six-year statute applicable to contract actions and the three (3) year statute applicable to oral contracts and fraud would apply. See McGowan v. Pillsbury, 723 F. Supp. 530 (W.D.Wash. 1989). 101

The pendency of any civil, criminal, or administrative proceedings against a person brought by the federal or Washington state governments or any of their agencies under the anti-trust laws, the Federal Trade Commission Act, the Consumer Protection Act, or any federal or state act related to anti-trust laws or to franchising, or under this chapter shall toll the limitation of this action if the action is then instituted within one year after the final judgment or order in such proceedings: Provided, That said limitation of actions shall in any case toll the law so long as there is actual concealment on the part of the person.102

h. Waivers

Any agreement, condition, stipulation or provision, including a choice of law provision, purporting to bind any person to waive compliance with any provision of the statute or any rule or order hereunder is void. A release or waiver executed by any person pursuant to a negotiated settlement in connection with a bona fide dispute between a franchisee and a franchisor, arising after their franchise agreement has taken effect, in which the person giving the release or waiver is represented by independent legal counsel, is not an agreement prohibited by this subsection.103

i. Cumulative Remedies

The provisions of the statute are cumulative and nonexclusive and shall not affect any other remedy available at law.104

14. Wisconsin Franchise Investment Law

a. Grounds for Rescission

Any person who sells a franchise in violation of the obligation to deliver a copy of an offering circular is provided to the prospective franchisee at least ten (10) business days prior to the execution by the prospective franchisee of any binding franchise or other agreement or at least ten (10) business days prior to the receipt of any consideration, whichever first occurs, if the violation was material in the franchisee's or subfranchisor's decision to purchase the franchise, shall be liable to the franchisee or subfranchisor, who may bring an action for rescission.105

b. Rescission Offer as Bar to Civil Action

No such specific provision in the statute.

102 Id. § 19.200.
104 Id. § 19.100.910.
c. **Agency Action**

No such specific provision in the statute.

d. **Defenses**

It shall be a defense to any action based upon joint and several liability that the person who would otherwise be liable hereunder had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist. 106

e. **Damages**

No provision in the statute specifies the measure of restitution damages.

f. **Counsel Fees and Interest**

No such specific provision in the statute. However by regulation, in any injunctive proceeding, the division may petition the court to order rescission of any sale or purchase of franchises determined to be in violation of the statute. 107

g. **Limitations of Actions**

No action may be maintained against any person to enforce any liability under this section unless brought before the expiration of three (3) years after the act or transaction constituting the violation upon which the liability is based or ninety (90) days after delivery to the franchisee of a written notice from or on behalf of that person that discloses any violation of this statute and that is filed with the division, whichever first expires. 108

h. **Waivers**

Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of the statute or any rule or order under the statute is void. This section does not affect the settlement of disputes, claims or civil lawsuits arising or brought under this statute. 109

i. **Cumulative Remedies**

The rights and remedies under this chapter are in addition to any other rights or remedies that may exist at law or in equity. 110

106 Id. § 553.51(3).
107 Wis. Admin. Code DFI-Sec. § 35.03.
108 Wis. Stat. § 553.51(4).
109 Id. § 553.76.
110 Id. § 553.51(5).
B. Selected Issues With Statutory Rescission

1. Rescission Offers

Four states, Illinois, Michigan, New York and North Dakota, bar an action for rescission if the franchisee has rejected an offer to return the consideration paid or to repurchase the franchise. In each case, the offer is voluntary on the part of the franchisor but is designed to avoid the need for a judicial determination that the franchisee is entitled to rescission. The offer must be in writing and remain open for acceptance for at least thirty (30) days.

The formula for the restitution made pursuant to such an offer varies slightly in each state. At the same time, there is no reported case that examines or seeks to interpret the meaning of the somewhat vague standards governing the restitution payment.

The Illinois Franchise Disclosure Act states that the amount paid is the full amount paid by the franchisee less any net income received by the franchisee, plus the legal rate of interest, and may require the franchisee to return to the franchisor all unsold goods, equipment, fixtures, leases and similar items received from the franchisor.

The Michigan Franchise Investment Law is very similar to Illinois, except that the interest rate is one (1) percentage point above the rate that may be recovered in a civil action. In New York the interest rate is six percent and in North Dakota it is seven percent.

The statutes in Michigan, New York and North Dakota each indicate that depreciation, amortization and other factors bearing on the value of the franchise being returned may be taken into account if there are substantial buildings or equipment assets and a significant period of time has elapsed since the sale. This provision, along with the basic framework in each statute, serves effectively to limit the franchisor's exposure in a rescission claim.

This barrier to a rescission claim under these four statutes must be taken seriously and literally by both franchisor and franchisee. In *Hot and Tasty Corp. v. IOB Realty, Inc.*, the Appellate Division of the New York Supreme Court affirmed the dismissal of a rescission claim under the New York State Franchise Act because the franchisor had made an offer of rescission which had apparently been rejected by the franchisee.

2. Willfulness

The franchise statutes of California, New York and Rhode Island require that the violation of franchise law giving rise to the claims for rescission and restitution must be willful. That other states may not imply such a requirement is illustrated by the decision in *Kirkham v. Smith*, in which the Washington Court of Appeals found that a claim for rescission under Washington Franchise Investment Protection Act does not require satisfaction of the elements of a common law fraud claim by proving a knowing and intentional misrepresentation. The court also stated that the Act contains no requirement that the defendant intend that the misrepresentation be acted upon by the person to whom it is made.

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112 *Id.*
114 *Id.*
By contrast, three cases decided under the New York Franchise Sales Act resulted in dismissal of franchise rescission claims for failure to provide any evidence that the franchise law violations were willful. These cases include *Baker Boy of Glendale, Inc. v. 35-63 82nd Street Corp.*[^115] where the franchisor failed to deliver a disclosure document. See also *King Computer, Inc. v. Beeper Plus, Inc.*[^116] and *Leung v. Lotus Ride, Inc.*[^117]

In *Reed v. Oakley*,[^118] decided under New York law, the court examined the level of proof required to satisfy the willfulness standard. In that case, there was an offer but not a sale made prior the approval of the offering by the state of New York. The Supreme Court held that willfulness did not require a showing of malice, only that the franchisor intended to violate the law. The franchisor’s motion to dismiss on that basis was denied.[^119]

In one of the most prominent franchise rescission cases, the Ninth Circuit in *Dollar Systems, Inc. v. Avcar Leasing Systems, Inc.*[^120] examined the definition of willfulness in the context of the California Franchise Investment Law. In this case, the franchisor made an offer and sale of a franchise that was not registered in California and its disclosure document was materially deficient in a number of respects. The court affirmed the district court’s approach, concluding that there need not be a showing of intent to violate the law and that good faith is not a defense. Willfulness was shown by proving that the franchisor knew it was not registered, that it had not filed for a notice of exemption and what it had and had not disclosed.[^121]

II. COMMON LAW RESCISSION

A. A Brief History

Throughout the history of the common law, the concept of rescission has been confounded by an historic distinction between legal and equitable rescission. The distinction played an important role when courts of common law and equity were separated. With the unification of equitable and legal jurisdiction, however, usage of the terms has often become confused. The Supreme Court of California described the complexity in prior statutes that preserved the archaic distinction:

[T]he two procedures which we have described contemplated “two types of action for rescissionary relief” – the first an “action to enforce a rescission” and the second an “action to obtain a rescission” . . . Significant substantive and procedural differences existed between these two methods for obtaining rescissionary relief. The right to a jury trial, the applicable statute of limitations, the availability of the provisional remedy of attachment and the possibility of joinder of other claims all depended upon which of these two methods the plaintiff elected to use in seeking rescissionary relief. The result was a body of law which was “unnecessarily complex and confusing to both courts and attorneys, to say nothing of laymen” [citations omitted].[^122]

[^119]: Id.
[^120]: 890 F.2d 165 (9th Cir. 1989).
[^121]: Id. at 172.
Courts have often used legal rescission to describe statutory rescission or the exercise of one party’s “statutory rescinding power.” Many courts also use legal rescission as a reference to an “agreement of rescission” or mutual agreement to rescind. Other uses of legal rescission by courts include references to a unilateral notification, by one party to the other, declaring a termination of the contract based on material misrepresentation or material breach.

Some courts have held that a legal rescission is one accomplished without court intervention, while others have expressed the opposite view, concluding that a court determination or order is one requirement of a legal rescission. Still others have indicated that although a legal rescission is accomplished without court involvement, a court must also enter an order of equitable rescission to give the rescission practical effect. Even Chief Justice Marshall used the same word, “rescind,” to refer to both a mutual agreement and a unilaterally requested, court-ordered rescission.

Equitable rescission, as the name implies, was historically requested when a party to a contract had no available remedy at law, but was equitably entitled to remediation. Typically, when a court grants equitable rescission, or grants one party an equitable “right to rescind,” the court has effectively voided the contract or effectuated the injured party’s “power of avoidance” or “right to avoid.” Both routes lead to the same destination.

In an attempt to avoid archaic distinctions, the Restatement (Second) of Contracts avoids the “legal” and “equitable” terminology entirely and uses the phrase “agreement of rescission” to refer to a mutual agreement between two parties to rescind a previous contract or agreement. Corbin on Contracts similarly urges that the old distinctions between legal and equitable rescission be abandoned in favor of “agreement of rescission” to mean a mutual agreement to rescind. Any rescission accomplished unilaterally, or by court order based on common law or equity, on the other hand, would be an “avoidance” of the contract. Of

128 Castleglen, 984 F.2d 1571, 1584 (1993) (“court decree might be necessary to give the rescission practical effect”).
130 Pino v. Union Bankers Ins. Co., 627 So. 2d 535, 536 (Fla. 3rd DCA 1993) (citations omitted); See also Nebco & Assoc. v. United States, 23 Cl. Ct. 635, 642 (Cl. Ct. 1991) (stating that an agreement of rescission “should not be confused with the word rescission,’ which is sometimes used to refer to a power of avoidance a party may exercise when there is fraud or mutual mistake) (citing Restatement (Second) of Contracts § 283, cmt. a (1981)); Corbin on Contracts § 67.8 (2006); Restatement (Second) of Contracts § 7.
131 Restatement (Second) of Contracts § 283.
132 Corbin on Contracts § 67.8; see also, United States v. San Pedro, 781 F. Supp. 761, 775 (S.D. Fla. 1991) (citing Corbin on Contracts § 1236(5)(A) (1964); Restatement (Second) of Contracts § 283 (1981)).
course, the law hasn’t quite progressed to the analytical framework proposed in the Restatement and Corbin on Contracts. So long as courts do not jettison the parlance of legal and equitable rescission, neither can we.

B. Rescission – A Practical View

1. “Agreement of Rescission;” Legal Rescission

An agreement to rescind, or legal rescission, is dispositive of both parties' remaining duties under the contract. In this context, the exercise and consequence of rescission are distilled to basic contract principles. The agreement to rescind is itself a contract, subject to all the basic contract requirements (i.e. offer, acceptance and consideration). When determining if the elements of a valid contract have been satisfied, the rules are the same as for any contract. For instance, the agreement need not be in writing, but can be made orally, subject to the statute of frauds and the parole evidence rule. An agreement to rescind may be implied through actions. Whether or not there is sufficient evidence of an implied rescission based on the actions of the contractual parties is always a factual issue. Where an agreement to rescind is unwritten, however, its terms must be sufficiently definite to warrant enforcement.

Sufficiency of consideration is rarely a difficult issue in the context of a mutual agreement to rescind. When one party relieves another of its duties/obligations, that other party has received a form of consideration. Therefore, when both parties agree to rescind a contract and relieve each other of their respective duties therein, sufficient consideration is received by both, and the agreement is enforceable.

2. “Power of Avoidance,” Equitable Rescission

Similar to the old equitable rescission, the Restatement confers a "power of avoidance" on the non-breaching party over any voidable contract. A voidable contract is one which is

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134 Restatement (Second) of Contracts §283; Corbin on Contracts §67.8.
136 See Alexander Hamilton Institute v. Hart, 180 Wis. 90, 96 (Wis. 1923); Kirk, 159 A.2d 48, 50 (1960) (citations omitted); 42 A.L.R.3d 242 § 3(b).
137 42 A.L.R.3d 242, § 3(b) (citing Restatement (Second) of Contracts §§222, 378).
141 Flegal v. Hoover, 156 Pa. 276 (Pa. 1893) (“the surrender of their mutual rights is sufficient consideration”); Kirk, 159, A.2d 48, 51 (1960) (when each party is subject to contractual duties, “the agreement of each party to surrender his rights under the contract affords sufficient consideration to the other for his corresponding agreement”).
142 Restatement (Second) of Contracts § 7. For those of us for whom law school is a hazy memory, recall that there is a difference between a void and a voidable contract. A void contract is an agreement to which the law does not
induced by fraud, mistake, or duress and thereby gives rise to the defrauded or mistaken party’s right to avoid its consequences. Courts will also allow a contract to be voided or rescinded due to impracticability, or, at the election of the non-breaching party, upon a substantial or material breach.

“[R]estoration of a benefit is a condition precedent to maintaining a rescission action.” Failure, refusal or inability of the complainant to restore benefits received under the contract is a bar to recovery, whether the action is legal or equitable. The perceived impossibility of restoring contractual benefits to the franchisor led the court to deny a rescission remedy in Watch What Develops Franchise Concepts, Inc. v. Custom 1-Hour Photo, Inc., 1990 Ohio App. LEXIS 4658 (Ohio App. 1990). There, the franchisee alleged that the franchisor fraudulently withheld information concerning a “kickback” scheme in which the franchisor received monies from a supplier based on franchisees’ purchase of equipment. The appellate court found ample evidence of each of the elements of common law fraud:

(a) A representation or, where there is a duty to disclose, concealment of a fact;
(b) which is material to the transaction at hand;
(c) made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred;
(d) with the intent of misleading another into relying upon it;
(e) justifiable reliance upon the representation or concealment; and
(f) a resulting injury proximately caused by the reliance.

The court nevertheless refused rescission and limited the franchisee to a contractual remedy, declaring that it was impossible to restore both parties to their pre-contractual positions. In particular, the franchisee could not return the benefits of the franchise to the franchisor, a prerequisite to a rescission remedy.

Any recognized basis for voiding a contract allows the faultless party to elect a rescission. Although the rescission remedy differs, the usual proof of the underlying wrong (breach, fraud, etc.) is required. For example, a party asserting material misrepresentation must first prove the elements of the underlying tort of misrepresentation, then seek a rescission remedy, rather than contractual damages. Some courts have required a higher standard of proof when a party seeks a rescission based on alleged misrepresentation. Sheulke v. Wilson, recognize the promisor’s duty of performance, nor provides a remedy for a breach by the promisor. Id., §7, cmt. a. An agreement to accomplish an illegal goal or to use illegal means to an end, for instance, is a void contract.

143 Id. § 7, cmt. b.
145 Restatement (Second) of Contracts § 7, cmt. b; First Ascent Ventures, Inc. v. DLC Dermacare, LLC, 2006 U.S. Dist. LEXIS 77945, 13 (D. Airz. 2006) (to rescind franchise agreement based on failure of consideration, there must be a substantial or entire failure); Hay v. Pacific Tastee Freez, Inc., 276 Ore. 569, 579 (Or. 1976) (breach must defeat the purpose of the contract) (citations omitted).
148 The franchisor no doubt would have preferred “rebate.”
250 Neb. 334 (1996), for instance, involved fraudulent misrepresentations in the procurement of a franchise agreement. The franchisor presented the potential franchisee with, among other things, projected profits for the franchise. The figures used were loosely based on past sales and profits of the franchisor’s own enterprise. However, the franchisor fudged the numbers slightly to reflect what he calculated would be lower costs to a franchisee who managed the business himself rather than one who hired a manager, as the franchisor did. The lower costs inflated the projected profits. When the franchisee later sued for misrepresentation and rescission, the court required the franchisee to demonstrate the usual elements of misrepresentation by clear and convincing evidence:

1. that a representation was made; 2. that the representation was false; 3. that when made, the representation was known to be false or made recklessly without knowledge of its truth and as a positive assertion; 4. that it was made with the intention that the plaintiff should rely upon it; 5. that the plaintiff reasonably did so rely; and 6. that he or she suffered damage as a result.

The franchisee could not satisfy the enhanced burden of proof, as the franchisor had placed an asterisk by the projected sales with an accompanying explanation, gave a verbal explanation when asked about the figures, provided the franchisee with all documents needed to verify the figures and suggested that the franchisee have them checked. The franchisee having not done so, the court granted no relief, concluding that the franchisee had not acted prudently in relying on the figures. In the case of fraud or misrepresentation, actual malicious intent to defraud on the part of the wrongdoer is not required. As the Supreme Court stated in *Aaron v. SEC*, 446 U.S. 680, 710, 100 S. Ct. 1945 (U.S. 1980), “common-law courts consistently have held that in an action for rescission or other equitable relief the fact of material misrepresentation is sufficient, and the knowledge or purpose of the wrongdoer need not be shown.”

The nature of a mistake sufficient to support rescission in a franchise context is exemplified by *McFadden v. Amoco Oil*, 486 F. Supp. 274 (D.S.C. 1979). Mr. McFadden had operated a gas station for a number of years when his doctor informed him that he had a serious medical condition and should not continue to stand for long periods of time. Upon learning this, he entered into a cancellation agreement with the franchisor, who agreed to search for a new buyer. Mr. McFadden later received the good news that the initial diagnosis was wrong and sought to rescind the cancellation based on mistake of fact. The court explained, “there is no question that contracts may be avoided upon the ground of mutual mistake of fact, but to do so the mistaken fact must be (1) a material fact; (2) a fact that forms the basis of the contract; and (3) one that animates and controls the conduct of the parties.” Mr. McFadden’s mistake of fact was too collateral to be material to the contract and therefore was an insufficient basis for rescinding the cancellation agreement, the court held.

Physical duress is usually not a factor in franchising agreements. Economic duress, by contrast, has occasionally provided the grounds for rescission. In *Gruver v. Midas Int’l Corp.*, 925 F.2d 280 (9th Cir. 1991), a franchisee claimed economic duress when, faced with the financial collapse of his business, the franchisee signed a termination agreement waiving all claims against Midas. The court described the elements of economic duress as, “(1) wrongful acts or threats; (2) financial distress caused by those acts; and (3) the absence of any reasonable alternative to the terms presented by the wrongdoer.”

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150 See also *Gunnells v. Healthplan Servs.*, 348 F.3d 417, 434 (4th Cir. 2003) (negligent misrepresentation).
151 486 F. Supp. at 276.
152 *Id.* (citing *Oregon Bank v. Nautilus Crane & Equip. Corp.*, 683 P.2d 95, 103 (Or. Ct. App. 1984)).
made fraudulent statements in inducing the franchisee to sign the franchise, and although the franchisee faced mounting debts (exact figure not disclosed) and obvious economic pressure, Midas had not made any threats, nor had it engaged in any wrongful conduct in connection with the termination agreement. The franchisee could not prove economic duress as a basis for rescinding the termination agreement and had therefore waived all causes of action against Midas.\textsuperscript{153}

Unsurprisingly, a mutual mistake is also grounds for equitable rescission. A mutual mistake sufficient to justify rescission can occur when both parties labor “under the same misconception as to a common fact, as when the parties know what they have agreed to, but through their common mistake the expression of their contract fails to correctly state that agreement,”\textsuperscript{154} or when the parties “contract on the assumption of a matter material to the contract but not expressed in it, and their common assumption is incorrect.”\textsuperscript{155} Notably, the mistakes of both parties need not be identical; rescission is still available so long as the mistakes relate to the same subject or so long as they evidence the absence of a meeting of the minds.\textsuperscript{156}

3. **Election of Remedies**

Contractual expectancy damages are analytically and conceptually antithetical to a rescission remedy, since the effect of rescission is to treat the contract as if it had never existed and restore the parties to the status quo ante.\textsuperscript{157} An aggrieved party may either void or rescind the contract, or accept and enforce it.\textsuperscript{158} This does not preclude a litigant pleading both rescission and breach of contract in a single complaint, consistent with the generally flexible rules of civil procedure. However, at some point, an election of remedies will be required, as a court will not grant recovery of damages under both theories.\textsuperscript{159}


[T]he presence of a merger clause in the underlying contract may be determinative as to the successful outcome. If the defrauded party has not rescinded but has elected to affirm the contract, he is relegated to a recovery in contract, and the merger clause will prevent his recovery. If, on the other hand, he does rescind the contract, the merger clause will not prevent his recovery under a tort theory.

\textsuperscript{153} Id. at 282-283. See also, *Ajir v. Exxon Corp.*, 1999 U.S. App. LEXIS 11046 (9th Cir. 1999).


\textsuperscript{155} *Volpe*, 614 S.W.2d 615, 618 (1981) (citing *Sun Oil Co.*, 84 S.W.2d 447 (1935); *Newsom*, 541 S.W.2d 468 (1976); *Corbin on Contracts* § 600, et seq.; Id. § 604).

\textsuperscript{156} *Volpe*, 614 S.W.2d 615, 618 (1981) (citing *Sun Oil Co.*; *Newsom*; *Corbin on Contracts* § 600, et seq.; Id. § 604).

\textsuperscript{157} E.g., *Flagship West, LLC v. Excel Realty Partners*, 2006 U.S. Dist. LEXIS 83244 (2006); *In re Arthur Treacher’s Franchisee Litigation*, 689 F.2d 1137, 1145 (3rd Cir. 1982) (“equity will at times affirmatively restore the status quo ante”).


\textsuperscript{159} *Flagship West*, 2006 U.S. Dist. LEXIS 83244, at *3* (2006); *Trien v. Croasdale Constr. Co., Inc.* 874 S.W.2d 478, 480-481 (Mo. App. 1994); *Corbin on Contracts* §1102.
Consequently, the only available remedy for the plaintiff was rescission. But that remedy had been foreclosed by plaintiff’s three year delay in seeking relief.

III. DEFENSES

A. Timeliness and Waiver

There are two separate and distinct timeliness standards that must be examined in any franchise rescission case. The first are the statutes of limitations that govern the period of time in which a claim must be filed, whether in litigation or arbitration. These are bright line standards which courts, as they do in other contexts, apply without flexibility if they are missed.

For example, the court in *Leunge v. Lotus Ride, Inc.* had little trouble dismissing the franchisee’s claim under the New York Franchise Sales Act because the franchise agreement had been executed more than three years prior to the commencement of the action in violation of section 691(4) of the Act. In *Sterling Vision DKM, Inc. v. Gordon*, the franchisee had purchased the assets of the franchised business and opened it for business more than three years prior to filing the rescission claim by way of counterclaim. The franchisor sought to dismiss the counterclaims based on the three year statute of limitations under the Wisconsin Franchise Investment Law, claiming that the filing was eleven (11) days late. The court found that the cause of action accrued on the date the franchise agreement had been signed, which was a month later that the date the business opened; the franchisee thus met the statute of limitations deadline by nineteen (19) days, and delay was not seen as unreasonable.

Waiver by delay has frustrated many attempts to rescind. Because rescission is an equitable remedy, filing the claim before the expiration of the statute of limitations will not always allow the franchisee to survive a dispositive motion based on waiver. While the Minnesota Franchise Law has a three year statute of limitations, summary judgment was granted on the basis of waiver to a franchisor in *Meg-La, Inc. v. Uniforms for America*. In that case, the franchise learned that the franchisor has not been registered to sell franchises in Minnesota after the execution of a franchise development agreement and the payment of the franchise fee, but before any locations had been opened. The franchisee, represented by counsel, proceeded with the venture and opened the first store four month later. Six months later, and only after it became evident at the investment was struggling, did the franchisee assert a claim for rescission based on what the court terms a technical violation of the statute. The court dismissed the rescission claims on the basis that the franchisee had waived its rights and that it would be inequitable to allow him to rescind the franchise agreement at any time, and choose to retain the benefits of the franchise until it was no longer profitable.

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160 In South Dakota and Virginia, the deadlines for asserting rescission are contained in the statute. In South Dakota, the claim must be asserted within ninety (90) days of the date of the franchise agreement or within seven days after a disclosure statement that meets the requirements of the statute is furnished to the franchisee, whichever expires first. In Virginia, the claim must be asserted within seventy-two (72) hours after discovery or ninety (90) days after execution of the franchise agreement for claims based on unlawful offers and sales, and thirty (30) days from the execution of the franchise agreement in the case of refusal to negotiate franchise provisions or failure to provide the execution copy of the franchise agreement at least seventy-two (72) hours before execution.


162 976 F. Supp. 1194 (E.D. Wis. 1997).

163 Id. at 1199.

If a party discovers a basis for rescission, yet chooses not to rescind until much later, the remedy may be denied. A party that chooses to affirm the agreement, with full knowledge of a ground for rescission and thereby receive benefits, cannot succeed in rescission.\textsuperscript{165} The party rescinding an agreement must do so promptly or is deemed to have waived, or voluntarily abandoned, the right.\textsuperscript{166} A statute of limitations or laches defense is likewise applicable in rescission.\textsuperscript{167} If there is more than one plaintiff, the statute of limitations will be applied on an individualized basis, potentially tolling some claims and not others.\textsuperscript{168}

In \textit{Holiday Hospitality Franchising, Inc. v. 174 West Street Corporation},\textsuperscript{169} the court dismissed the franchisee claims under the Maryland Franchise Registration and Disclosure Law because of a nearly three year delay in asserting the right to rescind. The franchisee had given notice of intent to rescind in 2002, but kept operating the hotel and did not formalize the notice of intent to terminate until 2005. The court also cited the failure of the franchisee to repay the franchisor for some of the benefits received under the agreement.

Similarly, in \textit{Two Men and Truck/International, Inc. v. Mayes},\textsuperscript{170} the franchisee alleged that the franchisor had provided a UFOC seven (7) days prior to the signing of the franchise agreement, rather than the required ten (10) days, and that earnings claims had been made in violation of the Michigan Franchise Investment Law. In finding that the franchisee had waived the right to rescind the franchise agreement, the court pointed out that franchisee knew the actual profits that the franchise provided, and the franchisee had entered into a second franchise agreement two years after the first. The franchisee did not notify the franchisor of its intent to seek rescission until it had reaped the benefits of the successful franchises for two years but continually defaulted on the royalty payments due the franchisor. Not until the franchisee notified the franchisor of its intent to terminate did the franchisee attempt to rescind the franchise agreements. Thus, franchisee failed to make a seasonable assertion of its right to rescind, never tendered to the franchisor the consideration and benefits it received by virtue of the franchise agreement, and was in default at the time it demanded rescission. Thus, rescission was not an available remedy.

As evident in \textit{Holiday Hospitality}, \textit{supra}, the choice between a contractual and a rescission remedy may be difficult to make, and even if an aggrieved party promptly files suit, a delay in pursuing rescission may prevent any relief. Consider for instance, \textit{Kane v. Schnitzler}, 376 N.W. 2d 337 (S.D. 1985). The franchisor was found to have fraudulently induced the franchisee into entering the contract in March, 1981. The franchisee had actual knowledge in November, 1981 and filed a breach of contract action in January, 1982. The franchise relationship continued until May, 1982. It was not until April, 1983 that the franchisee amended the complaint to seek rescission. The court held that the doctrine of waiver was an effective defense to the rescission claim. Although the lawsuit was filed within a reasonable time, the franchisee affirmed the contract by seeking contractual damages and continuing franchise operations. Rescission was sought less than a year after the franchisee ceased operations and

\footnotesize{\textsuperscript{165} See Bennett v. Coors Brewing Co., 189 F.3d 1221, 1233 (10th Cir. 1999) (citing Trimble v. City & County of Denver, 697 P.2d 716, 723 (Colo. 1985)). See also Nielsen v. McCabe, 442 N.W.2d 477, 482 (S.D. 1989).
\textsuperscript{166} Kane v. Schnitzler, 376 N.W.2d 337, 339 (S.D. 1985) (citations omitted).
\textsuperscript{170} Business Franchise Guide (CCH) ¶11,170 (W.D.Mich. 1996)}
within two years of receiving notice of grounds for rescission, but the court held the right to rescind waived because of the continued affirmance of the agreement.\textsuperscript{171}

A delay defense may also be expressed in the language of restitution.\textsuperscript{172}

**B. Contract Defenses**

The defenses available in a rescission action depend upon the nature of the claim. If the claim is based on an agreement of rescission (legal rescission), the usual contract defenses apply. This makes perfect sense, as the agreement to rescind is itself a contract. Among these are the statute of frauds and the parole evidence rule. The latter bars the admission of oral promises made contemporaneously with the written agreement.\textsuperscript{173} However, if fraudulent statements or misrepresentations are relied upon by the other party, then a court may admit them under a fraud exception to the parole evidence rule.\textsuperscript{174} As the court remarked in *Gunnels v. Healthplan Services*, 348 F.3d 417, 434-435 (4th Cir. 2003), “indisputably, negligent misrepresentation and fraud require proof of reliance.”\textsuperscript{175}

The terms of the franchise agreement, including its merger clause, may likewise affect the rescission right, as exemplified in *Holiday Hospitality Franchising*, supra. And in *Puffer v. National Business Consultants, Inc*, 1978 Ohio App. LEXIS 8270 (Ohio App. 1978), the court concluded that, where a franchisee sought rescission for breach, the contractual opportunity to cure must be provided prior to seeking relief.

**C. Equitable Defenses**

If the court is dealing with an equitable rescission or a voidable contract, equitable principles apply, including laches\textsuperscript{176} and unclean hands: “if the plaintiff creates or contributes to the situation on which it relies, the court denies equitable relief in order to deter the wrongful conduct.”\textsuperscript{177} Or, as it is more frequently put, “he who comes in equity must come with clean hands.”\textsuperscript{178}

In *Smallbizpros, Inc. v. Court*, 414 F. Supp. 2d 1245 (M.D. Ga. 2006), the defendant was denied the defense of unclean hands. The parties had entered into a franchise agreement, but the agreement had since been terminated, and the plaintiff franchisor sought to enforce the post-term covenant not to compete. The franchisees had begun operating a similar business in the same area, in violation of the covenant. In response, the franchisees asserted the doctrine of unclean hands, alleging that franchisor’s poor performance of its duties under the agreement led to the termination. That wrongdoing, the franchisee argued, should operate to void the non-compete clause. The court rejected the defense, stating that mere poor performance of a contractual obligation does not constitute unclean hands.

\textsuperscript{172} See “Damages,” below.
\textsuperscript{174} Id. (citing *Inter-Americas Ins. Corp. v. Xycor Sys., Inc.*, 757 F. Supp. 1213, 1222 (D. Kan. 1991)).
\textsuperscript{175} See also, Foster v. D.B.S. Collection Agency, 463 F. Supp. 2d 783, 810 (E.D. Ohio 2006).
\textsuperscript{176} See “Timeliness” discussion, above.
\textsuperscript{177} *Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies*, 970 F.2d 273, 282 (7th Cir. 1992) (quoting *Polk Bros. Inc. v. Forest City Enterprises, Inc.*, 776 F.2d 185, 193 (7th Cir. 1985)).
IV. FORUM FOR DECISION

Rescission is not always decided in a judicial forum. It has been clear since the U.S. Supreme Court’s decision in *Prima Paint Corp. v. Flood Conklin Mfg. Co*, 388 U.S. 395, 87 S. Ct. 1801 (1967) that rescission claims may be heard in arbitration. Early attempts to avoid arbitration saw plaintiffs arguing that the entire franchise agreement was a contract of adhesion, or obtained by fraud, thus rendering the entire contract – including the arbitration provision – null and void. That rationale has been thoroughly discredited. Only if the arbitration provision *per se* was obtained by fraud or oppression might the parties escape arbitration. A court determines arbitrability, not the merits of the claim. Of course, *Nagrampa v. MailCoups, Inc.*, 469 F3d 1257 (9th Cir. 2006) presents opportunities for a due process attack on an overreaching or unconscionable arbitration clause.

Other special tribunals may entertain rescission claims as well. In *American Honda Motor Co., Inc. v. Premier Quality Imports, LLC.*, 2005 U.S. Dist. LEXIS 17738 (E.D. La. 2005), the court rejected the dealer’s argument that the manufacturer’s rescission action was within the exclusive province of Louisiana Motor Vehicle Commission, yet deferred to the Commission under the doctrine of primary jurisdiction.

V. RESTITUTION

In a franchise context, restitution follows rescission. An overly optimistic court declared in *Marwell Louisiana, Inc. v. Harris*, 1996 U.S. Dist. LEXIS 8512, at *18 (W.D. Va. 1996), that “[R]estitution has a fixed meaning, providing inherent parameters to any award.” Jurisprudence belies the truth: “unsettled” is a kind descriptor of the law in this area. A more honest assessment is that there is an amazing lack of consistency. The *theory* of restitution is deceptively simple: undo the contract and return both parties to the *status quo ante*. Complicating that simplicity are intruding notions of fault or fraud on the part of one party; partial restitution; how to do the math; the role of third party entanglements; and the limits of possibility.

A very few statutes provide at least some guidance to the elements of restitution; most do not. For the majority of states in which a statute rosily declares a party entitled to restitution, the next step is into the abyss. A litigant leaves the relative safety of a statutory remedy for the confusion of common law restitution.

The starting point of any restitutionary calculation is what the plaintiff (the person seeking rescission) paid to the defendant (the person from whom restitution is sought) and what benefits the plaintiff obtained from the defendant. Assuming for purposes of discussion that the plaintiff is a franchisee and the defendant is a franchisor, then, a franchisee is required to return to the franchisor the benefits it received, in exchange for the franchisor returning what was paid by the franchisee.

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181 Some statutes allow the recovery of other damages, in addition to restitution. This discussion is limited to restitution damages *per se*.

182 E.g., Mich. Comp. Laws §445.1531

Beneath the veil of simplicity thorny issues abound. Precisely defining restitution requires skill and perseverance. Two cases in which the courts made laudatory efforts at explaining their rationale (and math) are *Flagship West, LLC v. Excel Realty Partners, LP*, 2006 U.S. Dist. LEXIS 83244 (E.D. Cal. 2006) and *Dollar Systems, Inc. v. Avcar Leasing Systems, Inc.*, 890 F.2d 165 (9th Cir. 1989). In *Dollar Systems*, the Ninth Circuit largely approved of the trial court’s efforts to calculate the franchisee side of the equation, namely what the franchisee paid to the franchisor. The court was less enamored of the lower court’s failure to credit the franchisor with the value of all benefits provided to the franchisee and remanded on that basis.

The most detailed discussion of restitution damages is undoubtedly that in *Flagship West*. The case involved a Golden Corral franchisee suing for restitution based on the other party’s breach of certain lease restrictions. The *Flagship West* plaintiffs actually won a jury verdict of $1.5 million in contractual damages. In a demonstration of bravery or arrogance, the plaintiffs apparently realized they could obtain more in equity and opted for rescission. The court does an excellent job of sifting through the numerous claims and defenses accompanying plaintiff’s demand for more than $3.5 million in damages, to arrive at solidly supported restitution damages of $2.1 million. The court patiently addressed the franchisee’s construction expenses, bridge loans, equipment expenses, opening inventory, building fees and permits, franchise fees, training expenses, rent, and interest expense. Admittedly, the court was less detailed in its discussion of franchisor benefit, specifically addressing only the franchisee’s use of the premises, rental income enjoyed by the franchisees, and franchisee’s earnings from the sale of equipment at auction – allowing credit to the franchisor for all.

*Dollar Systems* and *Flagship West* are unusual in providing a transparent rationale for decision-making. Most case law provides guidance on the calculation issue at best. Initial franchise fees, training fees, and royalties paid to the franchisor are routinely included and the franchisee side of the rescission equation, but the record is less clear for:

- Loans obtained by the franchisee
- Franchisee payments to suppliers
- Lease payments to third parties
- Governmental permit or other fees
- Franchisee losses


186 *Flagship West*, 2006 U.S. Dist. LEXIS 83244, at *19-20 (interest on construction bridge loan precluded due to lack of proof; court implies it would have been the subject of restitution had evidence supported); *Interstate Automatic Transmission Company Co., Inc. v. Harvey*, 350 N.W.2d 907 (Mich. App. 1984) (debt disallowed).
190 Franchisees were not permitted to recover their losses from operation of the business in *Flagship West*, 2006 U.S. Dist. LEXIS 83244 (2006); *Brader v. Minute Muffler Installation, Ltd.*, 81 Wn. App. 532, 914 P.2d 1220 (Wash. Ct. App. 1996). In *Young v. T-Shirts Plus*, 118 Wis. 2d 824, 349 N.W.2d 109 (Wis. App. 1984), the court took the extraordinary step of awarding plaintiff both her business losses and the income she would have earned had she not quit her bookkeeping job to enter the business. This is an anomalous result, given the somewhat benign franchisor
• Set up costs\textsuperscript{191}
• Franchisee’s expenses training employees\textsuperscript{192}

One court has even included franchisor profits on the franchisee side of the ledger. Employing an unjust enrichment rationale, the Sixth Circuit in \textit{Little Caesar Enterprises, Inc. v. OPPCO LLC}, 219 F.3d 547 (2000) required a franchisor to disgorge the profits it and its subsidiary made on sales of spices and dough to the rescinding franchisee.

Calculating the benefits the franchisee received from the franchisor is equally difficult.\textsuperscript{193} The profits enjoyed by the franchisee are usually obvious and readily quantifiable. But simplicity may end there. Courts have wrestled less successfully with the benefits of:

• Training\textsuperscript{194}
• Specialized information\textsuperscript{195}
• Use of franchisor marks\textsuperscript{196}
• Benefits of depreciation and amortization\textsuperscript{197}
• Occupancy of premises\textsuperscript{198}
• Franchisor’s marketing and promotional services\textsuperscript{199}
• Assets obtained from franchisor\textsuperscript{200}

Rescission can be the equivalent of a no-fault divorce, a court even-handedly calculating restitution notwithstanding the fault of one party. In \textit{Puskar v. Hughes}, 179 Ill. App. 3d 522, 533 N.E.2d 962 (Ill. App. 1989), for instance, the court rejected one party’s attempt to “assert misconduct on the part of the [other party] not to defeat any equitable claim…, but rather to expand the scope of the remedy of rescission so as to allow him to retain the benefits conferred by [the other party],”\textsuperscript{201} observing that “inherent in the remedy of rescission is restoration of both parties to the status quo.”\textsuperscript{202} But in some cases, the equation changes if one party is perceived to be at fault.

\textsuperscript{194} \textit{Interstate Automatic Transmission Co.}, 350 N.W.2d 907 (Mich. App. 1984) (remanded to provide franchisor credit for training); \textit{Runyan}, 466 P.2d 6821 (Cal. 1970) (court declares training without value, declines credit).
\textsuperscript{196} \textit{Interstate Automatic Transmission}, 350 N.W.2d 907, 909.
\textsuperscript{197} \textit{id.}
\textsuperscript{199} \textit{Tresprop}, 2000 U.S. Dist. LEXIS 3511, at *41 (remanded to quantify value to franchisee); \textit{Dollar Systems}, 890 F.2d at 169.
\textsuperscript{200} \textit{Dollar Systems}, 890 F.2d at 169 (inventory and furniture retained by franchisee included in benefit calculation).
\textsuperscript{202} \textit{Puskar}, 533 N.E.2d at 966.
Since rescission is an equitable action, courts retain the right to adjust the equities, and they have done so. The Supreme Court of California in Runyan v. Pacific Air Industries, Inc., 2 Cal. 3d 304; 466 P.2d 682 (Cal. 1970), supported by a statute that allowed a court to “adjust the equities” in a rescission claim, perceived fraud by the franchisors and awarded “other restitutionary damages” consisting of the income the plaintiff lost by undertaking the defendant’s venture. Hillpold v. T-Shirts Plus, Inc., 98 Wis. 2d 711, 298 N.W.2d 217 (Wis. App. 1980) is an extreme example of equitable adjustment, the court denying any credit in the restitution calculation for benefits provided by the franchisor: “Given the illegality of both franchise sales, the law will not permit T-Shirts … to benefit from their wrong by allowing a reduction of their liability for ‘benefits conferred.’” Although never overruled, franchisors may see both the Hillpold and Runyan cases as seemingly on shaky ground. Any litigant would be wise to exercise caution when relying on them.

Far more understandable is the court’s ruling in Neptune Society Corp. v. Longanecker, 194 Cal. App. 3d 1233, 240 Cal. Rptr. 117 (Cal. App. 1987). The franchisor’s failure to register, its misstatements, and its CEO’s “simply incredible” trial testimony prompted the court to adjust the equities and permit the aggrieved former franchisee to continue using the franchisor’s name. Franchisors might be willing to write off the Neptune case as an instance of “bad facts make bad law,” but the court’s rationale is tempting to franchisees and dangerous to franchisors: the court agreed with the franchisee that it, not the franchisor, built goodwill in the trade name.

With the passage of time, restoring the status quo ante becomes as difficult – and sometimes as impossible – as unwinding a knotted ball of twine. A particular asset may be impossible to restore and equally difficult to value; third parties may have been so impacted by the business that they pose an impediment to rescission; the restoration of intellectual property or confidential information may be problematic.

Fisher v. Jones, 306 Ark. 577, 816 S.W.2d 865 (Ark. 1991) involved the sale and repurchase of an auto dealership. The intricate relationship between the dealership and Mercedes-Benz, with resulting financing arrangements, so complicated restitution between buyer and seller that the court denied the remedy entirely. In Dollar Systems, 890 F.2d 165 (1989), principals of the franchisee had been required to sign guarantees for fleet vehicles with GMAC. It was impossible to rescind these, but the court instead required the franchisor to indemnify franchisees under the guarantees. As Fisher and Dollar System demonstrate, third party entanglements present significant challenges in implementing restitution. How a court may deal with them may be signaled by the language the court uses to describe the arrangement. If


204 The only other case to do so appears to be Young v. T-Shirts Plus, Inc., 349 N.W.2d 109 (1984).

205 Hillpold, 298 N.W.2d 217, 220 (1980).

206 Or, in the case of a franchisee, outrageous facts make great law.

207 Neptune Society, 240 Cal. Rptr. at 124.


it is “separate and unrelated,” it generally remains unaffected by rescission;\textsuperscript{211} if it is an integral part of or caused by the rescinded transaction, rescission may be granted.\textsuperscript{212}

It is well-settled that after rescission a former franchisee cannot continue using the franchisor’s trademarks and service marks.\textsuperscript{213} As the court noted in \textit{The Quizno’s Master v. Kadriu}, 2005 U.S. Dist. LEXIS 7626 (N.D. Ill. 2005), citing \textit{Gorenstein Enterprises, Inc. v. Quality Care USA, Inc.}, 874 F.2d 431 (7th Cir. 1989), “[O]nce the owner of a trademark has broken off business relations with a licensee’ continued use of the trademark by the licensee violates trademark law.”\textsuperscript{214} The same rationale should determine the post-rescission use of franchisor patents and copyrights. The fate of confidential or proprietary information is more precarious. Few courts have tackled the issue squarely and in a practical sense it is impossible to cleanse the franchisee’s brain and actually restore the information to the franchisor. Some courts have attempted to monetize these items and afford the franchisor credit for their benefit to the franchisee.\textsuperscript{215} A couple of courts eliminated the problem by declaring the information of no value to the franchisee.\textsuperscript{216} Another applied state law to deny trade secret status to the information and thereby render it valueless.\textsuperscript{217}

It bears repeating that rescission is an equitable remedy, subject to court discretion.\textsuperscript{218} That characterization allows courts wide latitude in implementing restitution. Faced with challenging situations, some courts have doggedly pursued a decision.\textsuperscript{219} Others have opted for partial restitution.\textsuperscript{220} Still others have completely thrown up their hands, declared the task impossible, and denied rescission.\textsuperscript{221}

The last choice finds slim support in jurisprudence. Denying rescission because literal restitution cannot be achieved creates impossibility of remedy as a defense to rescission. As the court stated in \textit{Motor City Bagels v. American Bagel Co.}, 50 F.Supp.2d 460, 483 (D. Md. 1999), “[I]t is immaterial that the status quo cannot be literally restored. The general rule … is not strictly applied in case of fraud, because it would become a loophole to escape the consequences of a fraudulent act. Equity makes a reasonable application of the rule by requiring whatever fair dealing requires under all the circumstances of the parties case, but it

\begin{footnotesize}
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\item \textsuperscript{211} \textit{Puskar}, 533 N.E.2d 962, 967-968 (1989); \textit{Jones v. CPR Div.}, 120 Ariz. 147, 584 P.2d 611 (Ariz. App. 1978) (creditor agreements not rescinded; non-franchise case).
\item \textsuperscript{212} \textit{Bonanza Restaurants v. Uncle Pete’s, Inc.}, 757 S.W.2d 445 (Tex. App. 1988) (guaranty rescinded, causation rationale); \textit{Neptune Society}, 240 Cal. Rptr. 117 (1987) (promissory notes rescinded).
\item \textsuperscript{214} \textit{Quizno’s Master}, 2005 U.S. Dist. LEXIS 7626, at *6 (2005). Remember, however, the action of the court in \textit{Neptune Society}, 240 Cal. Rptr. 117 (1987), in which franchisor wrong-doing led the court to allow continuing use of franchisor’s name by the former franchisee.
\item \textsuperscript{216} \textit{Bonanza Restaurants}, 757 S.W.2d 445 (Tex. App. 1988); \textit{Runyan}, 466 P.2d 682, 686 (1970) (court noted that plaintiff “lacked the skills to utilize much of the equipment”).
\item \textsuperscript{217} \textit{BJM & Assocs., Inc. v. Norrell Services, Inc.}, 855 F. Supp. 1481 (D. Ky. 1994).
\item \textsuperscript{218} \textit{Ogden Martin}, 932 F.2d 1284, 1287 (1991). However, there is a limit to discretion, as the court noted in \textit{Dollar Systems}, 890 F.2d 165, 174-175 (1989) (despite franchisor wrongdoing, the Ninth Circuit there required that the court afford the franchisor credit for benefits conferred).
\item \textsuperscript{220} \textit{Fisher v. Jones}, 816 S.W.2d 865 (1991).
\end{enumerate}
\end{footnotesize}
does not permit the rule [of restoration] to become a shield for wrongdoing." [citation omitted].

While at least one court has explicitly found impossibility of restoration to bar restitution, most have applied common sense to implement the remedy as reasonably as possible.

VI. RESCISSION AND THE FRANCHISEE

The following is a practical A to Z guide to the questions to be asked and issues to be addressed in representing a franchisee in a potential claim for rescission and restitution.

A. What state law applies to the offer and sale of the franchise? Is it one of the 14 states that have a franchise rescission statute?

B. Was the franchise represented by counsel at the time the offer and sale was made? Was that counsel experienced in franchise law?

C. Did the client leave gainful employment or another advantageous relationship in order to enter into the franchise opportunity?

D. Did the franchisee learn of the violation of law, fraud or misrepresentation before execution of the franchise agreement or before making a substantial investment in the business?

E. What was the nature of the violation of law, fraud or misrepresentation? Was the violation willful or inadvertent and technical?

F. Did the violation of law, fraud or misrepresentation have a material affect on the decision to invest? Did it cause harm to the franchisee?

G. Did the franchisee rely on the defective or non-compliant disclosure or the fraudulent misrepresentation? Was it reasonable for him or her to do so?

H. Is the franchisor experienced or been in business for a period of time? Has it been cited for franchise law violations on previous occasions? Does it have an excessive amount of discloseable litigation in Item 3? Is it represented by


225 In Nielsen v. McCabe, supra, the court recited the following facts regarding the franchisee: "In this case, (the franchisee) testified that he was aware of his rights under the contract prior to signing the agreement. He specifically discussed the agreement with an attorney hired for the purpose of advising him as to the interpretation and binding effect of the agreement. Id.


227 See BMW Co., Inc. v. Workbench, Inc., 1988 WL 45594 (S.D.N.Y.) (violations of the New York Franchise Act were not material to plaintiff’s investment decisions).

228 See Aron Alan, LLC v. Tanfran, Inc., Business Franchise Guide (CCH) ¶13,276 (W.D. Mich. 2006) (given the widely divergent figures presented to franchisee, he could not have reasonably relied upon any of those figures and should have made further inquiry). See also Emfore Corp. v. Blimpie Associates, Ltd., Business Franchise Guide (CCH) ¶13,412 (N.Y.S.C. 2006) (no reasonable reliance on representations regarding co-branding opportunities and earnings claims based on franchisee’s responses to the pre-sale Questionnaire and other documents) and Learning Centers of Central Florida v. Knowledge Points Development Corporation, Business Franchise Guide (CCH) ¶13,290 (AAA Arbitration 2006) (franchisee justifiably relied on presale misrepresentations that were material to the decision to enter into the franchise agreement).
experienced counsel that will assess the franchisor’s legal, regulatory and financial exposure to the client’s claims?

I. Has the business been profitable? If not, why not? What has the client earned from the franchised business?

J. Does the client wish to stay in business in the franchise system? Might the franchisor agree to financial or other concessions in order to induce the franchisee to waive the right to rescission and stay in the system?

K. Does the client wish to stay in business, but leave the system? Can the client assess the impact of the loss of the use of the franchisor’s brand, marks and proprietary information? How will the franchisor assess the impact on the system, if any, of the client’s post rescission competition with the system? What will be the cost of de-identification?

L. Are other franchisees similarly situated? Will the client benefit from asserting the claims in concert with others? Are there any barriers in the franchise agreement to doing so? Might the client achieve a better result with a quick and quiet resolution?

M. Has an offer of rescission and restitution been made by the franchisor? Was it voluntary? Does it specify an offer of restitution by dollar amount or a formula? What is the deadline for accepting the offer? Does the offer comply with any applicable state statute?

N. How likely is the franchisor to be willing to repurchase the franchised business? Does the franchisor have company owned locations that provide it with the expertise and experience necessary to run the business? Does it have the sales capacity to flip the location to another franchisee?

O. What are the nature and scope of the obligations that the franchisee has to third parties such as landlords, lenders, investors, employees and equipment lessors? Does any offer of rescission include a provision for the franchisor to assume these obligations? Are these obligations assignable or assumable under their terms?

P. Has the client given timely notice of intent to rescind under the statutes of South Dakota and Virginia, if applicable?

Q. Is the client prepared to promptly move forward with the claim for rescission so as to avoid the assertion of waiver or a statute of limitations as a defense?

R. What are the nature, scope and value of the benefits conferred, if any, by the franchisor over the course of the relationship? Is the client prepared to tender those benefits back to the franchisor? Is it possible or practical to do so?

229 See Hitpold v. T-Shirts Plus, 298 N.W.2d 217(1980) (franchisor has no right to have the liability assessed against it for an offer and sale in violation of the Wisconsin Franchise Investment Law offset for the benefits conferred on the franchisee). But see Tresprop, 2000 WL 290349 (2000) (franchisee cannot recover franchise fees and royalties paid unless there is an offset for benefits conferred on the franchisee).
S. Does the franchise have any goods, supplies or inventory purchased from the franchisor? Have these been paid for?

T. Has the client paid its obligations under the franchise agreement? Are there arrears? Has the franchisor sent one or more default notices? Did the arrears arise before or after the client gave notice of its dissatisfaction with the franchise or its claims regarding the offer and sale of the franchise? Will the client be vulnerable to a lack of clean hands defense? Are there other counterclaims that might be asserted by the franchisor?

U. How much has the client paid the franchisor since the inception of the franchise relationship, including the initial franchise or development fee, royalties and advertising or marketing contributions?

V. What is the total investment the client has made in the franchise business. How does the amount of that investment compare to the current value of the assets of the business or its value as a going concern?

W. Has the client consulted with an accountant to determine the tax consequences of rescission or a repurchase of the franchised business by the franchisor?

X. Has there been a sale, merger or other change in control of the franchisor since the offer and sale to the franchisee? Was that transaction a sale of stock or assets?

Y. What are the dispute resolution provisions of the franchise agreement? Is there an arbitration clause? Is there a fee shifting provision? Are multiple or punitive damages available under the agreement? Under state law?  

Z. Given all of the circumstances of the franchisee, is rescission a practical remedy? Is it possible to return the franchisee reasonably close to the status quo ante?

VII. FRANCHISORS AND RESCISSION

Franchisees (or at least their lawyers) demonstrate confidence in their use of rescission/restitution as a business tool. The record for franchisors is less clear. There are relatively few reported cases in which franchisors have initiated a rescission action, and most of those cannot be cited as a ringing endorsement of rescission as a successful solution to a business problem.

Honda sued for rescission of a letter of intent and incipient dealer agreement in American Honda Motor Co., Inc v. Premier Quality Imports, LLC, 2005 U.S. Dist. LEXIS 17738 (E.D. La. 2005). The dealer, Honda alleged, misrepresented the nature of its purchase of another import dealership, and rescission was warranted. The dealer moved to dismiss, arguing that the state motor vehicle commission had exclusive jurisdiction over the dispute. While the

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court rejected the dealer’s exclusive jurisdiction argument, it nevertheless deferred to the commission based on the doctrine of primary jurisdiction.

Aside from providing an interesting discussion of two of the more esoteric gatekeeping doctrines, the Honda case provides an opportunity to opine on the manufacturer’s attempted use of rescission as a business tool. Obviously, Honda wanted out of the relationship. It was of recent vintage, so the complexities of restitution that occur with the passage of time could be avoided, and Honda’s investment in the relationship was probably small. Rescission was an obvious choice.231 Absent a special tribunal, Honda’s strategy may have worked perfectly. However, the detour to the Louisiana Motor Vehicle Commission at least delayed relief and may have thwarted it.

Franchisors who find themselves in violation of registration statutes may consider offering rescission to forestall expensive franchisee litigation in the future.232 The franchisor’s attempt to do so had unexpected consequences in Marwell Louisiana, Inc. v. Harris, 1996 U.S. Dist. LEXIS 8512 (W.D. Va. 1996). The franchisor in that case had updated its franchise agreement to the then-current form. Two franchisees who had signed the old agreement transferred their businesses to two new franchisees, and the franchisor duly approved the transfers. A condition of each transfer was that the transferees execute the updated franchise agreements. Some four years later, the Virginia State Corporation Commission declared that the execution of the updated agreements was the sale of an unregistered franchise. In the hope of reducing the fine that might be levied by the Commission, Marwell offered to rescind the updated agreements and pay restitution, fully expecting each of the transferees to honor the old agreements. The offer did not specify the amount the franchisor was offering to pay by way of restitution.

The transferees cleverly accepted the rescission offer as presented but declined to be bound by the old agreement, having never signed it. Instead they “began operating independent, de-identified competing businesses on their respective franchise locations.”233 A plain vanilla, prophylactic rescission action resulted in a nightmare – former franchisees with fat wallets operating competing businesses.

Manpower, Inc. used rescission arguably more successfully in Manpower, Inc. v. Mason, 405 F.Supp.2d 959 (E.D. Wis. 2005). Mancan, Inc., controlled by Jonathan Mason, owned a number of very successful Manpower franchises, with combined gross revenues in excess of $73 million. His son Jason operated one of the franchises, to Manpower’s great distress. There is not a hint of complaint about daddy’s performance, but sonny seems to have been a renegade. His personal style, according to the court, left much to be desired;234 he routinely ignored the territorial restrictions of his franchise; he violated federal law (and franchise requirements) by failing to complete and retain I-9 forms; he falsely represented another entity formed by him to be a division of Manpower.

231 Honda’s complaint included causes of action for breach of contract as well, but it appears that rescission was the major thrust of its efforts.
232 In addition, state enforcement agencies frequently order rescission/restitution as remedies for statutory violations, as discussed above.
233 Marwell, 1996 U.S. Dist. LEXIS 8512, at *5 (one of the authors of this article, Eric H. Karp, was counsel of record for the franchisees in the Marwell case).
234 His recited deficiencies in people skills would provide a quintessential “before” example: poor judgment, dishonesty, temper tantrums, vulgar remarks (including to females), and immaturity, among other sins.
Manpower originally sought termination of all Mancan’s franchise agreements, but the franchisee successfully moved for preliminary injunction to prevent termination. Manpower then shifted gears, rescinded the agreements by notice, and filed a motion for preliminary injunction to prevent Mancan from continuing to use Manpower’s marks. Mancan filed a cross-motion for preliminary injunction to bar rescission. The court granted Manpower’s motion as to the franchise operated by Jason, and granted Mancan’s motion as to the other franchises. Both parties were required to file hefty bonds ($7.5 million for Manpower; $3.5 million for Mancan).

Manpower rid itself of a bad operator – or did it? One can surmise that the friction between Manpower and its successful franchisee continued.

These cases aptly demonstrate the shortcomings of rescission as a business tool. When a court (or, for that matter, any independent entity with authority to determine a result) becomes involved, the franchisor loses control of the remedy. Whether the franchisor’s business goal will be achieved becomes a crap shoot, as does the cost of that remedy.

The franchisors in Marwell and Manpower, with the power of hindsight, might have been able to improve their positions with a little planning. Could the franchisor in Marwell have required the transferees to sign the old franchise agreement as a condition of its rescission offer? If the state required pure rescission, perhaps not. Could the franchisor have offered material incentives for the franchisees not to accept the offer to rescind? Should its offer of restitution been more specific? In Manpower, a simple cross-default provision in each franchise agreement might have resulted in total victory for the franchisor, albeit at the cost of a very large bond.

VIII. CONCLUSION: A PRACTITIONER’S LAMENT

A judicial rescission remedy can be extremely risky to franchisors; their apparent reluctance to affirmatively use rescission as a business tool reflects that fear. One of the authors of this paper, McKnew, conducted an informal survey of franchise counsel in 2006. Initial review of the results reveals overwhelmingly greater interest on the part of franchisor attorneys in “informal” approaches to exit strategies. Even arbitration, once a preferred dispute resolution method, has all but fallen off the chart.

Mediation and even more informal negotiation are the chosen approaches to franchisor business issues in the current judicial environment. Franchise agreements increasingly include a three step (or four step) approach to dispute resolution – negotiation, then mediation, followed by arbitration and only as a last resort litigation. From the franchisor’s point of view, a review of the reported cases involving rescission and restitution certainly support this as a wise choice. These approaches allow the franchisor greater control over the resolution of the problem and provide multiple opportunities for saner minds to prevail before litigation. Franchisees may take a different view, given the cost of added steps, extended involvement by lawyers, and the chance that the franchisor may be able to flex its larger muscles to effect a solution that pleases only the franchisor.

235 Manpower, 405 F. Supp. 2d 959, 975 (2005) (The court acknowledges that no such provision appeared in the Manpower franchise agreement (citing Michael Garner Franchise & Distribution Law & Practice, § 3.3) recommending that franchisors include such provisions “to retain maximum flexibility”).
236 The popularity of informal ADR procedures, including mediation, has dramatically reduced the number of cases proceeding to trial, at least in South Carolina. No more than two dozen civil cases were tried to a jury in South Carolina in 2005, and at least one federal judge in that state was heard to complain about being bored! The author readily admits that the number of cases is pure repeated rumor, but interesting nonetheless.
Resort to informal procedures creates difficulties for franchise lawyers, too. Decreasing use of litigation results in fewer reported cases – learning franchise law well in the future may necessitate apprenticeship. And for volunteer commentators such as the authors it makes an accurate assessment of current trends entirely dependent on informal inquiry – our time in asking and our colleagues’ time and willingness to share. While mediation and arbitration often provide more limber and less formal methods of dispute resolution, a definite detriment is the absence of reported cases. Guidance becomes less available to the practitioner.
Ms. McKnew is a shareholder in the law firm of Leatherwood Walker Todd & Mann, P.C., and served as the firm’s Managing Director from January 1995 through December 2000. She received her B.A. degree in 1971 from the University of California at Santa Barbara, her M.A. degree in 1973 from the University of California at Los Angeles, and her J.D. degree in 1978 from Northeastern University. Tami joined the firm in 1978 and concentrates her practice in the areas of franchising, antitrust and unfair trade practice law, intellectual property and complex litigation. She has been a member of the ABA Section on Antitrust since 1979 and a member of the ABA Forum on Franchising since 1980. Tami has been a contributor to Greenville Magazine, South Carolina Lawyer, South Carolina Law Review, and is the author of "Franchise Litigation" in South Carolina Jurisprudence. She has served as a seminar faculty member on numerous occasions, addressing franchising, antitrust, dealership and firm management issues. Her current Board memberships include Attorney Liability Protection Society RRG (ALPS); Greenville Tech Foundation (Past President); the South Carolina Chapter of the Nature Conservancy (Past Chair; current National Trustee Council Member); the United Way of Greenville County (Chair-Elect; past Campaign Chair); The Priester Foundation; and the Advisory Boards of Clement’s Kindness for Children and the Greenville County Museum of Art. She has one daughter, Bronwyn Kelson, who is attending law school at USC. She loves to cook, read, and she skis badly but gamely.
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He served on the Board of Directors of the American Franchisee Association (AFA) for ten years. Mr. Karp also served as Chair of the AFA Model Responsible Franchise Practices Act Committee, was the principal author of the Model Act and served as the Program Chair of the 1999 AFA Franchisee Legal Symposium.

In June, 1994 Mr. Karp testified before the U.S. House Small Business Committee on "Self Regulation of Franchising: The IFA Code of Ethics." An elected delegate to the 1995 White House Conference on Small Business, Mr. Karp has twice testified before the Joint Committee on Commerce and Labor of the Massachusetts Legislature on franchise issues.

Since 1996, Mr. Karp has served on the Franchise Project Group of the Franchise and Business Opportunities Committee of the North American Securities Administrators Association. He has been a presenter at the American Bar Association Forum on Franchising and the International Franchise Association Legal Symposium.

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