

Court Watch: Potential Claims Under an FDD

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One of the most important parts of the franchise relationship comes before a single product is sold, and even before a franchise agreement is signed. And this part concerns the procedure and content of franchisor disclosure of information to the franchisee via the franchise disclosure document (FDD). As the cases below show, the process and content surrounding the FDD can make or break potential claims between franchisors and franchisees.

Franchisor's Violation of Wisconsin Disclosure Law Held Not Material

Normally, violating a state's disclosure law is enough to trigger rescission of the franchise agreement. In Wisconsin, however, the [Wisconsin Franchise Investment Law \(WFIL\)](#) requires that any such violation be "material" in order for rescission to be appropriate. In *Braatz, LLC, v. Red Mango FC, LLC*, Bus. Franchise Guide (CCH) ¶ 15,507, 3:14-CV-4516-G, 2015 WL 1893194 (N.D. Texas April 27, 2015), that distinction made all the difference, as Red Mango was found to have made an immaterial violation of WFIL.

The Braatzes received a copy of the Red Mango FDD in November 2011. The FDD included an example of the franchise agreement that all Red Mango franchisees must sign. The franchise agreement contained a mandatory franchisee questionnaire. After reviewing the documents contained in the FDD, the Braatzes decided to purchase a Red Mango franchise, and, in late December 2011, Red Mango sent the Braatzes an official franchise agreement to sign. The Braatzes returned a signed version of the franchise agreement, along with a check, to Red Mango on Jan. 5, 2012. Upon receipt of the agreement, a representative of Red Mango signed the document and cashed the Braatzes' check.

However, sometime between Jan. 6 and Jan. 16, 2012, Red Mango mailed a blank copy of the same questionnaire to the Braatzes. Through a sticky note attached to the blank questionnaire, Red Mango indicated that the Braatzes should change their answers to questions 12 and 13 in the questionnaire. Though the Braatzes felt they had answered honestly, they were told they could not own a franchise without re-sending the questionnaire with the "correct" answers. Sometime before Jan. 16, 2012, the Braatzes returned the questionnaire with the desired answers, and the franchise agreement was finalized.

The franchise failed in March 2014, and the Braatzes filed for bankruptcy. The Braatzes sued for rescission of the franchise agreement under WFIL. Specifically, Chapter 553.27(4) of the Wisconsin Statutes requires that the FDD be provided to prospective franchisees at least 14 days prior to the execution of any agreement, or rescission may be available. They argued that the 14-day clock started again when Red Mango sent back the blank questionnaire, and they had to also re-sign the franchise agreement — which they never did.

Chapter 553.51(1), however, requires that the violation be "material in the franchisee's or subfranchisor's decision to purchase the franchise." The court held that even if the re-sending of the blank questionnaire re-set the clock on the 14-day requirement, there was no evidence to show that the alleged violation was material. The court relied primarily on the fact that the Braatzes wasted no time resubmitting the questionnaire, indicating that Red Mango's request did not affect their decision-making. Plus, the court reasoned, the new answers to the questionnaire were necessary to ensure consistency with a previously agreed-to provision of the franchise agreement, which the Braatzes had ample time to consider before agreeing to originally. The case is on appeal to the Fifth Circuit.

Third Circuit Upholds Dismissal of Misrepresentation Claims

No one has a crystal ball, which can make the anticipatory nature of some of the information required to be provided in an FDD or franchise agreement a difficult proposition. Without bad faith intent, being wrong in predictions included in the FDD is not enough to constitute a misrepresentation under New Jersey or Maryland law, according to the U.S. Court of Appeals for the Third Circuit in *Fabbro v. DRX Urgent Care, LLC*, No. 2015 WL 1453537, Bus. Franchise Guide (CCH) ¶ 15,486 (3d. Cir. April 1, 2015). Doctors Express franchisees Laura Fabbro and Surendra Pai brought suit against their franchisor, alleging that their costs exceeded the initial estimates by a substantial margin, and that the franchisor made "deleterious system-wide changes," including changes in required vendors and company leadership, that amounted to constructive termination of the franchise. The claims were brought under the New Jersey Franchise Practices Act and the Maryland Franchise Registration and Disclosure Law. They were dismissed for failure to state a claim by a district court in the District of New Jersey.

The Third Circuit found the alleged misrepresentations not actionable under New Jersey or Maryland law. The court wrote: "Predictions or promises regarding future events — such as the expenses involved in starting a Doctors Express franchise — are necessarily approximate." In Maryland, predictions are not actionable as fraud at all, while in New Jersey predictions could be considered misrepresentations if the statements were made with intent to deceive. There was no evidence of bad motive or intention here.

The constructive termination argument failed, too. The plaintiffs relied on *Maintainco, Inc., v. Mitsubishi Caterpillar Forklift America, Inc.*, 408 N.J. Super. 461, 975 A.2d 510, Bus. Franchise Guide (CCH) ¶ 14,195 (N.J. Super Ct. App. Div. July 30, 2009), where the court held that termination under New Jersey franchise law included constructive termination, and found constructive termination where the "defendant's conduct was geared to terminate plaintiff's franchise, and, but for plaintiff's filing of this action, defendant would have succeeded." There were no such facts here, and the Third Circuit found no allegations from which it could reasonably infer the franchisor would want to terminate plaintiff's franchises.

Franchisees Survive Motion To Dismiss on NY GBL Claims

Sometimes a franchisor's pre-signing conduct is enough to convince a court that the franchisee may have been misled, which is usually enough to overcome a motion to dismiss. In *EV Scarsdale Corp. v. Engel & Voelkers N. E. LLC*, No. 651169/2011, 2015 WL 3549361 (N.Y. Sup. Ct. June 5, 2015), the franchisees managed to defeat a motion to dismiss, with the court finding enough potential evidence to support plaintiff's claims under New York General Business Law (GBL) which mandates that franchisors present prospective franchisees with the FDD either at the first face-to-face meeting, or 10 days prior to: a) signing any binding agreement; or b) the receipt of any consideration in connection with the sale of the franchise.

Three joined plaintiffs alleged similar factual circumstances. Each became interested in franchising an Engel & Voelkers property shop. Each met with representatives of Engel & Voelkers to discuss the possibility of franchising. At that initial meeting, the representative made representations about the market and success of other franchises. Sometime after the initial meeting, the plaintiffs received a copy of the FDD. All filed suit for rescission and damages ranging from \$400,000 to \$1.5 million. The three claims were joined in September 2012.

Plaintiffs claimed that they did not receive the FDD on the first personal meeting between the franchisor or its agent and the prospective franchisee, or in a timely manner, in violation of GBL § 683. Rather than refute that, defendants argued that any damages to the plaintiff were not proximately caused by that violation, relying on *A Love of Food I, LLC v. Maoz Vegetarian USA, Inc.*, 70 F. Supp. 3d 376, Bus. Franchise Guide (CCH) ¶ 15,384 (D.D.C. Sept. 30, 2014). The New York Superior Court distinguished *Maoz*, pointing out that the court there was relying on a robust record of undisputed facts, whereas no such record existed here. Additionally, the court in *EV Scarsdale* reasoned that the legislature created such a rule to give prospective franchisees a chance to review the documents before being hit with the full sales pitch.

Plaintiffs also claimed reliance on oral representations of defendants. Defendants pointed to a merger clause in the franchise agreement disclaiming collateral oral representations. But in *Emfore Corp. v. Blimpie Associates, Ltd.*, 51 A.D.3d 434, 860 N.Y.S.2d 12, Bus. Franchise Guide (CCH) ¶ 13,889 (N.Y. App. Div. May 6, 2008), the court held that such waivers are barred by New York franchise law and cannot be a defense to claims of reliance. The court here said that while it may not agree with such reasoning, or believe it applicable to the current set of facts, it is bound by precedent and cannot dismiss the claims.

The court did dismiss the franchisees' common law fraudulent inducement claims as duplicative, as well as the breach of contract and veil piercing claims.

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