Disclaimers: A Powerful Tool of Franchisors or Fickle Follies
In the Wake of the Amended FTC Franchise Rule

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DISCLAIMERS: A POWERFUL TOOL OF FRANCHISORS OR FICKLE FOLLIES IN THE WAKE OF THE AMENDED FTC FRANCHISE RULE?

I. INTRODUCTION

When franchise relationships deteriorate, the franchisee’s complaints often focus on pre-contractual representations relied upon in entering into the franchise agreement as the basis a fraud claim or as a way to expand the franchisor’s obligations beyond the express contract terms. When lawsuits are filed, franchisors look to the disclaimer clauses in the agreement as their first line of defense.

Franchisors and franchisees have skirmished along this battlefront for decades, with each side claiming its share of victories. Recently, the Federal Trade Commission (“FTC”) entered the fray by invalidating certain disclaimers. Has the FTC deprived franchisors of one of their key defenses or has the landscape in this longstanding dispute changed at all?

In this paper, we provide an objective, unbiased examination of the status of the case law, followed by our suggestions for arguing these issues, from the both the franchisor and franchisee viewpoints, at all stages of the case.

II. LEGAL ANALYSIS

A. The FTC Prohibition On Disclaimers

On January 23, 2007, the FTC issued a revised Franchise Rule, replacing the original 1978 Rule. The revised Franchise Rule was a long time in coming, with the process for amending the rule beginning in 1995 with a regulatory review of the Franchise Rule. The purpose of the revised Franchise Rule, however, remained unchanged from the original 1978 rule: “The final amended Rule maintains the benefits of the original Rule, preventing deceptive and unfair practices identified in the original rulemaking through presale disclosure of material information necessary to make an informed purchasing decision and prohibition of specified misrepresentations.”

16 C.F.R. § 436.9(h) now provides: “It is an unfair or deceptive act or practice in violation of Section 5 of the Federal Trade Commission Act for any franchise seller covered by part 436 to: . . . (h) Disclaim or require a prospective franchisee to waive reliance on any representation

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1 This paper represents the collective work of the authors. However, given the nature of the topic and its treatment, as well as the desire to analyze the topic in a unified paper, any particular views expressed herein do not necessarily represent the individual views of the authors. Jonathan Solish was counsel on the 6th & K v. Ramada, Century Pacific v. Hilton Hotels and Ayu's Global v. Big O cases. Carmen Caruso represents the plaintiff in Chicago Male Medical Clinic, LLC v. Ultimate Management, Inc. Carmen Caruso thanks attorney Sarah Isaacson for her assistance in the research and drafting of this paper. Elizabeth Weldon also thanks summer associates Leslie Barron and Anthony Carucci for their assistance in the research and editing of this paper.


3 Id. at 15,448.
made in the disclosure document or in its exhibits or amendments. Provided, however, that this provision is not intended to prevent a prospective franchisee from voluntarily waiving specific contract terms and conditions set forth in his or her disclosure document during the course of franchise sale negotiations.” This rule was one of “two anti-fraud provisions designed to preserve the integrity of the disclosure document and franchise agreement.” Specifically, subsection (h) was viewed as a mechanism that would cause franchisors to make sure that their disclosures were accurate before use and would, accordingly, avoid litigation and disputes after the sale.

The FTC had been urged by some to ban integration clauses entirely because such clauses are the “single greatest tool used by franchisors to evade responsibility for misrepresentations and omissions of material facts that take place in a franchise marketing program.” The FTC noted, however, that franchisors had raised two countervailing points. First, there was a right to rely on the final franchise agreement as the manifestation of the parties’ intent. Second, franchisors should have the right to disavow liability for the comments of rogue salesmen who might make unauthorized earnings claims. Franchisors argued that an anti-disclaimer provision was not necessary because the FTC had the ability to act against the franchisor if the disclosure document contained false information. Ultimately, the FTC chose what it believed to be a middle ground. The FTC’s prohibition is expressly limited to disclaimers of reliance on any representation made in the disclosure document. The FTC notes that there is no blanket prohibition on disclaimers; rather, the prohibition “is designed to address a specific problem,” namely, “franchisors’ use of integration clauses to disclaim authorized statements made in disclosure documents or in their exhibits or attachments.” The FTC’s Compliance Guide for the amended Franchise Rule clarifies this also: “[b]y its terms, the prohibition is limited to waivers or disclaimers pertaining to statements made in the disclosure document and its exhibits or attachments.”

1. **Impact Of The Revised FTC Rule**

The “Revised Rule does not attempt to ban integration clauses or contractual waivers entirely.” The FTC’s Statement of Basis and Purpose provides that franchisors may still include integration clauses and disclaimers for unauthorized statements made by salespersons or former or existing franchisees. Disclaimers may also cover franchise advertising and marketing materials, unattributed statements in the trade press and third party representations. The FTC recognized that integration clauses “serve valid purposes, including

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4 Id. at 15,530.
5 Id. at 15,534.
6 Id. at 15,533.
7 Id. at 15,534; see also BUREAU OF CONSUMER PROT., FED. TRADE COMM’N, Disclosure Requirements and Prohibitions Concerning Franchising, Staff Report to the Federal Trade Commission and Proposed Revised Trade Regulation Rule 257 (2004) [hereinafter Staff Report].
8 Staff Report, supra note 8, at 257.
11 DAVID J. KAUFMANN & DAVID W. OPPENHEIM, FTC DISCLOSURE RULES FOR FRANCHISING AND BUSINESS OPPORTUNITIES, 45 (CCH Editorial Staff eds., 2007).
ensuring that a prospective franchisee relies solely on information authorized by the franchisor or within the franchisor’s control in making an investment decision.13

The Compliance Guide went so far as to include a sample integration clause that presumably would comply with the amended Franchise Rule:

This Agreement and all exhibits to this Agreement constitute the entire agreement between the parties and supersede any and all prior negotiations, understandings, representations, and agreements. Nothing in this or in any related agreement, however, is intended to disclaim the representations we made in the franchise disclosure document that we furnished you.

You acknowledge that you are entering into this Agreement as a result of your own independent investigation of our franchised business and not as a result of any representations about us made by our shareholders, officers, directors, employees, agents, representatives, independent contractors, or franchisees that are contrary to the terms set forth in this Agreement, or in any disclosure document, prospectus, or other similar document required or permitted to be given to you pursuant to applicable law.14

Generally, contractual disclaimers are not directed at disavowing reliance related to the disclosure document, likely because such a disclaimer would violate the amended Franchise Rule. It is difficult even to conceive of an effective contractual disclaimer that would attempt to disavow the accuracy of statements made in a disclosure document or the right of a franchisee to rely on their accuracy. One example might be a provision stating that where the franchise agreement is inconsistent with anything in the disclosure document, the franchise agreement will prevail. Franchisors generally assume, however, that their disclosure documents must be accurate and that their franchisees have a right to rely upon the historical truth of statements made in disclosure documents. Thus, a recent article in the Franchise Law Journal concluded that “the risks of doing business have increased only slightly as a result of the Amended Rule’s prohibition on merger and integration clauses.”15

Although the anti-disclaimer provision was widely noted at the time it was initially adopted by the FTC, the final form of the anti-disclaimer rule is so limited in scope that it is unlikely to arise in many cases. This revision to the rule was widely viewed as a disappointment by many “franchisee advocates,” who had lobbied for a stronger condemnation of disclaimer clauses. For better or worse, the parties have been left to grapple with the very unpredictable approach of the courts in dealing with disclaimer clauses.

13 Id. at 15,534.

14 BUREAU OF CONSUMER PROT., FED. TRADE COMM’N, supra note 11, at 13.

15 Victor Vital & Elizabeth Wirmani, Surviving the Amended FTC Franchise Rule: Merger and Integration Clauses, Franchise Agreements, and Disclosure Documents, 30 FRANCHISE L.J. 88 (Fall 2010).
2. Examples Of Disclaimers In Franchise Agreements

Disclaimers may take many forms in franchise documents. Most common is the general integration clause. A typical integration clause, as excerpted from one of the principal cases that we discuss, provides that:

This Agreement, its exhibits and the Manual, as the Manual may be revised as permitted in this Agreement, comprise the entire agreement of the parties and supersede all prior representations and agreements with respect to its subject matter. No representations have been made to induce execution of this Agreement that are not included. The Agreement may not be amended or waived and no representations may be made by the Franchisor, except as stated in this Agreement or in writing signed by the Franchisor’s President.\footnote{Randall v. Lady of Am. Franchise Corp., 532 F. Supp. 2d 1071, 1075 (D. Minn. 2007).}

The same agreement also expressly disclaimed reliance: “The franchisor is relying on the franchisee to see that all matters are included in writing in this agreement, if they are not, the franchisee will not be able to rely in any way on any promises or representations and the franchisor will not be bound by them.”\footnote{Id.}

Franchise agreements often contain a “no earnings information” disclaimer. For example, an area representative agreement contained the following clause stating no earnings information had been provided:

[Area representatives] acknowledge that the success of the Area Representative Business is dependent upon your personal effort. . . . You acknowledge that neither [Sellstate] nor any other party has guaranteed to you or warranted that you will succeed in the operation of the Area Representative business nor provided any sales or income projections, forecasts or earnings claim of any kind to you. You have not relied upon any guarantee, warranty, projection, forecast or earnings claim, whether express, implied, purported or alleged, in entering into this Agreement.\footnote{Ellering v. Sellstate Realty Systems Network, Inc., 801 F. Supp. 2d 834, 837-38 (D. Minn. 2011).}

The UFOC for the area development agreement cited in the above example also contained a clause specifying that agents were not permitted to make financial performance representations:

We specifically instruct our sales personnel, agents, employees and officers that they are not permitted to make any claims or statements as to the earnings, sales or profits, or prospects or chances of success, nor are they authorized to represent or
estimate dollar figures as to any Franchise Business or Company-Owned unit.\textsuperscript{19}

Another form of disclaimer attempts to limit the reliance on financial information. For example, a typical disclosure document provides:

This is an estimate only for the additional operating capital needed to operate your Franchised Business during the initial 3 months after you open for business. We cannot guarantee that you will not have additional expenses starting the business. . . .

The expenses you incur during the start-up period will depend on factors such as local economic and market conditions, whether your Franchised Business is located in a new market or a mature market, your experience and business acumen, competition, and the sales level you reach during this initial period. . . .

. . . In compiling these estimates, we have relied on the experience and data collected from our affiliate that operates an urgent care center (in Maryland). Your costs will depend upon a number of factors including local economic and market conditions.\textsuperscript{20}

These clauses are typical of the kinds of disclaimers routinely contested in franchise disputes. Courts have been sharply divided over the enforceability and import of disclaimer clauses.

3. The Split In The Case Law

a. The View That Disclaimers Cannot Defeat Statutory Protection

The decision in \textit{Randall v. Lady of America Franchise Corp.} presents the most cogent argument against the enforcement of contractual disclaimers.\textsuperscript{21} On summary judgment, the franchisor argued that the integration clause and other contractual disclaimers were sufficient to defeat claims under the Minnesota Franchise Act (“MFA”). The court disagreed, holding that section 80C.21 of the MFA, which prohibits waiver of compliance with the MFA, invalidated the contractual disclaimers. The court assumed for the purpose of argument that an unlawful earnings claim or a non-disclosure had, in fact, been made. With this assumption, the historical truth of this misconduct could not be negated without violating the anti-waiver provision. As the court analyzed the issue, “if the dishonest franchisor made misrepresentations, then he made misrepresentations, no matter what the franchise agreement says. Thus, the disclaimer can only be an attempt to change the legal effect of those misrepresentations. That is precisely what section 80C.21’s anti-waiver language forbids.”\textsuperscript{22}

\textsuperscript{19} \textit{Id. See also California Bagel Co. v. Am. Bagel Co.}, No. CV 97-8863 MMM, 2000 WL 35798199, at * 1 (C.D. Cal. June 7, 2000) (same).


\textsuperscript{21} \textit{Randall v. Lady of Am. Franchise Corp.}, 532 F. Supp. 2d 1071 (D. Minn. 2007).

\textsuperscript{22} \textit{Id.} at 1087.
The court went beyond this to find that even the following language did not hold up to the anti-waiver statute: “I did not make any representations about the revenues of existing franchises. If you disagree, you must list such representation below. If you don’t list a representation, you cannot later sue me for making that representation.”23 Such language “cannot change the historical facts of what representations were made.”24 The court was critical of this contractual language because the document failed to provide space in which the franchisee could list any representations that had allegedly been made.

The court acknowledged that under its reading of the anti-waiver provision “franchisors cannot use contractual provisions to protect themselves from being sued for misrepresentations under the Minnesota Franchise Act. Consequently, even scrupulously honest franchisors will have to defend against some misrepresentation claims. . . .”25 The court justified its conclusion on the ground that the Act had meant to place that burden on franchisors so that franchisees who had been lied to would have redress.

Lady of America fared no better in California. In *Burgo v. Lady of America Franchise Corp.*,26 the franchisor argued that the franchisees “could not have reasonably relied on pre-contractual oral statements outside of their respective Franchise Agreements, in light of the express merger and integration clause contained therein, nor on any alleged oral representations based on the express disclaimers contained in the Franchise Agreement.” The court disagreed with this contention, referring to section 31512 of the California Franchise Investment Law, which provides that “[a]ny condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void.” Section 31512 reflects the legislature’s intent to protect citizens by preventing them from waiving rights provided under California statutes. In the court’s view, “the plain language of this provision makes merger and integration clauses and disclaimers of franchise agreements void, thus rendering the parol evidence rule inapplicable to this case.”

In *Emfore Corp. v. Blimpie Associates, Ltd.*, Blimpie franchisees had been asked to fill out a questionnaire that asked them whether any representations had been made to them before they had signed their franchise agreements.27 The franchisees signed a letter identifying the persons with whom they negotiated and all of the written materials they received, confirming that there had been no earnings claims, warranties or other representations made to them beyond those in the offering circular. The franchisees also executed a questionnaire, asking for them to circle “yes” or “no” as the various representations, and initialed each answer. One question asked whether any representations had been made to them about earnings. The franchisees executed the questionnaire without comment, and noted no pre-contractual statements.

Focusing on the term “clarification,” rather than disclaimer, it could fairly be said that the franchisees only confirmed that the deal was accurately stated in the agreement they were about to sign. Had the franchisees responded affirmatively to any of the questions, the

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23 Id. at 1089.
24 Id. at 1088.
25 Id. at 1089.
franchisor could have considered the proposed modification of the contract terms and been given a chance to affirm it or reject it. While the franchisees might have been very eager to embark on a business venture with augmented substantive terms, contracts require mutual consent. The franchisor likely would have contended that it had a right to correct any claims that the franchise terms went beyond the express terms of the agreement before committing itself to a business relationship with unknown parameters.

Like the franchisees in *Randall*, the franchisees in *Emfore* claimed that there had been fraudulent representations about potential and actual earnings claims. The franchisees alleged that the questionnaire violated the disclosure and anti-fraud provisions of the New York Franchise Act because it was an “illegal” waiver and merger clause. The trial court observed that while “the ‘clear and unambiguous’ language of the Franchise Act bars release and waiver clauses, there is no language barring the type of Questionnaire disclaimers herein. Nor is the broad statutory anti-fraud purpose furthered by construing the disclaimers in the Questionnaire/Rider as ‘illegal.’” Rather, it is consistent with the Franchise Act’s purpose to enable the prospective franchisee to assess the franchisee’s offer and to keep them fully informed as to its rights.”

Unlike the Minnesota court in *Randall*, the New York trial court in *Emfore* concluded that “the instant Questionnaire/Rider is an interactive document that is a reflection of the ‘ongoing contractual relationship between franchisor and franchisee’ and solicits factual information and representations from a prospective franchisee.” The questionnaire was “a responsible attempt by Blimpie to confront prospective purchasers about any misrepresentations or misconceptions.” Because the franchisee signed the questionnaire before executing the franchise agreement, “the [plaintiffs] could not justifiably rely on the alleged co-branding and earnings claims.”

The trial court noted that “[a] party is foreclosed from establishing justifiable reliance to support fraud where that party has, by its own specific disclaimer of reliance upon oral representations himself been guilty of deliberately misrepresenting his true intention.” The trial court accordingly granted summary judgment in favor of the franchisor on the plaintiffs’ common law fraud claims because it was “clear that it is unreasonable for plaintiffs to rely upon the purported representations as a matter of law.” The trial court held that “it would be ‘difficult to envisage language which could more completely eliminate the claimed representations as an inducing factor.’”

As it turned out, it was not all that difficult for the Appellate Division to reverse the trial court’s decision. In *Emfore Corp. v. Blimpie Assoc., Ltd.*, the Appellate Division of the Supreme Court of New York reversed because the questionnaire was a waiver of fraud claims barred by the New York Franchise Act. 28 In so ruling, the Appellate Division noted the franchisor’s desire to “root out dishonest sales personnel and avoid sales secured by fraud.” 29 Further, the questionnaire violated the Franchise Act because it had not been included in the offering prospectus. The Appellate Division, however, upheld the trial court’s dismissal of the common-law fraud claims because the franchisee’s disclaimer, stating that she was not relying on any representations, was not a generalized boilerplate exclusion but had been contained in a separate rider.

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29 Id. at 14.
In *Long John Silver's, Inc. v. Nickleson*, the court followed *Randall*, holding that a disclaimer of extra-contractual representations did not support a dismissal of fraud claims under the Minnesota Act.\(^{30}\) The court, however, noted that the disclaimer might raise issues as to reliance with a jury.\(^{31}\)

b. **The View In Favor Of Enforcing Disclaimers**

Courts have commonly enforced disclaimers in franchise agreements.\(^{32}\) In *Ellering v. Sellstate Realty Systems Network, Inc.*, franchisees with area development rights claimed that their franchisor had provided them with false and misleading revenue projections in a face-to-face meeting before any agreements had been signed.\(^{33}\) There, the lawyers who had represented the franchisor in *Randall* represented the franchisee. Demonstrating just how unpredictable disclaimer cases can be, they received a ruling from the same court that reached the opposite result.

The FTC requires franchisors that do not make earnings claims to disclose the following: “We do not make any representations about a franchisee's future financial performance or the past financial performance of company-owned or franchised outlets. We also do not authorize our employees or representatives to make any such representations either orally or in writing. . . . If you receive any other financial performance information or projections of your future income, you should report it to the franchisor's management by contacting [name, address, and telephone number], the Federal Trade Commission, and the appropriate state regulatory agencies.”\(^{34}\) The UFOC at issue in *Ellering* contained a general disclaimer called for by the FTC, and both the franchise agreement and area developer agreement contained express disclaimers that franchisees did not rely on financial projections or promises.\(^{35}\)

The lawyer for the franchisee pointed to the very recent *Randall* decision as authority that the disclaimer was unenforceable, as he had learned to his disappointment in that case. But on the defendant’s summary judgment motion, the *Ellering* court concluded that the disclaimer barred the franchisees' fraud claim regarding future financial representations as a matter of law, because the franchisees could not show reasonable reliance in the face of the disclaimers. The court pointed to the express acknowledgement that the franchisee had not relied upon any earnings claims, which was sufficient to establish that there could be no justifiable reliance as a matter of law.

31 Id. at * 8.
33 801 F. Supp. 2d 834 (D. Minn. 2011).
The Ellering court also distinguished Randall v. Lady of America Franchise Corp., pointing out that the court in that case had failed to cite an earlier case, Kieland v. Rocky Mountain Chocolate Factory, Inc., that had rejected a claim under the Minnesota Franchise Act on similar facts. While the Randall court found that a general disclaimer in a UFOC did not bar a claim that the franchisor had misrepresented future profits, the opinion also acknowledged that a claim under the Minnesota Franchise Act required a showing of reasonable reliance by the plaintiff.

Ellering and Randall went head-to-head in a 2013 case, Hanley v. Doctors Express Franchising, LLC, where a Maryland judge took note of both decisions and concluded that he found Randall to be persuasive. The Hanley decision is discussed in greater detail below, in connection with the evidentiary significance of disclaimers.

c. View That Disclaimers Have Evidentiary Significance

There are also cases that fall somewhere in the middle between enforcing and rejecting disclaimers. These cases allow disclaimers to be used as evidence on the point of whether or not there was reasonable reliance on an alleged misrepresentation, but they do not allow the disclaimer to be used to determine reasonable reliance as a matter of law—as the court did in Ellering.

The case of Long John Silver’s, Inc. v. Nickelson is a recent example of this evidentiary use of a disclaimer. The franchisor asserted claims against the franchisee and related business entities in relation to some failed franchises in Minnesota. The defendants asserted various counterclaims, including fraud and violation of the Minnesota Franchise Act (“MFA”), on which the franchisor sought summary judgment. In defending against the franchisee’s alleged untrue statements relating to the sale of the franchise that would violate the MFA, the franchisor argued that disclaimers and the integration clause in the franchise agreement and the franchise disclosure document barred such claims. The court denied summary judgment on these arguments, finding that a genuine issue of fact existed regarding reasonable reliance.

The court recognized that reasonable reliance was required to establish damages under the MFA. But it also recognized that “Minnesota’s treatment of disclaimers in franchising document is inconsistent.” The court specifically distanced itself from the proposition in Ellering that reliance could be decided as a matter of law. But the court also noted two apparent contradictions. First, it noted that “[a] disclaimer should suppress a franchisee’s

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39 Id. at *1.
40 Id. at *1-2.
41 Id. at *5-6.
42 Id. at *8.
43 Id. at *7.
44 Id. at *6.
45 Id. *7.
reliance on the purported misstatements."\textsuperscript{46} Second, it noted that in light of the MFA's anti-waiver provision and inconsistent law in Minnesota regarding disclaimers, a franchisee could assume that a disclaimer would not be enforced.\textsuperscript{47} This led to the court's conclusion that there was a genuine issue as to the franchisee's reasonable reliance.

The franchisee also argued that summary judgment could not be granted because the MFA anti-waiver provision voided disclaimers.\textsuperscript{48} In response, the court held that while the intention of the MFA probably was to stop franchisors from hiding behind disclaimers after making untrue statements, the disclaimer, nevertheless, was still influential in deciding reasonable reliance.\textsuperscript{49} "[T]he Court is hesitant to find the disclaimers altogether void. The disclaimers will no doubt influence a jury's determination of whether Defendant's reliance on the alleged untrue statements was reasonable. The Court merely finds that [the franchisor] cannot use a disclaimer to defeat Defendant's misrepresentation claim to the MFA."\textsuperscript{50}

The court also rejected the franchisor's assertions that the franchisee's common law fraud claims failed because of the disclaimers in the franchise disclosure document. While recognizing the existence of case law that prohibits a party from relying on representations that conflict with the written disclaimers, here the franchisee was faced with a "blanket disclaimer," that the court found to be "so general it envelopes almost any misrepresentation [the franchisor] could have made."\textsuperscript{51} The court advised that its opinion was not to be read to mean that the franchisee had proven its claims. Rather, this was only a denial of summary judgment on some of the franchisee's claims.\textsuperscript{52}

Another recent case that noted the evidentiary use of disclaimers is \textit{Hanley v. Doctors Express Franchising}.\textsuperscript{53} In \textit{Hanley}, plaintiff franchisees asserted misrepresentation claims against the franchisor and a franchise broker under Maryland law.\textsuperscript{54} Defendants each filed a motion to dismiss the claims.

The franchisor claimed, among other things, that plaintiffs' claims for violations of the Maryland Franchise Law and common law fraud failed because, in light of disclaimers in the franchise disclosure document and the franchise agreement, it was unreasonable for plaintiffs to rely on the allegedly offending financial projections and that projections were made outside of the franchise disclosure document.\textsuperscript{55} The court ultimately rejected this argument for purposes of the motion to dismiss, holding that dismissing the claims—"at least at the motion to dismiss stage"—based on a disclaimer would not be in line with Maryland Franchise Law, which prevents, as a condition of sale of a franchise, waiver of liability under Maryland law.\textsuperscript{56} But the

\begin{itemize}
  \item \textsuperscript{46} Id.
  \item \textsuperscript{47} Id.
  \item \textsuperscript{48} Id. *8.
  \item \textsuperscript{49} Id. *9.
  \item \textsuperscript{50} Id.
  \item \textsuperscript{51} Id. at *10.
  \item \textsuperscript{52} Id. at *12.
  \item \textsuperscript{54} Id. at *1.
  \item \textsuperscript{55} Id. at *24-26.
  \item \textsuperscript{56} Id. at * 27.
\end{itemize}
The court also declared that, despite its ruling on the motion to dismiss argument, “the disclaimers remain factually relevant, and might be persuasive to a fact finder with respect to the materiality of the alleged misrepresentations and omissions and the reasonableness of plaintiffs’ reliance on them.” In making this statement, the court cited Central Truck Center, Inc. v. Central GMC, Inc., in which the appellate court affirmed the trial court’s entry of summary judgment on fraud and related claims on the sale of a truck dealership, based on the integration clause. Rather, the court affirmed that it was not reasonable to rely on prior financial statements to guarantee future performance: “While we do not hold that an integration clause bars a claim of fraud based on pre-contractual representation in every instance, we do hold that the integration clause in the Agreement, together with evidence of the unreasonableness of Central Truck’s reliance, in combination with other evidence, defeated the fraud-based claims asserted by Central Truck in its counterclaim.”

4. The Parol Evidence Rule

Franchisors sometimes assert the parol evidence rule in defense against evidence of alleged representations that falls outside of the terms of disclaimers or integration clauses. For example, in Randall, discussed supra, the franchisor had argued that the parol evidence rule barred any evidence of earnings claims allegedly made by the franchisor. The Randall court rejected this argument, stating that the court “doubts whether the parol evidence applies to claims made under the Minnesota Franchise Act,” because claims under that Act are statutory claims and not contract claims. In Minnesota, parol evidence may be offered to establish a fraud claim when the alleged statement does not directly contradict a substantive contract term. The court ultimately rejected the parol evidence argument by finding that the earnings claims “do not so directly contradict the franchise agreement that the parol-evidence rule would bar evidence of those earnings claims.”

In contrast to the result in Randall, the court in Vino 100, LLC v. Smoke on the Water, LLC was more receptive to the franchisors’ parol evidence argument. The court granted the franchisors’ motion to dismiss defendant franchisees’ counterclaims for negligent misrepresentation, intentional misrepresentation, and fraudulent inducement that were based on statements regarding earnings and benefits of ownership the franchisors allegedly made before
execution of the franchise agreement. The court found that the three counts based on pre-contract representations could “not be maintained in light of the parol evidence rule.” Under Pennsylvania law, the parol evidence rule provided: “Where the parties, without any fraud or mistake, have deliberately put their engagements in writing, the law declares the writing to be not only the best, but the only, evidence of their agreement. . . . .While the parol evidence rule allows a party to prove that fraud, accident, or mistake resulted in an error in the execution of a contract, parol evidence is inadmissible to prove one party fraudulently induced another to enter into a contract.” Because the franchise agreements contained integration clauses stating that the written agreement represented the entire agreement, the court barred the franchisees from introducing parol evidence of the alleged fraudulent statements. The court also rejected the franchisees’ attempt to incorporate the UFOC terms into their breach of contract claims, as it found the UFOC statements were parol evidence to the actual agreement.

In Sherman v. Ben & Jerry’s Franchising, Inc., the court barred some, but not all, parol evidence in a franchisee’s claim of fraudulent inducement based on whether the disclaimers were sufficiently specific. Although the court ultimately granted defendant’s motion to dismiss the plaintiff’s fraudulent inducement claim that was based on allegations of misrepresented earnings in the UFOC, the court distinguished between boilerplate disclaimers (which were ineffective to bar a fraud claim) and more specific integration clauses and disclaimers (which were effective to bar such claims). The court noted that when a “seller expressly disclaims any express or implied warranty concerning specific representations, and a buyer expressly acknowledges the disclaimer and the need to conduct an independent investigation, that party may not sue on a claim she was defrauded into entering the contract in reliance on those very representations.” Here, the court held that the franchisee failed to state a claim of fraudulent inducement based on parol evidence of alleged misrepresented earnings claims, because the franchise agreement contained specific and clearly stated warnings and disclaimers regarding expected profits and earnings. The franchise agreement read, in part:

OPERATOR acknowledges that it has conducted an independent investigation of the business of operating a scoop shop, and recognizes that the business venture contemplated by this Agreement involves business risks and that its success will be largely dependent upon the ability of OPERATOR . . . as (an)

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67 Id.
68 Id. (citations omitted).
69 Id.
70 Id. at * 3. At the summary judgment stage of this case, the court rejected the franchisees’ attempts to use the Franchise Rule to support their claims that the franchisors engaged in unfair business practices and the contacts should not be enforced. The court held that Pennsylvania public policy did not incorporate the Franchise Rule requirements and only the FTC is permitted to enforce the Franchise Rule. Also, the court held that the parol evidence rule failed to support the argument that the contracts should not be enforced because the parol evidence rule bars claims for fraudulent inducement under these circumstances. Vino 100, LLC v. Smoke on the Water, LLC, 864 F. Supp. 2d 269, 279-81 (E.D. Pa. 2012).
72 Id. at *3-4.
73 Id. at *4.
74 Id.
independent businessperson(s). BEN & JERRY'S expressly disclaims the making of, and OPERATOR acknowledges that it has not received, any warranty or guarantee, express or implied, as to the potential volume, profits, or success of the business venture contemplated by this agreement.75

In contrast, the court held that the franchisee stated a claim for fraudulent inducement based on assurances about limitations on where ice cream would be sold by others, because “there is no specific disclaimer stating Plaintiffs did not rely on the alleged statements.”76 Sherman presents an interesting application of the parol evidence rule, because the court found the parol evidence rule barred some claims, like the above, but not other claims, which did not have a specifically applicable disclaimer.

As the foregoing discussion demonstrates, the parol evidence rule may be asserted as a defense by franchisors with varying success. The Sherman court’s treatment of parol evidence on the franchisee’s fraudulent inducement claim is similar to California’s former treatment of parol evidence under an old and recently-overruled case, Bank of America etc. Assn. v. Pendergrass.77

Originally, California statutory law created an exception to the parol evidence rule, allowing parol evidence to be admitted to establish fraud: “This section does not exclude other evidence of the circumstances under which the agreement was made or to which it relates, as defined in Section 1860, or to explain an extrinsic ambiguity or otherwise interpret the terms of the agreement, or to establish illegality or fraud.”78 Notwithstanding the clear language of section 1856, which specially allows parol evidence to establish fraud, Pendergrass limited the admission of parol evidence to establish fraud to situations where the parol evidence “tend[ed] to establish some independent fact or representation, some fraud in the procurement of the instrument or some breach of confidence concerning its use, and not a promise directly at variance with the promise of the writing.”79

This limitation to the fraud exception to the parol evidence rule, however, is now called into question with more recent cases such as Riverisland Cold Storage v. Fresno-Madera Production Credit Association, which changes the face of the rule in California.80 Riverisland Cold Storage revised California’s long-standing law to curb limits to the fraud exception to the parol evidence rule and, in turn, allows for parol evidence to be admitted more frequently. Specifically, Riverisland Cold Storage rejected and overruled Pendergrass calling it, among other things, “out of step with established California law” and an “aberration.”81 While Riverisland Cold Storage may not be a franchise case, it will likely have broad implications in arguments about disclaimers and integration clauses.

75 Id. at *10.
76 Id. at *12.
77 4 Cal. 2d 258 (1935).
80 Riverisland Cold Storage, 55 Cal. 4th at 1175.
81 Id. at 1181.
Following what may be a trend after *Riverisland Cold Storage*, a South Dakota court, in *Poeppel v. Lester*, similarly strengthens the fraud exception to the parol evidence rule, allowing a party to introduce parol evidence to establish fraud.\(^{82}\) In *Poeppel*, the Supreme Court of South Dakota clarified that the rule from an earlier case, *Schwaiger v. Mitchell Radiology Assocs., P.C.*, that stated a claim of fraud in the inducement could be dismissed as a matter of law if the alleged oral misrepresentation was in “direct contradiction” to the written document, “cannot be understood as anything other than dictum.”\(^{83}\) The court reversed and remanded the case in order to allow the seller to introduce parol evidence of fraudulent inducement.\(^{84}\) In relegating the rule in *Schwaiger* to dictum, the court went on to note that *Schwaiger* diverged from the longstanding precedent that parol evidence may be offered to show a contract is invalid due to fraud in the inducement no matter how unambiguous the contract may be.\(^{85}\)

These cases show that there is an inconsistent and mercurial application of the parol evidence rule (and its exceptions) among state courts. Irrespective of which side of the case a party is on, it is incumbent on the parties to review the most current applications of the parol evidence rule in each applicable state to ensure that the most current thinking on the rule is applied.

### III. FRANCHISOR VS. FRANCHISEE CONCERNS

#### A. The Franchisor’s Wholesome Concerns As To Disclaimers

The term “disclaimer” can be a loaded word in the franchise context. Its use seems to imply from the start that some fraudulent statement already has been made that must be disclaimed. The more appropriate concept might be better described as a “clarification” of the terms of the agreement.

Franchisors have legitimate and wholesome concerns that are served by contractual clauses that clarify the exact terms of the relationship and disclaim any others. The franchisor has developed a franchise concept that usually has proven to be a successful business model for a substantial number of franchisees. In a competitive marketplace, a franchisee has narrowed down his or her choices to the point where a disclosure document has been provided. Whether the franchisee is taken with the product, concept, range of investment, projected return on investment or other aspects of a particular franchise system, the franchisee has already decided to choose one brand and/or business model over others.

But at the point of signing an agreement, the franchisor holds no economic power over the franchisee at all, beyond the lure of the franchised concept. Arguably, if a prospective franchisee who is about to sign a franchise agreement with his or her first choice in hamburger franchises learns before signing that a desired term thought to be a part of the deal is not a part of the deal, he or she presumably can choose instead to sign with the second or third choice of hamburger franchise, some other kind of franchise, or accept the first choice without the desired term.

\(^{82}\) *Poeppel v. Lester*, 827 N.W.2d 580 (S.D. 2013).


\(^{84}\) *Poeppel*, 827 N.W.2d at 588.

\(^{85}\) *Id.* at 586.
Before a franchisee signs a franchise agreement, the franchisor must provide the franchisee with certain required disclosures. The parties are entitled to assume that these disclosures are accurate—that if the CEO has a recent prison record, it will be honestly disclosed; that Item 19 earnings claims contain accurate historical data; that locations that have gone out of business are properly listed. For all of its efforts in assembling the data that goes into a franchise disclosure document, the franchisor is granted no safe harbor by any statute. That is to say, even if the disclosure document is accurate in every detail, the franchisor can still be sued for fraud and misrepresentations.

In selling a franchise, the franchisor cannot guarantee the success of a franchised location because there are too many variables affecting the success of any business. From the franchisor's perspective, it has provided all of the relevant data on the business model in a regulated disclosure format; the franchisee has had the freedom to consider all of its competitors and businesses in widely varying industries; and the franchisee has chosen the franchise system he or she likes the most.

From its perspective, the franchisor has disclosed all of its vulnerabilities: ten units failed last year; some stores have earned far less than the system-wide average; the system has been sued by eight of the failed franchisees, who have all alleged fraud, etc. If, after reviewing all of this information, the franchisee still wishes to proceed, the franchisor takes the position that the terms of the relationship are in an agreement and the franchisee would not have signed the agreement if the terms were unacceptable. In other words, the franchisor’s expectations are that if the agreement states the franchisee must purchase pizza sauce from the franchisor's distribution arm, then the franchisee does not object; if the franchisee is required to contribute 4% of sales to an advertising fund that the franchisor will control in its sole discretion, then the franchisee is willing to do so; and if the agreement states that the name of the system can change and/or there are remodeling obligations upon renewal, then the franchisee understands the same. The franchisor expects that it has a right to rely on the terms of the franchise agreement to govern the parties’ relationship, and that the new franchisee has agreed to the terms stated in that document.

What the franchisor cannot control, however, is what the franchisee might believe to be a part of the final deal beyond what is stated in the franchise agreement based on pre-signing discussions, advertisements or documents. Before the contract is signed, the parties may have discussed many issues, but the final executed instrument is supposed to embody the entirety of the terms on which the parties have come to terms. The wholesome purpose of an integration clause is to declare that the executed instrument contains all of the agreed upon terms and that any oral agreements not enshrined in the final document are superseded. In theory, the inclusion of such a provision alerts the parties to speak up if the document appears to be incomplete and to refrain from signing if the document is not a full and complete statement of the terms of agreement as the party understood them.

In a perfect world, the franchisor has a wholesome interest in requiring a franchisee to commit to the terms of the franchise, as stated in the agreement. The franchisee has had a form of the agreement for a reasonable time and has been advised by warnings required by the FTC to have the agreement reviewed by a trusted adviser, like a lawyer or an accountant. As an example, assume the franchise agreement says that there is a one mile protected territory. If the franchisee believes that his protected territory is really two miles, the franchisor likely expects that the franchisee would point out the discrepancy before signing. Possibly the franchisor does not wish to grant a two mile territory. Or, as another example, perhaps the franchisee believes that he will not have to pay a 4% marketing fee, but the agreement says that
it is required. From the franchisor perspective, it is reasonable to expect that the prospective franchisee should demand the waiver of the marketing fee or to refuse to sign the franchise agreement.

Perhaps the most common complaint raised in franchisee lawsuits is that the franchisor made pre-contractual representations about financial performance, previously known as “earnings claims.” In fact, the first franchise law in the country was passed largely out of concern about such claims. Given the frequency of such claims, franchisors have taken a variety of approaches to insulating themselves against such claims. Whether this is viewed as an attempt to escape accountability for wrongful conduct, or a legitimate attempt on the part of the franchisor to understand the parameters of the relationship before signing an agreement and to avoid expanding obligations beyond those in the contract, the analysis comes out the same.

Beyond standard contractual disclaimers of any representations not included in the franchise agreement, franchisors have also taped or videotaped closings—where franchisees are asked to state all promises that have been made to them—or required franchisees to fill out various forms in which they deny that any extra-contractual promises have been made to them. However, in subsequent litigation, franchisees have sometimes claimed that they were told to say or write certain things and that they were merely following directions when saying that no promises had been made to them. Franchisees often point to statutory anti-waiver provisions and argue that any attempt to disclaim the protection of franchise statutes must be invalid.

However, anti-waiver provisions do not always provide shelter to a franchisee asserting fraud claims. For example, in Ellering v. Sellstate Realty Systems Network, Inc., discussed above, despite the existence of an anti-waiver clause in Minnesota, the court dismissed the franchisees’ claim for violation of the MFA based on allegations of future-income projection. The court based its decision not just on the general disclaimer in the UFOC, but also on the franchisees’ express acknowledgements in two agreements that they would not rely on such representations.

1. Franchisor Strategies In Enforcing Disclaimers

The franchisor’s first line of attack lies with the judge on legal motions. It is not enough to merely point to a disclaimer and insist on its enforcement. A review of the cases shows that courts have justified not enforcing disclaimers under certain circumstances and few judges are anxious to dismiss on the pleadings what appear to be legitimate claims of fraud.

Franchisors must, therefore, present a detailed record establishing the facts available to the franchisee and present facts that might tend to undermine a showing of justifiable reliance. Even if the FDD does not provide a complete safe harbor for franchisors, its detailed disclosures establish the facts that the prospective franchisee did know. A detailed presentation of the relevant facts disclosed in the FDD is critical to enforcing a disclaimer provision.

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87 801 F. Supp. 2d at 834 (D. Minn. 2011).
88 Id. at 845.
In Ayu’s Global Tire, LLC v. Big O Tires, LLC, the franchisee claimed, among other things, that the franchisor misrepresented the profitability of franchisees and concealed failed franchisees, thereby fraudulently inducing the franchisee’s purchase of a franchise. But on a summary judgment motion that was granted and upheld, the franchisor submitted contrary evidence that the failed franchises were not material to [the franchisee’s] decision to buy a Big O franchise, as he testified that knowledge of them would probably not have affected his decision to buy a Big O franchise. Further, detailed contact information about the departed franchisees, including a particular franchisee that the franchisor was alleged to have concealed, appeared in the franchise offering circular, but the franchisee had not contacted any of the franchisees who had left the system.

If the case proceeds to a jury trial, contractual disclaimers are still very important. Juries may not like all of the legalese in franchise documents, but they appreciate the legal consequences of signing an agreement and may well find an express contractual disclaimer to be dispositive. Franchisees often contrast their own mom-and-pop status with the economic power of the franchisor, but the franchisor can make its own contrast in that it lacks power over the prospective franchisee as it must compete with many other similar franchise offerings. Having conceived of the concept of the franchise system, the franchisor takes the position that it has the legal right to offer it to others on terms of its own choosing. If it wants to be the sole purveyor of “secret sauce,” it can structure the system around that; the prospective franchisee is free to choose another system where a secret sauce can be purchased from others and there are less restrictive contract disclaimers. It is therefore important to focus attention on the time when the franchisee still had a choice of several competing franchise systems.

B. The Franchisee’s Perspective: No Reliance Clauses Are Invitations to Exaggerate

For many years, and often with good reason, franchisee lawyers and other franchisee advocates have considered the type of contract language discussed in this paper to be among the most objectionable clauses in franchise agreements.

As discussed earlier in this paper, franchisee attorneys are likely to find, at best, a split in the case law as to the enforceability of these clauses. Outside the narrow category of attempts to preclude reliance on what is stated in the FDD, very few, if any, “no reliance” clauses are ever going to be ruled unenforceable as a matter of law. Most often, the challenge for the franchisee is to persuade the court that the “no reliance” clause should be unenforceable as a matter of fact in the particular case. The franchisee’s attorney must succeed in convincing the judge or arbitrator that, in the particular case, the franchisor is trying to use its contract language as an instrument of fraud.

The franchisee’s task is difficult, but not insurmountable. Here are some suggestions for the franchisee’s arguments. There is some overlap here, and in any particular case you will

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90 Id. at * 7.
91 Id. at * 16, n. 15.
92 For a historical reference that arguably remains timely today, see Joseph A. Thomson, Avoiding The Traps – Boilerplate That Bites: The 10 Most Dangerous Contract Terms, AMERICAN FRANCHISEE ASSOCIATION, 1999 LEGAL SYMPOSIUM, at 4 in which the “I didn’t say that” clause (a/k/a a “no representations” disclaimer) and the “this is it” clause (a/k/a an integration clause) were named at the first and second worst clauses for franchisees.
have to craft your own blending of these points. That being said, we take each argument strategy in turn.

1. **Bring The Truth To Light**

   From the franchisee perspective, the central problem with no reliance clauses, and integration clauses to a lesser degree, is that most often, they mask reality. When franchisors ask a court to “enforce the agreement as written” it often appears to the franchisee that the franchisor is asking the court to ignore the reality of what occurred in the particular franchise sales transaction. This arguable fiction stems from the premise that franchisees make, or should make, their entire purchase decision solely on the information that is disclosed within the four corners of the FDD and its exhibits, which include the franchise agreement, coupled with their “due diligence” as to matters beyond what the franchisor might have to say. In reality, the prospective franchisee’s receipt of the FDD is typically the springboard for further, in depth discussions that take place before the franchisee buys the franchise. That is why franchisors hold discovery days. Franchisees ask questions, and franchisors or their sales representatives answer them.

   The danger is that to limit the buyer’s legal right to rely to what is stated in the FDD or in the final version of franchise agreement, if any changes are negotiated, to the exclusion of everything else that is discussed, means (by design) that whatever is said during the sales pitches or on discovery day that augments or contradicts those sources must be ignored. Thus, franchisees tend to see “no reliance” or “no representation” clauses that permeate modern franchise agreements as being an invitation for franchisors to exaggerate, deflect, overpromise, embellish, misdirect, and even mislead the prospective franchisee in order to make the franchise sale.

   Most franchisors and their drafting attorneys like “no reliance” clauses not because they are planning to commit fraud, but because they minimize the risk that a salesperson might make an innocent misstatement that could be ginned up into a fraud claim that is costly to defend. After all, the delivery of the FDD is the last time that the franchisor has complete control over its message. However, the problem is that, even if we assume some good intentions behind these clauses, the “invitation to exaggerate” is nonetheless built in to every “no reliance” clause. Inevitably, and as a matter of human nature, it becomes far too easy for an unscrupulous or overzealous franchise seller to succumb to the temptation to exploit that invitation to its fullest potential, confident that the courts will enforce the parties’ contracts as written.

   Let’s revisit some of the examples used to justify these disclaimers:

   “For example, the franchisor has put all of its card on the table: ten units failed last year; some stores have earned far less than the system-wide average; the system has been sued by eight of the failed franchisees, who have all alleged fraud, etc. If, after reviewing all of this information, the franchisee still wishes to proceed, the franchisor takes the position that the terms of the relationship are in an agreement and the franchisee would not have signed the agreement if the terms were unacceptable.”

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\[93\] Supra text at 15.
Missing from this hypothetical are the conversations in which the franchisee asked the franchisor about the ten failed units, the under-performing stores, or the eight lawsuits. What if, when asked, the franchisor responded by criticizing the failed franchisees, e.g. “the problem was that s/he did not follow our system” and the franchisor adds the oral representation that “no one who actually follows our system has ever failed?” Should the franchisee be precluded as a matter of law from relying on this additional information? Likewise:

“the franchisor’s expectations are that if the agreement states the franchisee must purchase pizza sauce from the franchisor’s distribution arm, then the franchisee does not object…”

But, in the sales conversations that occur after the franchisee reviews this statement in the FDD, the franchisee asks to see the price list. The request is declined, with the franchisor’s statement that the past is no guarantee of the future and “we would not want to mislead you.” The salesperson might assure the prospective franchisee that “with the size of our system, we have tremendous buying power which gives our franchisees a huge advantage.” If it later turns out that the verbal representation of good pricing isn’t borne out in practice, should the franchisor be completely immunized from liability for fraud in the inducement based on a “no reliance” clause?

To overcome the fiction that sales conversations never occurred, the franchisee must allege every fraudulent misrepresentation with particularity as required by Fed.R.Civ.P. 9(b) or commensurate state law requirements, and must then support each allegation with persuasive, believable evidence sufficient to create questions of fact at the summary judgment stage. This might seem obvious, but the franchisee’s counsel must take extra care to make sure that this hurdle is cleared.

2. **Win The Clarification Issue**

Franchisors suggest that integration and no reliance clauses serve to “clarify” what is part of the enforceable agreement and what is not. To be sure, an intelligent franchisee will want “clarity” when entering into the franchise relationship as much as the franchisor. The notion that a franchisee might purposefully desire to leave some ambiguity in the franchise agreement is not a sound business strategy for anyone who is about to make an important investment. The problem is that when the franchisee receives the FDD, and then the parties talk, the franchisee may reasonably believe that these pre-sale conversations serve to clarify what was stated in the FDD. But then, ironically, to advance the goal of clarity, the conversations in which the franchisee was seeking clarity are excluded. To refute the “clarification” argument, franchisees must meet the other side head on. If a franchisor is attempting to persuade the court that its “no reliance” or “no representations” clause is merely a clarification of what the parties agreed upon, the franchisee’s lawyer must point out that the integration clause already covers that ground without creating the “invitation to exaggerate” that more aggressive disclaimers create. In most jurisdictions, and as stated by the Seventh Circuit, the parol evidence rule does not bar a claim of fraud based on extra-contractual statements:

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94 Id.
95 See Carmen D. Caruso, *Ambiguity In Your Franchise Agreement: Negotiate Now Or Litigate Later*, AMERICAN FRANCHISEE ASSOCIATION, 2000 LEGAL SYMPOSIUM.
By virtue of the parol evidence rule, an integration clause prevents a party to a contract from basing a claim of breach of contract on agreements or understandings, whether oral or written, that the parties had reached during the negotiations that eventuated in the signing of a contract but that they had not written into the contract itself. … But fraud is a tort, and the parol evidence rule is not a doctrine of tort law and so an integration clause does not bar a claim of fraud based on statements not contained in the contract. Doctrine aside, all an integration clause does is limit the evidence available to the parties should a dispute arise over the meaning of the contract. It has nothing to do with whether the contract was induced, or its price jacked up, by fraud.... And the majority rule is that an integration clause does not bar a fraud claim.96

If the franchisee can succeed in exposing this redundancy, the franchisee is now free to argue that the true nature of the “no reliance” or “no representations” clauses, as invitations to exaggerate, is clear. In this manner, the franchisee can try to reduce the risk of having those clauses enforced to serve the facially noble purpose of clarity.

Furthermore, it is essential when arguing for a franchisee to point out that the “clarification” argument rests on the possibly erroneous assumption that the franchise agreement and FDD are perfectly clear and complete. The franchisee’s theme is that reality contradicts this rosy assumption. Law professor Gillian Hadfield has aptly observed that franchise agreements are “relational contracts” because they require mutual performance over a number of years; they are necessarily incomplete in defining the parties’ exact duties in every situation that might arise during the term; and they necessarily vest discretion in both parties, but especially in the franchisor, as to exactly how the agreement will be performed over a long period of years.97 Actual “clarification” often comes in the discussions that follow the initial disclosures, rather than from disclaimers.

3. **Make The Most Out Of The Amended FTC Rule**

Franchisee advocates were disappointed with the amended FTC Rule, as the FTC saw fit to bar disclaimers only of those representations made in the disclosure document or in its exhibits or amendments. Under the principle *expressio unius est exclusio aterius* (the expression of one thing is the exclusion of another), it is likely that franchisors may argue that, by its silence, the FTC has approved disclaimers of reliance on anything other than the contents of the FDD.

The FTC’s Statement of Basis and Purpose explains that franchisors may still include integration clauses and disclaimers for *unauthorized* statements by salespersons, along with statements made by other franchisees, or in franchise advertising and marketing materials, or unattributed statements in the trade press and third party representations.98 This language puts

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96 *Vigortone Ag. Prods. V. AG Prods.*, 316 F.3d 641, 644 (7th Cir. 2002).

97 See Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN L. REV. 927 (1990). Hadfield offers valuable insight as to the way that an imbalance in bargaining power leads almost inevitably to an imbalance of discretionary versus mandatory duties and places the greater risk of injury (from potential exploitation of contractual discretion) squarely upon the franchisee. Her arguments offer strong support for a vigorous implementation of the implied covenant of good faith and fair dealing in franchising.

the focus, and properly so, on whether the franchisor was in control of the extraneous representations that give rise to a fraud claim. At discovery day, for example, it would appear difficult for the franchisor to argue that statements being made to prospective franchisees are not authorized. The FTC Statement of Basis and Purpose thus supports the argument that the FTC has not approved disclaimers of representations made under the franchisor’s control.

The distinction between authorized or unauthorized representations seems to correlate nicely with the question of reasonable reliance. If a sales agent takes the prospective franchise outside on discovery day and whispers a representation in the franchisee’s ear, as opposed to speaking out in front of everyone else, the franchisee ought to question whether this representation is coming from the franchisor, and reasonable reliance would be questionable. Clearly, any franchisee seeking to prove a fraud claim based upon extraneous statements must be prepared to plead and prove, in the first instance, that the representation came with the franchisor’s imprimatur and was not a rogue statement unworthy of belief.


Depending on the jurisdiction, the most formidable line of defense for franchisees might be the anti-waiver clauses of a state franchising law, when applicable. In a case discussed above, *Hanley v. Doctors Express Franchising, LLC*, the franchisee brought claims for fraud under the anti-fraud provisions of the Maryland Franchise Law and at common law.99 The franchisee alleged that he had been induced to buy a franchise “[i]n reliance upon the statements and representations made in the [FDD] and marketing materials, as well as materials, statements and representations communicated to them orally and in writing by [the franchisor or its representatives].”100 As happens in many of these cases, the franchisor asserted in a Rule 12(b)(6) motion “several disclaimers that were asserted in the FDD and the Franchise Agreement, as defenses to both the common law and statutory fraud claims.”101 The franchisor in *Hanley* argued that the “explicit terms of the Franchise Agreement ... unambiguously establish that Plaintiffs specifically agreed that they did not rely on any statements or representations outside the Agreement or FDD in deciding to acquire the franchise.”102 The franchisor went even further and argued that “even if misrepresentations were made in ... the extraneous communications, the misrepresentations were not ‘material,’ because a ‘‘material’ fact is one on which a reasonable person would rely in making a decision.” 103 Quoting from a federal district court decision from Minnesota, *Randall v. Lady of America Franchise Corp.*, the district court in *Hanley* observed that:

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99 The Maryland Franchise Law imposes fraud liability for “selling or offering a franchise ... by means of an untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, if the person who buys or is granted a franchise does not know of the untruth or omission.” B.R. § 14-227(a)(1)(ii)(2010 Repl. Vol., 2012 Supp.).


101 Id. at *24.

102 Id. at *26.

103 Id. at *27-29 (citing with approval, *Randall v. Lady of America Franchise Corp.*, 532 F. Supp. 2d 1071 (D. Minn. 2007)). In other words, the franchisor was explicitly arguing that based on all the disclaimers it had put into the FDD and the franchise agreement, and the related documents that the franchisee had to execute before closing, the law should excuse any misrepresentations that the franchisor might have made in the course of the franchise sales process. The district court in *Hanley* denied the franchisor’s motion to dismiss, holding that the anti-waiver provision of the Maryland Franchise Law precluded a finding “at least at the motion to dismiss stage” that the various contractual disclaimers negated the franchisee’s claims.
The disclaimer cannot change the historical facts; if the dishonest franchisor made misrepresentations, then he made misrepresentations, no matter what the franchise agreement says.\textsuperscript{104}

The \textit{Hanley} court commented that in \textit{Randall}, the court met the issue squarely when it held that “the disclaimer can only be an attempt to change the legal effect of those misrepresentations. That is precisely what [the statutory anti-waiver] language forbids.”\textsuperscript{105} The court in \textit{Hanley} concluded, for purposes of the statutory fraud claim, that the disclaimers and integration clauses were insufficient to defeat the plaintiff’s fraud claim “as a matter of law” at the pleading stage, but that these clauses would remain “factually relevant” to be considered with other evidence of whether the plaintiff could establish reasonable reliance.\textsuperscript{106}

On their face, \textit{Hanley} and \textit{Randall}, on one hand, and \textit{Ellering} on the other, appear contradictory because the facts were similar but the courts reached opposite results. In each of these cases, the FDD disclaimed the making of any financial performance representations, and then the franchisees in each case attempted to sue for fraud, asserting that financial performance representations were made outside the FDD.\textsuperscript{107} In \textit{Hanley}, which is the most recent of these decisions, the district court held that the state franchise act’s anti-waiver provision precluded the franchisor from asserting the disclaimers as a complete defense at the pleading stage, but signaled that the franchisor could still argue, as a factual issue, that the disclaimers served to defeat any claim of justifiable reliance.\textsuperscript{108} \textit{Ellering} came for decision at the Rule 56 stage, and the district court held that notwithstanding the statutory anti-waiver clause, the franchisee could not establish justifiable reliance because the representation that the franchisee sought to prove was “in plain contradiction” of the contractual disclaimer.\textsuperscript{109} In \textit{Randall}, on the other hand, which \textit{Hanley} found persuasive, the district court held at the Rule 12(b)(6) stage that the “direct contradiction” test was not satisfied.\textsuperscript{110}

In sum, these conflicting decisions are not necessarily irreconcilable. Franchisees seeking to avoid defeat of their fraud claims based on the disclaimers of reliance or integration clauses may continue to follow the road map presented by \textit{Randall} as adopted in 2013 by the court in \textit{Hanley}.\textsuperscript{111}

5. \textbf{Win The “No Direct Contradiction” Battle}

Of all the battles that a franchisee must win to overcome a “no reliance” or “no representation” clause, perhaps the most important is to convince the court that the

\begin{itemize}
  \item \textsuperscript{104} \textit{Hanley}, 2013 WL 690521 at *28.
  \item \textsuperscript{105} \textit{Id}.
  \item \textsuperscript{106} \textit{Id}. at *30.
  \item \textsuperscript{107} \textit{Randall}, 532 F. Supp. 2d at 1075, 1080; \textit{Ellering}, 801 F. Supp. 2d at 837, 842-43.
  \item \textsuperscript{108} \textit{Hanley}, 2013 WL 690521, at *30.
  \item \textsuperscript{109} \textit{Ellering}, 801 F. Supp. 2d at 845.
  \item \textsuperscript{110} \textit{Randall}, 532 F. Supp. 2d at 1085.
  \item \textsuperscript{111} Not every franchisee will be fortunate enough to be protected by a state anti-waiver statute. In \textit{Hanley}, the court also rejected the disclaimers and integration clauses as complete defenses to the common law fraud claim, and left open the question of justifiable reliance in the face of these clauses for later decision as a question of fact. \textit{Hanley}, 2013 WL 690521 at *30.
\end{itemize}
representation alleged by the franchisee does not directly contradict a disclaimer or other provision in the franchise agreement.

There appear to be at least two variations of this issue. In some jurisdictions, the issue is framed as not allowing a general disclaimer of “no representations” to negate proof of reliance on a specific misrepresentation. Other courts, such as the court in Ellering v. Sellistate Realty Systems Network, Inc., simply ask, does the claimed misrepresentation directly contradict the language of the contract or the FDD, including but not limited to the language of the disclaimer? These tests are not really different and they both evince a strong measure of common sense. What a court is really asking is “whether the plaintiff must have known in signing the contract that s/he was disavowing the claimed misrepresentation.” Where the contradiction is unmistakable and cannot be avoided, the court is hard-pressed to allow the claim to proceed to trial. The differing results in Lady of America and Ellering can most likely be explained on this basis. The judge in Lady of America apparently saw no attempt at direct contradiction, but that was not the case in Ellering. Any franchisee seeking to rely on Lady of America might be able to distinguish Ellering on this basis.

The question becomes: How can a franchisee avoid falling into the direct contraction trap? The first and more difficult path is to demonstrate that the written representation or contract provision is not perfectly clear such that the oral representation is a clarification and not a contradiction. Even better, the franchisee should be prepared to demonstrate that the oral representation is actually consistent with the franchisee’s reasonable interpretation of the given contract language.

6. Exceptional Cases – When It Might Be Necessary To Argue Lack Of Sophistication

There may be cases where it is tempting to franchisee’s counsel to present the franchisee client as unsophisticated in business matters. The Seventh Circuit may have invited this argument when it held that it saw no reason not to enforce a “no reliance” clause that was signed by a “sophisticated corporate entity.” An example might be cases where the franchisee is a “New American,” and at least one trial court has signaled its willingness to consider the fact that the franchisee is an immigrant in assessing the franchisee’s fraud claim. In this particular case the franchisor’s sales broker invited the argument based on its use of a sales manual that specifically addressed the “cultural tendencies of ‘New Americans,’ a phrase that encompasses immigrants from South Asia and the Middle East who comprise the overwhelming majority of prospective bidders” for the franchises that were being sold in that case.

A note of caution is in order before this strategy is invoked, however. A plaintiff that depends on its lack of sophistication in business might regret taking this approach when it

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113 801 F. Supp. 2d at 844-45.
114 Vigortone AG Products, Inc. v. PM AG Products, Inc., 316 F.3d 641, 644-45 (7th Cir. 2002).
comes time to prove that the damages that it suffered were proximately caused by the defendant’s conduct.

7. **Focus On Reliance In Fact And Materiality**

Make no mistake. From the franchisee point of view, “no reliance” clauses, or “clarifiers” as our learned colleague would say, are called upon to protect the franchisor from liability for the making of false or misleading statements. For this reason, when the misrepresentation can be proven, franchisees must strenuously argue that justice demands that these clauses not be enforced.

The key to achieve this result is to convince the court that notwithstanding the cited disclaimers, the franchisee *did* reasonably rely on the oral or written representations that were made outside the FDD and its exhibits. Establishing no direct contradiction is necessary but not sufficient on this score. The extraneous statements (or the omissions) must be placed in context in order to support the conclusion that reliance occurred and was reasonable. Once this table is set, the franchisee can be asked:

“Sir, when you signed the franchise agreement did you understand that you were giving them the right to lie to you about X?

Or to keep you in the dark about Y?

If you knew the truth about X or Y would you have bought the franchise anyway?”

Enforcement of a disclaimer would prevent the franchisee from ever giving this sort of testimony. The franchisee’s argument must be that to enforce the disclaimers would be to permit fraud. The franchisor’s argument, by contrast, is that a disclaimer bars any claim of fraud. The arguable flaw in the franchisor’s argument is that it ignores the franchisee’s “reliance in fact” on false statements made with the intent to deceive. “Fraud in fact” becomes “no fraud as a matter of law” only when a judge holds, expressly or by implication, that in signing the franchise agreement, the franchisee knowingly accepted the risk that what the franchisor or its authorized representatives stated might not only be wrong, but might be intentionally wrong. In sum, from the franchisee viewpoint, there is no perfect way to formulate a contractual disclaimer that will achieve the franchisor’s wholesome goal of avoiding the cost of defending bogus fraud claims while protecting the franchisee’s right to bring legitimate fraud claims. The only solution is to persuade courts that the facts of each case must be carefully examined, and that “no reliance” clauses should never be permitted to allow fraud to go unpunished.

**IV. SINS OF OMISSION**

**A. The Franchisor’s Perspective**

Franchisors are obligated to make extensive pre-contractual disclosures. Franchisees have often complained that the sheer volume of the mandatory disclosures was overwhelming, and it is not uncommon to hear that disclosure documents were either disregarded entirely or only briefly perused. Despite this, franchisees may claim that material information was not disclosed to them, leading to claims of fraudulent omission. Case law has made it clear that
franchisors do not, in fact, have a safe harbor based upon the provision of standard disclosure documents.116

Omission claims are especially difficult for franchisors. With the benefit of hindsight, many facts may be characterized as material under the circumstances. For example, a franchisor could face omission claims along the lines of: if only the franchisee had known that the franchisor's chief financial officer had just been diagnosed with cancer, or had just been arrested for drunk driving, or was going through a contested divorce, or was interviewing for a job with a competitor, the franchisee would never have signed on. The omission claims may seem to the franchisor as so far reaching that there is no end to the material facts that could have been disclosed but were not.

Franchisors sometimes believe that it is unfair to require extensive disclosures from franchisors, without also offering some sort of a safe harbor. If information is deemed to be material, regulators have only to require its disclosure and franchisors have no choice but to disclose. Franchisees claim that there is a duty to disclose additional facts where the facts disclosed would be misleading unless corrected by additional information, or where the franchisor has superior knowledge. But there must be a reasonable limit to what facts are enough to make an educated and reasoned decision to purchase a franchise. The uncertain standards of omission cases lead to complex analytical problems.

In Century Pacific, Inc. v. Hilton Hotels Corp., the owners of Red Lion hotel franchises sued Hilton for failing to disclose a purported intent to sell the Red Lion chain.117 Initially, the court dismissed the franchisee’s claims under the New York Franchise Sales Act, but permitted the franchisees to pursue their claims of fraudulent omission.118 After discovery, on summary judgment, the trial court dismissed the franchisees’ fraud claims. Among other arguments, the franchisees had argued that Hilton had failed to disclose that it would be open to selling Red Lion and that it had considered previous offers from potential buyers.119 The franchise agreement disclosed that Hilton had the unfettered right to sell the brand. The court held that there was no omission of any material fact because the right to sell had been expressly reserved. The court noted that the fact that Hilton periodically re-evaluated its portfolio was not inconsistent and did not require any further disclosures. The court’s decision was affirmed by the Second Circuit.120

In Martrano v. Quizno’s Franchise Co., LLC, the franchisees filed a RICO action claiming they had been defrauded into purchasing franchises based on the franchisor’s failure to disclose

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118 Referring to the case, commentators had noted that there is an inherent tension between the securities laws concerns about premature disclosure of sale negotiations and the desires of prospective franchisees to obtain complete information before committing to buy a franchise. JEFFREY A. BRIMER, LESLIE SMITH-PORTER, ANNUAL FRANCHISE AND DISTRIBUTION LAW DEVELOPMENTS 2004 17-18 (American Bar Association 2004). The analysis concluded: “We now have a case that provides a platform for claiming that failure to disclose the future plans for the system may constitute pre-sale fraud.” Id. at 18.


120 Century Pac., Inc. v. Hilton Hotels Corp., 354 F. App’x 496 (2d Cir. 2009).
the “true nature” of the franchise relationship.\textsuperscript{121} The franchisee alleged that Quizno’s had represented in its UFOC that the franchisor would negotiate service and supply agreements with suppliers in a way that would benefit franchisees. The court declined to dismiss the complaint on the pleadings, reasoning that a reasonable jury could believe that the franchisor had represented that it would negotiate favorable contracts when it had no present intent of doing so. The franchisees also claimed an omission of facts that would have shown the high rate of franchise failures.

In \textit{Colorado Coffee Bean, LLC v. Peaberry Coffee Inc.}, the franchisee sued for negligent omissions.\textsuperscript{122} The franchisor’s offering circular disclosed only the gross sales of existing stores, but stated that it contained no data on profits and no guarantee of profitability. Franchisees were advised to conduct their own financial analysis. The franchisees raised two claims for fraudulent non-disclosure: (1) that the franchisor had concealed losses at its existing stores, and (2) that the franchisor had failed to disclose its own losses. The trial court concluded that the franchisor had actively concealed material facts that should have been disclosed in equity and good conscience, but concluded that repeated acknowledgements of non-reliance were determinative in the franchisor’s favor. Specifically, the franchisees had signed acknowledgements stating that they were not relying on any information outside of the UFOC and the franchise agreement. The agreements contained various other disclaimers, statements of non-reliance and integration clauses. The trial court found that both claims of concealment were barred due to the lack of reasonable reliance.

The Colorado appellate court acknowledged that “clear and specific” language in the UFOC or the franchise agreement could preclude reasonable reliance. The court found that the franchisees’ first theory (that the franchisor had concealed losses at its existing stores) was barred by clear and specific disclaimers, which cautioned that the data provided should not be considered as actual or potential income; that business and legal advisors should be consulted; that costs of sales and operating expenses had to be deducted to determine net income; and that no other statements of actual or projected sales, costs or income had been made.

The franchisee had urged the court to reject the disclaimer clauses on public policy grounds. Instead, the court quoted a Delaware Chancery Court opinion for the following proposition: “[I]f there is a public policy interest in truthfulness, then that interest applies with more force, not less, to contractual representations of fact.”\textsuperscript{123} The court also followed \textit{Hardee’s of Maumelle, Arkansas, Inc. v. Hardee’s Food Systems, Inc.}, in which the court stated that “it is simply unreasonable to continue to rely on representations after stating in writing that you are not so relying.”\textsuperscript{124} On this basis, the court of appeal affirmed the trial court’s ruling that reliance on the non-disclosure of net losses of company stores was unreasonable.

In \textit{Colorado Coffee Bean}, the appellate court found, however, that there were no clauses in the agreement that negated reasonable reliance on information about the parent company’s financial condition (the franchisee’s second claim). The court reasoned that the disclaimers about the financial performance of company stores did not cover the parent company’s financial


\textsuperscript{122} \textit{Colorado Coffee Bean, LLC v. Peaberry Coffee Inc.}, 251 P.3d 9, 17 (Colo. App. 2010).

\textsuperscript{123} \textit{id. at 19.}

\textsuperscript{124} 31 F.3d 573, 576 (7th Cir. 1994).
condition. The court stated that disclosure of losses by the parent company could foreshadow its insolvency, and would undermine the value of a franchise.

The franchisor defended by arguing that because its parent company had not guaranteed the franchisor entity, the disclosure of financial information about the parent was prohibited. The court, however, cited FTC commentary that "franchisors are always free to disseminate additional truthful information to a prospective franchisee." The court, therefore, concluded that the franchisor could have further disclosed that it was a wholly owned subsidiary of its parent, which had not shown a profit for several years.

The appellate court further reasoned that disclosures do not "create a safe harbor for franchisors engaging in otherwise unlawful conduct." The appellate court could see no inconsistency between the prohibition of disclosing a parent's financial statements absent a guarantee and merely informing prospective franchisees that the franchisor's parent had been unprofitable for several years. The alleged fraudulent nondisclosure of the parent company's losses was, therefore, not protected by FTC regulations.

In Ayu's Global Tire, LLC v. Big O Tires, LLC—the first of 25 franchisee claims filed against Big O—the California Court of Appeal affirmed the trial court's dismissal of a fraud claim. All of the cases were deemed related for purposes of discovery and the Ayu case was designated the bellwether case, set to be tried first. Just before the case went to trial, the court dismissed the case on summary judgment. The decision was based upon the parties' agreement that Colorado law would be applied, although California franchise statutes also applied.

Ayu had raised 13 fraud counts and 12 counts of breach of contract. Focusing on alleged omissions, the franchisee asserted that Big O had failed to disclose: (1) that profits in the UFOC were exaggerated; (2) that the number of failed franchisees had been suppressed (particularly as to franchisees without experience); and (3) that Big O had failed to disclose its own internal pro forma, which had been less optimistic. Ayu specifically focused on a memo from a Big O employee expressing concerns that so many inexperienced franchisees had been failing recently: "We must come up with a plan to stop these new [o]wners with no experience from failing at such a high rate." The memo had been written shortly before the plaintiff had signed the franchise agreement.

125 Id. at 22.
126 Id. at 23 (citing 72 Fed. Reg. at 15536).
127 Ayu's Global Tire, LLC v. Big O Tires, LLC, No. B236930, 2013 WL 2298585 (Cal. Ct. App. May 24, 2013). Author Jonathan Solish was counsel for Big O in this case, and provides the following further details that are not mentioned in the court of appeal opinion: Although franchisees leaving the system had been disclosed in the offering circular, Ayu complained that there was no category disclosing the excessive failures of inexperienced franchisees. Hailemariam, the principal in Ayu, claimed that although he had been provided four or five offering circulars, he had never bothered to read any of them. Although he had paid his lawyer to negotiate his lease, he had not paid his lawyer to review the offering circulars. Somewhat paradoxically, Hailemariam also claimed that the disclosures he had been provided—which he described as overwhelming—had been insufficient and that he should have been provided with even more disclosures.
128 Id. at *6, * 12.
129 Id. at * 10-11.
130 Id. at *10.
The trial court granted summary judgment in favor of the franchisor, and the California appellate court affirmed, holding that Colorado law placed the plaintiff on “inquiry notice” that precluded any reasonable reliance.\(^{131}\) The express warnings in the UFOC to seek professional advice, coupled with the size of the investment, were sufficient to place the plaintiff on notice and called for further inquiry into the UFOC and the agreement.\(^{132}\) The plaintiff was charged with full knowledge of the terms and disclosures in the UFOC and the agreement. The claim of fraud by omission failed because there could be no reasonable reliance, given the terms and disclosures of the documents ignored by the plaintiff.\(^{133}\) The court closely followed the Colorado Coffee Bean decision.\(^{134}\) Under Colorado law, concealment by mere silence is not sufficient to give rise to a legal claim. There must be some trick or contrivance intended to exclude suspicion or to impede further inquiry.\(^{135}\)

The plaintiff claimed that he was told that he did not need experience to be successful.\(^{136}\) He also claimed that the alleged statement was misleading, because Big O personnel knew additional facts about the failures of franchisees, who, like the plaintiff, lacked experience.\(^{137}\) The appellate court found that the memo about franchisee failures was not inconsistent with the statement that experience was not necessary.\(^{138}\) In fact, at least 41 other franchisees with no prior experience in the tire business had been successful, proving that the representation was true.\(^{139}\) The court also pointed to the list in the UFOC of franchisees who had left the system.

Ayu claimed that Big O should have disclosed its own internal pro forma, which had been less rosy in its projections than its own pro forma.\(^{140}\) Ayu claimed that if it had seen the modest profits projected by Big O, it would not have proceeded. Under Colorado law, to succeed on a claim for fraudulent concealment, a plaintiff must show that a defendant was under a duty to disclose material facts that in equity or good conscience should be disclosed.\(^{141}\) If the parties place the risk as to the existence of a fact on one party, the other party has no duty of disclosure.

The UFOC provided that salespersons were not authorized to provide additional information about actual or potential sales beyond what was specifically provided in the UFOC. Because of this statement, the court concluded that Big O had no duty to disclose its internal pro forma.\(^{142}\) Notably, the appellate court rejected Big O’s argument that disclosure of the internal pro forma would have been an unlawful earnings claim. Citing 16 C.F.R. § 437.1 (a), (b) (2008), the court pointed out that further representations could have been provided to Ayu,

\(^{131}\) Id.\(^{132}\) Id.\(^{133}\) Id.\(^{134}\) Id. at * 5, * 10.\(^{135}\) Id. at * 5.\(^{136}\) Id. at * 6.\(^{137}\) Id.\(^{138}\) Id. at * 11.\(^{139}\) Id.\(^{140}\) Id. at * 12.\(^{141}\) Id.\(^{142}\) Id. at * 12-13.
even if there would have been a need for further warnings and stringent requirements would have had to have been met.\textsuperscript{143} Because of the disclaimers in the UFOC, the court found that any duty to disclose the internal pro forma did not go to the basis or essence of the transaction.\textsuperscript{144} The court also found no obstacle to Ayu developing less optimistic estimates along the lines of those developed by Big O.

Ayu’s allegations about the failure to disclose information about franchise failures were also rejected.\textsuperscript{145} Ayu had alleged that the franchisor concealed a specific franchisee who had left the system.\textsuperscript{146} The specific name and contact information of that franchisee were listed in the UFOC, providing contact information for the plaintiff. Therefore, the court found that Ayu’s fraud claim failed for lack of triable issues as “nothing before us suggests that Big O failed to disclose information regarding failed or terminated franchises material to Hailemariam’s decision to go forward.”\textsuperscript{147}

\textit{Domino’s Pizza LLC v. Deak,}\textsuperscript{148} overruled in a not for publication opinion,\textsuperscript{149} shows how difficult it is to analyze integration clauses. Deak was a Domino’s area developer who signed an initial 10 year agreement that was extended for an additional five year period, until July 31, 2005. Deak claimed, however, that he had been orally promised that the area developer agreement would be extended for as long as he operated Domino’s stores. Deak brought suit when Domino’s did not renew the contract upon its expiration in 2005.

The district court held that because the integrated written contract provided a clear termination date the issue of term could not be modified by parol evidence. Thus any discussions between Domino’s and Deak on renewability were inadmissible. Applying Pennsylvania law, the court refused to “throw out a viable and extensive contract” “because the contract was less accurate than [the plaintiff’s] off-the-record discussions with a Domino’s employee.”\textsuperscript{150} The district court was “not disputing or even considering whether such discussions were made,” but found the factual question of what had been said to be “simply not relevant to the matter before this Court for adjudication.”\textsuperscript{151} The district court lacked “the omniscience that would enable complete understanding of all representations and all intentions upon the date of contract formation,” and so had to “rely upon what is available: the signed, executed, integrated contracts.”\textsuperscript{152} The court held that if the parties had intended to provide

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\textsuperscript{143} \textit{id.} at * 13, n. 12.
\textsuperscript{144} \textit{id.} at * 13.
\textsuperscript{145} \textit{id.} at * 11.
\textsuperscript{146} \textit{id.} at * 16, n. 15.
\textsuperscript{147} \textit{id.} at * 16.
\textsuperscript{149} No. 09-3772, 2010 WL 2222781 (3d Cir. June 4, 2010).
\textsuperscript{151} \textit{id.}
\textsuperscript{152} \textit{id.}
renewal rights to Deak, that term “should have been included in the written, signed, and executed Area Agreements.”

The district court ruling in *Deak* was overruled by the Third Circuit because a party has a right under Pennsylvania law to show by “clear, precise and convincing evidence” that the agreement as written did not express what the parties had intended and that an agreed-upon term had been omitted from the contract by mistake or accident. The appellate court held that although the burden was on the plaintiff to establish that the written document was incomplete, the matter should not have been resolved on a motion to dismiss.

**B. The Franchisee’s Perspective**

Since the ultimate purpose of any “no reliance” or “no representations” clause is to defeat a fraud claim by precluding the franchisee from proving justifiable reliance, the best strategy often is to avoid having to prove justifiable reliance as an element of the fraud claim. Accordingly, in any case in which the franchisee has disclaimed the existence of any representations made outside the FDD or its exhibits, and has represented that s/he did not rely on anything extrinsic, the franchisee’s best course is probably to plead and prove a case based on fraudulent omissions.

Where the franchisee is able to bring its claims under the anti-fraud provisions of a state franchise act, which was modeled after Rule 10(b)-5 in the federal securities law, there is a very strong argument that reliance need not be proven:

> When a securities fraud claim is based on material omission, positive proof of reliance is not prerequisite to recovery; all that is necessary is that facts withheld be material in the sense that reasonable investor would have considered them important in making his decision.

Some courts have recognized this principle in the franchising context. In a 1986 case, *Morris v. International Yogurt Co.*, the Supreme Court of Washington held that the omission of

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153 Id. See also 6th & K, Ltd. v. Ramada Franchise Systems, Inc., No. 93-1968, Bus. Franchise Guide (CCH) ¶10,721 (S.D. Cal. June 5, 1995) (holding that the parties must have addressed the substantive issues that mattered to them in their written contract).

154 Domino’s Pizza LLC v. Deak, 383 F. App’x 155, 159 (3d Cir. 2010).

155 Id.


material fact concerning availability of yogurt mix to nonfranchisees in the sale of a yogurt store franchise, in violation of the Washington Franchise Investment Protection Act, established a presumption of reliance by franchisees on such misrepresentation by nondisclosure.159 The franchisor could attempt to rebut this presumption by proving that the franchisee would have purchased the franchise anyway, even if the additional facts had been disclosed, but the “no representations” and “no reliance” clauses should not help the franchisor in that effort.

Franchisees seeking to avoid the effect of a “no reliance” clause by pleading an omissions case must be careful not to over-plead with a laundry list of affirmative misrepresentations and omissions in the same case, because in a “mixed case” the presumption of reliance may not be available.160 To qualify for the presumption of reliance, the plaintiff must persuade the court that the franchisor’s culpability is “primarily” based on a failure to disclose.161 The case must be shaped in this direction from the pleadings onward.

Franchisors complain that there is no limit to what might be claimed as an omission, but in general the test of materiality is “[whether] a buyer would have acted differently knowing the information, or if it concerned the type of information upon which a buyer would be expected to rely in making a decision regarding the purchase of the [franchise].”162 Franchisees thus cannot simply assume that the franchisor has a duty to disclose every particular fact that might have factored into the buying decision, especially where the franchisor has already disclosed the information required by the FTC Rule. The duty to disclose must be established, and in franchising, there are generally three ways to do it:

1. Establish that the fact is known only to the franchisor and simply beyond the reach of any buyer despite the exercise of due diligence.163
2. Establish that the franchisor has actively concealed the material fact.164
3. Establish that without disclosing additional facts, the representations made (including those in the FDD) are merely “half-truths.”165

159 729 P.2d 33 (citing Wash. Rev. Code Ann. § 19.100.170(2) (West 2013)).
161 Id. (citing Affiliated Ute Citizens of Utah v. U.S., 406 U.S. 128, 153-54 (1972)).
163 See Forest Pres. Dist. of Cook Cnty. v. Christopher, 321 Ill. App. 91, 52 N.E.2d 313, 319-20 (Ill. App. 1st Dist. 1943) (when “the other remains silent when it is within his power to prevent the expenditure of money under a delusion . . . to permit one to take advantage of the mistake of another would be revolting to every sentiment of justice.”). The court further stated, “there are times . . . when it becomes the duty of a person to speak, in order that the party he is dealing with may be placed on equal footing with him, and when a failure to state a fact is equivalent to a fraudulent concealment, and amounts to [an] affirmative falsehood.” Accord City of Chicago v. Am. Nat. Bank & Trust Co., 233 Ill. App. 3d 1031, 599 N.E.2d 1126, 1130-1 (Ill. App. 1st Dist. 1992). As one court put it, the defendant must be “clearly dominant, ‘either because of superior knowledge of the matter derived from . . . overmastering influence on the one side, or from weakness, dependence, or trust justifiably reposed on the other side.’” Mitchell v. Norman James Const. Co., Inc., 291 Ill. App. 3d 927, 684 N.E.2d 872, 879 (Ill. App. 1st Dist. 1997).
164 “Mere silence in a transaction does not amount to fraud.” Hirsch v. Feuer, 299 Ill. App. 3d 1076, 702 N.E.2d 265, 273 (Ill. App. 1st Dist. 1998). However, silence accompanied by deceptive conduct or suppression of material fact, can give rise to concealment and “it is then the duty of the party which has concealed information to speak.” Id. Courts sometimes refer to this as “active concealment.” Heider v. Leewards Creative Crafts, Inc., 245 Ill. App. 3d 258, 613 N.E.2d 805, 814 (Ill. App. 2d Dist. 1993).
The third course, proving that the FDD makes statements that are only half-truths, might be particularly fruitful for a franchisee confronting a “no representations” clause, as it allows the franchisee to acknowledge and indeed affirm that s/he was relying on the FDD, just as the franchisor claims that s/he should, but was defrauded anyway in view of the material omissions that would be necessary to place the FDD into context. A perfect example here relates to financial performance representations that might be true, on their face, but where the franchisor has failed to disclose relevant circumstances that separate the top from the bottom performers.

V. CONCLUSION

As recent cases have shown, judges in the same courthouse have been unable to see eye-to-eye on the enforcement of contractual disclaimers. The recent FTC pronouncement on disclaimers has done little to tilt the balance between franchisors and franchisees in these disputes. Ultimately, the enforceability of disclaimer clauses may be dependent on the language used in the clause, the facts in a particular dispute and the disposition of the judge or jury deciding the case. At this point, it simply cannot be said that there is any unifying principle in the law that will explain all decisions.

165 W.W. Vincent & Co. v. First Colony Life Ins. Co., 351 Ill. App. 3d 752, 814 N.E.2d 960, 969 (Ill. App. 1st Dist. 2004) (“A statement which is technically true may nevertheless be fraudulent where it omits qualifying material since a ‘half-truth’ is sometimes more misleading than an outright lie.”); see also The Clearing Corp. v. Fin. And Energy Exch. Ltd., 09 CV 5383, 2010 WL 2836717, at *2-5 (N.D. Ill. July 16, 2010) (plaintiff sufficiently alleged a duty to disclose where he alleged facts to show that the defendant’s acts contributed to the plaintiffs misapprehension of a material fact and the defendant intentionally failed to correct plaintiffs misapprehension).
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Carmen has been active in the American Bar Association (Forum on Franchising) since 1997, and he has broad experience in most areas of franchise litigation. He is experienced in defending franchisors, but in more recent years he has concentrated on representing franchisees and dealers, in all industries, and including large national franchisee associations.

Carmen has defended law firms accused of negligence in the preparation of franchise agreements and offering circulars, and he also represents a start-up franchisor as a plaintiff alleging legal malpractice against its former attorneys.

Carmen has defended executives at franchising companies that have faced personal liability, for example in a sexual harassment case. He has also defended a franchise industry consultant that was accused by a franchisor of committing “bait and switch” fraud in the delivery of its consulting services.

Carmen has been repeatedly recognized by Best Lawyers in America, Illinois Leading Lawyers, Illinois Super Lawyers, and as a “Legal Eagle” by Franchise Times. He also serves as an Arbitrator for the American Arbitration Association on its franchise, large case and commercial arbitration panels, and he has served as both a mediator and as an expert witness in franchise cases.

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Ms. Weldon is currently the co-chair of the Southern California Chapter of the International Franchising Association’s Women’s Franchise Network, a member of the State Bar of California’s Franchise Law Committee, and a member of the Litigation and Dispute Resolution Committee of the American Bar Association’s Forum on Franchising. In addition to her professional affiliations, Ms. Weldon has been a member of the Board of Directors for Girls Inc. of Orange County since 2011 and was elected Secretary of the Board in 2013.