LITIGATING CLAIMS OF FRAUD
IN CONNECTION WITH THE SALE OF A FRANCHISE

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October 14-16, 2009
The Westin Harbour Castle
Toronto, Canada

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LITIGATING CLAIMS OF FRAUD
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I. AN INTRODUCTION

We franchise “litigators” are hybrids — a unique combination of business and divorce lawyers. We describe the franchise relationship as a “business marriage” for good reason. It is at the same time a business deal between two parties that are independent and a “marriage” between two that are interdependent. The old saw in franchising is true — the franchise is governed by the contract (the business deal) but managed by the relationship (the marriage).

Like a newlywed, the franchisee begins the relationship at the first of Greg Nathan’s six stages of the franchise relationship, the “glee” stage — “somewhat nervous about their new venture but ... also excited and optimistic about the future.” And like marriage, the franchise relationship sometimes sours. Marriages falter over money issues. Similarly, a major cause of tension in the franchise relationship is that the franchise has not performed as well financially as the franchisee had hoped or expected. If poor financial performance becomes chronic, the upshot (to continue the marriage analogy) may be “irreconcilable differences” between the franchisor and franchisee. In a marriage, when the parties cannot reconcile their difference, they often turn to divorce to fix the problem; in a franchise relationship, we call it an “exit strategy.” The inevitable question in a failed franchise (like in a failed marriage) is who is responsible for the breakdown in the relationship. A good candidate for the blame is, of course, the other party to the relationship. In a franchise context, this may manifest itself in a franchisee claim that franchisor has not fulfilled its contractual obligations (i.e., materially breach the franchise agreement), thus giving to the franchisee a right to terminate the franchise agreement and rid itself of any ongoing obligation to pay royalties and typical post-term obligations like the duty not to compete. It may also appear as a claim that the franchisor committed some sort of fraud in the sale of the franchise that gives the franchisee the right to rescind the franchise relationship, or sue for damages, or both.

Almost all divorce proceedings involve emotions, but none touches raw nerves more than a claim of cheating. The counterpart in franchise litigation is a claim of fraud, particularly fraud in the sale of a franchise opportunity. There are certainly franchisee fraud claims that do not impugn the integrity of the franchisor. Claims of negligent misrepresentation or strict liability under a franchise or consumer fraud statute may not be particularly offensive to most franchisors. But typical fraud claims accuse the franchisor of the most nefarious conduct in which it could possibly engage — lying to cheat an innocent franchisee out of its money. Fraud claims are personal. At their core, they ask the question whether the franchisor’s employees are honest, decent individuals or liars and cheats.

1 The authors thank Patrick Burns and Mark Dady, attorneys at Dady & Garner, for their assistance in writing this paper. The authors also thank their legal assistants, Joanne Victorson at Dady & Garner and Joni Martin at Faegre & Benson, for all of their help and support in this endeavor.


3 Franchisors may also assert fraud by the franchisee in the purchase of a franchise opportunity. For example, a franchisor may claim that a franchisee misrepresented its financial wherewithal — either as an affirmative claim or in response to a claim by the franchisee. Because such affirmative fraud claims are unusual, we do not focus on them in this paper.
While franchisee fraud claims may challenge a franchisor to protect its honor “at all costs,” “all costs” can be staggering. “All costs” include not only attorneys’ fees, but also potentially huge damages. The pale of a jury-gone-wild hangs over the franchisor. Indeed, nothing short of a class action has the same potential in terrorem effect on a franchisor as a significant franchisee fraud claim, particularly one spiked with a request for punitive damages.

Into this fray steps the franchise litigator. This paper is all about how franchise litigators may best manage their walk through the difficult terrain of a franchisee claims of fraud in the sale of a franchise. It is the product of two lawyers that practice on opposite sides of the fence — a trial lawyer representing only franchisees and one representing only franchisors. Our particular bent may be evident from time to time in the pages that follow, but we ultimately do agree on a number of concepts, concepts that serve as the basic outline of this paper. They are:

1. The law of fraud is complicated in general, but sometimes mystifying in the franchise context. In addition to common law fraud, the franchisee has potential claims of statutory fraud under RICO, the anti-fraud statutes enacted in most of the big states for franchising, as well as “little FTC Acts” in every other state. Although most state franchise anti-fraud statutes are modeled after the California Franchise Investment Law, the courts in a number of the states construe them differently. Some little FTC Acts apply to franchises, some do not. Fraud claims of which courts dispose on summary judgment in one state will get to the jury in another. We therefore begin this paper with a review of the basic laws governing franchisee fraud claims. Our review is not exhaustive, but only identifies basic pressure points.

2. Franchise fraud cases are all about where the case ends. For the franchisee trial lawyer, the end game is a meaningful settlement or a favorable jury verdict. The major hurdle is often getting beyond a motion to dismiss or for summary judgment to clear the way to get the case to the jury. For the franchisor lawyer, the objective is to dispose of the case before a jury touches it — preferably through a motion to dismiss or summary judgment. For both sides of the litigation, the proverbial cost of poker goes up if the judge is ready to let the jury decide the parties’ fates. In between these various stages is the ever-present opportunity to settle.

3. The initial battleground in franchise fraud litigation is the motion to dismiss. For the franchisor, the motion to dismiss is an opportunity to focus the court on narrow legal issues without the baggage of “facts” designed to put the franchisor in the worst possible light. For the franchisee, the motion to dismiss presents the risk that it cannot put its case in proper context. Because this is a critical junction of any fraud case, the motion to dismiss receives special consideration in this paper.

4. Perhaps the most critical element in franchisee fraud litigation is the role of the disclaimer. The disclaimer appears in merger, no-reliance, and no-authority clauses. It is frequently the franchisor’s best hope for keeping the fraud case from the jury and for the franchisee that successfully resists its preclusive effect, the battle is half over. This too is discussed in detail in this paper.

5. Ultimately, franchise fraud cases are all about strategy. It is the proverbial game of chess. We finish by presenting the best moves available to the franchisee and franchisor.

II. THE BASICS — FRANCHISE LAW OF FRAUD AND MISREPRESENTATION

As laypersons, we equate fraud with lying, deceit, and trickery. It is the antithesis of
truth and honesty. Shakespeare described the heart of the honest person “as far from fraud, as heaven from earth.”

But fraud in a legal sense is much broader. It includes, to be sure, the combination of an impure heart and deliberate misconduct, but it sometimes also encompasses negligent and even innocent acts. The sort of fraud that is typically of concern to franchise lawyers when it comes to franchise sales is all about words — those spoken and those left unspoken. The law of misrepresentation is a more apt description of fraud that relates to words. We next turn to the basic law of fraud (more appropriately, misrepresentation) in the context of the sale of a franchise.

A. Common Law Intentional Misrepresentation

The basic components of common law fraud or misrepresentation are: (1) a false representation by the defendant of past or present fact; (2) made with knowledge of its falsity; (3) to induce the plaintiff to act; (4) upon which the plaintiff reasonably relied; and (5) which caused injury to the plaintiff. Seems simple enough, but as usual, the devil is in the details.

1. The Elements

a. False Representations

Fundamentally, a fraudulent misrepresentation claim rests on a statement that was false when it was made. If a statement was not false at the time it was made, there can be no claim for common law fraud. For instance, in *Cathay Enterprises, Inc. v. Ramada Franchise Systems, Inc.*, the court granted summary judgment for the defendant franchisor in part because one of the franchisor's alleged misrepresentations — that there was no punch list for the property — was not false when it was made. Although truth is almost always the perfect defense to a fraud claim, half-truths may also be actionable under theories of fraudulent concealment, failure to disclose, and wrongful omission, as discussed below.

b. Past or Present Fact

Only statements of existing fact — as opposed to statements about the future — are actionable. Franchisees often claim that during pre-contract discussions the franchisor fraudulently misrepresented some future aspect of the franchise, such as probable or potential earnings. These claims fail in most jurisdictions. In *Cathay Enterprises*, the court held that defendant’s representations that the franchisee would need to spend only a limited amount of money on improvements to the existing hotel were statements regarding the future and not representations of existing fact. The representations, therefore, were not actionable fraud.

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4 William Shakespeare, *Two Gentlemen of Verona*.

5 Claims of fraud in the sale of a franchise are not, however, necessarily limited to misrepresentation claims. For example, in the *Quizno’s* cases discussed in Section III of this paper, the plaintiffs’ common allegations include claims that *Quizno’s* intentionally over-saturated the market and otherwise committed wrongful acts with the primary intent of inflating the apparent profitability of franchisees so as to drive up the sales value of the entire franchise system to a third party.

6 See Restatement (Second) of Torts § 525.


8 *Id.;* but see *Motor City Bagels, LLC v. American Bagel Co.*, 50 F. Supp. 2d 460, 473 (D. Md. 1999) (noting that courts are increasingly willing to consider predictive statements because “a statement that is in form a prediction or
Predictions about the future are different from promises of future events. Promises are typically governed by the law of contracts, but promises may also constitute fraud if made with no present intent to keep them. *Ramada Franchise Systems, Inc. v. Tresprop Ltd.*,\(^9\) represents one court’s application of promissory fraud. The court found in *Tresprop* that the franchisor fraudulently induced Tresprop to enter into a franchise agreement by assuring Tresprop that it would terminate permanently the other underperforming franchise in the area. Despite the general rule about statements of future action, the court held that “the misrepresentation becomes actionable if the promise concerning a future act is coupled with a present intention not to fulfill the promise.”\(^10\) The court found that the franchisor was assisting the underperforming franchise at the same time that it was promising Tresprop that it would close down the franchisee. Based on these facts, the court concluded that the franchisor never intended to permanently terminate the other franchise operation and that its statements regarding the other franchise could constitute fraud.

Statements of opinion fall into the same category as statements regarding the future: they are not statements of “past or existing fact” and, therefore, not actionable. Courts regularly find that representations and assurances made in the course of pre-agreement discussion are mere statements of opinion. In *Boyle v. International Truck and Engine Corp.*,\(^11\) a would-be franchisee sued the franchisor when it denied his franchise application. The plaintiff claimed that the franchisor committed fraud when its representatives advised plaintiff that his approval as a franchisee was a “mere formality.” The court ruled against the plaintiff, characterizing these assurances as opinion. In contrast, the court in *California Bagel Co. v. American Bagel Co.*\(^12\) reached a different result under somewhat similar facts. The franchisees in *California Bagel* entered into a franchise agreement with American Bagel Company (ABC) to open and operate five Chesapeake Bagel Bakery stores in an exclusive area. Both franchisees that plaintiffs opened failed. After they closed the stores, plaintiffs sued ABC claiming that prior to entering into the franchise agreement, ABC fraudulently represented the typical annual sales of Chesapeake Bagel Bakery stores and the assistance that the franchisor would provide in finding superior locations for the franchises. On the franchisor’s motion for summary judgment, the court acknowledged that a fraudulent misrepresentation must relate to a past or present fact, not statements of opinion. Because the statements by ABC regarding earnings at existing franchise locations were representations of verifiable facts, however, the court found that they were not opinions. The court also held that the assurances of franchisor assistance were statements of fact that, if false, were actionable.

Some courts also recognize an exception to the opinion rule where one party possesses specialized knowledge that the other party does not.\(^13\) For example, in *California Bagel*, the court held that even if the representations of typical sales were statements of opinion predicting promise as to the future course of events may justifiably be interpreted as a statement that the maker knows of nothing which will make the fulfillment of his prediction or promise impossible or improbable*).

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10 Id. at *10.


13 *E.g., Little Caesar Enters., Inc. v. OPPCO, LLC*, 219 F.3d 547 (6th Cir. 2000).
future profitability, ABC had knowledge that California Bagel could not have had. As a result, the court held that ABC’s opinion, based as it was on superior knowledge, might reasonably be a statement of fact for purposes of a fraud claim.

Opinions may also be actionable where the statement containing the opinion has no factual basis and is not reflective of the past or present circumstances. For instance, the plaintiffs in *Randall v. Lady of America Franchise Corp.* alleged, among other things, that the franchisor had fraudulently induced them into signing franchise agreements by making misrepresentations regarding potential future earnings. The franchisor argued that these representations related to future events, and, therefore, could not serve as the basis for a fraud claim. The court noted that, pursuant to Minnesota law, “whether [p]rojections . . . [are] actionable or not in fraud . . . depend[s] upon whether they accurately reflect surrounding past and present circumstances.” Accordingly, the court found that if the franchisor “made assurances to franchisees about their expected membership numbers, revenues, and profitability — and if those assurances did not ‘accurately reflect surrounding past and present circumstances,’” then the franchisor could be liable for fraud, notwithstanding that the representations related to an opinion of future events.

Finally, “puffery” is not fraud because it, like an opinion, does not constitute a statement of past or present fact. Puffery typically refers to exaggerated salesmanship, in which all parties are expected to understand the game. Thus, in *Vaughn v. General Foods Corp.*, a Burger Chef franchisee alleged that the franchisor had committed fraud by making material misrepresentations of fact regarding the viability and success of the franchise. The Seventh Circuit dismissed the claim, and held that “in a sales or marketing context, and franchisor-franchisee negotiations certainly are to be placed in that context, such expressions of opinion are known as ‘puffing’, ‘trade-talk,’ or ‘sales talk’ and do not constitute actionable fraud.” After specifically noting that statements regarding “viability” are mere puffing, the court concluded that “General Foods’ idea of viability did not match the [plaintiffs’] expectations is unfortunate — but it is not fraud.” A similar result was reached in *BO Foods, Inc. v. Bojangles’ of America, Inc.*

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14 See *Watts v. Jackson Hewitt Tax Service Inc.*, 579 F. Supp. 2d 334, 352 (finding that “an opinion may constitute fraud where it has no basis in fact or the speaker was aware of facts undermining the accuracy of the statement” . . . . defendants’ alleged knowledge of the inaccuracy of [the] opinion made it fraudulent”).


16 Id. at 1090.

17 Id. at 1089 (quoting *Berg v. Xerxes-Southdale Office Building Co.*, 290 N.W.2d 612, 615 (Minn. 1980)).

18 Id. at 1090. While this section of the opinion related to fraud under the Minnesota Franchise Act, the court used the same reasoning to support a claim for common law fraud in *Berg*, 290 N.W.2d 612.


20 Id.

21 Id.

where the court concluded that a statement that a franchisor was “confident” of the franchisee’s success “is merely puffery which cannot be characterized as fraud.”

**c. Concealment, Omissions, and Failures to Disclose**

Fraud actions often involve claims of fraudulent concealment. Concealment is a variation on the misrepresentation theme, and some states define the torts separately. Generally, concealment involves failing to disclose or hiding material information where there is a duty to disclose the information. In states that define concealment apart from misrepresentation, the definition often tracks the definition of misrepresentation. For example, Illinois uses a five-part definition, as it does for misrepresentation, but modifies the five elements by requiring plaintiff to show it could not have discovered the truth through reasonable efforts:

Plaintiffs must establish (1) the concealment of a material fact, (2) the concealment was intended to induce a false belief, under circumstances creating a duty to speak, (3) the innocent party could not have discovered the truth through a reasonable inquiry or inspection, and relied upon the silence as a representation that the fact did not exist, (4) the concealed information was such that the injured party would have acted differently had it been aware of it, and (5) the reliance by the person from whom the fact was concealed led to his injury.

The common law of most states requires a franchisor to disclose material facts that are necessary to prevent a previous or concurrent statement from being false or misleading. A franchisor also may be required by the common law to disclose material information to a franchisee if the franchisor believes that the franchisee cannot obtain the information on his or her own and if there is a fiduciary or other special relationship between the franchisor and franchisee. For the most part, courts have refused to find that a fiduciary relationship exists between a franchisor and franchisee, but franchisors should not conclude that they do not have a common law duty to disclose under any circumstances. The special relationship factor can arise from a “confidential” relationship or where the practice in the trade is to disclose such information.

In *Hoffman v. Midas*, a Midas franchisee brought a claim of fraudulent concealment against Midas for allegedly concealing plans to open a competing Midas location. The court dismissed the franchisee’s claim, holding that Midas had no duty under the franchise agreement to offer a new franchise property to existing franchisees and that franchisees could have discovered Midas’ plans for a new franchise through reasonable inquiry.

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23. *Id.* at *4. For more cases, where the court held mere “puffery” could not constitute actionable fraud, see *Properties Unlimited, Inc. Realtors v. Cendant Mobility Servs.*, No. 01-C-8375, 2002 WL 1147460, at *2 (N.D. Ill. May 28, 2002) (noting that several statements by franchisor were not actionable because they fit “within the realm of puffery, bragging, ‘mere words,’ and casual bonhomie, rather than to that of serious commitment”) and *Lang, Lang & Suhor Investors, LLC v. The American Bagel Co.*, Bus. Franchise Guide (CCH) ¶ 11,447 (D. Md. Apr. 29, 1998) (summarily dismissing claim of fraud based on promise from franchisor that “you will make lots of money” as “mere puffery”).


25. *Id.*
Concealment cases frequently turn on the question of duty. In *Interim Healthcare of N.E. Ohio, Inc. v. Interim Services, Inc.*,²⁶ plaintiffs, home health care providers, brought a claim of fraud when the franchisor allegedly concealed information about Medicare reimbursements. The court held that the franchisor had communicated the risk of nonreimbursement and that the franchisor had no further duty of disclosure information to the franchisee. According to the court, there is a presumption in business transactions that neither party has a duty to disclose to the other party. The court acknowledged, however, that certain exceptions to this presumption exist: (a) where a fiduciary relationship exists; (b) where there is an informal relationship with an understanding of special trust; or (c) where disclosure is necessary “to dispel misleading impressions that are or might have been created by partial revelation of the facts.”²⁷ None of these exceptions applied in this case.

Florida employs a similar analysis: there is no general duty of disclosure between franchisor and franchisee, but a duty to disclose may arise where there is a confidential relationship or where the particular circumstances of the case impose the obligation.²⁸ In *Williams v. Dresser Industries, Inc.*,²⁹ sophisticated businessmen initiated contact with the franchisor and subsequently entered into a franchise relationship. Three days after the franchise agreement was executed, the franchisor announced a joint venture with another construction equipment company. The franchisees claimed that they were fraudulently induced to enter into the franchise agreement through the franchisor’s concealment of the pending joint venture. The court found that the parties had an arms-length business relationship that did not give rise to a confidential relationship. Furthermore, there were no particular circumstances creating a duty to disclose; there was no prior contract regulating their communication and no fiduciary relationship.

Under Kentucky law, a duty may arise in the absence of a confidential or fiduciary relationship when one party only partially discloses material facts to the other but creates the impression of full disclosure.³⁰ In *Rivermont Inn, Inc. v. Bass Hotels Resorts, Inc.*,³¹ however, no such duty arose because the franchise applicant signed an acknowledgement that the franchisor did not make any oral representations or enter into any oral agreements. Having executed this acknowledgement, the applicant could not claim to have relied on a fraudulent omission.

**d. Knowledge of Falsity**

In order to establish intentional misrepresentation, the plaintiff must prove that the defendant is making a false statement. If the defendant honestly believes that he is telling the

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²⁷ Id. at 712.

²⁸ See, e.g., *Barnes v. Burger King Corp.*, 932 F. Supp. 1420, 1430 (S.D. Fla. 1996) (“It is well-settled . . . that a franchisor is not in a fiduciary relationship with a franchisee.”).

²⁹ 120 F.3d 1163 (11th Cir. 1997).


³¹ Id.
truth, his representations cannot be fraudulent. In *Tresprop*, for example, the court found that the franchisor must have known that it was making a false representation because it was aiding the existing franchisee while representing to the prospective franchisee that it would permanently shut down the other existing franchisee. In *Conner v. Hardee’s Food Systems, Inc.*, the court reached a different result. The plaintiff in *Conner* applied to become a Hardee’s franchisee, intending to open a restaurant in Sevier County, Tennessee. After Hardee’s opened company-owned restaurants in Sevier County, the franchise applicant sued for misrepresentation, alleging that Hardee’s agents told him that Hardee’s did not intend to open company-owned restaurants in Sevier County. The court ruled against plaintiffs, holding that because Hardee’s agents made those statements with the qualifier, “to their knowledge,” and at the time they spoke, they had no actual knowledge that their statement was false, there was no basis for a misrepresentation claim.

**e. Intent to Induce**

Most jurisdictions require that the plaintiff prove that the defendant intended to cause the plaintiff to rely on a misrepresentation to her detriment. This standard is relatively easy to meet. Intent may be inferred when the plaintiff establishes that the defendant knowingly made a false statement. In *Miller Enterprises, Inc. v. Dog N’ Cat Pet Centers of America, Inc.*, the Supreme Court of North Dakota upheld the trial court’s finding of fraud against a franchisor despite the franchisor’s claim that it did not intend to defraud. The court held that the franchisor’s intent could be inferred from circumstantial evidence. First, the franchisor knew that the franchisee was inexperienced and was depending on the franchisor for training. Second, at the time of entering into the franchise agreement, the franchisor did not have the resources to provide the training that it promised to the franchisee. Under these facts, the court found that the franchisor never intended to perform the contract and intended to defraud the franchisee into believing that it would perform.

**f. Reasonable Detrimental Reliance**

The law typically requires parties claiming fraudulent inducement to prove both actual (subjective) and reasonable reliance, although there are exceptions in some states. Some jurisdictions place a duty to investigate on the party claiming fraud. Reasonable reliance in these jurisdictions means that the party claiming to have been defrauded must have taken reasonable steps to ascertain the truth. In *Williams v. Dresser Industries, Inc.*, for instance, the plaintiff did not take ordinary steps to investigate the franchisor, and such an investigation would have revealed that the franchisor was actively looking for a joint venture partner. The court held that the franchisee could not have reasonably relied on any representations or omissions that would have been contradicted if the franchisee had

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33 No. 01-5679, 2003 WL 932432 (6th Cir. Mar. 6, 2003).
35 447 N.W.2d 639, 644 (N.D. 1989).
36 See Section III for a detailed discussion on reliance.
37 120 F.3d 1163 (11th Cir. 1997).
investigated the matter: “[O]ne who relied upon the representations of another must have used the means available to him, in the exercise of diligence, to discover the truth.”38

**g. Injury**

Finally, a plaintiff must show that the fraud proximately caused her damage. In other words, there must be an actual injury that occurred because of the fraudulent misrepresentation. In franchise (and other) cases, causation can be difficult to prove. In *Midwest Home Distributor, Inc. v. Domco Industries Ltd.*,39 the franchisor represented that the franchisee would have certain exclusive rights in Iowa. At the same time, the franchisor was negotiating with another franchisee. The franchisor then assured its franchisee that because the system was growing, the additional franchisee would not harm projected sales levels. After the second franchise opened, the franchisee’s profits declined noticeably. The Iowa Supreme Court upheld the jury’s verdict against the franchisor, holding that it was reasonable to conclude that if the franchisor’s representations had been true, the franchisee would have earned higher profits.

Because causation can be difficult to prove, reliance may sometimes serve as a proxy. Stated differently, some courts view the actions taken in reliance on misrepresentations as the required injury. In *Tresprop*,40 the court held that the reliance element of fraudulent misrepresentation “serves the function of causation in fact.” Reliance, in other words, demonstrates that a party acted, or refrained from acting, because of the misrepresentation.41 Using this logic, the *Tresprop* court held that by the very act of opening its own franchise, the franchisee was harmed by its franchisor’s misrepresentations regarding the other local franchise.

**2. Burden of Proof Under Common Law Intentional Misrepresentation**

In many jurisdictions, the plaintiff bears the burden to prove the elements of intentional misrepresentation by clear and convincing evidence.42 These jurisdictions impose a higher burden on the plaintiff in cases of intentional fraud in part because a finding of fraud carries significant non-monetary consequences and courts seek to ensure that the defendant’s

38 *Id.* at 1171-72.

39 585 N.W.2d 735 (Iowa 1998).


41 See, e.g., *Motor City Bagels, LLC v. American Bagel Co.*, 50 F. Supp. 2d 460 (D. Md. 1999) (denying summary judgment in part because plaintiffs could show that they sustained injuries because they never would have entered into any franchise agreements had they been presented with updated and accurate cost estimates).

reputation is not falsely tarnished. Although courts provide differing views on what “clear and convincing” means, the definition is generally agreed to refer to more than a preponderance and usually means evidence that leaves little doubt in the mind of the trier of fact. Some courts hold that a plaintiff need prove the elements of common law representation only by a preponderance of the evidence.

3. RICO Claims

The law does not limit a franchisee deceived by a fraudulent representation to claims based on common law fraud alone. In fact, fraudulent statements, along with a scheme to obtain money, may serve as the basis for a RICO claim. For example, in Westerfield v. Quizno’s Franchise Co., LLC, the court noted that the RICO statutes:

apply to any scheme “where in order to get money or something else of monetizable value from someone you make a statement to him that you know to be false, or a half truth that you know to be misleading, expecting him to act upon it to your benefit and his detriment.”

In the Westerfield case, a group of franchisees brought a RICO claim against Quizno’s arguing that Quizno’s had a practice of “overcharging franchises and requiring kickbacks from approved vendors,” and that Quizno’s had made fraudulent statements in its UFOC to further this scheme. The purportedly fraudulent statement was that Quizno’s would negotiate purchase arrangements with suppliers “for the benefit of [its] Franchisees.” The court, however, expressed doubt as to whether the term “benefit” was definite enough to be fraudulent, and therefore might not be sufficient to serve as the basis for the RICO claim. Ultimately, the court reversed its earlier decision and held that the determination of whether the word “benefit” was fraudulent or simply puffery “must be left for trial, or at least a more complete development of the record.” Franchisors, therefore, must be aware that where a claim of fraud is alleged, other, more serious, claims may follow.

44 See, e.g., Varbel v. Sandia Auto Elec., 988 P.2d 317, 321 (N.M. Ct. App. 1999) (“For evidence to be clear and convincing, it must instantly tilt the scales in the affirmative when weighed against the evidence in opposition and the fact finder’s mind is left with the abiding conviction that the evidence is true.”); In re Conduct of Johnson, 300 Or. 53, 55 (1985) (clear and convincing means highly probable); Hocks v. Jeremiah, 759 P.2d 312, 315 (Or. Ct. App. 1988) (“‘Clear and convincing’ means that the evidence is free from confusion, fully intelligible and distinct and that the truth of the facts asserted is highly probable”). For a full and interesting discussion of the history of the “clear and convincing” standard, see Riley Hill Gen. Contractor, Inc. v. Tandy Corp., 303 Or. 390 (1987).


46 No. 06-C-1210, 2008 WL 2512467 (E.D. Wis. Apr. 16, 2008).
47 Id. at *7 (citing Emery v. American Gen. Fin., Inc., 71 F.3d 1343, 1346 (7th Cir. 1995)).
48 Id. at *6.
49 Id. at *7.
50 Id.
B. Common Law Negligent Misrepresentation

In addition to intentional misrepresentation, many jurisdictions recognize the related tort of negligent misrepresentation. Negligent misrepresentation is a lesser claim of fraudulent misrepresentation in which the plaintiff need not prove that the defendant knew its representation was false. Negligent misrepresentation is not an available alternative in some states. Virginia law, for example, does not recognize negligent misrepresentation as a tort separate from fraud.\(^{51}\) Other states treat the two as separate but similar claims, defining negligent misrepresentation as a variation on intentional fraud. In Georgia, for instance, courts have defined negligent misrepresentation in terms of fraud by explicitly substituting negligence for the intent element of fraud.\(^{52}\) Massachusetts similarly explains the difference between the two as a matter of the knowledge or intent of the allegedly defrauding party. In \textit{Zuckerman v. McDonald's Corp.},\(^{53}\) the court explained that to prove negligent misrepresentation, instead of intent, “plaintiff must prove that the misrepresentation of defendant’s statement could have been discovered by the defendant if the defendant had exercised diligence.”\(^{54}\) In that case, the plaintiff claimed, among other things, that when McDonald’s encouraged plaintiff to reinvest in its restaurant, McDonald’s should have known that it intended to terminate plaintiff’s franchise. The court disagreed, finding that it was pure speculation that McDonald’s knew it would terminate the franchise in that location and that the evidence actually pointed in the opposite direction.

Some jurisdictions focus on an analysis of duties owed between the parties. In other words, the party making the negligent misrepresentation must have some duty to discover and convey the truth to the allegedly defrauded party. Many states, including Texas, use a version of the Restatement (Second) of Torts definition:

One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.\(^{55}\)

In \textit{Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin},\(^{56}\) the issue was a law firm’s liability for misrepresenting itself as expert in franchise law and then providing faulty legal advice. The court there explained that the Restatement standard is essentially a test for whether the person presenting information has a duty of care in presenting that information to someone who might reasonably be expected to rely upon it. In \textit{Beverly Hills}, the lower court


\(^{54}\) \textit{Id.} at 144.


found that the attorneys’ failure to advise plaintiffs about serious and basic requirements of Connecticut franchise law constituted negligent misrepresentation. In the subsequent history of the case, the Connecticut Supreme Court reversed in part, holding that plaintiff did not sustain its burden of proof regarding damages. In the portion of the holding relevant to negligent misrepresentation, the court held that a junior attorney’s presence at the time of the misrepresentation did not make her liable, but upheld the lower court’s analysis of negligent misrepresentation.

Unlike an intentional misrepresentation claim — which often requires clear and convincing evidence — most jurisdictions require the plaintiff to show the elements of negligent misrepresentation only by a preponderance of evidence. Like “clear and convincing evidence,” courts have defined the phrase “preponderance of evidence” in different ways, but most courts generally require a level of evidence that is required to make a fact more probable than not.

C. Statutory/Disclosure Violations

1. The FTC Rule

The Federal Trade Commission’s rule regarding “Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures” (the “FTC Rule”) requires franchisors and franchise brokers to provide prospective franchisees with what the FTC has determined is important information about the franchise. Franchisors can use either the format contained in the FTC Rule or the Franchise Registration and Disclosure Guidelines (“FDD”) adopted by the North American Securities Administrator’s Association.

Under both formats, the disclosure document must contain information on twenty-two separate items related to the franchise as well as the franchisor’s financial statements and any contracts the franchisor will require the franchisee to sign. If franchisors elect to make earnings claims or financial performance representations, the franchisor must identify certain specified information. The remedies available to the FTC enforcing the FTC Rule include restitution, rescission, civil penalties, attorneys’ fees and injunctions.
There is, however, no stated private right of action under the FTC Rule and a long and fairly unbroken line of cases has refused to imply a private right of action. The most promising case to date for a franchisee advocating a private right of action is Rodopoulos v. Sam Piki Enterprises, Inc., decided over a decade ago. In Rodopoulos, the Supreme Court of Alabama held that the requirements of the FTC Rule were admissible in a common law fraud case with regard to defendant's duty to disclose. The court upheld the trial court's finding for the franchisees, where the franchisor had misrepresented projected earnings and failed to disclose the earnings of the two existing franchisees. The court said the FTC Rule is relevant in determining what common law duty the franchisor had to disclose those earnings, notwithstanding no independent cause of action under the FTC Rule. An earlier case in New Jersey, Morgan v. Air Brook Limousine, Inc., had a similar holding, concluding that the FTC Rule established a standard for franchisor disclosure, violation of which creates a per se deceptive or unconscionable act or practice and that there was a private right of action for such an act under the New Jersey “little FTC Act.” Neither of these cases has generated a significant following.

Rather, courts generally have followed cases like Morrison v. Back Yard Burgers, Inc., in which the Eighth Circuit held that “[a] plaintiff should not be permitted to plead violation of FTC regulations as part of a state common law fraud case.” To do so, said the court, would effectively extend a private cause of action under the FTC Rule, which would be unacceptable.

2. Little FTC Acts

These acts typically protect consumers from “unfair or deceptive practices.” Issues under the varying state statutes include whether businesses (such as franchises) may rely upon the statute’s protections, whether a plaintiff must allege “consumer injury” and “injury to the public,” and whether the harm must result from the sale or distribution of goods versus alleged “anticompetitive conduct” of a business. Courts in a number of states have allowed little FTC actions by franchisees.

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62 570 So. 2d 661 (Ala. 1990).
64 91 F.3d 1184 (8th Cir. 1996).
a. Application to Franchise Sales

Nearly every state has enacted statutes closely modeled on the FTC Act, commonly referred to as "Little FTC Acts," or other statutes patterned on the Uniform Deceptive Trade Practices Act or Uniform Sales Practices Act. Some of these statutes specifically grant private rights of action for parties injured by violation of such statutes. Statutes based on the FTC Act’s prohibitions sometimes provide that state court decisions are to give consideration to decisions interpreting the FTC Act. Franchisees have asserted the protection of these statutes in lawsuits alleging fraud or misrepresentation, in lieu of or in addition to common law claims. Some actions have alleged that failure to comply with the FTC franchise disclosure rule amounts to a violation of the applicable state Little FTC Act.

Little FTC Acts and deceptive practices statutes vary from state to state in a number of ways — including standing (e.g., what persons may sue) and available types of remedies. Interpretations of their substantive scope also differ. Thus, some statutes by language or interpretation limit relief to “consumers” — which some courts have construed to exclude franchisees — while other statutes by language or interpretation permit recovery by franchisors, franchisees and retail consumers alike. Others do not permit private causes of action. Some courts have engrafted a "public interest" requirement, i.e., that the complained of act must have some adverse effect on the public generally and not just on the plaintiff.

To what extent is a violation of the FTC franchise disclosure rule a violation of a state Little FTC Act? One court has held under New Jersey law that the FTC Rule establishes a minimum standard of fairness and that failure to disclose in compliance with the rule is a per se


70 Compare Meineke Disc. Muffler v. Jaynes, Bus. Franchise Guide (CCH) ¶ 10,263 (5th Cir. Aug. 30, 1993) (former franchisee not a "consumer" with standing to sue franchisor under the Texas little FTC Act on a claim focusing on the validity of the franchisor’s trademarks and service marks; the validity of the marks involved intangible personal property rights, and the Act required that claims arise from the purchase or lease of tangible goods or services), with Carlock v. Pillsbury Co., 719 F. Supp. 791, 851 (D. Minn. 1989) (Idaho legislation did not limit standing to the purchasing public as consumers).

71 See, e.g., Hardee’s of Maumelle, Ark., Inc. v. Hardee’s Food Sys., Inc., 31 F.3d 573 (7th Cir. 1994) (Arkansas "little FTC Act" does not explicitly permit private causes of action).

A deceptive act or practice in violation of the New Jersey Consumer Fraud Act. One of the most clear-cut precedents in this area concerned a franchisee who complained of a franchisor's misleading earnings claims — statements that the franchisee would be making a “living wage” within six months. The court, finding the Connecticut Unfair Trade Practices Act was modeled after the FTC Act, reasoned that since unsubstantiated earnings claims were unlawful under federal law, they were likewise unlawful under state law. In another case under a different state’s unfair trade practices law, the court held that a manufacturer’s repeated representations that problems in a software package would be fixed when they were not in violation of that law. On the other hand, in LeBlanc v. Belt Ctr., Inc., the court reached an opposite conclusion, because the franchisee had not alleged or proved prejudice resulting from the franchisor’s failure to disclose FTC-required information and there was “no element of fraud, misrepresentation, deception, or unethical conduct in the confection of the franchise agreement.”

b. **Scienter**

If a plaintiff can establish that a Little FTC Act or unfair deceptive trade practice statute applies to their relationship, the plaintiff may not have to prove that the party making the misrepresentation intended to lie or mislead the receiver of the representation. Some states dispense with scienter; other states essentially make it an element of the plaintiff’s claim.

c. **Reliance**

Unlike common-law claims based upon misrepresentation (both intentional and negligent), claims based upon unfair deceptive trade practice statutes often will not require either objective reliance (that is, it was reasonable for the harmed party to rely upon the misrepresentation) or subjective reliance (that is, the harmed party actually did rely upon the misrepresentation). Although the court in Bailey Employment Systems, Inc. v. Hahn, rejected

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75 Computer Sys. Eng’g, Inc. v. Qantel Corp., 740 F.2d 59 (1st Cir. 1984).


77 Id. at 137; see also Symes v. Bahama Joe’s Inc., No. 87-0963-Z, 1988 WL 92462 (D. Mass. Aug. 12, 1988) (violation of FTC franchise disclosure rule is not necessarily a violation of Massachusetts Little FTC Act; objectionable conduct must attain a level of “rascality” that would raise an eyebrow in the world of commerce; allegations of fraud and nondisclosures as to potential earnings directly contradicted by contractual disclaimers of representations made outside the contract).


79 545 F. Supp. at 67-68.
various claims under common law fraud analysis, it held the franchisor liable for violation of the Connecticut Unfair Trade Practices Act. The court said that the franchisor’s representations about the size of its system and its financial condition have a tendency or capacity to deceive, and it was, therefore, unnecessary to prove that the plaintiff relied on a misrepresentation or that it was the basis of the bargain. Yet some courts have rejected franchisee claims for failure to show reliance or damages on the statements at issue.

**d. Damages and Attorneys’ Fees**

Most Little FTC Acts provide for a range of remedies, including injunctive relief and actual damages. Many of them provide for multiple or punitive damages and the award of attorneys’ fees. Thus, under the Idaho Consumer Protection Act a court may award punitive damages or such equitable relief as it deems necessary in cases of repeated or flagrant violations of the Act. Under the Connecticut Act, punitive damages may be awarded in the discretion of the court if the defendant’s conduct was recklessly indifferent, intentional or wanton, malicious, violent or motivated by evil. In one case, a franchisor’s furnishing of estimates of income to a franchisee, which a jury later found to be misleading, was not such conduct as to support an award of punitive damages. Under the New Mexico Unfair Trade Practices Act, a prevailing party may obtain attorneys’ fees. Under the Texas Deceptive Trade Practices Act, multiple damages may be awarded if the defendant’s conduct is intentional. Additionally, under the Texas Act a plaintiff may seek injunctive relief.

**3. Registration Statutes**

The states with franchise statutes requiring disclosure or registration, or both, all provide private rights of action for noncompliance. Most statutes apply to franchises located within the state, purchases of franchises within the state, and offers of sale made from within the state.

There are two, and sometimes three, elements to registration and disclosure: (1) a required disclosure; (2) a manner in which the required disclosure must be made; and (3) registration with the appropriate state agency. In non-registration jurisdictions, only the first two elements come into play.

As discussed below, the fact of disclosure creates a duty to disclose and lays the foundation in all jurisdictions for the franchisor’s duty to make full disclosure to the prospective franchisee. The manner of disclosure addresses whether the disclosure, once made, is not misleading, even if truthful. And the requirement of registration, as a creature of statute, in

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80 Id. at 69-71; see also Salkeld v. V.R. Bus. Brokers, 548 N.E.2d 1151, 1160 (Ill. App. Ct. 1989) (plaintiff not required to show actual reliance on defendant’s statements and may recover for innocent misrepresentations); Atl. Sport Boat Sales v. Cigarette Racing Team, Inc., 695 F. Supp. 58, 62 (D. Mass. 1988) (general criteria for finding an unfair or deceptive act is whether conduct is within “at least the penumbra of some common-law, statutory or other established concept of unfairness, [or] is immoral, unethical, oppressive, or unscrupulous”).

81 Bartolomeo v. S.B. Thomas, Inc., 889 F.2d 530, 534 (4th Cir. 1989) (although defendant’s intent or good faith is irrelevant under North Carolina statute, and plaintiff must only prove that acts complained of tended to deceive or created likelihood of deception, plaintiff must still show he was injured as a proximate result of defendant’s actions); see also In re Pharmaceutical Industry, 252 F.R.D. at 97-98 (discussing reliance requirement, or lack thereof, in various states’ Little FTC Acts).

some jurisdictions will create a statutory prerequisite to the lawful sale of a franchise opportunity.

Sometimes a franchisee wishing to get out from under an allegedly oppressive franchise relationship need only show that the franchisor failed to register its disclosure statement as required by the applicable state law. The franchisor’s failure to register with a state does not in and of itself void the franchise agreement, however. Only when the statute provides that a franchise agreement is voidable by the franchisee if the franchisor fails to register will the courts allow the franchisee to void the agreement for failure to register. Efforts to rescind a sale for failure to register are subject to the standard equitable defenses.

Some courts have held that a franchisor’s failure to register a franchise offering prior to entering into an agreement with a prospective franchisee is a condition precedent to the effectiveness of the franchise agreement. Consequently, when a franchisor has sought to enforce the franchise agreement, the courts have denied enforcement, reasoning that an unregistered franchise offering was an illegal and thus unenforceable contract.83

Some states limit the franchisee’s right to void the franchise agreement for a failure to register to situations in which the franchisor’s failure was “willful.”84 Other states require a franchisee to show that it actually was damaged by the failure to register before the franchisee can seek relief.

4. Disclosure Statutes

a. Device, Scheme, or Artifice to Defraud — Statutory Elements

Although the FTC Rule does not grant franchisees private rights of action for a franchisor’s failure to disclose, all of the franchise statutes that require disclosure do create private rights of action. The disclosure obligation requires franchisors to timely provide franchisees with certain information in a certain time and in a certain manner. Most of these statutes require a franchisor to provide a disclosure a certain number of days prior to execution of the franchise agreement. The FTC Rule, for example, requires a franchisor to give the offering circular to a prospective franchisee “at least 14 calendar-days before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or an affiliate in connection with the proposed franchise sale.”85

The key element in most of these statutes is whether the disclosure (or failure to disclose) was misleading. Thus, it is possible for a disclosure to be truthful, but because it is incomplete or presented in an improper manner, it still can be misleading. Although most franchise statutes allow a franchisee to recover its actual damages, a franchisee would not


85 16 C.F.R § 436.2(a).
necessarily have to establish any damages to seek and obtain other kinds of relief, such as equitable remedies, exemplary damages and/or attorneys’ fees.

Although some courts have found that a franchisee must establish some level of reliance upon the misrepresentation or omission before asserting a successful claim pursuant to the statute, others have not. In addition, integration and/or acknowledgment clauses might be rendered ineffective by those statutes that include anti-waiver provisions.

b. Materiality

When asserting a “misrepresentation-type” claim (whether under the common-law or a statute), a franchise lawyer should always refer to the disclosure requirements contained in the FTC Rule and/or FDD Guidelines as a basis for establishing materiality. The FTC Rule, FDD Guidelines and particularized state requirements call for disclosure of specified information or “Items.” It can be persuasively argued that such governmental requirements define the information required therein to be material.

The FTC Rule defines “material” to include “any (1) fact, circumstance, or set of conditions which has a (2) substantial likelihood of influencing a reasonable franchisee or a reasonable prospective franchisee in the making of a significant decision relating to a named franchise business or (3) which has any significant financial impact on a franchisee or prospective franchisee.” The commentary to the FTC Rule also provides that the offering circular must be updated, on at least a quarterly basis, whenever a material change occurs in the information contained in the document. In addition to the updating requirement, prospective franchisees must be notified of any material changes in the information contained in the earnings claim document prior to entering into a franchise relationship.

The Indiana Supreme Court has held that a franchisor's failure to disclose that its underground tank testing system failed to meet Environmental Protection Agency standards constituted a violation of the anti-fraud provision of the Indiana Franchise Act. Enservco, Inc. v. Indiana Securities Division. The court concluded that the performance capacity of the tank system is information which a reasonable investor would certainly consider crucial to an investment decision.

c. Reliance

Although most courts have concluded that a plaintiff must have justifiably and reasonably relied upon the misrepresentation to succeed on claims for intentional and/or negligent misrepresentation, courts have concluded that plaintiffs need not establish reliance (justifiable or not) to successfully pursue a misrepresentation-type claim under applicable state disclosure statutes. See Randall v. Lady of America Franchise Corp., discussed below in Section III.C.

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86 See Section III of this paper for a more in depth discussion on Reliance.

87 See, e.g., Randall v. Lady of America Franchise Corp., 532 F. Supp. 2d 1071 (D. Minn. 2007) (finding that the Minnesota Franchise Act’s anti-waiver provision voided disclaimer clause in franchise agreement).

88 623 N.E.2d 416 (Ind. 1993).

d. Damages

There is considerable variation as to how much the franchisee can recover from the franchisor for non-compliance with a disclosure statute. For example, Hawaii and Washington allow the court to increase the award to as high as three times the actual damages sustained. While Minnesota, South Dakota and North Dakota do not specifically provide for treble damages, the courts may award "such relief as the court deems appropriate." On the other hand, some states, (i.e., Maryland, Michigan, New York and Virginia) limit awards to actual damages sustained, plus interest, reasonable attorneys' fees and costs and disbursements.90

Under several of the state franchise laws, in an action for damages for a statutory violation, the franchisee must prove that the franchisor's alleged violation caused the franchisee to suffer the alleged damages. For instance, in Dunkin' Donuts, Inc. v. HWT Associates, Inc.91 a franchisee alleged that its franchisor had failed to properly disclose the locations of certain competing franchises. The court held that, even if the franchisor were required to disclose this information, summary judgment in favor of the franchisor was appropriate because the franchisee "failed to establish that they were damaged by the existence or nondisclosure of competing franchises in the vicinity of their shop."92

Rescission is a remedy under all of the state franchise laws.93 However, a franchisee may not always be entitled to rescission even if the franchisor violated some provision of a state franchise law.94

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90 The following are damages provisions by selected states: ARKANSAS — treble damages, injunctive relief, reasonable attorneys' fees and costs of litigation, Ark. Code Ann. § 4-72-208. FLORIDA — injunctive relief, damages, reasonable attorneys' fees, costs, Fla. Stat. § 817.41. HAWAII — actual damages, reasonable attorneys' fees and costs, discretion to award an amount not to exceed three times actual damages, HRS § 482E-9. ILLINOIS — consequential damages (includes lost future profits for a reasonable length of time), interest (8%), reasonable attorneys' fees, Ill. Comp. Stat. § 705/26. IOWA — damages, costs and reasonable attorneys' and experts' fees, and other appropriate injunctive and equitable relief, Iowa Code § 523H.14. MARYLAND — actual damages, rescission, restitution, injunctive relief, Md. Code Ann., Bus. Reg. § 14-227. MICHIGAN — damages or rescission, with interest at 6% per year from the date of purchase until June 20, 1984, and 12% per year thereafter and reasonable attorneys' fees and court costs, Mich. Comp. L. § 445.1531. MINNESOTA — damages, rescission, or other relief as the court may deem appropriate, costs and disbursements plus reasonable attorneys' fees, Minn. Stat. § 80C.17. MISSISSIPPI — damages, costs, any equitable relief the court deems proper, Miss. Code §§ 75-24-57, 75-24-59. NEBRASKA — damages, injunctive relief, attorneys' fees and costs, Neb. Rev. Stat. § 87-410. NEW JERSEY — injunctive relief, damages, attorneys' fees, N.J. Stat. Ann. § 56:10. NEW YORK — damages, if willful and material, for rescission, with interest at 6% per year from date of purchase, and reasonable attorney and court costs, N.Y. Gen. Bus. L. § 691. NORTH DAKOTA — damages, rescission, or such other relief as the court may deem appropriate, costs and disbursements plus reasonable attorneys' fees, N.D. Cent. Code § 51-19-12. OREGON — amount to which franchisee would be entitled upon an action for a rescission, reasonable attorneys' fees, Or. Rev. Stat. § 650.020. PUERTO RICO — damages, injunctive relief, L.P.R.A. § 278b. RHODE ISLAND — damages, costs, attorneys' and experts' fees, rescission, R.I. Gen. Laws § 19-28.1-21. SOUTH DAKOTA — damages (not to exceed three times actual damages), rescission, or other relief as the court deems appropriate, reasonable attorneys' fees and costs, S.D. §§ 37-5A-83, 37-5A-85. VIRGINIA — damages, reasonable attorneys' fees, costs, and any remedies that may exist at law or in equity, Va. Code § 13.1-571. WASHINGTON — damages (an amount not to exceed three times actual damages provided that the prevailing party may recover costs including reasonable attorneys' fees), rescission or other relief as the court may deem appropriate, RCW § 19.100.190. WISCONSIN — damages, rescission, and any other rights or remedies that may exist at law or in equity, Wis. Stat. § 135.06.

92 Id. at 712.
franchise law. Although there is relatively little case law on the topic, courts have required franchisees to satisfy certain prerequisites in order to obtain rescission under state disclosure laws. Some of the more important prerequisites that a franchisee seeking rescission may have to satisfy include showing actual injury, showing that the violation by the franchisor was willful and showing that it sought rescission in a timely manner.

Several cases have held that the plaintiff must show actual injury in order to obtain rescission. In Layton v. AAMCO Transmissions, Inc.,94 a franchisee sought rescission based upon the franchisor’s failure to disclose the existence of settlement negotiations with fourteen attorneys general over consumer complaints about the franchise system. However, the plaintiff could prove no damages — his revenues exceeded even his own estimates. The court found that AAMCO’s nondisclosure was not morally reprehensible or in clear violation of public policy. There were sound business reasons for AAMCO to keep its negotiations secret. The court held that the plaintiffs could not wait out a game of “heads we win and tails you lose.”95

Under many state franchise laws, a franchisee will be entitled to rescission if the franchisor has committed a “willful” violation. California, New York and Rhode Island specifically require that a violation be willful to entitle a franchisee to rescission. The statutes, however, do not contain a definition of “willfulness,” leaving it to the courts to decide. Based on case law, in order for a violation to be “willful,” the franchisor must have committed the act despite knowledge that it is a violation of the law. For example, in Neptune Society Corp. v. Longanecker,96 the court held that a crematory service franchisor’s failure to register the corporation under the California Corporations Code was a willful violation based on evidence that the franchisor’s attorney had advised him that the business constituted a franchise. Further, a prospectus given to the franchisee during negotiations specifically described the agreement which the parties eventually executed as a “Franchise Agreement.”

Hawaii, Washington and Wisconsin also explicitly provide a “good faith” defense for innocent misrepresentations. These provisions provide important defenses to franchisors. For example, in King Computer, Inc. v. Sports Page Plus of New York, Inc.97 the court found that the franchisor’s failure to register under the New York Franchise Sales Act did not require rescission of a franchise agreement with a distributor. After a trial, the district court entered judgment for the franchisor because, under New York law, a claim for rescission must be based on a finding that a violation of the statute was willful and material. The court held that if the evidence did not show that the franchisor intended to defraud plaintiff, only that the franchisor failed to research adequately the viability of a particular location.

Also, a franchisee may waive its right to rescission by operating under the franchise agreement for some time period after learning of the facts giving rise to the claim. Some states have specific time limits that must be observed to effectuate a rescission.98 Additionally, a

plaintiff may waive the remedy of rescission by electing to proceed under a breach of contract theory. In *Layton v. AAMCO Transmissions, Inc.* an additional reason that the district court refused to grant the plaintiff rescission was that the plaintiff had not timely filed his claim. The court held that if the plaintiff had sought rescission immediately when the entry of the consent orders with the attorneys general was publicly announced, the claim that the franchisee had been materially misled would have been much more compelling and the statutory purpose of requiring full disclosure in the sale of franchisees could have been more easily reconciled with commercial reality. In short, if the plaintiff wanted to seek rescission, he should have done so at the time he discovered the violation.

III. RELIANCE

Reliance is frequently the most critical element in a franchise fraud case arising from the sale of a franchise opportunity. Although reliance is typically an issue of fact, the franchisor’s best hope for disposing of a fraud claim on summary judgment is often to demonstrate that a franchisee could not, as a matter of law, have reasonably relied on the alleged misrepresentation in entering the franchise relationship.

A. Disclaimers and Reliance: A Summary of the Law

The franchisor’s principal tools for arguing no reliance as a matter of law are disclaimers in franchise documents that are at the same time extremely broad and also quite specific. In contrast, the franchisee that avoids summary dismissal of its case based on disclaimers greatly increases its odds of getting its case to the jury, and a case bound for the jury has significantly more settlement value.

Franchisors use three forms of disclaimers in franchise documents: integration clauses, “no-reliance” clauses, and “no-authority” clauses. The first consists essentially of a statement that the franchise documents contain the entire agreement of the parties and that the parties have made no promises, warranties, or representations that are not contained in the documents themselves. The second is a statement that the franchisee has not relied on any representation not contained in the franchise documents. The third is a statement that the franchisor does not authorize its employees to make representations not contained within the franchise documents. Savvy franchisors also specifically disclaim garden-variety forms of claimed misrepresentations. For example, franchise documents regularly disclaim earning claims or financial performance representations. Franchisors typically include within their franchise documents a combination of these three forms of disclaimer.

A court’s analysis of the effect of a disclaimer theoretically turns on the type of disclaimer at issue. As discussed more fully in the remainder of this section and by way of a general summary of the law, the courts find that an integration clause does not bar claims of fraud (the so-called “fraud exception” to the parol evidence rule). Most courts hold, however, that an integration clause alone may bar such claims where the claimed representation (typically promissory fraud) conflicts with the terms of the parties’ agreement (a version of the “direct contradiction rule” discussed below). The courts tend to treat general no-reliance clauses the same as integration clauses. A general statement that the franchisee has not relied on any representation not in the franchise documents will not necessarily preclude a fraud claim. Where, however, the franchisee has specifically disclaimed reliance on the very representation

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99 717 F. Supp. at 374.
upon which it now bases its lawsuit, the courts typically hold as a matter of law that the franchisee could not have reasonably or justifiably relied on the alleged misrepresentation (another version of “the direct conflict rule”). Courts have rarely, if ever, considered separately the effect of a no-authority clause.

Because franchisors tend to use all three forms of disclaimers, and because standard disclaimers are typically all-encompassing, the courts often do not distinguish one form of disclaimer from another. Instead, they identify the disclaimers collectively and rule on their overall effect on the franchisee’s fraud claim.

The majority of courts hold that standard franchisor disclaimers bar franchisee fraud claims as a matter of law. A number of courts have said, however, that standard disclaimers do not automatically bar claims by franchisees. These courts typically rely on one or more of the following theories: (1) disclaimers automatically bar misrepresentation claims only by sophisticated parties; (2) applicable law does not require that the franchisee’s reliance be reasonable (an objective test), so the trier of fact must decide whether the franchisee in fact relied, even in the face of a disclaimer; (3) only those claimed misrepresentations that are entirely at odds with a specific disclaimer are barred; and (4) anti-waiver clauses under applicable state statutes bar the use of a disclaimer to defeat a statutory action for fraud.

Because of these varying approaches to disclaimers in a franchise context, the very same disclaimers that will bar recovery in one case before a particular judge in a particular jurisdiction may not bar recovery in another case before a different court or in a different jurisdiction. We begin with a review of different approaches courts have taken in their treatments of the disclaimers in the Quizno’s and Lady of America franchise documents.

B. Different Approaches to Disclaimers — the Quizno’s Cases

Several recent Quizno’s cases illustrate the differing approaches courts have taken to the same integration clause. Westerfield v. Quizno’s Franchise Co. was the first of a trilogy of cases to consider in detail the effect of disclaimers in the standard Quizno’s franchise documents. In a decision dated November 5, 2007, Judge Griesbach of the Wisconsin Federal District Court summarily dismissed franchisees’ fraud claims against Quizno’s on the ground that they were “fatally undermined by the express disclosures, disclaimers and non-reliance clauses contained in both the Uniform Franchise Offering Circular . . . that each plaintiff received and the Franchise Agreement that each plaintiff signed.” The disclaimers included a specific representation that the franchisees had received no earnings claims except those specifically identified in the disclaimers, to which the franchisees wrote on a blank line, “none.” Regarding the franchisees’ claim that Quizno’s employees made oral misrepresentations about future profitability, the court ruled that “in the face of these clear and unambiguous disclaimers and non-reliance clauses, plaintiffs cannot plausibly claim that they reasonably relied on oral statements concerning likely profits and expenses in deciding whether to invest in a Quizno’s franchise.”

100 527 F. Supp. 2d 840 (E.D. Wis. 2007).
101 Id. at 846.
102 Id. at 849.
A few months later, on March 31, 2008, Judge Pallmyer of the Eastern District of Pennsylvania reached a similar conclusion in the second Quizno’s case, Siemer v. Quizno’s Franchise Co. The court said that it “concurs with Judge Griesbach that it is unreasonable for Plaintiffs to claim reliance on extra-contractual representations despite having stated in writing that they would not rely on representations outside the UFOC and Franchise Agreement.”

Quizno’s winning streak ended when Judge Griesbach reconsidered his first ruling. On April 16, 2008, Judge Griesbach, in response to a motion for reconsideration, concluded from a “more detailed consideration” of the cases that he had “erred in concluding that Quizno’s disclaimers and non-reliance clauses fatally undermined” plaintiffs’ fraud claims as a matter of law. The court distinguished the cases upon which he had previously relied and concluded that Seventh Circuit and Wisconsin case law warranted the fraud claims surviving a motion to dismiss. As it relates to the plaintiffs’ federal law claims (RICO), the judge said that under prevailing Seventh Circuit authority, a court or trier of fact must consider the sophistication of the parties before ruling that a no-reliance clause bars a claim as a matter of law. In terms of the state law claims, the court held that Wisconsin follows the Restatement, which makes exculpatory clauses unenforceable where a defendant intentionally or recklessly caused the alleged harm. Seemingly important to the court from its quote of a Massachusetts case was the possibility that a plaintiff could sign a disclaimer or non-reliance clause, yet still in fact rely on representations that are in fact false. The court therefore denied the motion to dismiss and granted the plaintiffs’ motion to amend.

The next blow to Quizno’s came on June 15, 2009, when Magistrate Judge Lisa Pupo Lenihan of the Western District of Pennsylvania also denied Quizno’s motion to dismiss fraud claims in light of its standard disclaimers. The magistrate judge said she was “in complete agreement with the just and insightful observations of the Massachusetts Supreme Court, as quoted in Judge Griesbach’s Opinion.” The court also said was that the disclaimers did “not purport to nullify an important representation on which Plaintiffs’ fraud claim is based in substantial part.”

C. The Lady of America Cases

Two cases involving the franchisor Lady of America (LOA) further illustrate how courts treat the same disclaimer clauses differently. The LOA form franchise documents contain all of the usual disclaimers, including the liberal use of capital letters. Thus, the franchisee acknowledges that (1) it has conducted an independent investigation, (2) the franchise investment is risky, (3) it has received no representations regarding actual or potential earnings or expenses, (4) it will identify in writing all representations not in the franchise documents, and (5) it is not relying on anything not set forth in the written documents. This was enough for


104 Id. at *8.


107 Id. at *14.

108 Id.
Florida federal Judge Cohen to grant LOA’s motion to dismiss a 2006 case, *Lady of America Franchise Corp. v. Malone.* 109 The court held that the Florida Franchise Act requires a plaintiff to justifiably rely on oral representations. The court said that the LOA franchise documents contained “an extremely comprehensive and unambiguous disclaimer that directly addresses all the statements Malone seeks to introduce,” 110 including “representations received regarding profits and successes.” 111 Because plaintiff failed to “establish any set of facts which circumvent the unambiguous disclaimer,” the court dismissed plaintiff’s claims. 112

LOA was not as successful with the same argument in a 2007 case, *Randall v. Lady of America Franchise Corp.* 113 LOA relied in *Randall* on the same disclaimers that were so helpful to it in the *Malone* case. Minnesota Federal District Court Judge Schiltz considered himself bound by *Malone* to dismiss most of the Florida Franchise Act claims. He found, however, that he had a cleaner slate upon which to write his opinion on the effect of the standard disclaimers under Minnesota law. In the process, Judge Schiltz delivered one of the most franchisee-friendly decisions on the books. The court first held that the Minnesota Franchise Act, in contrast to the Florida version, does not demand justifiable reliance on a misrepresentation. Because the Minnesota Act does not require justifiable reliance, according to Judge Schiltz, it is irrelevant whether the plaintiffs’ reliance in *Randall* was reasonable in light of the disclaimers. The court further held that the anti-waiver provision of the Minnesota Franchise Act rendered the disclaimers in the LOA franchise documents unenforceable. Finally, Judge Schiltz ruled that the disclaimers did not bar the common law claims. He also found that the parol evidence rule did not apply and that justifiable reliance is not an element of Minnesota common law fraud.

D. The General Rule

As illustrated by the *Quizno’s* and *Lady of America* cases, the legal effect of a disclaimer depends on the controlling law and the judge applying it. Still, based on case count alone, the general rule remains that the disclaimers commonly used by franchisors today will bar franchisee fraud claims. Franchisors have available to them a long list of cases holding that franchisees may not, as a matter of law, reasonably rely on alleged misrepresentations where the franchise documents contain the franchisor’s full arsenal of disclaimers. The string cite includes the following: *Cook v. Little Caesar Enterprises, Inc.* 114 (reliance upon oral representations or prior documents, even if false, unreasonable, precluding fraud claim, if parties enter subsequent agreement); *Hardee’s of Maumelle, Arkansas, Inc. v. Hardee’s Food Systems, Inc.* 115 (reliance on sales estimates unreasonable given plaintiffs’ acknowledgment that Hardee’s “has not made any statements regarding the profitability of any restaurant to be operated by franchisee” 116); *Call Carl, Inc. v. B.P. Oil Corp.* 117 (unreasonable to rely on oral

110 Id. at 41,849.
111 Id.
112 Id.
114 210 F.3d 653 (6th Cir. 2000).
115 31 F.3d 573 (7th Cir. 1994).
116 Id. at 576.
representations directly contradicting written agreement); \textit{Siemer v. Quizno's Franchise Co. LLC} \textsuperscript{118} (unreasonable to rely on oral representations after agreeing not to rely on representations outside the UFOC or franchise agreement); \textit{Carrel v. George Weston Bakeries Distribution, Inc.} \textsuperscript{119} (fraud claims precluded where distribution agreement contained an integration clause that provided that the agreement constituted the entire agreement between the parties, superseding all prior agreements, discussions and representations); \textit{Kieland v. Rocky Mountain Chocolate Factory, Inc.} \textsuperscript{120} (summary judgment on fraud claim where franchisee acknowledged that no representations had been made by the franchisor regarding projected sales volumes, market potential, revenues, or profits); \textit{American Casual Dining, L.P. v. Moe's Southwest Grill, L.L.C.} \textsuperscript{121} (merger and acknowledgment clauses precluded restaurant franchisee’s negligent misrepresentation claim based on franchisor’s pre-contractual representations regarding food and labor costs); \textit{S & B Investments, LLC v. Motiva Enterprises, LLC} \textsuperscript{122} (unreasonable for franchisee to rely on prior representations that were inconsistent with and expressly contradicted by the later written contract); \textit{McDonald v. Friedman} \textsuperscript{123} (even if defendant deliberately misrepresented the site location and time frame provisions, plaintiffs could not have reasonably relied on such misrepresentations given the clear terms of their franchise agreement and related documentation to the contrary); \textit{Papa John's International, Inc. v. Dynamic Pizza, Inc.} \textsuperscript{124} (merger and integration precludes claim of fraudulent oral representations regarding business costs and revenue opportunities); \textit{Wooten Enterprises, Inc. v. Subaru of America} \textsuperscript{125} (actionable statements made during negotiations superseded by fully integrated franchise agreement); \textit{Motor City Bagels, L.L.C. v. American Bagel Co.} \textsuperscript{126} (alleged reliance on representations of average annual sales of stores in the franchise system was unreasonable because the offering circular stated that “[t]he franchisor is unable to provide actual, average, projected or forecasted sales, profits or earnings because . . . sales levels and profits are expected to vary depending upon the location of each particular Chesapeake Bagel Bakery”\textsuperscript{127} and that “there is no agent, officer or other representative of the franchisor who is authorized to make any sales, profit or earnings projections on behalf of the franchisor relating to the operation of a Chesapeake Bagel Bakery franchise”\textsuperscript{128}); \textit{Lang, Lang & Suhor Investors,}

\textsuperscript{117} 554 F.2d 623 (4th Cir. 1977).
\textsuperscript{118} No. 07 C 2170, 2008 WL 904874 (N.D. Ill. Mar. 31, 2008).
\textsuperscript{119} No. 1:05-CV-1769, 2007 WL 2827405 (S.D. Ind. Sept. 25, 2007).
\textsuperscript{120} No. 05-150, 2006 WL 2990336 (D. Minn. Oct. 18, 2006).
\textsuperscript{121} 426 F. Supp. 2d 1356 (N.D. Ga. 2006).
\textsuperscript{122} No. 03-61993, 2004 WL 3250306, at *5 (S.D. Fla. Dec. 6, 2004).
\textsuperscript{124} 317 F. Supp. 2d 740 (W.D. Ky. 2004).
\textsuperscript{125} 134 F. Supp. 2d 698 (D. Md. 2001).
\textsuperscript{126} 50 F. Supp. 2d 460 (D. Md. 1999).
\textsuperscript{127} \textit{id.} at 472.
\textsuperscript{128} \textit{id.}
LLC v. The American Bagel Co.129 (no reasonable reliance on costs and sales information where franchise agreements contained an integration clause as well as a disclaimer); Sangemino v. Money Mailer, Inc.130 (unreasonable for the franchisee to rely upon a gross sales chart where the franchise agreement provided that the franchisor “does not furnish or authorize its sales persons to furnish any oral or written information concerning actual or potential sales, costs, income or profits of the franchised business in connection with the offer and sale of its franchises”131); Barnes v. Burger King Corp.132 (reliance on representations contained in a letter unreasonable “as [the letter] flatly contradicted the terms of the UFOC and the Franchise Agreement”133); Shubot v. McDonald’s Corp.134 (reliance upon oral representations, even if false, unreasonable if the party enters into a subsequent written agreement containing contradictory terms); Carlock v. Pillsbury Co.135 (”party cannot reasonably rely upon allegedly fraudulent promises which are directly contradicted by the terms of an applicable offering statement . . . or a subsequently executed contract”136); Rosenberg v. Pillsbury Co.137 (purported reliance on oral representations was unreasonable because offering circular stated that “[n]either franchisor’s sales personnel nor any employee or officer of the franchisor is authorized to make any claims or statements as to the earnings, sales, or profits or prospects or chances of success that any franchisee can expect or that present or past franchisees have had”138); Hacienda Mexican Restaurant of Kalamazoo Corp. v. Hacienda Franchise Group, Inc.139 (no fraud claim based on alleged false, projected revenues, start-up expenses, and earnings, where disclaimer expressly stated that the franchisee had not relied upon any guarantees concerning revenues, profits, or the success of the franchise.); cf. Webb v. Savik140 (no exception to parol-evidence rule allowing plaintiff to introduce evidence of conversations with franchisor that would vary the terms of his written franchise agreement); Casserlie v. Shell Oil Co.141 (no claim for alleged false financial performance representation where UFOC said franchisor made no representation regarding profit or income, and franchise agreement contained an integration

131 Id. at *5.
133 Id. at 1427.
136 Id. at 829.
138 Id. at 1152.
A minority of courts have refused to dismiss franchisee fraud claims, notwithstanding all-encompassing disclaimer clauses. They typically rely on a number of theories for doing so, as discussed in III.E, F, and G below.

E. Reasonable v. Subjective Reliance

A core issue on the likely effect of disclaimers is whether the franchisee’s reliance on a claimed representation must be reasonable under the applicable law. This is certainly an issue in every fraud case, but its impact on summary dismissal relates particularly to disclaimers. Where the controlling law requires that the reliance be reasonable or justifiable, courts typically have little difficulty throwing out fraud claims in the face of standard franchisor disclaimers, as illustrated by the decisions identified above. Where, however, the test is whether the franchisee did in fact rely upon the alleged misrepresentation (i.e., subjective), even the most comprehensive disclaimers may not preclude a jury trial.

Judge Schiltz’s decision in Randall is again the poster child. Judge Schiltz found in Randall that “reliance under Minnesota [common] law is necessarily fact-specific, because it must be assessed from the subjective perspective of the person allegedly defrauded, not from some objective viewpoint.” Judge Schiltz further held that reliance under the Minnesota Franchise Act is subjective. To make matters worse for the franchisor, the judge concluded that the anti-waiver provision in the Minnesota Franchise Act voided the disclaimers in the Lady of America standard franchise documents. One might read Randall as saying that there is virtually nothing that a franchisor can do to preclude a fraud claim (common law or statutory) from going to the jury, at least as it relates to Minnesota Franchise Act claims. The question is always whether the franchisee in fact relied on the alleged misrepresentation (i.e., subjective), even the most comprehensive disclaimers may not preclude a jury trial.

The Court recognizes that, under its broad interpretation of § 80C.21, franchisors cannot use contractual provisions to protect themselves from being sued for misrepresentation under the Minnesota Franchise Act. Consequently, even scrupulously honest franchisors will have to defend against some misrepresentation claims that would not be brought — or that would be quickly dismissed — if contractual disclaimers were enforceable. But under the interpretation of § 80C.21 advocated by Lady of America — that is, under a rule in which courts give effect to contractual disclaimers regardless of whether franchisors have actually made false statements of material facts — a certain number of franchisees who have been lied to will have no redress against dishonest franchisors. The Minnesota legislature has decided to burden franchisors, and protect franchisees, and this Court is bound to enforce that decision.

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142 223 S.W.3d 676 (Tex. App.-Dallas, 2007).

143 Randall v. Lady of America Franchise Corp., 532 F. Supp. 2d 1071, 1086 (D. Minn. 2007).

144 Id. at 1089.
In most states, the test of reliance is objective, both under common law and statutory law, thus indicating that most courts will not follow suit with *Randall*. Under these cases, the issue is not simply whether the particular plaintiff relied, but whether a reasonable person would have relied upon the representation to their detriment. Courts following this test hold for common law fraud, identified in Section III.D. above, that a franchisee may not reasonably rely on an alleged representation in the face of the typical franchisor disclaimers. Most cases also hold, contrary to *Randall*, that state antifraud statutes require reasonable reliance. Cases holding that reliance under the anti-fraud provision of a franchise act must be reasonable include the following: *Lady of America Franchise Corp. v. Malone*, 145 *California Bagel Co. v. American Bagel Co.*, 146 *Cook v. Little Caesar Enterprises, Inc.*, 147 *Hardee’s of Maumelle, Arkansas, Inc. v. Hardee’s Food Systems, Inc.*, 148 *Motor City Bagels, LLC v. American Bagel Co.*, 149 *Harb v. Norrell Services, Inc.*, 150 and *Bonfield v. AAMCO Transmissions, Inc.* 151

F. The Surrounding Circumstances Cases

Some courts have held that a court should consider the circumstances surrounding execution of a no-reliance clause before deciding whether it is a bar to a fraud claim. The Seventh Circuit in *Extra Equipamentos E Exportacao LTDA v. Case Corp.*, 152 explained *in dicta* why a standard no-reliance clause might not automatically preclude a fraud claim: “The purpose of such a clause is to head off a suit for fraud, but the clause doesn’t say that; it uses the anodyne term ‘reliance’ and a lay person might not realize how much he was giving up by agreeing to the inclusion of the clause in his contract.” 153 The Seventh Circuit notes, however, that this does not mean that a court may not resolve enforceability of a no-reliance clause on summary judgment. It means only that a court might properly inquire into the circumstances before enforcing the clause.

Few courts have embraced the concept directly in the franchise context. A Washington federal judge found a middle ground in *Harb v. Norrell Services, Inc.*: 154

While such disclaimers do not, as a matter of law, preclude justifiable reliance on oral representations, plaintiffs must at least demonstrate some plausible explanation or factor justifying their reliance on oral representations inconsistent

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146 *Bus. Franchise Guide (CCH) ¶ 11,880 (C.D. Cal. June 9, 2000).*

147 210 F.3d 653 (6th Cir. 2000).

148 31 F.3d 573 (7th Cir. 1994).


152 *Bus. Franchise Guide (CCH) ¶ 13,975 (7th Cir. Sept. 3, 2008).*

153 *Id.* at 44,138.

with the express terms of their franchise agreements and offering circulars. Plaintiffs have not offered any such explanation. Both plaintiffs reviewed and understood the offering circulars and franchise agreement, and had them reviewed by their accountant, banker, or attorney.155

G. The Impact of Anti-Waiver Laws

Judge Schiltz held in Randall that the anti-waiver provisions of the Minnesota Franchise Act precluded a franchisor from using disclaimers as a bar to a fraud claim. Not many courts have ruled on the issue. A California federal court judge said in Burgo v. Lady of America Franchise Corp.156 that the anti-waiver provision of the California Franchise Investment Law precluded reliance on disclaimers: “the plain language of this provision makes merger and integration clauses and disclaimers of franchise agreements void . . . .”157 The New York Appellate division in Emfore Corp. v. Blimpie Associates, Ltd.,158 also held that the New York Franchise Act preclude use of a disclaimer to bar a franchisee fraud claim.

Some courts have specifically held that anti-waiver provisions do not preclude the use of disclaimers to defeat franchisee fraud claims. The court held in Harb v. Norrell Services, Inc.,159 as follows:

One issue of law, however, can be resolved at this point. The no-guarantee clause in the franchise agreements disclaiming any warranty or guarantee “as to the potential volume, profit, income or success of the business licensed under” the agreement is not barred by the anti-waiver provision of FIPA. The antiwaiver provision makes it unlawful to “[r]equire franchisee to assent to a release, assignment, novation, or waiver which would relieve any person from liability imposed by this chapter.” RCW 19.100.180(g). There is a similar provision in RCW 19.100.220:

Any condition, stipulation or provision purporting to bind any person acquiring a franchise at the time of entering into a franchise or other agreement to waive compliance with any provision of this chapter or any rule or order hereunder is void.

The no-guarantee clause does not constitute “a release, assignment, novation, or waiver,” of FIPA rights; rather it is evidence of the parties’ understanding. It is not dispositive as to possible Norrell misrepresentations or omissions, but Norrell may offer it as evidence that there were none.160

155 Id.
157 Id. at 41,049.
160 Id.
See also Quality Inns International, Inc. v. Dollar Inns of America, Inc.\textsuperscript{161} (the disclaimer is not a waiver, or release, but “it is a statement that tries to make clear to the parties and reach an understanding with respect to the parties that there were no statements made or at least none that would be relied on relating to future reservations.”)

\textbf{H. Authority}

Franchisors have an independent argument that their sales staff committed unauthorized acts when they made misrepresentations and that the franchisee knew of the lack of authority. Many of the cases that rejected fraud claims as a matter of law based on disclaimers have emphasized the franchisor’s statement that its sales personnel were not authorized to make certain representations. The court in Sangemino v. Money Mailer, Inc.\textsuperscript{162} observed that a franchisee could not reasonably rely on a gross sales chart where the franchise agreement stated that the franchisor “does not furnish or authorize its sales persons to furnish any oral or written information concerning actual or potential sales, costs, income or profits of the franchised business . . . .”\textsuperscript{163} Franchisors facing decisions like Randall that seem to make impossible disposing of a franchisee fraud claim on summary judgment may wish to consider greater reliance on the argument that the sales person had no authority to make a representation and the franchisee knew it.

\textbf{I. The Direct Contradiction Rule}

Although a minority of courts has rejected a franchisor’s use of disclaimer to bar fraud claims, even the most franchisee-oriented jurisdictions use some form of the “direct contradiction rule” to bar fraud claims. The direct contradiction rule takes one of two forms: (1) it makes the parol evidence rule applicable to claims of fraud; and (2) it precludes a finding of reliance as a matter of law.

\textbf{1. The Direct Contradiction Rule and Parol Evidence}

The parol evidence rule does not apply to claims of fraud. The “fraud exception” does not apply, however, where the alleged fraud is contradicted by the express and unambiguous terms of the franchise agreement. This iteration of the direct-contradiction rule typically applies to promissory fraud claims (claims that the defendant made promises with no present intent to perform them). The idea is that the law should not allow a plaintiff to ignore the express terms of a contract by the expedient of a promissory fraud claim. For example, Judge Schiltz held in Randall that “in Minnesota, only when an allegedly fraudulent statement directly contradicts substantive contract term will courts rely on the parol-evidence rule to reject a fraud claim.”\textsuperscript{164} California follows the same rule. “The fraud exception to the parol evidence rule does not apply to . . . promissory fraud if the evidence in question is offered to show a promise which contradicts an integrated written agreement. Unless the false promise is either independent of or consistent with the written instrument, evidence thereof is inadmissible.” Alling v. Universal

\textsuperscript{163} \textit{Id.} at *5.
\textsuperscript{164} Randall, 532 F. Supp. 2d at 1083.
Manufacturing Corp. A New Jersey federal judge held in Travelodge Hotels, Inc. v. Honeysuckle Enterprises, Inc. that “the general rule [in New Jersey] is clear that a parol agreement which is in terms contradictory of the express words of a contemporaneous or subsequent written contract, properly interpreted, necessarily is ineffectual and evidence of it inadmissible, whether the parol agreement be called collateral or not.”

2. The Direct Contradiction Rule and Reliance

Courts typically apply the second version of the direct-contradiction rule to the issue of reliance as well. Under this version of the rule, the courts hold that a franchisee may not reasonably rely on a claimed representation that the franchisor has disclaimed in the franchise documents. The degree to which there must be a conflict between the representation and the disclaimer varies from case to case. Even the most franchisee-oriented laws apply some version of the direct contradiction rule to claims of reliance. For example, the Eighth Circuit, in applying Minnesota law, held in Commercial Property Investments, Inc. v. Quality Inns International, Inc. that “when a promise is not in plain contradiction of a contract, or if contradictory, when it is accompanied by misrepresentations of other material facts in addition to the contradictory intent the question of reliance is for the trier of fact.” This statement is similar to Judge Schiltz’s description of the first version of the direct-conflict rule, the one that applies to the parol evidence rule. This seemingly inconsistent application of the rule (Judge Schiltz describes the rule as an exception to the fraud exception of the parol evidence rule, and the Eighth Circuit applies the same rule to the issue of reasonable reliance) reflects the reality that the courts often do not draw fine distinctions between which particular form of disclaimer precludes a fraud claim.

IV. SOME ADDITIONAL ISSUES IN FRANCHISE FRAUD CASES

A. The Economic Loss Rule

The economic loss rule “is one of the most confusing doctrines in tort law.” In its traditional form, the economic loss rule says that a party claiming economic losses cannot recover under a tort theory unless accompanied by physical damage to property or personal injury. Most jurisdictions embrace some form of the economic loss rule, also called the gist-of-the-action doctrine in some jurisdictions. An exposé on the economic loss rule is beyond the scope of this paper. Instead, we refer the reader to an article by Christian Burden and Sean Trende in the winter 2008 edition of the Franchise Law Journal entitled, “The Economic Loss Rule and Franchise Attorneys.”

167 Id. at 796.
168 938 F.2d 870 (8th Cir. 1991).
169 Id. at 876.
170 R. Joseph Barton, Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims, 41 Wm. and Mary L. Rev. 1789 n.3 (2000).
Attorneys addressing the applicability of the economic loss rule to a particular dispute must necessarily analyze the law in a particular jurisdiction and, notwithstanding the fairly widespread adoption of the rule, will likely find that the particular jurisdiction has not fully vetted application of the rule to a franchise dispute. For the franchisor, good arguments and solid authority exist for the proposition that “statements or misrepresentations made to induce an individual to enter into a contract, if later contained within the terms of the actual contract, cannot constitute a basis on which to bring a fraud claim.”

Broad application of the economic loss rule to a franchise dispute would preclude promissory fraud claims where the promise is contained within the franchise agreement. The following summary from the Burden and Trende article best summarizes the present state of the law:

[M]any courts have concluded that if the claimed fraud arises from the making of the contract rather than its performance, the contract is a nullity and the economic loss rule does not apply. In other words, tort claims, such as fraudulent inducement claims, that are independent from contract claims are not precluded by the economic loss rule.

Many courts have in turn taken steps to prevent such an end run around the economic loss rule, creating an “exception to the exception” by holding that “statements or misrepresentations made to induce an individual to enter a contract, if later contained within the terms of the actual contract, cannot constitute a basis on which to bring a fraud claim.” One court has explained the rationale behind such an exception to the exception: “It is patently unreasonable for [plaintiff] to rely on a promise that the Agreement would be renewed annually . . . based on performance where the Agreement specifically and unambiguously creates only a single renewal term based on performance.”

B. Statutes of Limitation in Fraud Cases

Given that most franchisees that come to realize that the franchise they purchased is not what the franchisor promised do not typically run straight to court, or a franchise lawyer, statutes of limitation often are critical defenses that franchisees must overcome. Many times a franchisee who realizes that the franchise is not performing at the level represented by the franchisor will first approach the franchisor and ask what is wrong. Oftentimes, the franchisor will tell the franchisee “that the business takes time to get going,” or “to be patient.” Other times, the franchisor might point to what the franchisor believes are operational problems or other issues with the franchisee’s performance. As a result, franchisees often visit a franchise lawyer several years into the operation of a franchise that never has operated at the level represented by the franchisor.

So what is a franchisee lawyer to do? In short, the key for defeating a statute-of-limitations defense is to establish that the franchisor’s assurance that “things will get better” meant that the claim had not yet accrued because the franchisee has not yet “discovered” that the franchisor’s representations were untruthful. This is called the “discovery rule.”


As a general proposition, the statute of limitations period begins to run when the plaintiff knows or has reason to know of the act causing it injury or harm. The limitations period begins to run, under the discovery rule, when, in the exercise of reasonable care and prudence, an ordinary person could and should have suspected that someone has done something wrong to it and is, accordingly, under a duty to investigate with reasonable diligence.\(^{173}\) For purposes of the discovery doctrine, the plaintiff discovers the cause of action when it at least suspects a factual basis, as opposed to a legal theory, for a claim. Even if the plaintiff lacks knowledge of all elements of a legal claim, if it suspects that someone has done something wrong to him, “wrong” being used in its lay sense, the statute of limitations begins to run.\(^{174}\) Thus, for example, in the case of an alleged failure by a franchisor to make disclosures required under the FTC Franchise Rule, the statute of limitations began to run when the franchisor failed to make the disclosures or made incomplete disclosures because it was at that point that the wrong occurred.\(^{175}\)

When the franchisee’s claim is based upon a representation made by the franchisor, whether verbal or in the disclosure document, the franchisee can often successfully assert that the constant assurances from the franchisor that “things will get better,” or that “there is nothing wrong,” made it unreasonable for them to assume that the representations of the franchisor were untruthful, and, therefore, actionable. The “discovery rule” does not, however, allow a party to delay filing its claim until after it has completed the investigation of its claim. Nor does the discovery rule toll the limitations period until the plaintiff is aware that it has a legal claim. See, e.g., *Anderson v. Board of Education of Fayette County*\(^ {176}\) (discovery of the injury, not discovery of the other elements of the claim, is what starts statute of limitations clock). Rather, the discovery rule merely provides the franchisee with the ability to wait until a reasonable person would conclude that the franchisor’s representations were, in fact, untruthful.

As stated above, however, the key determination is not whether the franchisee knows that it has a legal claim, but whether the franchisee is aware (or should be aware) of the facts that make up a legal claim. Neither ignorance of the law nor failure to consult an attorney to inquire about one’s legal rights will expand the period of limitations within which suit must be filed. *Crowder v. Master Financial, Inc.*\(^ {177}\) The key is whether the franchisee has become aware of facts, or, with reasonable investigation, could have become aware of facts sufficient to suspect that the franchisor’s statements were untruthful. Knowledge of facts, not actual knowledge of their legal significance, starts the statute-of-limitations clock. See, e.g., *Anne Arundel County v. Halle Development, Inc.*\(^ {178}\) (the discovery rule applies to discovery of facts, not to discovery of law; knowledge of the law is presumed); *In re W.R. Grace & Co.*\(^ {179}\) (plaintiff’s ignorance either of legal significance of known facts will not delay running of statute of

\(^{173}\) Id.


\(^{175}\) *Randall v. Lady of America Franchise Corp.*, 532 F. Supp. 2d 1071, 1079 (D. Minn. 2007).

\(^{176}\) No. 5:08-320, 2009 WL 1211178 (E.D. Ky. May 1, 2009).


\(^{178}\) 971 A.2d 214 (Md. Ct. App. 2009).

As one federal court has explained, “[d]elaying the statute of limitations until an injured party consulted with an attorney would eviscerate it, essentially rendering it meaningless . . . .” K.B. Restaurants, Inc. v. Country Hospitality Corp. 181

This basic tenet of the discovery rule — that it is based on the franchisee’s reasonable discovery of the facts and not on the franchisee’s knowledge of the law, is why this rule does not typically extend the statute-of-limitations period for technical violations. 182 For example, in Randall v. Lady of America Franchise Corp., 183 the court held that certain technical violations of the Florida Deceptive and Unfair Trade Practices Act, such as making earnings claims when the UFOC stated that no earnings claims would be made, would not be saved by the discovery rule, because if the franchisor committed the alleged technical violations of the act, the “violation was necessarily apparent to the plaintiffs before they signed their franchise agreements.” 184 As to the non-technical violations of the act, the court held that the discovery rule would apply because those representations “could not be proven false” until the franchisees opened their stores and operated for a period of time. 185

V. THE MOTION TO DISMISS

The motion to dismiss is often the first battleground in a case alleging fraud in the sale of a franchise. The franchisor typically has four grounds for moving to dismiss such claims: (1) the franchisee has not pled fraud with particularity; (2) the claimed representation is not one of fact, but constitutes an expression of an opinion or a prediction of a future event; (3) the claim is barred by one or more disclaimers; and (4) the statute of limitations has run on the claim.

Rule 9(b) of the Federal Rules of Civil Procedure (and its state counterparts) requires that a plaintiff states that “[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.” Rule 9(b) requires plaintiffs, at a minimum, to state the identity of the person who made the alleged misrepresentation, the time, place and content of the misrepresentation, and the method by which the misrepresentation was communicated to the plaintiff. 186 Some courts have referred to this as the “who, what, where,
when, and why” of fraud. Although dismissals for failure to plead fraud with particularity often will be without prejudice, smart franchisee lawyers carefully draft a complaint that includes as many details as possible, if for no reason other than to make sure the court allows the franchisee to substantiate its claims later in the case.

The reality is that franchisee counsel tend to include multiple counts in the complaint, only one of which is fraud. As a consequence, the fraud counts tend to be sketchy. There is little reason that the franchisor should not hold the franchisee to plead the who, what, when, where, and why of the fraud claim. The only possible downside is that maybe it forces the franchisee to develop the details of the fraud claim in advance of a deposition, thus precluding the franchisor from the advantage of catching the franchisee “cold” on the facts that supposedly supporting the fraud claim in a deposition. Whatever small advantage this may present the franchisor is outweighed by the benefit of locking the franchisee into only those representations specifically identified in its complaint. If the franchisor allows the franchisee to proceed with a fraud claim based on loose language in the complaint, it risks a court later saying that it was on sufficient notice of the general claim that it should have fleshed out in discovery.

Likewise, there is little advantage to the franchisee counsel failing to plead fraud claims with as much particularity as possible. Not only do the federal rules (and most, if not all, state rules) require such particularity, a franchisee who hopes to survive a pre-trial motion must be able to tell his or her case with precision. Who made the statement? When was it made? What did it include? If a franchisee cannot provide such details, there is little chance the franchisee’s claims will carry the day anyway.

Moreover, since a franchisee is likely to face several pre-trial motions on any claims for fraud, it is essential for the franchisee to provide the judge or arbitrator with the facts necessary to garner some support. If, upon presenting the complaint or demand the first time, the franchisee can persuade the judge or arbitrator that the franchisor did, in fact, make some hurtful statements, a franchisee will greatly increase his or her chances at surviving such motions.

If the franchisor elects to move to dismiss under Rule 9(b), it should plan to be persistent. As noted above, the court will likely allow the franchisee to amend to meet the pleading requirements. If the amended complaint is as loose as the first one, the franchisor must move again. The court will eventually tire of either the plaintiff’s inability to craft a

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187 See, e.g., DiLeo v. Ernst & Young, 901 F.2d 626, 627 (7th Cir. 1990).

compliant complaint or the franchisor’s repeated motion. Either way the franchisor has little to lose but a little aggravation of the court.

The elements of a common law or statutory fraud claim are contained in a checklist for identifying allegations in the complaint that might not survive a motion to dismiss. Most fertile for a motion to dismiss are the requirements that the alleged misrepresentation be one of fact and that the franchisee has justifiably relied upon the representation. As to the latter, courts will generally consider documents that are not attached to the complaint on a motion to dismiss (e.g., a franchise agreement and a disclosure document) as long as they are referenced in the complaint.

VI. FRANCHISEE STRATEGIES IN PURSUING FRAUD CLAIMS

Fraud claims, especially those based upon the common-law claims of intentional and negligent misrepresentation are among the most difficult claims for franchisees. Not only do franchisees have to prove that the information provided by the franchisor was false, franchisees have to prove that they justifiably and reasonably relied upon the information to their detriment. As addressed in detail in this paper, that often means the franchisee is going to have to defeat motions based upon several contractual provisions, such as no-reliance, integration and merger clauses, as well as the accompanying parol evidence rule.

That said, franchisee counsel still should aggressively interview its clients to discover whether the franchisor made misrepresentations upon which the franchisee reasonably relied because, as will be addressed below, fraud claims can provide franchisees with some real weapons against franchisors, should the franchisee survive the franchisor’s pretrial motions.

One key for surviving such motions is to painstakingly plead your client’s facts. Not only do the federal rules of civil procedure (and most state rules of civil procedure) require fraud plaintiffs to plead their claims with particularity, such detailed pleadings make it far more likely that franchisees will successfully defeat such motions.

Another key for surviving such motions is to aggressively argue that the representations are not contradictory to the unambiguous provisions of the written agreement, and, therefore, not subject to the merger and integration clauses in the written agreement.

And yet another key is to focus on each particular representation individually and to argue that reliance is typically a question of fact. Ordinarily, the person to whom the statements are made must exercise ordinary care to ensure that the statements are true. The courts generally look to all of the factual circumstances in assessing reliance, including: the parties’ relative knowledge of specific facts; the position of the speaker within a defendant corporate organization and his authority to make the statements; whether defendant gave plaintiff access to underlying information; the sophistication and experience of the plaintiff; and the context in which the statements were made. Another aspect of the reliance requirement is the relationship between reliance and the parol evidence rule. For example, even though a manufacturer’s verbal representations that a distributorship would be continued forever contradicted the distributorship agreement’s one year terms, under Missouri law, it was for the jury to decide whether a distributor’s reliance on the oral statement was justified.

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At one end of the spectrum, a plaintiff will be allowed great latitude in relying upon a defendant’s statements when the statements are specific, and the defendant is actively deceiving and concealing facts from the plaintiff. As one case stated, “[t]he law does not require that a person assume that everyone with whom he has business transaction is a rogue and act accordingly.” Thus, when the defendant actively and intentionally deceived the plaintiff, the plaintiff’s failure to discover the fraud through the exercise of reasonable diligence frequently will be excused. It is not, however, necessary that the misrepresentation was the sole or even the primary reason for the plaintiff’s conduct. At the other end of the spectrum, a sophisticated plaintiff who has access to the relevant facts but chooses to ignore them cannot claim to have relied upon general statements made about the business.

An important issue concerning reliance in the franchise context is whether franchisees can rely upon statements contradictory to those contained in a franchise offering circular. In one case, the court held that a franchisee could not justifiably rely upon the franchisor’s oral statements concerning profitability of the franchise when the offering circular clearly set forth the basis for the profitability projections, and they were clearly marked as estimations. The court’s decision, however, may have rested in part on the fact that the offering circular squarely addressed the subject matter of the allegedly fraudulent statements. In other contexts, for example, the plaintiff, a former franchisee of Carvel ice cream, alleged that the franchisor had deceived it by making representations that the franchisor had significant experience. Although the court dismissed the fraud claim because the franchisee showed no evidence of the franchisor’s intent to deceive, the court’s treatment of the franchisor’s defense, based on the disclaimers in the offering circular, is instructive. The obligation to locate a suitable site sprang from an application and deposit agreement between the franchisor and prospective franchisee. The court characterized this agreement as a contract that did not apply to this preliminary agreement.

Reliance upon oral misrepresentations, even if false, is unreasonable if the party enters into a subsequent agreement that squarely addresses and contradicts the subject matter of the oral representation. Similarly, a disclaimer that a product’s specifications were subject to change did not bar reliance upon deliberately false descriptions of the product.

Yet another key is to look for applicable statutory provisions that require certain types of disclosures and/or prohibit the provision of untrue statements of material fact (or omissions of material facts). Typically, these statutes do not require a plaintiff to establish that the bad actor “intended” to lie, only that the bad actor provided untruthful information. This difference alone is sufficient reason to closely examine all arguably applicable statutes. Moreover, many statutes do not require objective and/or subjective reliance upon the misrepresentation, and/or provide for additional damages such as rescission and/or restitution, exemplary and/or punitive damages, and attorneys’ fees. It also is important to note that at least one court has found that a franchisor’s violation of the FTC disclosure obligations can provide evidence that the franchisor’s misrepresentations were material for the purposes of a common-law fraud claim.\(^\text{200}\)

A. Other Uses of Fraud

1. **Expand Scope of Discovery**

   One of the major advantages of asserting fraud claims is that it can expand your client’s ability to discover information. Fraud claims open the door to all kinds of discovery regarding your opponent’s plans, state of mind, and performance. Fraud claims also can allow you to inquire about a franchisor’s relationship with other franchisees, in that such behavior can help prove whether the franchisor was aware that its representations were truthful at the time they were made.

2. **Place Pre-Contractual Representations Before the Fact Finder**

   Perhaps the greatest advantage of asserting a fraud claim is the ability to place pre-contractual representations before a judge, jury or arbitrator. In most circumstances, your opponent will want to preclude you from presenting to the judge, jury or arbitrator those pre-contractual promises that were made but did not come true. Since most (if not all) franchise agreements include integration and merger clauses, your opponent will argue that such pre-contractual representations are inadmissible due to the parol evidence rule.\(^\text{201}\) Even if that is true, however, the general rule is that the parol evidence rule does not preclude the admissibility of pre-contractual representations when a party has asserted that it was induced to enter the agreement by fraud.\(^\text{202}\) Even if your opponent successfully defeats your fraud claim, the judge, jury or arbitrator has heard the “promises” that were made, and very well might rely upon those promises in deciding other claims.

3. **Seek Punitive Damages**

   Because they arise in tort, fraud claims also carry the specter of punitive damages. Fraudulent conduct can result in the imposition of severe punitive damage awards.\(^\text{203}\) The


\(^{201}\) See Section III.I.1, *supra*.

\(^{202}\) Vigortone AG Prods., Inc. v. PM AG Prods., Inc., 316 F.3d 641 (7th Cir. 2003).

\(^{203}\) See, e.g., Robertson Oil Co. v. Phillips Petroleum Co., 14 F.3d 373 (8th Cir. 1993) (separate punitive damages awards under Arkansas law totaling $8 million deemed not to be excessive or duplicative in claims for fraud and interference with business relations); Cox v. Doctor’s Assocs., Inc., 613 N.E.2d 1306 (Ill. Ct. App. 1993), cert. denied, 510 U.S. 1118 (1994) (affirming punitive damages of $1 million for nondisclosures and misrepresentations violating
Restatement (Second) of Torts, § 908(2), which a number of jurisdictions have adopted in whole or in part, provides in pertinent part:

Punitive damages may be awarded for conduct that is outrageous, because of the defendant’s evil motive or his reckless indifference to the rights of others. In assessing punitive damages, the trier of fact can properly consider the character of the defendant’s act, the harm the defendant caused or intended to cause and the wealth of the defendant.

In most jurisdictions, proof of fraud alone does not justify the imposition of punitive damages. Rather, the conduct must be “outrageous” (or some similar standard of egregious behavior such as vindictiveness or a wholly wanton disregard for the right of others).

Because franchisor’s must take seriously the possibility of punitive damages, plaintiff’s counsel should use the possibility of a large punitive damages award as a valuable bargaining chip. Punitive damages in a fraud case against a franchisor always will serve as the plaintiff’s most powerful weapon, and constitute the defendant’s worst fear. Although this likely will never change, some fairly recent decisions show that the threat of large punitive damage awards has decreased.

Although the Supreme Court always has recognized that the due process clause of the Fourteenth Amendment to the United States Constitution sets substantive limits “beyond which penalties” — including in particular punitive damages — “may not go,” it wasn’t until 1996 that the Court provided significant guidelines to this principle in BMW of North America, Inc. v. Gore. In that case, the Court overturned what it stated was an award of excessive punitive damages. The plaintiff in Gore discovered that his new car had been repainted. He brought suit against BMW, alleging that the failure to disclose the repainting constituted fraud under Alabama law. At trial, BMW admitted that it had a nationwide policy of not advising the dealers of minor pre-delivery damage and the jury found BMW liable for fraud and awarded the plaintiff $4,000 in compensatory damages and several million dollars in punitive damages. The Alabama Supreme Court reduced the punitive damages award to $2 million.

The United States Supreme Court vacated the judgment, noting that the $2 million punitive damages on the fraud claim was still excessive under the Due Process Clause. The

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204 See, e.g., Tunis Bros. Co., Inc. v. Ford Motor Co., 952 F.2d 715 (3rd Cir. 1991) (punitive damages award of $2.8 million overturned because fraud did not rise to level of outrageous conduct required by Pennsylvania law); Jacobs Mfg. Co. v. Sam Brown Co., 19 F.3d 1259 (8th Cir. 1994) (reversing district court, and holding that jury could have reasonably found that manufacturer acted with reckless disregard of distributor’s rights and that $2.7 million punitive damage award was not so excessive or unreasonable that it shocked court’s sensibilities or could have only resulted from irrational jury behavior).

205 For a more thorough discussion on what effects these Supreme Cases have for franchisors and franchisees, see Edward Wood Dunham, Applying Constitutional Limits on Punitive Damages to Franchise Disputes, 22 Franchise L.J. 203 (Spring 2003).


Court identified three guidelines for assessing the substantive constitutionality of punitive damages award: (1) the degree of reprehensibility of the conduct at issue, in light of all the facts in the record; (2) the ratio of the punitive damages to the actual and potential harm inflicted on the plaintiff; and (3) the criminal or civil penalties that the state could impose for comparable misconduct.208

Based on the fact that (1) BMW’s conduct was not particularly reprehensible because it only caused economic damages; (2) the punitive damages were 526 times greater than the compensatory damages; and (3) the only comparable statutory penalty was $10,000 for BMW’s conduct and, thus, did not provide notice to BMW that it could incur such a large award, the Court concluded that the punitive damages for the fraud claim were excessive under the United States Constitution.

The Supreme Court further limited the availability of large punitive damages awards a few years later in State Farm Mutual Auto Insurance Co. v. Campbell.209 In that case, the United States Supreme Court once again reaffirmed the importance of the Gore factors and struck down a punitive damages award based on a fraud claim that was 145 times greater than the compensatory damages. The lower courts had found State Farm to have acted in bad faith and to have engaged in fraud by (1) refusing to settle a case for its insured, Campbell, even though there was a “near-certain probability” that “by taking the case to trial, a judgment in excess of the policy limits would be awarded;” (2) altering internal documents to make Campbell appear less culpable; and (3) promising Campbell “that his assets were safe,” but then telling him after an adverse verdict to “put up a for-sale sign” on his home.210 In addition, courts heard evidence about “State Farm’s business practices for over 20 years in numerous States,” most of which “bore no relation to . . . the type of claim underlying . . . the Campbells’ complaint against the company.”211

As to the first Gore factor, the Court concluded that the jury could not consider evidence of the fraud or other bad conduct outside of Utah that was not directly related to this case. Writing for the majority, Justice Kennedy chastised the Utah Supreme Court because “State Farm was being condemned for its nationwide policies rather than for the conduct directed toward the Campbells.”212 Although the Court viewed the conduct as reprehensible, it concluded that these acts were not egregious enough to justify such a high award, and that the “Utah courts should have gone no further” than what was necessary “to satisfy the State’s legitimate objectives.”

On the second Gore factor, the Court held in no uncertain terms that any award where the punitive/compensatory ratio surpasses single-digits is constitutionally suspect:

We decline again to impose a bright-line ratio which a punitive damages award cannot exceed. Our jurisprudence and the principles it has now established demonstrate, however, that, in practice, few awards

208 Id.
210 Id. at 419.
211 Id. at 415.
212 Id. at 420.
exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.213

In addition, the Court concluded that the defendant’s wealth has no part to play in deciding whether punitive damages are excessive. Finally, refusing to “dwell long on [the third] guidepost,” the Court quickly dismissed any suggestion that a $10,000 civil penalty for State Farm’s conduct came anywhere close to justifying the punitive damages award affirmed by the Utah courts.214 This relatively modest penalty did not provide State Farm with any notice that it could be hit with such a large punitive damages award.

Based on the three Gore guidelines, the Supreme Court, in a case it called “neither close nor difficult,” vacated the $145 million punitive damages award.215

In the more recent case of Exxon Shipping Co. v. Baker,216 the Supreme Court further limited the punitive damages ratio when it intimated that in certain causes, the ratio could be no greater than 1:1:

In State Farm, we said that a single-digit maximum is appropriate in all but the most exceptional of cases, and “[w]hen compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee.” Applying this standard to the present case, we take for granted the District Court’s calculation of the total relevant compensatory damages at $507.5 million. See In re Exxon Valdez, 236 F. Supp. 2d 1043, 1063 (D. Alaska 2002). A punitive-to-compensatory ratio of 1:1 thus yields maximum punitive damages in that amount.217

Gore and its progeny certainly make it more difficult for franchisee lawyers to present a specter of large punitive damages awards in a fraud cause. That said, these cases focused on cases in which lower courts awarded punitive damages in the hundreds of millions of dollars. In most franchise cases, a potential for punitive damages in the tens of millions, or even millions of dollars can provide a franchisee with a strong fraud claim a valuable bargaining chip at settlement.

B. Examine Post-Contractual Disclosures

Generally speaking, most lawyers in the franchise field conclude, perhaps incorrectly, that actionable franchisor fraud occurs only before the execution of the franchise agreement. The thinking is that once the franchisee has executed the franchise agreement, the franchisee no longer is legally capable of acting in reliance on any misrepresentation — that is, actions such as locating a site, signing a lease, and building the facility are actions required by the franchise agreement itself. Such arguments are only part of the story, however. If a franchisee

213 id. at 425.
214 id. at 428.
215 id. at 418.
217 id. at 2634.
can establish that it would not have taken such actions if it had known the truth — that is, it would have chosen not to undertake the financial risk inherent with such actions — it still can establish an arguable claim of fraud.

Of course claims based upon post-contractual representations will be easier to prove in one respect: franchisees making such claims can more easily avoid pre-contractual defenses such as integration clauses, acknowledgment provisions, and the parol evidence rule.

1. The Effect of Contractual Provisions

Although contractual obligations will make it more difficult for a franchisee to establish reliance upon post-contractual misrepresentations, see discussion on reliance infra, contractual provisions precluding reliance upon pre-contractual representations very likely will be inapplicable.

a. Do Integration and/or Acknowledgment Clauses Apply?

Any claim based upon post-contractual representations arguably will not be precluded by integration and/or acknowledgment clauses in that such clauses typically preclude reliance upon representations made prior to the execution of the agreement. Claims based upon post-contractual representations, however, could be subject to defenses based upon the economic loss doctrine.

2. Reliance (Acts Other Than Signing Franchise Agreement)

Suppose that a franchisor has become aware of a fact that makes it highly unlikely that a new franchisee will be successful, and that the franchisor breaches a legal obligation by withholding that fact from the new franchisee. Suppose further that the new franchisee would not undertake the sufficient additional risk of committing to a loan, or signing a lease, or hiring a contractor, or opening its location, or continuing to operate if it is made aware of that fact? Most lawyers would argue that so long as the agreement obligated the franchisee to undertake these obligations, a franchisee could not point to such actions as evidence of its reasonable reliance upon the misrepresentation.

Given the fact that a plaintiff can assert a claim for common-law fraud based upon “detrimental” reliance, it would seem that if the plaintiff can assert that its decision to perform an obligation (as opposed to its decision to breach such an obligation) caused it to spend more money than it would have had to spend through a mere breach of contract, that a persuasive argument could be made that the plaintiff relied upon the representation (or omission) to its detriment. In other words, if the franchisee had been made aware of facts that made it likely that the franchise was going to fail before the franchisee undertook such commitments, the franchisee should have the right to pull the plug before obligating itself to banks, landlords and vendors.

The key to arguing such claims will be to establish: (1) that the franchisee suffered more damages by performing its obligations than it would have suffered had it chosen not to meet its obligations; and (2) that the franchisee would have chosen to breach its obligations had it known all the facts. Such an argument not only meets the standards of reliance required by common-law fraud, it is consistent with the underlying purposes of intentional breach — that is, a party that will lose more money by performing its obligations is justified in choosing to breach its obligations.
Moreover, it can be persuasively argued that if the franchisor’s misrepresentation (or omission) covers up a material breach, all of the franchisee’s subsequent actions would be in reliance upon the misrepresentation (and/or omission) in that the franchisee, had it known the truth, arguably would not have had an obligation to perform pursuant to the contract.

a. **Loans**

Many franchisees finance their franchises with loans. Franchisees typically acquire these loans after the execution of the franchise agreement. Yet in many circumstances, franchisees are able to acquire these loans only because the franchisor has lied (or provided misleading information) about the earnings potential of the franchise. Although such representations would not be precluded by the FTC Rule, FDD Guidelines or most Little FTC Acts or franchise disclosure statutes, an argument can be made that, but for the franchisor’s representation, the franchisee never would have qualified for the very loan that oftentimes is the largest liability that franchisees have following a failed franchise relationship. At the very least, franchisees can persuasively argue that they acquired the bank financing only because of the financial representations of the franchisor.

b. **Leases**

Lease obligations are another significant liability that franchisees face following a failed franchise relationship. Although most written agreements require a franchisee to acquire a location, a franchisee can argue that it would not have obligated itself to its particular lease had the franchisee been aware that its franchise would have failed. Under those circumstances, the franchisee can persuasively argue that it very well might have chosen to breach of the obligation and face the damages, to the extent there would be any, resulting therefrom.

c. **Opening**

If a franchisee can prove that it would not have opened its location had it known all the facts, the franchisee can persuasively argue that all damages caused as a result of the opening were caused as a result of its reliance upon the franchisor’s misrepresentation.

d. **Continued Operation**

Many a franchisee continues to operate a business that is losing money only because the franchisor keeps telling the franchisee that things are going to get better. If a franchisee can establish that those representations are fraudulent, the franchisee can persuasively argue that its decision to remain open (even if required by the written agreement) caused it to lose more money than it otherwise would have lost had the franchisee chosen to cut its losses by closing shop.

C. **The Big Picture**

Fraud claims are difficult. Franchisors fight fraud claims harder than any other type of claim, and given the willingness of courts to dismiss such claims as a matter of law on the basis of integration and merger, no-reliance, and acknowledgment clauses, franchisors have plenty of weapons at their disposal to win these fights before the claims even get to the fact finder (be it a jury or arbitrator).
That said, franchisee counsel cannot be afraid to assert such claims when the facts dictate. The very essence of franchising makes such claims inevitable. Franchisors need to sell franchises. Franchisors need to pay their salesmen commissions based on these sales. Many prospective franchisees are naïve. These factors provide a combustible mix in which those persons selling a franchise far too often “oversell” the franchise to the persons, many of whom do not understand the rough-and-tumble world of business dealings, to all-too-often rely on statements to their detriment.

Despite the difficulty of asserting such claims, it is the duty of franchisee counsel to work with their clients to help identify the representations upon which they relied in making what, if the client is visiting with franchisee counsel, was a very damaging purchase. In doing so, franchisee counsel must carefully interview his or her clients. Franchisee counsel must ask what was said, ask who said it, ask if any documents corroborate those statements, and then make sure that if the franchisor had not made those statements, the franchisee would not have acted to purchase the franchise. This is very difficult, frustrating and time-consuming work, and oftentimes it will make it clear that the franchisee does not have a legitimate fraud claim.

But sometimes such aggressive interviewing will uncover a statement, perhaps even contained in a document, upon which the franchisee reasonably relied to its detriment. In those cases, the franchisee counsel must work even harder to craft a complaint (or demand for arbitration) that accurately describes in great detail not only the representation, but the basis of the reliance and the extent of the harm.

This paper has addressed many of the ways that franchisors try to protect themselves from such claims. It is the duty of franchisee counsel, when the franchisor has made such representations that have cost the franchisee hundreds of thousands (if not millions) of dollars, to assert these claims and prepare for the inevitable defenses franchisors will present.

These defenses are not insurmountable. As addressed in this paper, merger and integration clauses typically do not preclude pre-contractual representations upon which the franchisee reasonably relied in signing the franchise agreement. No-reliance and acknowledgment clauses do not necessarily render the franchisee’s reliance (which all too often is subjectively, if not necessarily objectively, real) unreasonable. Dig into those clauses and examine whether they expressly state that the franchisee could not have relied on the particular representation made. If the clause in question does not expressly include the type of representation upon which the franchisee relied, then the court is likely to deny the franchisor’s motion to dismiss.

Fraud will always be among the most (if not the most) difficult claims to win. Given the tendencies of franchisors to oversell their franchises, especially in these tough economic times, such claims will continue to present themselves to franchisee counsel. Do not shy away.

This paper has focused on common law fraud. But franchisee counsel should be diligent in examine all of the fraud-type claims available to their clients. These include negligent misrepresentation and violations of “fraud” type statutes such as franchise-disclosure and consumer protection (or “little FTC Act”) statutes. This paper has addressed, at least briefly, the elements making up each of these different “fraud” type claims, but, generally, the key elements franchisee counsel must consider in determining whether to plead each of these types of “fraud” claims are:
• Did the speaker intentionally, knowingly or recklessly make a material misrepresentation upon which the speaker intended the hearer to rely? If so, counsel should consider pleading intentional misrepresentation.

• Did the speaker have a duty to make sure that the untruthful representations it made to the hearer were truthful? If so, and if the representations were not truthful, counsel should consider pleading negligent misrepresentation.

• Does an applicable state or federal statute obligate the speaker to make only truthful statements, or to make certain kinds of statements in a certain way? If so, counsel should consider pleading violations of those applicable statutes.

Since none of these claims is mutually exclusive with the others, many times it will be possible to plead all three of these types of “fraud” claims.

In the end, the diligent franchisee counsel should take these claims on with the vigor they require, because, in the end, there probably is nothing more damaging to franchisees than the reliance upon unlawful representations of the franchisor.

VII. FRANCHISOR STRATEGIES IN RESPONDING TO FRANCHISEE FRAUD CLAIMS

A. An Introduction

The successful defense of a franchisee fraud case is rarely a matter of simply applying the facts to the law. At their core, franchise fraud cases involve an interface of a number of different principles. These principles include:

1. Whether franchisees in general and the plaintiff in particular are essentially consumers, vulnerable to the wiles of crafty franchisors, or savvy business people capable of fending for themselves, or something in between.

2. How a particular judge or a particular jurisdiction strikes the balance between the competing values of contractual certainty on the one hand and protecting seemingly innocent parties from fraud on the other.

3. The written record — the documents the franchisor has to wage war against the franchisee fraud claim. How tightly worded is the franchise agreement? How encompassing are the disclaimers? What does the franchisor do to protect itself against earnings claims beyond disclaimers? How adequately has the franchisor created a written record that is helpful?

4. The extraneous facts that put either the franchisor or the franchisee in a bad light. Who, as between the franchisor and franchisee, will ultimately wear the white hat before a judge or a jury?

Many of the variables are beyond the control of the franchisor lawyers. There are, however, a number of things that a franchisor trial lawyer can do to overcome the natural sympathies toward franchisees and otherwise level the playing field.
B. The Sympathies of the Judge and Jurisdiction

The franchisor trial lawyer’s greatest challenge is often overcoming the natural sympathies of a judge toward a plaintiff franchisee. The challenge is magnified where the court perceives that the jurisdiction within which it sits favors franchisees over franchisors. This means challenging the “modern myth of the vulnerable franchisee.”\(^{218}\)

The *Randall* decision illustrates how a court’s perception of franchise legislation shades its view of the equities. Relying on the rule of statutory construction that courts should construe legislation to effectuate its beneficial purpose, Judge Schiltz characterized the Minnesota Franchise Act as “a remedial statute designed to favor franchisees over franchisors.”\(^{219}\)

Franchise statutes do indeed at times expressly state that the court should liberally construe to achieve their objective, but the principle is hardly universal and surely subject to misuse. In fact, the majority of franchise legislation was adopted in the 1970s and is a product of its time. It was a product of state legislature’s grappling with a relatively new phenomenon, namely, the widespread use of business format franchising. And it was the product of widely divergent views of franchising. It was in the midst of these divergent views that state legislatures grappled with how best to protect their constituents while still protecting franchising as an economic concept. In the process, state legislators passed acts that were the product of a careful balancing of the interests of the franchisor, the franchisee, the consumer, and other stakeholders. It was not a directive, by and large, for courts to favor one side of the franchise relationship over the other. Where, as with most franchise statutes, the legislature is engaged in a careful balancing of competing interests, the courts will not apply the remedial purposes doctrine.

Similarly, franchising as we know it today is markedly different than franchising as it existed in the 1970s. After nearly forty years of franchise presale disclosure and relationship regulations, ever-increasing competition among franchisors for franchisees, and a market change in sophistication of franchisees, franchising should not continue to suffer a hangover in the twenty-first century from abuses that may or may not have been rampant decades ago. In many ways, the wrong the state legislators set out to correct beginning in 1970 has now been righted. Franchisees today have a wealth of information available to them before they sign a franchise agreement. Franchise agreements contain the protections that various laws have deemed necessary to temper the supposed adverse consequences of presumed gross bargaining disparity. Although still generally take-it-or-leave-it agreements, the typical franchise agreement reflects competition among franchisors for the most sophisticated franchisees. These conclusions are supported by valid data and worthy of presentation to the court in the hopes that the court may temper its own sympathies and any perception that it is under a directive to favor one side of the franchise relationship at the expense of the other.

The challenge for the franchisor lawyer is to present these points to a judge with a lot of demands on her time and limited interest in the history of franchise legislation. Nevertheless, it is a challenge that the franchisor’s advocate must meet in briefing the court, in motions, in affidavits, in depositions, and the like.


\(^{219}\) *Randall v. Lady of America Franchise Corp.*, 532 F. Supp. 2d 1071, 1087 (D. Minn. 2007).
C. The Balance Between Contractual Certainty and Protecting Innocent Victims

The divergent views of the courts on the effect of disclaimers in franchise documents ultimately reflects the basic conflict between enforcing contract rights on the one hand and protecting innocent parties on the other. Using once more the Randall decision as an example, Judge Schiltz concluded that the Minnesota Franchise Act precludes franchisors from using contractual provisions to protect themselves from fraud lawsuits by franchisees. According to Judge Schiltz, “the Minnesota legislature has decided to burden franchisors, and protect franchisees, and this Court is bound to enforce that decision.” 220 The First Circuit in Turner v. Johnson & Johnson 221 struck balance in a different direction, albeit it was not construing a franchise act. The First Circuit held as follows:

We have no doubt that the balance shifts [in favor of contractual certainty] when the party asserting fraud is not seeking to avoid an ambiguous or deceptive “contractual device” but is trying to reverse the precise terms of an agreement . . . . a contractual provision flatly contradictory to prior oral assurances should cause most people — and particularly experienced, knowledgeable businesspeople — to pause. Moreover, if a jury is allowed to ignore contract provisions directly at odds with oral representations allegedly made during negotiations, the language of a contract simply would not matter anymore . . . . Thus, in weighing the competing interests, the Massachusetts Supreme Judicial Court undoubtedly would find that the threat to contractual certainty usually would outweigh the possible injustice of denying a claim of fraud. 222

The conflict represented by Randall and Turner becomes, in many ways, the decisive issue on summary judgment in a franchise case. Franchisor trial lawyers are typically armed with powerful disclaimers. To avoid their seemingly obvious effect, the court must decide that the right of the franchisee to compensation for fraud outweighs the franchisor’s right to certainty in its relationship with its franchisees, even to the point of ignoring clear disclaimers. The task of the franchisor lawyer is to convince the court that it should resist what Judge Kozinski of the Ninth Circuit Court of Appeals calls the metastasizing of contract law into tort law and strike the balance in favor of contractual certainty. After all, in the final analysis, it will be a rare case that the plaintiff franchisee will be so naïve that it truly believed that it had somehow preserved a claim for fraud against a franchisor, notwithstanding the broad disclaimers in the typical franchise agreement.

D. The Weapons of War

The franchisor trial lawyer has a right to expect that his client will give her the necessary weapons of war. These include the best possible combination of disclaimers — merger clauses that specifically state that agreements, warranties, and representations do not survive their execution; separate, independent disclaimers of reliance on representations not contained in the franchise documents, including specific and detailed disclaimers of the typical misrepresentation

220 Id. at 1089.

221 809 F.2d 90 (1st Cir. 1986).

222 Id. at 96 (emphasis in original).
claims; and powerful no-authority clauses. Equally importantly, however, is that the franchisor should vigorously enforce within its organization policies against misrepresenting franchise opportunities. In particular, the sales staff must be instructed on the laws governing the franchise sales process and must be disciplined when they violate those policies. Disclaimer clauses are not a license for the franchisor to engage in misrepresentations with impunity. They must fulfill their proper purpose, namely, to avoid phony misrepresentation claims and implausible claims of reliance.

E. The White Hat

Franchise fraud cases are rarely decided in the abstract. They are fleshed out by real life facts. Reading cases decided against the franchisor does prove the old saw that bad facts make bad law. In all things, the prudent franchisor asks itself how what it does today may play out before a judge or a jury someday, maybe years into the future. Judges and juries do have a way of punishing bad conduct, no matter how protective the law may be of it. Similarly, franchisor trial lawyers are as much story tellers as are their counterparts on the other side of the franchise relationship. The trick is to put the black hat on the franchisee in a way that does not alienate a judge or jury. Again, the natural sympathies of both are with the franchisee. The franchisor lawyer that attacks the franchisee in an obnoxious way will only add to the sympathy.

F. Some Suggested Strategies

The following are some suggested strategies for defending franchisee claims of fraud in the sale of a franchise:

1. The first issue is typically whether to move to dismiss for failure to plead a claim with particularity under Rule 9 or failure to set forth a claim upon which the court may grant relief as required by Rule 12. The fraud complaint will invariably try to leave open the possibility for presenting additional claims of fraud as the case proceeds without amending the complaint. In the end, the franchisor is entitled to know the who, what, when, where, and how of the claims fraud, and there is little reason for the franchisor not to exercise the right.

2. Again, the franchisor’s most powerful weapon in defeating the fraud claim is often the disclaimer. The first opportunity to fire it is the motion to dismiss. The franchisee will typically wish to put the disclaimer in a context. It will want a full record of the franchisor’s supposed bad acts to help it resist the proclivity of a court to reject summarily a representation completely at odds with disclaimer. The franchisor, in contrast, would likely prefer to focus the court’s attention only on the claimed representation and the disclaimer. A motion to dismiss may be the best way to do this.

3. If the disclaimer does not dispose of the case in its entirety on a motion to dismiss, it may carry the day on summary judgment. And even disclaimers that do not result in complete summary judgment may result in partial summary judgment. Most vulnerable are claims of promissory fraud, i.e., claims that the franchisor made promises with no intent to keep them. As explained above, the franchisor has a number of arguments to present to the court in support of summary dismissal of such claims. They include the not only disclaimers, but also the economic loss rule. Accordingly, a motion for summary judgment should be one that seeks partial summary judgment on some of the claims in the event the court is not disposed to grant complete summary judgment on all of them.
4. Disclaimers do not lose their punch just because they do not avail the franchisor on summary judgment. They are at least evidence for the trier of fact to consider when deciding whether the franchisee actually relied on an alleged representation. For most folks, a claim that the franchisee relied on an alleged representation that is directly contradicted by a disclaimer is suspect.

5. An effective deposition should set up the disclaimer as a tool to win the fraud claim, either on motion or at trial. A significant problem for the franchisee resisting the effect of a disclaimer is that it must essentially claim that its spoken word (in the deposition or prior to the purchase of the franchise) is more honest and credible that its written word. The standard disclaimer tends to say the same thing in several different ways, is frequently in different type (all caps for example), and requires the franchisee to identify specifically any representations not in the agreement. It is a rare franchisee that truly does not understand that it is disclaiming receipt and reliance on oral representations not in the franchise documents. The franchisee will admit in a deposition that its written word is as much its bond as its spoken word. It will acknowledge that when it tells the franchisor something in writing that it is giving the franchisor “its word.” Was the franchisee telling the truth when it promised the franchisor in the disclaimer that it had received no representations outside the franchise documents, or is it telling the truth now when it says it did?

6. Similarly, the franchisor should emphasize the laudable purposes behind a disclaimer. It is not about depriving a franchisee of a legitimate claim for relief. It is about the parties getting their cards on the table at a time when memories are fresh. It is about a franchisor identifying sales representatives who are exceeding their authority at a time when something can be done about it. The franchise lawyer should develop these themes in the deposition of the franchisee for use in summary judgment and eventually at trial, if necessary.

7. A key part of the defense of any franchisee misrepresentation case is the franchisee’s own due diligence. Franchisees truly do have a wealth of information to them today in evaluating a franchise opportunity. Indeed, the disclosure document identifies past and present franchisees, and most franchisees do contact one or more of these. In addition, the web has become a valuable source of information on franchise opportunities. The deposition of the franchisee should result in a laundry list of what the franchisee did by way of due diligence in evaluating the opportunity. Ferreting out everything requires a detailed inquiry as opposed to a summary question or two.

8. An effective deposition identifies all claimed misrepresentations that will help the franchisor on summary judgment and at trial. Rambling deposition testimony about representations by a franchisee that spans several pages are not useful in impeaching the franchisee at trial. Franchisor counsel must capture the claimed representations in a couple of pages that counsel can use effectively at trial to impeach the franchisee who now remembers a number of other representations it had neglected to mention at the deposition. One technique is to ask the franchisee at the deposition whether it has completely exhausted its recollection of all representations that form the basis of its lawsuit. Another technique is for counsel to tell the franchisee in the deposition that she wants a complete record now to prepare her case and will complain at trial if the franchisee identifies more representations then.

9. The “litigator” and “trial lawyer” are not necessarily synonymous. Actual trials these days are rare. The great, great majority of cases settle. There was a day when lawyers saved evidence and techniques for trial. Depositions were rarely an exercise in cross-examination in prior times. Today, “the trial” starts earlier than before. It begins with the
complaint and continues throughout the discovery process. The franchisor lawyer’s deposition of the franchisee, for example, should communicate to the franchisee and its lawyer that the franchisee’s case has significant problems. The franchisor’s lawyer’s “opening statement” to a mediator has more to do with telling the franchisee directly that it has problems with its case than it is educating the arbitrator. Every step of the way is about softening the opposition for a settlement.

10. Lastly, the effective franchisor lawyer is one that is not afraid to try a case. We tend to practice in a small community of lawyers. If we are not willing to try cases, our opponents will find it out eventually. The best settlements are the product of franchisors and their lawyers who are willing to try cases that they cannot settle on a reasonable basis.

VIII. CONCLUSION

We end where we began — comparing a fraud lawsuit to a divorce proceeding. Some might fairly criticize the continued comparison as trite, but the analogy does illustrate some important points, so we return to it one last time.

The best divorce lawyers are multifaceted. They tend to exemplify the best of the profession when it comes to zealously representing the interests of their clients, but the really good ones are not one-trick ponies. They are, at the same time, counselors and mediators.

Like first class divorce lawyers, quality franchise litigators are passionate about the cause of their clients. The March 2009 ABA Journal published an outstanding article entitled “Lions of the Trial Bar.” It featured seven trial lawyers “in the autumn of their careers.” One was Joe Jamail, a plain-spoken lawyer that represented Pennzoil in securing a $10.53 billion jury verdict against Texaco. He is quoted in the ABA article as saying “today’s law schools teach students how not to get emotionally involved in their cases. That’s [b.s.].”223 “If you are not emotionally involved, your client is not getting your best effort.”224 Judging from the article, Jamail has a propensity to take this shared emotion to the extreme, but the point is nevertheless valid. Franchise fraud claims are all about emotions (passions), and good franchise litigators share their clients’ emotions (passions).

The best divorce lawyers do not, however, allow their zeal for their clients’ cause to cloud their good judgment on the direction of a lawsuit. They do not simply follow the dictates of their clients to make life as miserable as possible for a soon-to-be former spouse. They share their clients’ passion for their cause, but they temper that passion with reasoned judgment. They counsel their clients not to let emotions drive their decisions. The same is true of solid franchise litigators.

And good divorce lawyers are good mediators. Mediation is about lawyers working together in the litigation process to bring the case to a conclusion, whether by settlement or a trial. It includes treating each other with respect. Many states now have specific and detailed standards on how lawyers should conduct themselves in addition to the typical rules of professional conduct. Utah has, for example, its “Standards of Professionalism and Civility,” a copy of which is appended to this paper. Utah identifies 20 different standards for how lawyers

223 Mark Curriden, Lions of the Trial Bar, ABA Journal, March 2009, at 33.
224 Id. at 31.
should relate to each other and the court in the conduct of litigation. The standards are preceded by the following preamble:

A lawyer’s conduct should be characterized at all times by personal courtesy and professional integrity in the fullest sense of those terms. In fulfilling a duty to represent a client vigorously as lawyers, we must be mindful of our obligations to the administration of justice, which is a truth-seeking process designed to resolve human and societal problems in a rational, peaceful, and efficient manner. We must remain committed to the rule of law as the foundation for a just and peaceful society.

Conduct that may be characterized as uncivil, abrasive, abusive, hostile, or obstructive impedes the fundamental goal of resolving disputes rationally, peacefully, and efficiently. Such conduct tends to delay and often to deny justice.

Lawyers should exhibit courtesy, candor and cooperation in dealing with the public and participating in the legal system. The following standards are designed to encourage lawyers to meet their obligations to each other, to litigants and to the system of justice, and thereby achieve the twin goals of civility and professionalism, both of which are hallmarks of a learned profession dedicated to public service.

Ultimately, our clients’ interests are best served when we are vigorous advocates for their cause, while at the same time following standards of professionalism and civility similar to those in Utah. When both sides are represented by able counsel, the legitimate interests of their clients will be met. The case will get tried; the relevant evidence will be obtained; the appropriate motions will be made. The lawyers and their clients can achieve these ends in a civil and professional way, or they can follow a scorched earth approach. In our experience, members of the franchise bar uniformly prefer the former to the latter and in the process ultimately serve the best interests of franchisor and franchisee alike.
Article 3. Standards of Professionalism and Civility

Rule 14-301. Standards of Professionalism and Civility. Preamble

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We expect judges and lawyers will make mutual and firm commitments to these standards. Adherence is expected as part of a commitment by all participants to improve the administration of justice throughout Utah. We further expect lawyers to educate their clients regarding these standards and judges to reinforce this whenever clients are present in the courtroom by making it clear that such tactics may hurt the client's case.

Although for ease of usage the term "court" is used throughout, these standards should be followed by all judges and lawyers in all interactions with each other and in any proceedings in Utah. Copies may be made available to clients to reinforce our obligation to maintain and foster these standards. Nothing in these standards supersedes or detracts from existing disciplinary codes or standards of conduct.

1. Lawyers shall advance the legitimate interests of their clients, without reflecting any ill-will that clients may have for their adversaries, even if called upon to do so by another. Instead, lawyers shall treat all other counsel, parties, judges, witnesses, and other participants in all proceedings in a courteous and dignified manner.

2. Lawyers shall advise their clients that civility, courtesy, and fair dealing are expected. They are tools for effective advocacy and not signs of weakness. Clients have no right to demand that lawyers abuse anyone or engage in any offensive or improper conduct.

3. Lawyers shall not, without an adequate factual basis, attribute to other counsel or the court improper motives, purpose, or conduct. Lawyers should avoid hostile, demeaning, or humiliating words in written and oral communications with adversaries. Neither written submissions nor oral presentations should disparage the integrity, intelligence, morals, ethics, or personal behavior of an adversary unless such matters are directly relevant under controlling substantive law.

4. Lawyers shall never knowingly attribute to other counsel a position or claim that counsel has not taken or seek to create such an unjustified inference or otherwise seek to create a "record" that has not occurred.

5. Lawyers shall not lightly seek sanctions and will never seek sanctions against or disqualification of another lawyer for any improper purpose.

6. Lawyers shall adhere to their express promises and agreements, oral or written, and to all commitments reasonably implied by the circumstances or by local custom.

7. When committing oral understandings to writing, lawyers shall do so accurately and completely. They shall provide other counsel a copy for review, and never include substantive matters upon which there has been no agreement, without explicitly advising other counsel. As drafts are exchanged, lawyers shall bring to the attention of other counsel changes from prior drafts.

8. When permitted or required by court rule or otherwise, lawyers shall draft orders that accurately and completely reflect the court's ruling. Lawyers shall promptly prepare and submit proposed orders to other counsel and attempt to reconcile any differences before the proposed orders and any objections are presented to the court.

9. Lawyers shall not hold out the potential of settlement for the purpose of foreclosing discovery, delaying trial, or obtaining other unfair advantage, and lawyers shall timely respond to any offer of settlement or inform opposing counsel that a response has not been authorized by the client.

10. Lawyers shall make good faith efforts to resolve by stipulation undisputed relevant matters, particularly when it is obvious such matters can be proven, unless there is a sound advocacy basis for not doing so.

11. Lawyers shall avoid impermissible ex parte communications.

12. Lawyers shall not send the court or its staff correspondence between counsel, unless such correspondence is relevant to an issue currently pending before the court and the proper evidentiary foundations are met or as such correspondence is specifically invited by the court.

13. Lawyers shall not knowingly file or serve motions, pleadings or other papers at a time calculated to unfairly limit other
counsel's opportunity to respond or to take other unfair advantage of an opponent, or in a manner intended to take advantage of another lawyer's unavailability.

14. Lawyers shall advise their clients that they reserve the right to determine whether to grant accommodations to other counsel in all matters not directly affecting the merits of the cause or prejudicing the client's rights, such as extensions of time, continuances, adjournments, and admissions of facts. Lawyers shall agree to reasonable requests for extension of time and waiver of procedural formalities when doing so will not adversely affect their clients' legitimate rights. Lawyers shall never request an extension of time solely for the purpose of delay or to obtain a tactical advantage.

15. Lawyers shall endeavor to consult with other counsel so that depositions, hearings, and conferences are scheduled at mutually convenient times. Lawyers shall never request a scheduling change for tactical or unfair purpose. If a scheduling change becomes necessary, lawyers shall notify other counsel and the court immediately. If other counsel requires a scheduling change, lawyers shall cooperate in making any reasonable adjustments.

16. Lawyers shall not cause the entry of a default without first notifying other counsel whose identity is known, unless their clients' legitimate rights could be adversely affected.

17. Lawyers shall not use or oppose discovery for the purpose of harassment or to burden an opponent with increased litigation expense. Lawyers shall not object to discovery or inappropriately assert a privilege for the purpose of withholding or delaying the disclosure of relevant and non-protected information.

18. During depositions lawyers shall not attempt to obstruct the interrogator or object to questions unless reasonably intended to preserve an objection or protect a privilege for resolution by the court. "Speaking objections" designed to coach a witness are impermissible. During depositions or conferences, lawyers shall engage only in conduct that would be appropriate in the presence of a judge.

19. In responding to document requests and interrogatories, lawyers shall not interpret them in an artificially restrictive manner so as to avoid disclosure of relevant and non-protected documents or information, nor shall they produce documents in a manner designed to obscure their source, create confusion, or hide the existence of particular documents.

20. Lawyers shall not authorize or encourage their clients or anyone under their direction or supervision to engage in conduct proscribed by these Standards.
Bill Killion is a partner with the Faegre & Benson firm in its offices at Minneapolis, Minnesota. His bio is at [www.faegre.com/showbio.aspx?Show=1722](http://www.faegre.com/showbio.aspx?Show=1722). His recognitions include: Top 100 Super Lawyers in Minnesota; Best Lawyers in America; Who’s Who of Franchise Lawyers; and Franchise Times Legal Eagle. Bill's many writings include two award-winning publications: “The Modern Myth of the Vulnerable Franchisee: the Case for a More Balanced View of the Franchisor-Franchisee Relationship,” *Franchise Law Journal* (Summer 2008), winner of the Burton Award; and “But It Doesn't Walk or Talk Like a Duck: The Perils of the Hidden Franchise,” *Business Law Today*, publication of the ABA Business Law Section (Sept./Oct. 2007), reprinted in the “Best of ABA Sections” in *GPSDO Magazine* (March 2008). Bill received his B.A. from the University of Nebraska (Phi Beta Kappa) and J.D. from the same school (Order-of-the-Coif). Bill has served as the Editor-in-Chief of the Nebraska Law Review and the Franchise Law Journal. He is Certified as a Civil Trial Specialist by the Minnesota State Bar Association and Board Certified in Civil Trial Advocacy by the National Board of Trial Advocacy.
SCOTT E. KORZENOWSKI

As a partner at Dady & Garner, P.A., Scott Korzenowski exclusively represents franchisees and dealers in their disputes with franchisors and manufacturers. Scott graduated from the University of Minnesota with a Bachelor of Arts degree in Journalism. He then wrote sports columns for about seven years until he no longer could stand interviewing *prima donna* athletes, so he enrolled at the University of Minnesota Law School, where he graduated magna cum laude. Scott now has the burden of dealing with *prima donna* franchisor counsel such as Bill Killion. Scott learned to care for the little guy while clerking for The Honorable Esther Tomljanovich of the Minnesota Supreme Court, and watching first hand as his father struggled with a difficult franchisor. Scott also hosts a radio show (mostly about sports) from 8-10 a.m. Sundays on AM 1500 KSTP in the Twin Cities.