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COMPARISON OF THE TRILOGY: COMMON LAW FRAUD, FRANCHISE INVESTMENT LAWS, AND LITTLE FTC LAWS REMEDIES FOR MISREPRESENTATIONS AND OMISSIONS IN THE OFFER AND SALE OF FRANCHISES

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Forty years ago, relief for franchisees for misrepresentations and omissions in the sale of franchises typically centered on common law fraud claims. But fraud and deceit actions required proof of justified reliance and were sometimes barred by integration and other waiver clauses in franchise agreements. Beginning in the 1970s, the Federal Trade Commission (“FTC”) and several states enacted statutory remedies to provide additional rights and remedies for franchisees. In addition, many states also have Little FTC Acts and other unfair business practices statutes which may also provide remedies for misrepresentations and omissions in business or consumer transactions.

The trilogy requires franchise counsel to analyze different elements of claims, defenses, and ultimately the availability of damages and other remedies. These topics will be analyzed under the trilogy recognizing that each state may have nuances at common law or under the applicable statutes. Indeed some states do not have a trilogy applicable to franchise transactions. Finally, the paper concludes with drafting considerations for franchisors and franchisees.

I. STATUTORY PURPOSE AND CONSTRUCTION

While common law fraud remedies have existed for centuries, franchise disclosure statutes and Little FTC Acts were enacted to address perceived deficiencies in common law fraud remedies and to broaden the circumstances under which courts could fashion appropriate remedies. Before addressing these statutes and their purposes, we first address the seminal Federal Trade Commission Act.

A. The Federal Trade Commission Act

The seminal unfair business practices law, the Federal Trade Commission Act, emanated from concerns that the federal antitrust laws were not being effectively enforced. When originally enacted in 1914, the FTC Act addressed “unfair methods of competition.” In 1938, the FTC Act expanded with the Wheeler-Lea amendments to protect consumers as well as businesses.1 Section 5 of the FTC Act thus now proscribes both “unfair or deceptive acts and practices” as well as “unfair methods of competition.”2

Unfair or deceptive acts of practices under the FTC Act include misrepresentations of material facts made to induce the purchase of goods or services. Misrepresentations of expected benefits or profits from a business opportunity are prohibited by the FTC Act.3 In maintaining an action to enjoin a deceptive practice under Section 5 of the FTC Act, the Commission need not establish actual deception, but rather only that the misrepresentation or

3 Beneficial Corp. v. FTC, 542 F.2d 611, 617 (3rd Cir. 1976), cert denied, 430 U.S. 983, 97 S.Ct. 1679, 52 L.Ed.2d 377 (1977); Goodman v. FTC, 244 F.2d 584, 596, 599 (9th Cir. 1957); FTC v. Kitco of Nevada, Inc. 612 F.Sup. 1282, 1292-93 (D.Minn. 1983).
omission has the capacity to deceive.\textsuperscript{4} However, an “unfair” business practice generally must cause “substantial injury” to consumers.\textsuperscript{5}

In addition to the statutory proscriptions, in 1979 the Federal Trade Commission promulgated a trade regulation rule governing franchise sales disclosures referred to as the FTC Franchise Rule.\textsuperscript{6} Prior to enacting the Rule, the Federal Trade Commission held extensive hearings and issued a statement of basis and purpose. The FTC made the following key findings:

The franchise industry...has been plagued by numerous cases of abuses and misrepresentations aimed at unsophisticated prospective franchisees. Widespread instances have been documented involving such malpractices as high pressure franchise sales tactics, unscrupulous and inexperienced franchisors, financially unstable franchisors, hidden fee requirements and kick-backs, failure to provide information on services and training to be furnished to the franchise, and use of coercive methods to get quick large deposits.

The prospective franchisee does not approach the contract negotiations with the franchisor as an equal. The usual tremendous economic disparity between the parties to the franchise agreement is obvious. Moreover, a severe informational disparity exists as well... Third, the franchisor presents the information about the franchise and its sales and profits. Unlike the franchisee, he knows how much of the information is fact and how much puffery.

As further illustrated by such complaints and related public record materials, such “get rich quick” claims frequently either are unsubstantiated by the franchisor, or they misrepresent material facts with regard to the “potential earnings” of a particular franchise business.

The typical investor in a franchise, in a very real sense, is “buying a job.” Hence the item of information about which the prospective franchisee is most concerned is the amount of earnings he can expect to derive from the franchise.

The skillful advertiser can mislead the consumer without misstating a single fact.

In a related area, the record also discloses that many franchisors have highlighted the atypical success of a few franchisees without disclosing

\textsuperscript{4} FTC v. Raladam, 316 U.S. 149, 62 S.Ct. 966, 862 L.Ed. 1336 (1942); Exposition Press, Inc. v. FTC, 295 F.2d 869 (2d Cir. 1961).

\textsuperscript{5} FTC v. Sperry and Hutchinson Co. 405 U.S. 233, 244, fn. 5, 925 S.Ct. 898, 31 L.Ed.2d 170 (1972) (citing the FTC Cigarette Rule factors for determining an “unfair” business practices).

\textsuperscript{6} 16 CFR Part 436. The FTC Franchise Rule has been amended including most recently in January of 2007.
the nonrepresentative nature of these claims. Such representations are an unfair and deceptive trade practice.7

**B. State Franchise Disclosure Laws**

While the Federal Trade Commission was examining the need for franchise sale regulation, the California legislature (and later, legislatures in other states) was studying the same subject. The California Franchise Investment Law, the first state law governing the sale of franchises, provides the following statement of legislative purpose:

Sec. 31001. The Legislature hereby finds and declares that the widespread sale of franchises is a relatively new form of business which has created numerous problems both from an investment and a business point of view in the State of California. Prior to the enactment of this division, the sale of franchises was regulated only to the limited extent to which the Corporate Securities Law of 1968 applied to those transactions. California franchisees have suffered substantial losses where the franchisor or his or her representative has not provided full and complete information regarding the franchisor-franchisee relationship, the details of the contract between franchisor and franchisee, and the prior business experience of the franchisor.8

Similarly, the Hawaii Franchise Investment Law provides the following statement of legislative purpose and intent:

The purpose of this chapter is to regulate the sale of franchises in the State to minimize losses to the franchisee in cases where the franchisor or the franchisor’s representative has not provided full and complete information regarding: (1) the franchisor-franchisee relationship; (2) the details of the contract between franchisor and franchisee and (3) the prior business experience of the franchisor.

It is the intent of the legislature to: (1) provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered; (2) prohibit the sale of franchises which would lead to fraud or a likelihood that the franchisor’s promises would not be fulfilled; and (3) protect the franchisor or subfranchisor by providing a better understanding of the relationship between the franchisor or subfranchisor and the franchisee with regard to their business relationship.9

The Illinois Disclosure Act provides the following statement of legislative purpose:

Sec. 705/2. (1) The General Assembly finds and declares that the sale of franchises is a widespread business activity. Illinois residents have suffered substantial losses where franchisors or their representatives

7 FTC Statement of Basis and Purpose.
9 HRS § 482E-1.
have not provided full and complete information regarding the franchisor-franchisee relationship, the details of the contract between the franchisor and franchisee, the prior business experience of the franchisor and other factors relevant to the franchise offered for sale.

(2) It is the intent of this Act: (a) to provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered for sale; and (b) to protect the franchisee and the franchisor by providing a better understanding of the business and the legal relationship between the franchisee and the franchisor.\(^\text{10}\)

The Nebraska Franchise Law provides the following statement of legislative intent:

87-401. The Legislature finds and declares that distribution and sales through franchisee arrangements in the state vitally affect the general economy of the state, the public interest, and public welfare. It is therefore necessary in the public interest to define the relationship and responsibilities of franchisors and franchisees in connection with franchise arrangements.\(^\text{11}\)

The New York Franchise Sales Act provides:

1. The legislature hereby finds and declares that the widespread sale of franchises is a relatively new form of business which has created numerous problems in New York. New York residents have suffered substantial losses where the franchisor or his representative has not provided full and complete information regarding the franchisor-franchisee relationship, the details of the contract between the franchisor and franchisee, the prior business experience of the franchisor, and other factors relevant to the franchise offered and sale.

2. It is hereby determined and declared that the offer and sale of franchises, as defined in this article, is a matter affected with a public interest and subject to the supervision of the state, for the purpose of providing prospective franchisees and potential franchise investors with material details of the franchise offering so that they may participate in the franchise system in a manner that may avoid detriment to the public interest and benefit the commerce and industry of the state. Further, it is the intent of this law to prohibit the sale of franchises where such sale would lead to fraud or a likelihood that the franchisor's promises would not be fulfilled.\(^\text{12}\)

The Florida Franchise Act contains a unique provision barring franchisors from misrepresenting “the prospects or chances of success.”\(^\text{13}\)

\(^\text{10}\) 815 Ill. p. Stat. § 705/2(1).


The need for franchise legislation in New York was discussed in *A.J. Temple Marble & Tile, Inc. v. Union Carbide Marble Care, Inc.*

Notwithstanding the foregoing, the court believes that the existence of the merger and waiver clauses would not bar plaintiff's statutory claims under the Franchise Act. Prior to 1981, franchise sales fraud was endemic. In its 1979-1980 session, the New York Legislature heard testimony that, since 1972 alone, an estimated 14,000 New Yorkers had been victimized by fly-by-night and unethical franchisors that New Yorkers had lost nearly 40 million dollars through franchise fraud (19 McKinney's Cons. Laws of N.Y., Practice Commentaries by Kaufmann, at pp. 587-88 [West 1984]).

This widespread franchise abuse prompted the Legislature to enact the New York Franchise Sales Act. Its purpose was to curb such abuses and to protect the would-be franchisee from fraudulent and unethical practices (id). The Franchise Act deliberately was drafted to incorporate stringent disclosure and broad anti-fraud provisions (id.).

Many state franchise disclosures also hold that the statutes are remedial and designed to favor franchisees in need of protection from franchisors. For example, in *Randall v. Lady of America Franchise Corp.*, the district court held that: “Minnesota courts have repeatedly observed that the Minnesota Franchise Act is a remedial statute designed to favor franchisees over franchisors.”

The Indiana Supreme Court discussed the legislative statement regarding the Indiana Franchise Disclosure Act as follows:

That statement directs that we liberally construe the franchise fraud statute to prohibit and prevent fraud, and to assure disclosure of sufficient and reliable information to afford investors reasonable opportunity to exercise independent judgment in franchise transactions. This statement indicates the legislature intended franchise fraud liability not as punishment for negligently or intentionally making false statements, but as a means to prohibit and prevent material, false statements and to assure that investors receive full and accurate disclosure regarding franchises.

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16 *Randall v. Lady of America Franchise Corp.*, 532 F.Supp.2d 1071 (D. Minn. 2007). (citations omitted); see also, *Pacific Equipment & Irrigation, Inc. v. The Toro Co.*, 519 N.W.2d 911 (Minn. 1994); *Petereit v. S.B. Thomas, Inc.*, 853 F.Supp. 5 (D. Conn. 1993), aff'd in part, rev'd in part, 63 F.3d 1169 (2d Cir. 1995) (“The Connecticut Franchise Act was intended to clarify the rights and obligations between franchisors and franchisees because the greater bargaining power of a party in control of a product could result in injustice and losses which could not be recouped, Id., 853 F. Supp. At 60).

Many of the franchise disclosure laws contain anti-waiver provisions or otherwise confirm the importance of the public policy reflected in the statute to protect franchisees.\textsuperscript{18} Some franchise disclosure laws are expressly or by case law applicable only to franchisees operating within the state.\textsuperscript{19}

\section*{C. Little FTC Acts and Unfair Business Practice Statutes}

Many states have enacted unfair business practices statutes which are sometimes modeled after the FTC Act and are often referred to as Little FTC Acts. Other state statutes are broader than the FTC Act and are sometimes referred to as “Unfair Trade Practices Acts.” Yet others are narrower such as those applying only to “consumer” transactions. Due to the various statutes and the thousands of cases involving all manner of challenged business practices, this article will only partially address selected franchise actions under state Little FTC Acts and Unfair Trade Practices Acts.

An illustrative overview of the breadth of Little FTC Acts and the extension of proscribed misconduct beyond common law fraud is found in \textit{Tucker v. Sierra Builders},\textsuperscript{20} applying the Tennessee Little FTC Act:

With the enactment of the Tennessee Consumer Protection Act (“TCPA”) in 1977, Tennessee joined the growing number of states that had passed so-called “little FTC acts.” The little FTC acts were so designated because of their similarity to the provision of the Federal Trade Commission Act that outlawed unfair or deceptive trade practices. The TCPA, like the little FTC acts of many other states, explicitly provides that it is to be interpreted and construed in accordance with interpretations of 15 U.S.C.A. § 45(a)(1) of the Federal Trade Commission and the federal courts.

The TCPA was not intended to be a codification of the common law. To the contrary, one of the express purposes of the TCPA is to provide additional, supplementary state law remedies to consumers victimized by unfair or deceptive business acts or practices that were committed in Tennessee in whole or in part. Moreover, the TCPA is explicitly remedial, and Tennessee courts are therefore required to construe it liberally to protect consumers in Tennessee and elsewhere.

The scope of the TCPA is much broader than that of common-law fraud. Under the TCPA, a consumer can obtain recovery without having to meet

\begin{itemize}
  \item \textit{Tucker v. Sierra Builders}, 180 S.W.2d 109 (Tenn.App. 2005).
\end{itemize}
the burden of proof that is required in common-law fraud cases, and the numerous defenses that are available to the defendant in a common-law fraud case are simply not available to the defendant in a TCPA case. Misrepresentations that would not be actionable as common-law fraud may nevertheless be actionable under the provisions of the little FTC acts, including the TCPA. Claims under the TCPA are not limited to misrepresentations that are fraudulent or willful. Instead, the TCPA applies to any act or practice that is unfair or deceptive to consumers.21

Many other states follow the FTC statutory prohibition prohibiting statements with the tendency or capacity to deceive.22

Some Little FTC Acts are expressly applicable only to consumers and define consumer transactions as involving the purchase of goods and services for household use. These statutes effectively bar franchisee claims under the Little FTC Act treating them as non-consumer commercial transactions.23 But injunctive actions may be available under certain statutes for non-consumer businesses. Still other statutes, such as the Louisiana Unfair Trade Practices Act, generally provide standing to consumers and business competitors.24

Other courts have addressed the issue of whether the sale of a franchise meets Little FTC Act statutory definitions of goods or services. In Texas Cookie Co. v. Hendricks & Peralta, Inc., the Texas Deceptive Trade Practices Consumer Protection Act (“TDTPA”) was found applicable despite arguments that the plaintiff franchise involved only intangible property rights, because the training program and operation manual were held to constitute the requisite services.25 Other cases under the TDTPA however, including one focused on trademark ownership as intangible property rights, were held not sufficient to invoke a consumer transaction.26 In ATS Southeast Inc. v. Carrier Corp., the Tennessee Supreme Court reversed


earlier Tennessee Court of Appeal decisions in finding that the Tennessee Consumer Protection Act could apply in business to business actions as the statutory term persons included corporations. Other states also allow Little FTC Act claims by businesses.

California has a broader Unfair Trade Practices Act covering not only “unfair and deceptive” practices like the FTC Act, but also covering “illegal” business practices. The latter provision bans, under state law, acts or practices declared illegal by other federal, state, and local laws.

Several Little FTC Acts provide that violations of FTC rules are per se violations of the state statutes. Massachusetts by statute mandates that: “It is the intent of the legislature that in construing paragraph (a) of this section in actions brought under sections four, nine and eleven, the courts will be guided by interpretations given by the Federal Trade Commission and the Federal Courts to section 5(a)(1) of the Federal Trade Commission Act (15 U.S.C. 45(a)(1)), as from time to time amended.” On the other hand, some state Little FTC Acts decline private actions for violation of the FTC Act or rules because there is no federal private right of action under the FTC Act. Under the Indiana Franchise Act, a private right of action exists for only anti-fraud violations rather than for disclosure violations not involving fraud.

Several Little FTC Act decisions hold that the statutorily proscribed misconduct requires a showing of more than just a breach of contract. Such an argument was presented the North Carolina Unfair Trade Practices Statute in Morningstar, LLC v. Hardee’s Food Systems, Inc. Plaintiff franchisee and its personal guarantors under the franchise agreement alleged multiple violations of the North Carolina statute by defendant Hardee’s improperly interfering with their sale of their franchise. The district court noted that the North Carolina statute required

27 ATS Southeast, Inc. v. Carrier Corp., 18 S.W.3d 626 (Tenn. 2000).
28 Id., 18 S.W.3d at 630.
30 California Business & Professions Code Section 17200, et. seq.
32 Mass. Gen. Laws §93A(2)(b) (the substantive provision under the Massachusetts’ statute is virtually identical with the FTC Act, proscribing: “Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.” Mass. Gen. Laws § 93A(2)(a).
35 Morningstar, LLC v. Hardee’s Food Systems, Inc., 2009 WL 36406 (E.D.Mo. 2009)(holding that withholding of contractual duty of performance to obtain benefit to which violator was not entitled was an unfair practice); compare, Pepsi-Cola Metropolitan Bottling Co., Inc. v. Checkers, Inc., 754 F.2d10 (1st Cir. 1985).
substantial aggravating circumstances beyond "garden variety" breaches of contract. However, the plaintiff's allegations requiring general releases without valid consideration, requiring new guarantees, and several other acts of alleged misconduct interfering with a sale were sufficient to state a claim for relief. In Anthony’s Pier Four, Inc. v. HBC Associates, the Massachusetts Little FTC Act was held to proscribe conduct "in disregard of known contractual arrangements and intended to secure benefits for the breaching party constitutes an unfair act or practice . . ."36

An example of an unfair business practice under the Connecticut Unfair Trade Practices Act is also illustrative. In Walker Indus. Products v. Intelligent Motion Systems, Inc.,37 the alleged misconduct consisted of a manufacturer obtaining customer information from its distributor. The manufacturer then terminated the distributor and used customer information from the terminated distributor to obtain a new distributor. The manufacturer’s conduct was held to violate the Connecticut statute prohibition of immoral, unethical, oppressive or unscrupulous conduct.

Colorado requires that the alleged statutory misconduct constitute “a public injury to consumers as a whole.”38 The FTC Act contains a similar requirement that its actions be “in the interest of the public.”39

Some Little FTC Acts by statute apply only to proscribed misconduct occurring within the state borders.40

II. ACTIONABLE MISREPRESENTATIONS

The common law tort of fraud encompasses misrepresentations, misleading omissions, and “all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain advantage over another by false suggestions or by the suppression of truth.”41 The express language of the various state franchise investment laws prohibits the use of any misrepresentations and/or other deceptive acts in the offer and/or sale of a franchise. For example, New York’s Franchise Sales Act states that “[i]t is unlawful for any person to make any untrue statement. . . [of] any material fact.”42 Several courts, interpreting the language of their particular franchise laws, have determined that a plaintiff must allege each element of a common law fraud claim in order to state a claim for fraud under the statute.43 For example, the

41 McClellan v. Cantrell, 217 F.3d 890, 893 (7th Cir. 2000).
43 See, e.g., Cook v. Little Caesar Enters., 210 F.3d 653, 659 (6th Cir. 2000) (stating that a showing of reasonable reliance is required for a fraud claim pursuant to Michigan’s franchise law); Hardee’s of Maumelle, Ark., Inc. v. Hardee’s Food Sys., Inc., 31 F.3d 573, 578-79 (7th Cir. 1994) (noting that it “would follow the holdings of the lower Indiana courts that the [Indiana franchise statute] requires proof of reasonable reliance”); Rand v. CM Franchise Sys.,
District of Indiana has held that, to state a franchise fraud claim under Indiana’s Franchise Sales Disclosure Act, a plaintiff must plead three elements: (1) a false statement or omission, (2) materiality, and (3) detrimental reliance.\textsuperscript{44} Little FTC Acts prohibit the use of deceptive business practices, including fraud. For example, Minnesota’s Consumer Fraud Act prohibits the “act, use, or employment by any person of any fraud, false pretense, misrepresentation, misleading statement, or deceptive practice, with the intent that others rely thereon. . . .”\textsuperscript{45} As such, it is important to understand that various types of misrepresentations might serve as a predicate for a plaintiff’s fraud claim under each branch of the Trilogy.\textsuperscript{46} Several common predicates are discussed below.

A. Misrepresentations of Fact

An affirmative misrepresentation of fact is often the basis for a plaintiff’s fraud claims. While the elements of a common law intentional misrepresentation claim may differ slightly by state, a plaintiff will generally be required to show: (1) that the defendant made a false statement about a past or present material fact; (2) that the defendant knew the statement was false or recklessly made the statement without knowledge of its accuracy; (3) that the defendant intended that the plaintiff rely on the misrepresentation; and (4) that the plaintiff did rely on the misrepresentation to his or her detriment.\textsuperscript{47} A misrepresentation of fact may also be actionable if made negligently. To state a claim for negligent misrepresentation, a plaintiff will typically need to allege: (1) that the defendant supplied false information to the plaintiff; (2) that the plaintiff was justified in relying on the information; and (3) that the defendant did not exercise reasonable care in obtaining or communicating the information.\textsuperscript{48} Some jurisdictions, such as New York, require a plaintiff to establish that the defendant had a duty, as the result of a special Inc., No. 61828-8-1, 2009 Wash. App. LEXIS, at *8 (Wash. Ct. App. Mar. 16, 2009) (stating that a WFIPA fraud claim requires proof of each element of common law fraud).  


\textsuperscript{45} Minn. Stat. § 325F.69, subd. 1.  

\textsuperscript{46} See, e.g., Hardee’s v. Hardee’s Food Sys., 31 F.3d 573, 579 (7th Cir. 1994) (stating that “under the Indiana Franchise Practices Act, Ind. Code § 23-2-2.5-1 et seq., fraud includes “any misrepresentation in any manner of a material fact, any promise or representation or prediction as to the future not made honestly or in good faith, or the failure or omission to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading.”).  

\textsuperscript{47} See, e.g., Overall v. Univ. of Pa., 412 F.3d 492, 498 (3d Cir. 2005) (stating that “[u]nder Pennsylvania law, a fraudulent misrepresentation claim has six elements: (1) a representation; (2) which is material to the transaction at hand; (3) made falsely, with knowledge of its falsity or recklessness as to whether it is true or false; (4) with the intent of misleading another into relying on it; (5) justifiable reliance on the misrepresentation; and (6) the resulting injury was proximately caused by the reliance”); Bray Int'l, Inc. v. Collings, No. 05-1618, 2006 U.S. Dist. LEXIS 67587, *7-8 (D. Minn. Sept. 20, 2006) (stating that “[t]o state a claim for intentional misrepresentation under Minnesota law, a plaintiff must allege that: (1) the defendant made a false misrepresentation about a past or present material fact that was susceptible of knowledge; (2) the defendant knew the misrepresentation was false or asserted it as of his own knowledge without knowing whether it was true or false; (3) the defendant intended to induce the plaintiff to act and the plaintiff was indeed induced to act; and (4) the plaintiff acted in reliance on the representation and was thereby damaged”).  

relationship, to give correct information to the plaintiff. Courts in other jurisdictions, such as Ohio, have held that a special relationship is not a required element for a negligent misrepresentation claim.

B. Half Truths

In addition to statements that are wholly false, a statement containing a “half-truth” may also be actionable as fraud. As the Illinois Appellate Court has recognized, “a half-truth is sometimes more misleading than an outright lie.” Similarly, the Minnesota Supreme Court has held that half-truths may also amount to fraudulent misrepresentations because “[t]o tell half a truth only is to conceal the other half.” The Eighth Circuit has also noted that “though one may be under no duty to speak as to a matter, if he undertakes to do so, either voluntarily or in response to inquiries, he is bound not only to state truly what he tells, but also not to suppress or conceal any facts within his knowledge which materially qualify those stated. If he speaks at all, he must make a full and fair disclosure.” The Southern District of New York is in agreement, stating that “[a] statement that is ambiguous or a half-truth may ground liability in fraud if the speaker knows it to be materially misleading and does nothing to correct the misunderstanding.

C. Material Omissions

A claim of fraud may also be predicated on an omission. As explained by the Eighth Circuit, “if a party conceals a fact material to the transaction, and peculiarly within his own knowledge, knowing that the other party acts on the presumption that no such fact exists, it is as much a fraud as if the existence of such fact were expressly denied or the reverse of it expressly stated.” When asserting a common law fraud claim based on an omission, plaintiffs will often be required to establish that a special relationship existed between the parties. For example, “Texas's law of fraud does not impose liability for silence except when the one who has remained silent is under a special duty to speak.” Similarly, in New York a plaintiff is

49 See, e.g., Hydro Investors, Inc. v. Trafalgar Power, Inc., 227 F.3d 8, 20 (2d. Cir. 2000) (stating that “[u]nder New York law, the elements for a negligent misrepresentation claim are that (1) the defendant had a duty, as a result of a special relationship, to give correct information; (2) the defendant made a false representation that he or she should have known was incorrect; (3) the information supplied in the representation was known by the defendant to be desired by the plaintiff for a serious purpose; (4) the plaintiff intended to rely and act upon it; and (5) the plaintiff reasonably relied on it to his or her detriment”).

50 See, e.g., Nat’l Mulch & Seed, Inc. v. Rexius Forest By-Products, Inc., No. 02-1288, 2007 U.S. Dist. LEXIS 24904, *29-30 (S.D. Ohio 2007) (“This Court agrees that a special relationship is not a formal element of a negligent misrepresentation claim under Ohio law.”).


52 Rochester Methodist Hospital v. Travelers Ins. Co., 728 F.2d 1006, 1017-1018 (8th Cir. 1984) (quoting Newell v. Randall, 32 Minn. 171, 173 (1884)).

53 Id.


55 Rochester Methodist Hospital v. Travelers Ins. Co., 728 F.2d 1006, 1017-1018 (8th Cir. 1984) (citing Swedeen v. Swedeen, 270 Minn. 491 (1965)).

56 See Taylor v. Southern Farm Bureau Cas. Co., 954 So.2d 1045, 1049 (Miss. Ct. App. 2007) (“In Mississippi, a claim of fraud by omissions arises only where the defendant had a duty to disclose material facts purportedly omitted. This duty generally arises only where there is a fiduciary relationship between the parties.”)

57 Stinnett v. Colorado Interstate Gas Co., 227 F.3d 247, 253 (5th Cir. 2000).
required to show a contractual relationship or a confidential or fiduciary relationship between the parties in order to recover for a fraudulent concealment of fact “since absent such a relationship, there is no duty to disclose.” 58  Keep in mind, however, that New York’s Franchise Sales Act prohibits the omission of any “material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.” 59

D. Earnings Claims and Projections

Whether statements concerning financial projections and expected earnings are actionable as fraud usually depends on whether the statements at issue are determined to be representations pertaining to past or present facts, or whether the statements are merely predictions or opinions as to possible future events. 60  Under Arkansas common law, “[p]rojections related to franchise profits are representations related to future events” and, without more, are not actionable as fraud. 61  But in Randall v. Lady of America Franchise Corporation, the District of Minnesota found that, if franchisor Lady of America “made assurances to franchisees about their expected membership, numbers, revenues, and profitability — and if those assurances did not accurately reflect surrounding past and present circumstances. . . then those assurances could subject Lady of America to liability under the Minnesota Franchise Act.” 62  Similarly, in California Bagel Company, LLC v. American Bagel Company, the Central District of California found that statements made by a franchisor concerning the profitability and average financial performance of existing franchised stores — statements from which the plaintiffs might be expected to draw inferences regarding future franchise performance – were not properly construed as non-actionable opinions because the statements were actually “representations as to verifiable facts, i.e., the revenue being generated by existing franchise locations.” 63

E. False Opinions

Defendants will frequently argue that the alleged misrepresentations are not actionable because they are mere opinions or “puffery”.  As recognized by the Arkansas Supreme Court, “an expression of opinion, i.e. a statement concerning a matter not susceptible of accurate


60  See, e.g., Superior Care Pharm, Inc. v. Med. Shoppe Int'l, Inc., No. 10-207, 2011 U.S. Dist. LEXIS 13013, 31-32 (D. Ohio Feb. 10, 2011) (finding that statements about the future of a new franchise system were not actionable because “[a] claim of fraud cannot be predicated upon promises or representations relating to future actions or conduct.”) (citation omitted); Berg v. Xerxes-Southdale Office Building Co., 290 N.W. 2d 612, 615 (Minn. 1980) (stating that whether projections are actionable or not in fraud depends on whether they accurately reflect surrounding past and present circumstances).

61  Morrison v. Back Yard Burgers, 91 F.3d 1184, 1186 (8th Cir. 1996); see also, e.g., Hardee’s of Maumelle, Arkansas, Inc. v. Hardee’s Food Sys., Inc., 31 F.3d 573, 579 (7th Cir. 1994) (rejecting plaintiff’s assertion that projected financial statements can support a claim of fraud because they are predictions or opinions regarding future profitability, not representations of pre-existing material fact).


knowledge, cannot furnish the basis for a cause of action for deceit or fraud.”

64 Under Michigan law, the general rule is that “an action for fraud may not be predicated upon the expression of an opinion or salesmen’s talk in promoting a sale, referred to as puffing.”

65 Whether an alleged statement is ultimately found to be a representation of fact or an expression of opinion depends on the specific facts and circumstances of each case, such as the “actual language used and the context in which the comment is made.”

66 Defendants should be aware, however, that it has been held that “a prediction of future events or an opinion becomes actionable where made by a [defendant] presumably possessed of superior knowledge to a party who is situated so as to reasonably rely on that opinion.”

F. False Promises

Generally, promises are actionable as fraud where the promisor had a positive intent not to perform the promise, or where the promisor made the promise without a present intent to perform it.

68 Depending on the nature of the alleged promise, a plaintiff may have difficulty overcoming the usual fraud requirement that a statement pertain to past or present material facts. For example, in Ramada Franchise Systems, Inc. v. Polmere Lodging Corporation, the plaintiff alleged that Ramada promised her that her franchised facility would achieve revenue equal to that it achieved as a Holiday Inn guest lodging facility.

69 Noting that a common law fraudulent inducement claim requires a plaintiff to establish that the statement was known to be false when made, the District of New Jersey found that this alleged promise could not be actionable as fraud because it was a statement pertaining to future events; as such, Ramada could not have known the statement was false when it was made.

70 But in B-Dry Systems of

64 Delta School of Commerce, Inc. v. Wood, 298 Ark. 195, 200 (1989); see also, e.g. Rivermont Inn, Inc. v. Bass Hotels Resorts, Inc., 113 S.W.3d 636, 640 (Ky. App. 2003) (holding that mere statements of opinion or prediction, such as future profits or how well a business will do in a particular market, may not be a basis for a fraud or misrepresentation action because predictions are not past or present material facts); Yo-Can, Inc. v. The Yogurt Exchange, Inc., 149 Ohio App. 3d 513, 525 (2002) (“Generally, fraud claims are not predicated on a representation concerning a future event, as such representation is more in the nature of a promise or contract or constitutes mere predictions or opinions about what the future may bring.”)


67 Id. (rejecting franchisor’s argument that alleged statements concerning franchise revenue were mere opinion and denying franchisor’s motion for summary judgment because “a fact finder could reasonably conclude . . . that a franchisor’s sales agent has superior knowledge regarding franchise sales, whether or not its representatives specifically state that they possess such knowledge.”)

68 See, e.g., Wynfield Inns v. Edward Leroux Group, Inc., 896 F.2d 483, 490-91 (11th Cir. 1990) (quoting Bissett v. Ply-Gem Indus., Inc., 533 F.2d 142, 145 (5th Cir. 1976)); B-Dry System of Kansas City, Inc. v. B-Dry System, Inc., No. 88-653, 1990 U.S. Dist. LEXIS 17012, *9-10 (W.D. Mo. Dec. 12, 1990) (“a promise accompanied by a present intent not to perform also is considered to be a misrepresentation of a present state of mind and will not support a cause of action for fraud”); Olivieri v. McDonald’s Corp., 678 F. Supp. 996, 1001 (E.D.N.Y. 1988) (“In New York, statements involving future promises are not actionable as fraud unless a plaintiff can show that defendants had no intention of carrying them out at the time the promise was made. . . A mere showing of nonperformance does not suffice as proof of fraud under New York law; a plaintiff must prove that the promise was made with the intention not to carry it out”).


70 Id.
Kansas City, Inc. v. B-Dry System, Inc., the District of Missouri held that false promises regarding future results may be considered false representations of existing conditions where a party possesses “superior knowledge and past experience”.\(^{71}\) In B-Dry Systems, the franchisees alleged that the franchisor promised that the franchise would generate sales of over a million dollars per year, and the court recognized that, under Missouri law, the statement might properly be considered an actionable misrepresentation as to an existing fact based on the franchisor’s knowledge and past experience in the franchise industry in that geographical area.\(^{72}\)

### III. SCIENTER AND INTENT TO DECEIVE

Generally, under the common law, Little FTC Acts, and “Franchise Investment Acts” across the fifty states, either: (1) some level of “scienter” must be established to prove misrepresentations and omissions in the offer and sale of franchises; or (2) a showing of scienter has been specifically omitted or drastically reduced as a factor to be proven by the plaintiff. Because of this, the scienter requirement among the 50 states vary widely.\(^{73}\)

Many states have limited or eliminated scienter as a necessary requirement to bring a cause of action under either the respective state’s common law, Little FTC Act, or Franchise Investment Act. Scienter is an amorphous term encapsulating both that the misleading statement was both “made knowingly” and “made with the intent to deceive.” Scienter is usually proven through circumstantial evidence.

Most states having enacted a Little FTC Act or Franchise Investment Act have intentionally afforded broader protections to franchisees because the scienter factor has historically been more difficult to prove than a mere negligent misrepresentation standard. The following portions of this section will discuss generally scienter under the common law; under Little FTC Acts; and, finally, under Franchise Investment Acts.

#### A. Scienter under the Common Law

Specifically, under the common law, scienter is synonymous with the phrase of art “made knowingly” and “made with intent to deceive.” In other words, in a common-law fraud claim the defendant must have made the statement with the actual intent to deceive. Some jurisdictions, including Texas, allow proof of scienter under the lesser standard of recklessness - i.e., allowing the plaintiff to prove that a defendant made a comment “recklessly without


\(^{72}\) Id. (citing Nichols v. Hendrix, 312 S.W.2d 163, 165-166 (Mo. Ct. App. 1958) (“false representations and promises as to what will result in the future, when made by one having or professing to have superior knowledge based on past experience of himself or others, are, in effect, false representations of existing conditions and support allegations of fraud.”))

\(^{73}\) Note that some franchisor/franchisee relationships are regulated by federal statute. This includes petroleum marketing. See 15 U.S.C.A. § 2805.
knowledge of the truth.”

Under the common law, scienter must be proven to carry the misrepresentation cause of action under the common law.

B. Scienter under Little FTC Acts

The scienter requirement under Little FTC Acts from state to state varies from requiring proof of intent akin to the common-law standard to eliminating the “intent” requirement altogether. States subscribing to the common-law tradition of scienter require that a plaintiff prove either a willful, knowing, or intentional misrepresentation of an act or omission.

On the other hand, some states have disposed of the scienter concept entirely and require that the plaintiff merely show that the alleged conduct of the defendant equates to negligent misrepresentation. The negligent representation standard requires the plaintiff to prove that the defendant showed a disregard to whether the statement was true or false and that the statement is ultimately a falsehood. In Texas, “[o]ne can be held liable for facts he does not know because the element of scienter need not be proved under” its Little FTC Act. Stated another way, some states require the plaintiff to prove that the defendant actually intended to mislead the plaintiff through acts or omissions, while other states require that the plaintiff only prove that the acts, regardless of “intent,” demonstrate a disregard to whether the facts are true or false and that those facts are false.

C. Scienter under Franchise Investment Acts

A handful of states have adopted Franchise Investment Acts that afford franchisees another layer of protection against deceptive practices. Some states’ Franchise Investment Acts require proof of actual intent in order to bring a cause of action while other states do not. For example, Florida requires scienter while Indiana does not.

In Florida, a plaintiff must allege that a defendant intentionally (1) “misrepresented the prospects or chances for success of a proposed or existing franchise or distributorship; (2) misrepresented, by failure to disclose or otherwise, the known required total investment for such franchise or distributorship; or (3) misrepresented or failed to disclose efforts to sell or establish more franchises or distributorships than is reasonable to expect the market or market area for

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76 See e.g. Or. Rev. Stat. 646.605 (West 2009).


82 Compare West’s F.S.A. § 817.416(2), and West’s A.I.C. § 23-2.5-27(2, 3).
the particular franchise or distributorship to sustain.” 83 However, under Indiana’s Franchise Investment Act, “the legislature has used words whose common understanding does not convey a requirement of scienter, or indeed any measure of culpability at all.” 84

In summary, a plaintiff must be cognizant of the specific scienter requirements of the state in which the cause of action -- i.e., common-law fraud, Little FTC Act violations, or Franchise Investment Act violations -- is to be brought. If at all possible, a plaintiff obviously should bring a misrepresentation or omission cause of action in a state where pleading scienter is not required. 85

IV. RELIANCE

One of the hallmark elements of the tort of deceit is that the plaintiff must have justifiably relied on the misrepresentations or omissions of the fraudfeasor. Justified reliance thus serves as a form of causation, namely the nexus between the actor’s conduct and the plaintiff’s actions resulting in damages. But many statutes, indeed tort law more broadly, often invoke a broader form of causation sometimes labeled causation in fact. Thus a plaintiff may recover under such a standard even if the plaintiff’s reliance might be deemed not reasonable or justified.

A. Reliance and Common Law Fraud and Deceit

A quintessential element of the common law tort of fraud is justified reliance. A representative case of the justified reliance element of a fraud claim is Century Pacific, Inc. v. Hilton Hotels Corp. 86 The plaintiff had purchased a Red Lion hotel franchise and alleged fraud against Hilton via a scheme to sell the Red Lion brand afterwards. Plaintiff’s claim was dismissed on summary judgment as involving a “sophisticated party” represented by counsel who knew Hilton had reserved the right to sell the Red Lion brand afterwards. Plaintiff’s claim was dismissed on summary judgment as involving a “sophisticated party” represented by counsel who knew Hilton had reserved the right to sell the Red Lion brand. The Second Circuit noted that the reasonable reliance inquiry required examination of “the entire context of the transaction, including factors such as its complexity and magnitude, the sophistication of the parties, and the content of any agreements between them.” In Kiddie Academy Domestic Franchising, LLC v. Faith Enterprises, LLC, 87 a franchisee’s reliance on alleged fraudulent pro formas was held not reasonable as the franchisee had discovered discrepancies in the pro formas but had still proceeded to purchase the franchise.

B. Reliance and Statutory Franchise Disclosure Claims

While most franchise disclosure statutes expressly provide for either reliance or causation as an element of a statutory damage remedy, virtually none of the statutes expressly require justified reliance. Typical in the absence of express language of a justified or reasonable reliance requirement are the following California Franchise Investment Law remedy provisions: “… franchisee … who may sue for damages caused thereby, and if the violation is

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83 West’s F.S.A. § 817.416(2).
85 Restatement (Third) of Unfair Competition§ 1 (2010), gives a broad overview of consumer protections laws including a list of every states consumer protection law.
willful, the franchisee may also sue for rescission ...” and “Any person who violates ... shall be liable to any person not knowing or having cause to believe that such statement was false or misleading) who, while relying upon such statement shall have purchased a franchise ...”

Other courts nonetheless graft a justifiable reliance element for a franchisee to recover under the state franchise disclosure law. A series of cases, many citing earlier cases from other state statutes, have required that a franchisee plaintiff establish reasonable or justified reliance on misrepresentations to recover under certain franchise disclosure statutes. These cases appear to have started with the Indiana statute, then moved on to Illinois, Michigan, New York, and California.

Several of these decisions involve federal courts seeking to divine whether justified reliance is required on first impression under state franchise disclosure laws. And these decisions harken back to two Indiana Court of Appeals decisions which did not carefully analyze whether a justified reliance requirement exists under the Indiana Franchise Disclosure Act. In Moll v South Central Solar System, the oldest decision, the court affirmed dismissal of plaintiff’s franchise disclosure claims for failure to raise “facts which would support even an inference of fraud, misrepresentation or deceit by defendants”, with no mention of a justified reliance requirement under the statute. The second Indiana decision, Master Abrasives Corp. v. Williams, involved a franchisee who successfully asserted a breach of the Indiana Franchise Investment Law via a counterclaim. The Indiana Court of Appeal affirmed finding that the trial court record established fraud by the franchisor in the sale of the franchise. But nowhere in the opinion did the court purport to study the statute and find a requirement of justified reliance, rather it generally stated a “showing of fraud, deceit or misrepresentations” was required citing the earlier Moll decision. A later decision by the Indiana Supreme Court, Continental Basketball

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88 California Corporations Code Section 31300.
89 California Corporations Code Section 31301.
93 Cook v. Little Caesar Enterprises, Inc., 210 F.3d 653 (6th Cir. 2000)( The Third Circuit noted that there was no direct authority for a reasonable reliance element under the Michigan Franchise Investment Law, but then followed the earlier Indiana and Illinois decisions under those state Franchise investment statutes.
98 Id., 419 N.E.2d 154, 163.
Association v. Ellenstein Enterprises, Inc.,\textsuperscript{100} confirmed that Moll and Master Abrasives were disapproved to the extent requiring proof of culpability or scienter for statutory franchise fraud noting that: “the elements of franchise fraud are not as extensive as the elements of common law fraud [although] the plaintiff in a franchise fraud action must nevertheless plead the facts and circumstances alleged to constitute fraud, deceit or misrepresentation with at least the same degree of particularity and detail as would be necessary to maintain an action for common law fraud.”\textsuperscript{101}

One of the cases finding a justified reliance element, California Bagel v. American Bagel Co.,\textsuperscript{102} involved a garden variety CFIL fraud claim brought by a well heeled plaintiff who was also an attorney. Under these less than helpful facts for the plaintiff franchisee, and noting the case under the CFIL as of first impression, the federal district court denied relief to the plaintiff franchisee by inserting a justified reliance element into CFIL statutory damages remedy. One of the underpinnings of the California Bagel decision was the court’s finding that: “The statute does not compel the conclusion plaintiffs seek to have the court draw, however, since, absent some indication to the contrary “fraud” as used in the statute must be given its common law meaning.”\textsuperscript{103} This conclusion was incredibly reached even though the CFIL expressly provides in another section that “[f]raud and ‘deceit’ are not limited to common law fraud and deceit.”\textsuperscript{104}

Other cases have questioned or declined to require a justified or reasonable reliance requirement to recovery for franchise fraud. In Simos v. Embassy Suites, Inc.,\textsuperscript{105} the Seventh Circuit concluded that “the element of detrimental reliance is not necessarily required” under the Washington Franchise Investment Law. The court then analyzed the enforcement provision of the statute including that the franchisor could avoid liability by establishing that the franchisee knew the underlying misrepresentations and omissions.\textsuperscript{106} This defense proved fatal to the franchisee as evidence established that the franchisee knew the underlying facts of misrepresentation prior to purchasing the franchise.\textsuperscript{107}

In Randall v. Lady of American Franchise Corp,\textsuperscript{108} the district court conducted extensive analysis of the lack of language requiring justifiable reliance under the Minnesota Franchise Act:

Nowhere does the statute mention justifiable reliance. Of course, some kind of reliance - reasonable or unreasonable - is required because a


\textsuperscript{101} Id., 669 N.E.2d 134 at 137, also citing, Enservo, Inc. v. Indiana Sec. Div., 623 N.E.2d 416, 425 (Ind. 1997) (In Enservo, the Indiana Supreme Court struck down a scienter requirement for franchise fraud under the Indiana statute, and while not directly addressing the issue, stated only that “harm caused by reliance on the statement or omission” is required without using the word justifiable or reasonable reliance. Id., 623 N.E.2d 416 at 425.


\textsuperscript{103} Ibid.

\textsuperscript{104} Cal. Corp. Code § 31012. Other franchise disclosure laws contain similar or identical language. For example, “Fraud and deceit” under the Illinois Franchise Disclosure Act is also not limited to common law fraud and deceit. III. Ch. 815, § 703/3(11).

\textsuperscript{105} Simos v. Embassy Suites, Inc., 983 F.2d 1404, 1410 (7th Cir. 1993).

\textsuperscript{106} Ibid.

\textsuperscript{107} Ibid.

franchisee can only recover for damages that are caused by a franchisor’s violation of the Minnesota Franchise Act. See, Minn. Stat. § 80C.17. Without reliance, there can be no causation. But a franchisee could, as a factual matter, suffer damages as a result of unreasonably relying on a franchisor’s misrepresentation. 109

In Randall, the district court also found that the legislative purpose, the remedial nature of the statute and the plain language of the statute all pointed to a lack of requiring justifiable reliance for franchise statutory fraud in Minnesota:

This plain-meaning approach, if applied to the question whether to read a requirement of justifiable reliance into § 80C.13 would lead to the conclusion that justifiable reliance-like scienter-is not an element of a claim under the statute. As noted, nowhere does the statute require that any reliance on a misrepresentation be justifiable or reasonable. If, as the Court suspects, the Minnesota Franchise Act does not require that a franchisee’s reliance on misrepresentations be justifiable, then it is irrelevant whether the plaintiffs’ reliance on the earnings claims made by Lady of America was reasonable in light of the disclaimers in the UFOC and the franchise agreement. Lady of America is plainly not entitled to summary judgment on the basis of its justifiable-reliance argument. 110

Disclosure failure violations also would not appear subject to a reliance requirement much less a reasonable reliance requirement. 111

Declining to add a justified or reasonable reliance element to franchise investment laws is also supported by reference to antecedent mail fraud and securities statutes. In re Parmalet Securities Litigation, held that reliance in a 10b-5 securities fraud claim required only causation. 112 State securities statutes have also been held to require only causation in fact rather than reasonable or justified reliance. 113 In Bridge v. Phoenix Bond & Indemnity Co., 114 the United States Supreme Court held reliance is not a required element for mail fraud serving as a RICO predicate, as distinct from common law fraud.

109 Id., 983 F.2d at 1086.
110 Id., 983 F.2d at 1087.
112 In re Parmalet Securities Litigation, 376 F.Supp.2d 472, 480 (S.D. N.Y. 2005) (“The reliance requirement in that context has a very specific function: in the Supreme Court’s words, to ‘provide the requisite casual connection between a defendant’s misrepresentation and a plaintiff injury’ or in the formulation of the Second Circuit ‘to certify that the conduct of the defendant actually caused the plaintiff injury.’”).
114 Bridge v. Phoenix Bond & Indemnity Co., 533 U.S. 639, 648-661, 128 S.Ct. 2131, 2140-41, 170 L.Ed.2d 1012 (2008) (“Congress defined the predicate act not as fraud simpliciter but mail fraud - a statutory offense unknown to the common law. In these circumstances, the presumption that Congress intends to adopt the settled meaning of common law terms has little pull.”)
C. **Reliance under Little FTC Acts**

Some Little FTC Acts contemplate remedies for deceptive practices well beyond the confines of common law fraud. Such Little FTC Acts may allow relief for plaintiffs without proof of even actual reliance much less justified reliance.\(^{115}\) The Massachusetts statute virtually mirroring the FTC Act, as interpreted in *Slaney v. Westwood Auto, Inc.*\(^{116}\) is illustrative:

As numerous FTC cases have made clear, the definition of an actionable ‘unfair or deceptive act or practice’ goes far beyond the scope of the common law action for fraud and deceit. To cite only a few distinctions, in the statutory action proof of actual reliance by the plaintiff on a representation is not required, *United States Retail Credit Assn. Inc. v. Federal Trade Commn.*, 300 F.2d 212, 221 (4th Cir. 1962), and it is not necessary to establish that the defendant knew that the representation was false, *Montgomery Ward & Co., v. Federal Trade Commn.*, 379 F.2d 666, 670 (7th Cir. 1967). The Section 9 claim for relief is the creation of that statute. It is, therefore, sui generis. It is neither wholly tortious nor wholly contractual in nature, and is not subject to the traditional limitations of preexisting causes of action such as tort for fraud and deceit.\(^{117}\)

Other Little FTC statutes have, to the contrary, been construed as requiring differing forms of reliance.\(^{118}\)

V. **REMEDIES**

Damages available under the common law, Little FTC Acts and Franchise Investment Laws are not uniform from state to state. Some states limit damages to actual damages while others allow equitable remedies, actual damages and punitive damages. Therefore, it is imperative to understand what damages each individual state allows when bringing a misrepresentation or omission cause of action. The following subsections discuss the types of damages typically available to a plaintiff and how states generally treat that damage under the common law, Little FTC Acts, and Franchise Investment Acts.

A. **Actual Damages**

Generally, actual damages are allowed in most states under either the common law, Little FTC Acts, or Franchise Investment Act. Actual damages are the “amount[s] awarded to a complainant to compensate for a proven injury or loss; damages that repay actual losses.”\(^{119}\) “There must be some data by which the actual damages may be calculated.”\(^{120}\) The vast majority of states at least allow for the recovery of actual damages, and many of those states do

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\(^{117}\) Ibid., 366 Mass. 688 at 703-704.


\(^{120}\) *Boesch v. Graff*, 133 U.S. 697, 706 (1890).
not limit the dollar amount for actual economic damage sustained. Generally, all states that have adopted a Little FTC Act also provide for actual non-economic relief.

**B. Statutory Damages**

“Statutory damages are by definition a substitute for unproven or unprovable actual damages, statutory damages are arguably the quintessential equitable remedy, invoked when the legal remedy is inadequate.” Some states have enacted statutes that specifically calculate actual damages or another specified amount. For example, in Utah, a plaintiff is allowed the greater of either actual damages or $2,000. Georgia provides a statutory formula for treble damages by stating that punitive damages shall be three times actual damages.

States that provide for statutory damages have afforded franchisees a minimum amount of recovery regardless of actual damages sustained. Though the statutory limits are fairly low, these statutory schemes help smaller and likely less sophisticated parties from being taken advantage of by typically larger, more sophisticated, franchisors.

**C. Punitive and Exemplary**

“Punitive damages by definition are not intended to compensate the injured party, but rather to punish the tortfeasor . . . and to deter him and others from similar extreme conduct.”

State statutes vary on whether to cap punitive damages or whether to allow them at all. In Georgia, a court may only award punitive damages when the fact-finder determines that the misrepresentation was made intentionally. Other states, like Washington state, however, allow for punitive damages up to three times actual damages regardless of intent, but in the discretion of the court.

Other states, including Florida, are still determining if its statute provides for punitive damages. Under Florida’s Franchise Investment Act, there is no provision specifically mentioning or allowing punitive damages. Notwithstanding, under Griffin v. Swim-Tech Corp., punitive damages were allowed to stand on appeal. This illustrates that even within a given state, the law may not be settled and a detailed analysis of both the statute and case law must be conducted to determine the pros and cons of filing a misrepresentation action within any given state.

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122 See 115 A.L.R. 5th 709.
123 Cass County Music Co. v. C.H.L.R., Inc, 88 F.3d 635, 643 (8th Cir. 1993).
125 See Ga. Code Ann., § 10-1-399(c).
128 See West’s RCWA 19.100.190(3).
Lastly, the common law of some states provides for punitive damages. Other states provide for treble damages under the Little FTC Acts or Franchise Investment Laws and punitive damages under the common law, but the plaintiff must choose which damage award to pursue.

D. Rescission

Rescission is defined as an “unmaking of a contract, or an undoing of it from the beginning, and not merely a termination.” Rescission was originally a common-law remedy that would allow a franchisee to void a franchise agreement. Some states provide rescission as available to a franchisee, but other states do not. Under Michigan’s Franchise Investment Act statute, “[a] person who offers or sells a franchise in violation of section 5 or 8 is liable to the person purchasing the franchise for damages or rescission.” Other states do not specifically provide for rescission in the statutes, but plaintiffs have sought rescission under common law principles. A smaller minority of states require a plaintiff to choose before trial whether to seek rescission or actual damages.

E. Injunctive Relief

Court issue injunctive relief to prevent harm -- i.e., irreparable harm -- as distinguished from actual damages, which generally are designed to provide a remedy for harm that has already occurred or that can be remedied through dollars and cents. Most states, if not all, allow for a plaintiff to seek injunctive relief under either the common law, a Little FTC Act, or a Franchise Investment Act.

F. Declaratory Judgment

A declaratory judgment is a judgment of a court in a civil case that declares the rights, duties, or obligations of one or more parties in a dispute. However, plaintiff must be aware that a declaratory action may “fall outside the constitutional definition of a ‘case’ in Article III.” Thus, courts will analyze the specific cause of action alleged and the specific declaratory relief sought in the complaint to determine if the suit is “ripe for review.” California generally allows for

135 M.C.L.A. 445.1531.
138 In re Neiberg, 161 B.R. 606, 609 (Bankr..W.D.Pa.,1993) (holding that Pennsylvania’s common law allows for an injunction remedy).
declaratory judgments.\textsuperscript{142} Michigan, also, allows for declaratory judgments as well as Texas.\textsuperscript{143}

G. Attorneys' Fees

Generally, the common law does not allow for the recovery of attorneys’ fees; however, many states provide for the recovery of attorney’s fees through statute. For example, under California’s Franchise Investment Act, reasonable attorney’s fees are awarded to plaintiff’s counsel when simply a judgment is entered against the defendant.\textsuperscript{145} However, under New York’s Little FTC, attorney’s fees are only awarded if the court finds the defendant willfully or knowingly violated McKinney’s General Business Law § 349.\textsuperscript{146}

In general, however, states that have enacted a Little FTC Act typically provide for attorney’s fees in recoverable damages. States, wanting to encourage enforcement of their “consumer protection” laws, enabled the recovery of attorney’s fees.\textsuperscript{147} Other states do not specifically provide for attorney’s fees for a misrepresentation cause of action by specific statute, but may provide generally for the recovery of attorneys’ fees by enacting a broader civil statute that allows recovery of attorneys’ fees in certain causes of action.\textsuperscript{148}

VI. INTEGRATION, NO REPRESENTATION, AND NO RELIANCE CLAUSES

Enforcement of integration, no representation and no reliance clauses varies depending on the jurisdiction as well as the type of claim, i.e. among breach of contract, common law fraud, franchise disclosure statutes, and Little FTC Acts. Courts also sometimes fail to distinguish between integration, no representation and no reliance clauses, while other courts separately analyze each of these provisions. Such analysis is appropriate especially regarding the many statutes which contain anti-waiver provisions.

A. Integration Clauses

Integration clauses are provisions stating that the contract is intended as an integrated agreement containing all of its terms with no other terms. Franchisors use integration clauses to invoke the parol evidence rule. This famous rule however, bars evidence of additional contract terms beyond the terms of an integrated contract. Issues arise, however, when franchisors seek to use the parol evidence rule to bar fraud and franchise disclosure claims.

The parol evidence rule does not bar proof of fraud or other civil wrong in most states. Restatement of Contracts 2d § 214 recognizes that the parol evidence rule does not apply to

\textsuperscript{142} See Bride Fund Capital v. Fastbucks Franchise, 622 F.3d 996 (9th Cir. 2010).
\textsuperscript{143} See Cook v. Little Caesar Enterprises, Inc., 210 F.3d 653 (6th Cir. 2000).
\textsuperscript{146} See McKinney's General Business Law § 349(h).
\textsuperscript{147} See generally, 35 A.L.R.4th 12, 53.
“illegality, fraud, duress, mistake, lack of consideration, or other ground for invalidation.” The theory behind the above Restatement exceptions allowing evidence despite the parol evidence rule is that fraud in the inducement vitiates all the contract including the integration and related clauses.\(^{150}\)

Many courts address integration and related no representation and no reliance clauses using a fraud in the inducement approach. Namely a party committing a fraud ought not to be able to use fine print in the contract obtained through the fraud to negate a fraud claim at the outset. Thus, these courts, notwithstanding the integration and related clauses, allow plaintiff franchisees to present evidence of factual misrepresentations.\(^{151}\)

The rationale for allowing evidence of fraud despite integration and related clauses was lucidly stated by the Massachusetts Supreme Court in *Bates v. Southgate*.\(^{152}\)

As a matter of principle it is necessary to weigh the advantages of certainty in contractual relations against the harm and injustice that result from fraud. In obedience to the demands of a larger public policy the law long ago abandoned the position that a contract must be held sacred regardless of the fraud of one of the parties in procuring it. No one advocates a return to outworn conceptions. The same public policy that in general sanctions the avoidance of a promise obtained by deceit strikes down all attempts to circumvent that policy by means of contractual devices. In the realm of fact it is entirely possible for a party knowingly to agree that no representations have been made to him, while at the same time believing and relying upon representations which in fact have been made and in fact are false but for which he would not have made the agreement. To deny this possibility is to ignore the frequent instances in everyday experience where parties accept, often without critical examination, and act upon agreements containing somewhere within their four corners exculpatory clauses in one form or another, but where they do so, nevertheless, in reliance upon the honesty of supposed friends, the plausible and disarming statements of salesmen, or the customary course of business. To refuse relief would result in opening the door to a multitude of frauds and in thwarting the general policy of the law.\(^{153}\)

\(^{149}\) Restatement of Contracts 2d § 195(1) provides that: “exculpatory clauses are unenforceable on public policy grounds where the alleged harm is caused intentionally or recklessly.”


Typical of more recent rulings is Ron Greenspan Volkswagen, Inc. and Ford Motor Land Development Corp.:

A party to a contract who has been guilty of fraud in its inducement cannot absolve himself from the effects of his fraud by stipulation in the contract, either that no representations have been made or that any right which might be grounded upon them is waived. Such a stipulation or waiver will be ignored, and parol evidence of misrepresentations will be admitted for the reason that fraud renders the whole agreement voidable, including the waiver provision.\(^{154}\)

Courts allowing evidence of factual misrepresentations despite integration clauses, will, however, often not allow evidence of additional promises which would vary the terms of the integrated contract.\(^{155}\)

But some states differ and strictly enforce integration and related clause to bar fraud claims. For example, “Pennsylvania law prohibits recovery on a claim of fraud in the inducement where the contract represents a fully integrated written agreement.”\(^{156}\)

B. No Representation and Reliance Clauses

No representation clauses are much more than integration clauses usually stating that nothing was represented to induce the parties to enter the contract beyond the franchise agreement and the FDD. No reliance clauses add that the parties are not relying on any representations not contained in the franchise agreement or the FDD. Many franchise agreements also add specific acknowledgements which franchisees are asked to execute at time of contract execution. These franchisor prepared acknowledgement documents ask the franchisee to acknowledge some or all of the following: that no additional representations were made beyond the franchise agreement and FDD; that nothing else was relied upon by the franchisee, that no earnings claims were made, and that any franchisee receiving an earning claim should state it in writing and immediately contact management of the franchisor.

Courts differ on the application of no representation and reliance clauses in franchise agreements to fraud in the inducement claims. Some courts adhere to the premise that fine print in a contract obtained by fraud should not bar a claim for deceit, although some of these courts may allow the no reliance clause as evidence to the fact finder to consider regarding justified reliance.\(^{157}\)

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\(^{157}\) *Commercial Property Investments v. Quality Inns.*, Inc. 938 F.2d 870 (8\(^{th}\) Cir. 1991); *Essex v. Gritty Oil*, 661 S.W.2d 544, 549 (Mo. App. 1983) (Missouri law).
Other jurisdictions invoke in essence a per se rule; that a plaintiff who executed a no reliance clause may not establish justified reliance because of the disclaimed reliance.\footnote{Guesthouse International Franchise Systems, Inc. v. British American Properties Macarthur Inn, LLC\footnote{Guesthouse International Franchise System, Inc. v. British American Properties Macarthur Inn, LLC, 2009 WL 278214 (M.D. Tenn. 2009); compare, Water Craft Management, LLC v. Mercury Marine, 2011 WL 2119677 (5th Cir. 2011) (reliance found unreasonable due to integration clause); Dannan Realty Corp. v. Harris, 5 N.Y.2d 317, 184 N.Y.S.2d 599, 601-602, 157 N.E.2d 597 (1959) (New York distinguishes between general merger clauses and specific disclaimers with the latter enforced as to the subject of the specific disclaimer).} is illustrative of such jurisdictions. The district court started with a premise under Tennessee law that “proof of fraud in the inducement or promissory fraud is limited to subject matter which does not contradict or vary the terms that are plainly expressed in the written agreement.”\footnote{Other jurisdictions invoke in essence a per se rule; that a plaintiff who executed a no reliance clause may not establish justified reliance because of the disclaimed reliance. Guesthouse International Franchise Systems, Inc. v. British American Properties Macarthur Inn, LLC, is illustrative of such jurisdictions. The district court started with a premise under Tennessee law that “proof of fraud in the inducement or promissory fraud is limited to subject matter which does not contradict or vary the terms that are plainly expressed in the written agreement.” Guesthouse International integration clause included no representation and no reliance provisions, namely that there were no representations relied upon in entering the license agreement not set forth in the license agreement. In dismissing the fraud claim based on this no representation and reliance language, the district court also noted that the plaintiffs included sophisticated purchasers with substantial involvement with hotels and franchising.}

The application of integration and related clauses to franchise disclosure statutes would appear barred as a matter of public policy. Franchisors should not be able to override statutory requirements by private contract clauses. This is especially the case with franchise disclosure laws.

Integration clauses and no representation clauses contained in a franchise agreement should usually not vitiate a franchise disclosure or Little FTC Act claim. Stated differently, private contract disclosures do not trump statutory rules enacted by legislatures.

Other courts have declined to enforce no reliance clauses due to the absence of any dispute for which reliance would have been relevant at the time of execution of the franchise agreement. Such a result occurred in Carousel's Creamery, LLC v. Marble Slab Creamery, Inc.\footnote{Carousel's Creamery, Inc. v. Marble Slab Creamery, Inc., 134 S.W.2d 385 (Tex.App. 2004).} with the court examining the circumstances at time of execution of the franchise agreement including that no dispute existed at time of signing the franchise agreement, the franchisee did not have legal counsel at the time, and there was no negotiation at arm's length of the franchise agreement.

In 2008 the amended FTC Franchise Rule prohibited franchise sellers to “disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments.”\footnote{In 2008 the amended FTC Franchise Rule prohibited franchise sellers to “disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments.” In Martrano v. Quizno's Franchise Co., the 16 CFR Part 436.9(h), see also, Carousel's Creamery, Inc. v. Marble Slab Creamery, Inc., 134 S.W.2d 385 (Tex.App. 2004).}
sandwich maker franchisor unsuccessfully invoked a non-reliance clause in a Rule 12(b)(6) Fed.R.Civ. Pro. motion. The no reliance provisions were in a disclosure acknowledgment statement stating that the franchisee did not rely on anything not in the UFOC or in the franchise agreement. Because the franchisee alleged that UFOC statements regarding negotiation with suppliers were fraudulent, the express disclaimer allowing reliance on representations in the UFOC allowed the claim to proceed.

In Randall v. Lady of America Franchise Corp., the district court held that an integration clause had narrow application to claims under the Minnesota Franchise Act, and that the parol evidence rule would not bar asserted fraudulent earnings claims under the statute. Then the court held that the anti-waiver provisions of the Minnesota Franchise Act rendered no representation and no reliance clauses contained in the franchise agreement void:

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

Other courts have also held that integration and related clauses may not bar claims for violation of franchise disclosure laws due to anti-waiver provisions in the statutes.

VII. CHOICE OF LAW AND VENUE CLAUSES

Franchisors and Franchisees often try to implement a choice-of-law and/or a venue clause in the franchise agreement. Generally, venue clauses are “prima facie valid and are enforced unless they are unjust or unreasonable or invalid for reasons such as fraud or
overreaching.” However, some states that strictly enforce their Franchise Investment law or Little FTC will void any venue clause.

Usually choice-of-law and/or venue clauses benefit the Franchisor more than the Franchisee due to the stronger bargaining position of the franchisor. Some states take a strict approach in not allowing choice-of-law or venue clauses to control an agreement while other states are more tolerant of the clauses. The remainder of this section will discuss choice-of-law and venue provisions under the common law, Little FTC Acts, and Franchise Investment Acts.

States that have not enacted an anti-waiver clause under either a Little FTC Act or Franchise Investment Act generally decide choice-of-law issues by using a common-law choice-of-law analysis. For example, Louisiana does not have an anti-forum selection clause or waiver clause and only looks to see if the clause violates legal or strong public policy considerations.

The anti-waiver provisions under some Little FTC Acts or Franchise Investment Laws prevent choice-of-law clauses or venue-selection clauses that are contrary to the particular state's statutes, including Little FTC Acts and Franchise Investment laws themselves. Some state courts have held that venue-selection clauses and choice-of-law clauses are not prevented by anti-waiver provisions, while other states bar such clauses under their respective anti-waiver provisions. The majority rule is that choice-of-law and venue-selection clauses in franchise agreements normally will be respected.

To illustrate the majority rule, the Sixth Circuit has stated that Michigan's anti-waiver statute does not specifically target choice-of-law provisions. Thus, in cases involving Michigan franchisees, the parties' choice-of-law clause is not affected under the Michigan anti-waiver rule. To demonstrate, in a Michigan case, the anti-waiver provision of Michigan's Franchise Investment Act did not negate a choice-of-law provision contained in a franchise agreement between a Michigan franchisee and an Arkansas franchisor. Ultimately, the Michigan court found that Arkansas law governed the agreement.

Also, the Minnesota Franchise Act’s anti-waiver provision did not operate to void a choice-of-law provision in a franchise agreement between a Florida franchisee and a Minnesota franchisor that explicitly chose Florida law to govern the parties' relationship. Some of the factors the Minnesota court considered were that the franchisee’s owner was not a resident of

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167 M.B. Restaurants, Inc. v. CKE Restaurants, Inc., 183 F.3d 750, 752 (8th Cir. 1999).
168 See Bradley v. Harris Research, Inc., 275 F.3d 884 (9th Cir. 2001).
171 Faulkenberg v. CB Tax Franchise Systems, LP, 2011 WL 1125592 *6 (7th Cir. 2011).
172 See JRT, Inc. v. TCBY Systems, Inc., 52 F.3d 734, 739 (8th Cir. 1995).
173 JRT, 52 at 739; See also Banek Inc. v. Yogurt Ventures U.S.A., Inc., 6 F.3d 357, 361 (6th Cir. 1993).
174 Id.
Minnesota, the franchisee was not organized or incorporated in Minnesota, and the franchisee’s franchises were to be operated in Florida not Minnesota.\textsuperscript{176}

On the other hand, some states do closely relate the choice-of-law provision with the anti-waiver analysis. For example, Maine’s Franchise Investment Act contains an anti-waiver provision.\textsuperscript{177} Relying on this statute, the court held that Maine’s anti-waiver provision “evidences a strong public policy against contracts that violate the franchise law generally,” and that “because Maine has expressed a strong public policy against allowing choice-of-law provisions to prevail over the statute, franchisees could not waive protection under the Maine law.”\textsuperscript{178} Connecticut is another example of a state that won’t allow a choice-of-law or venue clause.\textsuperscript{179}

California also strictly interprets any choice-of-law provision with its anti-waiver provision, and by-in-large does not uphold choice-of-law provisions.\textsuperscript{180} In enacting the California Franchise Investment Law, the California legislature has stated that “California franchisees have suffered substantial losses where the franchisor or his representative has not provided full and complete information regarding the franchisor-franchisee relationship. . . .”\textsuperscript{181} “It is the intent of this law to provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered.”\textsuperscript{182} Courts have recognized the importance of the California Franchise Investment Law in protecting the rights of California franchisees.\textsuperscript{183}

VIII. DEFENSES

A. Statute of Limitations

As with damages under the common law, Little FTC Acts, and Franchise Investment Acts, the statute of limitations defense is not uniform across the states. A statute of limitations is a maximum time limit in which a potential plaintiff may bring suit on a particular cause of action, after which the suit is barred. “As a very general rule, most statute of limitations are three to four years and run from the date the alleged violation was discovered.”\textsuperscript{184}

\textsuperscript{176} See id.
\textsuperscript{177} See 10 M.R.S.A. § 1363(3)(B).
\textsuperscript{178} Cromeens, Holloman, Sibert, Inc v. AB Volvo, 349 F.3d 376, 389 (7th Cir. 2003).
\textsuperscript{180} California also bars venue clauses as well under its Franchise Investment Act. See generally Jones v. GNC Franchising, Inc., 211 F.3d 495, 497-98 (9th Cir. 2000).
\textsuperscript{181} Cal. Corp. Code § 31001.
\textsuperscript{182} Id.
\textsuperscript{183} See, e.g., Cottman Transmission Systems, LLC v. Kershner, 492 F. Supp. 2d 461, 467 (E.D.Pa.2007) (CFIL embodies fundamental policy of California); America Online, Inc. v. Superior Court, 108 Cal. Rptr. 2d 699 (Cal. Ct. App. 2001) (holding that California’s Franchise Investment Law was “enacted to protect the statute’s beneficiaries from deceptive and unfair business practices”).
For example, under Texas common law, a general fraud claim must be brought within four years after the day the cause of action accrues.\textsuperscript{185} However, under Pennsylvania common law a general fraud claim must be brought within 2 years after the day the cause of action accrues.\textsuperscript{186} And Texas’s Little FTC law, claims must be brought within two years after the day the cause of action accrues,\textsuperscript{187} whereas under South Carolina’s Little FTC, the statute of limitations runs for three years.\textsuperscript{188} Franchise Investment Acts employ similar statutes of limitations. Under Washington’s Franchise Investment Law, the statute of limitations is three years.\textsuperscript{189} Whereas under California’s Franchise Investment Act, the statute of limitations is two years.\textsuperscript{190}

It should be noted that tolling may play a key factor in the determining of any given state’s statute of limitations. Tolling is an equitable remedy that varies from state to state. Usually a statute of limitations may be tolled or halted upon a showing by the franchisee that the franchisee “used reasonable care and diligence in attempting to learn the facts that would disclose the defendant’s fraud or other misconduct.”\textsuperscript{191}

B. Waiver and Releases

Many franchisors attempt to limit liability through waivers or releases of liability.\textsuperscript{192} For example, franchisors often try to contract out of being liable for any punitive damages that may arise pursuant to the execution of the duties enumerated in the agreement. Like choice-of-law and venue clauses, states that have not enacted an anti-waiver statute will usually look to the common-law’s public policy considerations to determine if the waiver or release will be upheld. The remainder of the section will discuss waiver and releases under Little FTC Acts and Franchise Investment Acts.

Under Texas’s Little FTC, there is a general anti-waiver provision, but the statute allows for waivers to be valid when certain conditions are met.\textsuperscript{193} These conditions are as follows: “(1) the waiver is in writing and is signed by the consumer; (2) the consumer is not in a significantly disparate bargaining position; and (3) the consumer is represented by legal counsel in seeking or acquiring the goods or services.”\textsuperscript{194} Under Illinois’s Deceptive Franchise Practices Act, it is unlawful for any franchise agreement to contain a provision “[r]equiring the franchisee to prospectively assent to a release, assignment, novation, waiver, or estoppel which purports to relieve any person from liability to be imposed by this chapter or requiring any controversy

\textsuperscript{185} See TIG Ins. Co. v. Aon Re, Inc., 521 F.3d 351, 354 (5th Cir. 2008).
\textsuperscript{186} Werwinski v. Ford Motor Co., 286 F.3d 661 (3d Cir. 2002).
\textsuperscript{187} See TIG Ins. Co., 521 F.3d at 354.
\textsuperscript{188} See S.C. Code Ann. § 39-5-150.
\textsuperscript{190} See West’s RCWA 19.100.190(3).
\textsuperscript{192} Mendoza v. Wilmington Finance, 2011 WL 2182914 *4 (N.D. Cal. 2011).
\textsuperscript{193} See Edwards v. Kia Motors of America, Inc., 486 F.3d 1229, 1231 (11th Cir. 2007).
\textsuperscript{194} Id.
between the franchisee and the franchisor to be referred to any person, if referral would be binding on the franchisee.\(^{195}\)

Many states will enforce choice-of-law agreements, but are more restrictive when deciding whether to enforce a waiver or release provision. Generally, however, states with a Franchise Investment Act tend to have anti-waiver provisions in their statutory schemes. Both Minnesota and Nebraska illustrate the majority rule by enforcing parties’ choice-of-law agreements while, under anti-waiver provisions, disallowing waivers and releases of liability.\(^{196}\)

The public policy behind voiding these waivers is that the state recognizes “the often superior bargaining power and economic resources of the franchiser, and seeks to protect against the use of that power to avoid the law.”\(^{197}\) Washington state’s Franchise Investment Law also strictly enforces its anti-waiver statute. Washington state’s code provides that “[a]ny agreement . . . purporting to bind any person to waive compliance with any provision of this chapter or any rule or order hereunder is void,” unless executed “pursuant to a negotiated settlement in connection with a bona fide dispute between a franchisee and a franchisor . . . in which the person giving the release or waiver is represented by independent legal counsel.”\(^{198}\)

Virginia, also a state that has enacted a Franchise Investment Act called the Virginia Retail Franchising Act, strictly enforces its prohibition against anti-waiver provisions.\(^{199}\) “Like the California, New York and Wisconsin statutes, the Virginia statute contains an anti-waiver provision, which prevents franchisees from waiving the protections provided by the Retail Franchise Act.”\(^{200}\)

States having enacted a statute that bars the enforcement of waivers and releases provide franchisees an additional layer of protection against larger, more sophisticated, franchisors as a matter of public policy.

C. Claims Sound in Contract Rather Than Tort

The “general rule is that a party may only maintain a tort claim in addition to a claim for breach of contract if the tort claim is independent of the contract claim.”\(^{201}\) For example under Texas law, to “determine whether a tort claim is independent of a contract claim, the court analyzes the source of the duty and the nature of the remedy.”\(^{202}\) “If a party seeks damages for breach of a duty created under a contract, the claim sounds only in contract, but if a party seeks


\(^{198}\) Taylor v. 1-800-GOT-JUNK?, LLC, 387 Fed. Appx. 727, 728-29 (9th Cir. 2010) (citing Wash. Rev. Code § 19.100.220(2)).


\(^{200}\) Id.

\(^{201}\) Nichols v. YJ USA Corp. 2009 WL 722997 *23 (N.D. Tex. 2009) (citations omitted)

\(^{202}\) Id.
damages for breach of a duty imposed by law, the claim sounds in tort.\textsuperscript{203} “When the loss or damage is the loss to the subject of the contract, the claim sounds in contract.”\textsuperscript{204} Generally, this concept is referred to as the “Economic Loss Doctrine.”

As the economic loss doctrine focuses on the type of loss the “Gist of the Action” doctrine focuses on the nature of the claim to determine the origin of the alleged wrong and can also serve to bar a tort claim.\textsuperscript{205} Tort actions are for breaches of duty imposed by law as a matter of social policy while contract actions are based upon mutual consensus agreements between particular individuals.\textsuperscript{206} The gist of the action doctrine does not permit a tort action absent a factual basis that is primarily separate from/independent of the contractual relationship.\textsuperscript{207}

A classic example of case holding that a claim sounds in contract rather than tort is Sherman v. PremierGarage Systems, LLC.\textsuperscript{208} The court in Sherman found that because the claims of the franchisee were for certain lost profits affiliated with the contract and the specific risks were allocated in the signed contract, then tort claims were barred by the economic loss doctrine.\textsuperscript{209} The Court reasoned that “contracts often are negotiated between the parties on a project-specific basis and have detailed provisions allocating risks of loss and specifying remedies.”\textsuperscript{210} “In this context, allowing tort claims poses a greater danger of undermining the policy concerns of contract law.”\textsuperscript{211} Davaco, Inc. v. Dunkin’ Brands, Inc., further expands this idea by stating that “[t]he breaking of a promise is necessarily present in every breach of contract action, and does not automatically transform a breach of contract into a tort. Plaintiff has failed to make a prima facie showing of either fraud or negligent misrepresentation.”\textsuperscript{212}

\begin{thebibliography}{9}
\bibitem{203} Id.
\bibitem{204} Id.
\bibitem{208} 2010 WL 3023320 *4 (D. Ariz. 2010).
\bibitem{209} Id.
\bibitem{210} Id. (citing Flagstaff Affordable Housing Ltd. P’ship v. Design Alliance, Inc., 223 Ariz. 320, 223 P.3d 664, 669 (Ariz. 2010)
\bibitem{211} Id.
\bibitem{212} 2008 WL 4975880 *3 (N.D. Tex. 2008).
\end{thebibliography}
IX. PERSONAL LIABILITY, OFFICERS, DIRECTORS AND SALESPERSONS

The principals discussed in this article do not apply only to franchisor entities. It is possible, under each branch of the Trilogy, for directors, officers, shareholders, and employees to be held personally liable for fraud in connection with the sale of a franchise.

A. Common Law

At common law, there are generally two avenues by which liability can be imposed upon individuals associated with a franchisor entity: direct liability and piercing the corporate veil.

1. Direct Liability

One way to hold an individual personally liable is to bring a direct liability fraud claim against that individual. To do so, a plaintiff will typically need to show direct personal involvement of the director, officer, or employee in the wrongful activity, and the plaintiff will need to establish each element of a common law fraud or misrepresentation claim. As discussed above, a common law fraud claim typically requires that a plaintiff show an intentional, material misrepresentation by the defendant, knowledge by the defendant that the statement was false, an intent that the plaintiff rely on the statement, and that the plaintiff did rely on the statement to his or her detriment. Generally, a franchisee will usually allege that high-level individuals made material misrepresentations that induced the franchisee to enter into the franchise agreement. For example, in Wright v. The Spaghetti Place, two individual defendants, both shareholders, directors, and officers of The Spaghetti Place, appealed from a judgment of the trial court holding them personally liable for fraud based on their active participation in the preparation of a fraudulent promotional brochure that was sent to the plaintiff. The appellate court affirmed the judgment, stating that “[t]o fasten personal liability upon a corporate officer or director for fraud it must be shown that such officer or director took part in the fraud by knowing a false statement was made and intending it be acted upon by the injured party and that it was acted upon to the injury of such party.”

2. Piercing the Corporate Veil

See, e.g., Bray Int’l, Inc. v. Collings, No. 05-1618, 2006 U.S. Dist. LEXIS 67587, * 7-8 (D. Minn. Sept. 20, 2006) (“To state a claim for intentional misrepresentation under Minnesota law, a plaintiff must allege that: (1) the defendant made a false misrepresentation about a past or present material fact that was susceptible of knowledge; (2) the defendant knew the misrepresentation was false or asserted it as of his own knowledge without knowing whether it was true or false; (3) the defendant intended to induce the plaintiff to act and the plaintiff was indeed induced to act; and (4) the plaintiff acted in reliance on the representation and was thereby damaged.”); Momans v. St. John’s Northwestern Military Academy, Inc., No 99-8510, 2000 U.S. Dist. LEXIS 5129, * 16 (N.D. Ill. Apr. 20, 2000) (“The elements of a cause of action for common law fraudulent misrepresentation are: (1) false statement of material fact, (2) known or believed to be false by the party making it; (3) intent to induce the other party to act; (4) action by the other party in reliance on the statement; and (5) damage resulting from such reliance.”); Yo-Can, Inc. v. The Yogurt Exchange, Inc., 149 778 N.E.2d 80, 89 (Ct. App. Ohio 2002) (“The tort of fraud or fraudulent inducement has the following elements: (1) an actual or implied false representation concerning a fact or, where there is a duty to disclose, concealment of a fact, material to the transaction; (2) knowledge of the falsity of the representation or such recklessness or utter disregard for its truthfulness that knowledge may be inferred; (3) intent to induce reliance on the representation; (4) justifiable reliance; and (5) injury proximately caused by the reliance.”).


A plaintiff may also seek to pierce the corporate veil to hold shareholders and owners of a franchisor entity personally liable for fraud. Typically, a plaintiff must establish that the individual exercised significant control over the company such that the company did not actually function as a separate entity, and that the individual used this control over the company for an improper purpose.\textsuperscript{216} Attempts to pierce the corporate veil are often unsuccessful, though, because courts continue to “respect the presumption of separateness between a corporation and its owners.”\textsuperscript{217} Moreover, any such attempt will often require the time and expense of significant discovery to establish the facts necessary to pierce the veil, and a court’s decision to disregard the corporate form is fact-specific and typically involves a detailed and weighted analysis of the nature and significance of the relevant facts.\textsuperscript{218} For example, in \textit{United States v. Jon-T Chemicals, Inc.}, the Fifth Circuit discussed a number of factors to be considered in determining whether to disregard the corporate form in a case involving parent and subsidiary companies, including, among other things, whether there is common stock ownership, directors or officers, and business departments, whether the parent company finances or incorporates the subsidiary company, and whether the corporations keep their daily operations separate and observe separate corporate formalities.\textsuperscript{219} The \textit{Jon-T Chemicals} court ultimately held that “one hundred percent ownership and identity of directors and officers are, even together, an insufficient basis for applying the alter ego theory to pierce the corporate veil,” further illustrating that the imposition of liability in corporate veil cases turns on the specific facts of each case.\textsuperscript{220}

\textbf{B. State Franchise Statutes}

The franchise statutes of fourteen states expressly extend liability to certain individuals for fraudulent activities in connection with the registration, promotion, and sale of franchises.\textsuperscript{221} The individuals subject to these provisions typically include directors, officers, and employees.

For example, New York’s Franchise Sales Act provides that

\begin{quote}
(a person who directly or indirectly controls a person liable under this article, a partner in a firm so liable, a principal executive officer or director of a corporation so liable, a person occupying a similar status or performing similar functions, and an employee of a person so liable, who materially aids in the act of transaction)
\end{quote}

\textsuperscript{216} \textit{See}, e.g., \textit{Yo-Can, Inc. v. The Yogurt Exchange, Inc.}, 778 N.E.2d 80, 90 (Ct. App. Ohio 2002) (stating that “[t]he corporate form can be disregarded and individual shareholders held liable for corporate wrongdoing when control is so complete that the corporate has no separate will, mind, existence (the alter-ego doctrine) and the control is exercised to commit fraud or an illegal act which injures the plaintiff.”)

\textsuperscript{217} Dunham, Edward Wood. \textit{The Liability of Shareholders, Officers, Directors, and Employees for Franchise Law Violations.} 13 Franchise L.J. 103 (Spring 1994) (quoting \textit{American Protein Corp. v. AB Volvo}, 844 F.2d 56, 60 (2d Cir. 1988)).


\textsuperscript{219} \textit{United States v. Jon-T Chemicals, Inc.}, 768 F.2d 686, 691 (5th Cir. 1985).

\textsuperscript{220} \textit{Id.}

\textsuperscript{221} California (Cal Corp Code § 31302); Hawaii (HRS § 482E-9); Illinois (815 ILCS 705/22); Indiana (Burns Ind. Code Ann. § 23-2-2.5-29); Maryland (Md. Code Ann., Bus. Reg. § 14-227); Michigan (MCLS § 445.1532); Minnesota (Minn. Stat. § 80C.17); New York (NY CLS Gen. Bus. § 691); North Dakota (N.D. Cent. Code, § 51-19-12); Oregon (ORS § 650.020); Rhode Island (R.I. Gen. Laws 19-28.1-21); South Dakota (S.D. Codified Laws 37-5B-49); Washington (Wash. Rev. Code 19.100.190); Wisconsin (Wis. Stat. § 553.51).
constituting the violation, is also liable jointly and severally with and to the same extent as the controlled person, partnership, corporation or employer.222

Thus, New York’s franchise statute, like that of other states such as Minnesota and Illinois, requires the individual to “materially aid” the franchisor’s violation in order for liability to attach.223

Maryland’s Franchise Registration and Disclosure Law defines the contours of liability differently, extending joint and several liability to

(i) each person who directly or indirectly controls a person liable under this section; (ii) each partner in a partnership liable under this section; (iii) each principal officer or director of a corporation liable under this section; (iv) each other person that has a similar status or performs similar functions as a person liable under this section; and (v) each employee of a person liable under this section, if the employee materially aids in the act or transaction that is a violation under this subtitle.224

Note that, while Maryland’s franchise statute uses the “materially aid” language, that requirement is limited only to the “employee” category of liable persons.

Each of the franchise statutes extending liability to directors, officers, principals and other controlling individuals also provides a defense to any individual who did not know or could not have reasonably known about the wrongful conduct. For example, New York’s statute provides that “[i]t shall be a defense to any action based upon such liability that the defendant did not know or could not have known by the exercise of due diligence the facts upon which the action is predicated.”225 Similarly, Maryland’s Franchise Registration and Disclosure Law provides that “liability under this subsection does not extend to a person who did not have knowledge of or reasonable grounds to believe in the existence of the facts by which the liability is alleged to exist.”226 Even though this defense is provided, as a practical matter it can be

223 See, e.g., A.J. Temple Marble & Tile, Inc., v. Union Carbide Marble Care, Inc., 87 N.Y.2d 574, 582 (N.Y. Ct. App. 1996) (“Additionally, however, where a statutorily defined person affiliated with the franchisor does not personally violate the Act by participating in the fraudulent offer or sale, he or she may still be held liable for the statutory violations of others if his or her actions materially aided the violation.”). See also Cherrington v. Wild Noodles Franchise Company, LLC, No. 04-4572, 2006 U.S. Dist. LEXIS 39981, * 13-14 (D. Minn. June 15, 2006) (stating that “merely being an officer isn’t enough,” and that a controlling person must have been in a position of control at the time of the alleged violation or otherwise actively participated in the violation for liability to attached under Minnesota’s Franchise Act) (citing Randall v. Lady of Am. Franchise Corp., No. 04-3394, 2005 U.S. LEXIS 26543, * 2 (D. Minn. Oct. 21, 2005) and Dr. Performance of Minn., Inc. v. Dr. Performance Mgmt, L.L.C., No. 01-1524, 200 U.S. Dist. LEXIS 22501, *4 (D. Minn. Nov. 12, 2002)); To-Am Equip. Co., Inc. v. Mitsubishi Caterpillar Forklift America, 913 F. Supp. 1148, 1153 (N.D. Ill. 1995) (stating that, under Illinois Franchise Disclosure Act, the individual officer must materially aid the violation for liability to attach).
difficult for individuals closely involved in franchise sales to escape liability if those individuals could have, upon reasonable investigation, learned of the facts upon which liability is based.227

C. Little FTC Acts

In addition to possible liability under common law theories and state franchise statutes, fraud liability can be imposed upon directors, officers, and employees under state deceptive and unfair trade practices and consumer fraud statutes. As in the case of direct liability common law fraud claims, liability is not imposed upon these individuals based upon their titles, but rather upon a showing of the individual’s direct, active participation in the wrongful conduct of the corporate entity.228 Typically, courts find that directors, officers, and employees fall within the broadly construed definition of “person[s]” subject to liability under little FTC Acts, and cite the broad remedial purpose of such legislation as support for this interpretation.229 In some jurisdictions, an officer or director’s “knowing acquiescence” in a corporation’s fraudulent activity may be sufficient to impose liability under a little FTC Act. For example, in *State v. Keaton Model Management, Inc.*, the State of Minnesota brought an action against Keaton Model Management and two of its officers, alleging that the corporation committed deceptive trade practices, false advertising, and consumer fraud, and further alleging that the individual officers were personally liable for the corporation’s violations. The Court of Appeals of Minnesota reversed summary judgment dismissing the Consumer Fraud Act claim against one of the officers, finding a genuine issue of fact existed as to that individual’s knowing acquiescence, as a director, in the corporation’s fraudulent conduct.230

X. DRAFTING AND PLANNING CONSIDERATIONS

Whether representing franchisees or franchisors, attorneys practicing in the area of franchise law should be aware of the principles discussed in this article. The foregoing sections have discussed various considerations that will guide your analysis in deciding whether to bring a claim based on misrepresentations or omissions, which claims to bring, where to bring them, and/or how to defend against them.


228 See, e.g., *Allen v. V&A Bros*, 414 N.J. Super. 152 (App. Div. 2010) (holding that a principal of a corporation may be held personally liable for a violation of the New Jersey Consumer Fraud Act where the individual personally participated in the corporation’s violation); *Ayers v. Quillen* No. 03C-02-004, 2004 Del. Super. LEXIS 443, * 10 (Del. Sup. Ct. June 30, 2004) (stating that an officer, director, agent, or other employee “must be shown to have been actively involved in the alleged violative activity” for liability to be imposed under Delaware’s Consumer Fraud Act); *Momans v. St. John’s Northwestern Military Academy, Inc.*, No. 99 C 8510, 2000 U.S. Dist. LEXIS 5129, *29 (N.D. Ill. Apr. 20, 2000) (“under Illinois common law and under the Consumer Fraud Act, the alleged wrongdoer must have actually participated as a perpetrator of the fraud to be held liable”); *State v. Preferred Florist Network, Inc.*, 791 A.2d 8, 21 (Del. Ch. 2001) (finding that corporate officer was not shielded from liability under Delaware’s Consumer Fraud Act despite the fact that he was acting in his corporate capacity); *Ayers v. Quillen*, No. 03C-02-004, 2004 Del. Super. LEXIS 443, * 10 (Del. Sup. Ct. June 30, 2004) (stating that officer, director, agent or other employee “must be shown to have been actively involved in the alleged violative activity” for liability to be imposed under Delaware’s Consumer Fraud Act).

229 See, e.g., *Ayers v. Quillen* No. 03C-02-004, 2004 Del. Super. LEXIS 443, * 10 (Del. Sup. Ct. June 30, 2004) (stating that “[t]he Consumer Fraud Act is to be liberally construed in keeping with its primary purpose of protecting the consumer.” and that, although the definition of “person” under the Consumer Fraud Act “does not specifically mention officers of a corporation, the definition is broad enough to include a corporate officers as a responsible party”) (quoting *T.V. Spano Bldg. Corp. v. Dep’t of Natural Res. And Envtl.. Control*, 628 A.2d 523 (Del. Super. Ct. 1990)).

When deciding whether and where to bring a claim, you must examine the language and interpretation of the applicable state franchise investment law(s) and little FTC Act(s), as well as the required elements of a common law fraud claim in each possible jurisdiction to determine whether your facts will support a claim. In addition, you will want to confirm that the statutes in question provide a private right of action, and that they have been interpreted to apply to the sale of a franchise. You will also want to consider the available remedies. If successful, will your client be able to recover actual damages, equitable remedies (such as rescission, an injunction, or a declaratory judgment), punitive or trebled damages, statutory damages, and/or attorneys’ fees? As we have seen, another consideration is the presence of a choice of law or choice of venue clause. If the governing agreement in your case does contain such a provision, will it be enforced in your jurisdiction? You will also want to determine whether your state franchise law contains an anti-waiver provision and, if so, what effect (if any) it will have on the enforceability of any waiver or release language in the governing agreement. Similarly, you will want to determine whether your governing agreement contains an integration, no reliance, or no representation clause and, if so, whether it will be enforced. Does the applicable state franchise law void the clause? Does your jurisdiction recognize an exception for claims of fraudulent inducement?

When drafting pleadings, you must consider the various requirements of the common law and statutory claims. For example, does your jurisdiction require a showing of a “special relationship” between the parties to establish your fraud claim? Will your plaintiff be required to show reliance, or allege scienter? If reliance is a required element of the fraud claim you intend to assert, you must be aware of the degree of reliance that is required. As discussed above, common law fraud claims generally require a showing of justified or reasonable reliance, but many state franchise laws and several little FTC Acts don’t explicitly require reasonable reliance. Similarly, as we’ve seen, the scienter requirement varies greatly. If there is a scienter requirement in your jurisdiction, you need to be aware of the applicable standard or required showing. Will your plaintiff need to establish a willful, knowing, or intentional act of deception, or will recklessness be sufficient?

Each of the considerations discussed above is equally important to an attorney defending a client against claims of fraud in connection with the sale of a franchise, since a defendant could be successful in dismissing the fraud claims if a plaintiff hasn’t met the required showing or is barred from bringing certain claims or introducing certain evidence in support of the claims. In addition, defense attorneys will want to be aware of the applicable statute(s) of limitation, and would be wise to consider whether the plaintiff’s claim, although styled as fraud, actually sounds in tort such that it might be barred by the Economic Loss Doctrine.
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