No. 13-0750

IN THE APPELLATE COURT OF ILLINOIS
FIRST JUDICIAL DISTRICT

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<tr><td>AVON HARDWARE COMPANY d/b/a
AVON ACE HARDWARE, MICHAEL A.
CLARK and BEVERLY A. CLARK, YIDO,
INC. d/b/a MR. MIKE'S ACE HARDWARE,
DEBBIE PASCIAK and MICHAEL
PASCIAK,

Plaintiffs-Appellants,

v.

ACE HARDWARE CORPORATION,

Defendant-Appellee.</td><td>)
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Appeal from Circuit Court of
Cook County
Circuit Case No. 2012-L-362
Trial Judge: Hon. John C. Griffin</td></tr>
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AMICUS CURIAE BRIEF OF THE COALITION OF FRANCHISEE ASSOCIATIONS, INC.

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I. INTRODUCTION

Amicus Curiae The Coalition of Franchisee Associations, Inc. ("CFA") submits this brief on behalf of Plaintiffs-Appellants and urges this Court to reverse the decision issued by the Circuit Court because neither Defendant-Appellee's franchise disclosure documentation nor its *pro forma* projections was prepared in keeping with black-letter franchise disclosure requirements in force nationwide, including in Illinois and Indiana.

The CFA is the only trade association dedicated to franchisees and franchisees only. Founded in 2007 and comprised of franchisee association leaders dedicated to the development and growth of their own franchisee organizations, the CFA brings together some of the most reputable independent franchisee associations with a mission "to leverage the collective strengths of franchisee associations for the benefit of the franchisee community." *See* the Affidavit of John D. Holland submitted herewith.

Among the goals of the CFA is protecting the integrity of franchising and preserving the value of franchised businesses. *See Id.* As a result, the CFA focuses its efforts on government affairs at the state and federal levels, fair franchising, and franchisee education and training. *See Id.* The CFA is particularly concerned with preserving the integrity of the pre-sale, franchise disclosure process because pre-sale disclosure protocols are among the sole means that a prospective franchisee has to assess the viability of the franchises being marketed by franchisors within the United States. *See Id.*

The CFA's Member Associations include:

- Asian American Hotel Owners Association
- Buffalo Wings National Franchisee Association
- Domino's Franchisee Association
- Dunkin' Donuts Independent Franchise Owners

- Edible Arrangements Independent Franchisee Association, LLC
- Independent Association of Massage Envy Regional Developers
- Independent Coalition of Franchise Owners Independent Hardee's® Franchisee Association
- Independent Organization of Little Caesars® Franchisees
- Long John Silver's Franchisee Association
- Meineke Dealers Association
- National Coalition of Associations of 7-Eleven Franchisees
- National Franchisee Association, Inc.
- North American Association of SUBWAY® Franchisees
- Pharmacy Franchisees and Owners Association, Inc.
- San Francisco - Monterey Bay 7-11 Franchise Owners Association
- Service Station Franchise Association, Inc.
- Supercuts Franchisee Association

The CFA provides a voice for more than 30,000 franchise owners, operating over 70,000 franchise locations staffed by over 1.3 million employees.

II. SUMMARY OF ARGUMENT

In the United States, franchisors are obligated to prepare and present pre-sale disclosure documentation to prospective franchisees who are contemplating the purchase of a franchise. When properly prepared, franchise disclosure documentation serves the public interest of protecting consumers and the remedial purpose of providing prospective purchasers with material and non-misleading information regarding the nature of the franchise opportunity. However, when prepared in a fashion other than that contemplated under applicable law, franchise disclosure documentation is inherently misleading and undermines the public's interest in fair and honest business transactions.

Appellee Ace Hardware Corporation ("Ace") presented to Plaintiffs certain Uniform Franchise Offering Circulars ("UFOCs") as well as *pro forma* projections, regarding the alleged performance of a subset of Ace's existing franchises.

Plaintiffs-Appellants Avon Hardware Company, Michael Clark, Beverly Clark, Yido, Inc., Debbie Pasciak and Michael Pasciak (hereinafter collectively identified as the

"Plaintiffs") were entitled to full and fair disclosure regarding the franchise opportunity being marketed by Ace and to rely on the information prepared by Ace, as franchisor. Both the Federal Trade Commission and many state legislatures have concluded that franchisees who have been presented with misleading UFOCs and/or *pro forma* projections are entitled to relief.

Amicus Curiae CFA submits that neither Ace's UFOCs nor Ace's *pro forma* projections were prepared in conformance with applicable UFOC Guidelines. As a result, Plaintiffs' claims, all relating to the misleading nature of the UFOCs and *pro formas*, should have survived a motion to dismiss (as a matter of law) by the franchisor. As more fully detailed below, other courts which have passed on this issue have concluded that whether a prospective franchisee has "reasonably relied on" a pre-sale disclosure is a question of fact.

On a more fundamental level, however, the ruling by the Circuit Court undermines the disclosure frameworks adopted by both the federal and state regulators. Franchise disclosure frameworks were intended to provide prospective franchisees with full and fair disclosure – *without material omission*. Ace's UFOCs and *pro formas* did not include a host of the substantive disclosure information which Ace was required to include in all such documents.

Granted, both Ace's UFOCs and *pro forma* projections included a "conspicuous admonition" (*i.e.*, a "disclaimer") that Plaintiffs' franchises may not duplicate the financial performance (allegedly) enjoyed by that subset of existing Ace franchisees documented in the UFOC. However, the inclusion of such a "conspicuous admonition" is just one required element to be included in any UFOC and/or *pro forma* earnings claim

crafted by a franchisor. To rule that a franchisor may, *by inclusion of this disclaimer alone*, refute as a matter of law any argument by a franchisee that he or she has materially relied on the franchisor's pre-sale disclosures, is to undermine the entire franchise disclosure framework. This is particularly the case, as here, where the franchisor has otherwise failed to comply with its disclosure obligations under the UFOC Guidelines.

The consequences of Ace's failure to include required disclosure information consistent with the UFOC Guidelines in its UFOCs and *pro formas* should fall on Ace, as opposed to Plaintiffs. Had Ace complied with its disclosure obligations, Plaintiffs likely would have been dissuaded from purchasing their respective franchises.

Ace should not be rewarded for having crafted earnings claims which fall woefully short of the black-letter UFOC Guideline requirements.

Reversal of the Circuit Court ruling would serve the remedial purpose of ensuring that prospective franchisees receive full and fair disclosure, without material omission, consistent with applicable franchise disclosure requirements. By contrast, affirmance of the Circuit Court's decision would serve only to embolden franchisors in their efforts to sidestep their disclosure obligations.

III. FACTS

Ace crafted and presented to Plaintiffs certain UFOC franchise disclosure documentation (*see* Plaintiffs' Appendix at A. 70-225 and 298-425), as well as *pro forma* projections (*see* A. 45-68, 227-250, 252-275, and 427-446), regarding the franchises being purchased by Plaintiffs.

As more fully explained below, neither the UFOCs nor the *pro formas* crafted by Ace were prepared according to the substantive requirements of the UFOC Guidelines.

IV. ARGUMENT

In the United States, the sale of franchises is regulated in much the same fashion as the sale of securities. Franchisors are prohibited from making unfounded projections of financial performance to prospective franchisees by disclosure requirements intended to provide prospective franchisees with all of the material information needed to make an informed purchase decision.

The record below reflects that Ace failed to prepare its franchise disclosure documents and *pro formas* according to the black-letter requirements of the UFOC Guidelines governing a franchisor's presentation of financial data to prospective franchisees. As a result, Plaintiffs were deprived of that very information which might have dissuaded Plaintiffs from making a franchise purchase from Ace.

Nonetheless, in proceedings before the Circuit Court, Ace successfully argued that Ace's use of certain disclaimers should shield it from liability for having made misleading "earnings claims" regarding the potential performance of Plaintiffs' franchised locations.

Other courts that have considered these issues have concluded that franchisors cannot use improperly-formatted disclaimers to shield Ace from claims that its UFOC disclosures and/or *pro forma* projections were misleading.

The decision of the Circuit Court, dismissing Plaintiffs' statutory and common law claims as a matter of law, should be reversed. Plaintiffs were entitled to rely on the accuracy of the pre-sale UFOC disclosures and *pro formas* crafted by Ace.

A. The FTC Imposed Disclosure Requirements on Franchisors because of Misleading Practices by Franchisors in Connection with the Sale and Marketing of Franchises.

The sale of franchises is regulated on both the federal and state level.

By way of background, in the 1950s and 1960s modern franchising took off as a method of doing business, but sales of franchises were unregulated and subject to widespread abuse. *See* Bus. Franchise Guide (CCH) ¶ 6302. Thousands of people lost their substantial franchise investments as a result of having been "misled as to the true risks involved in the franchise investment by the franchisor's failure to disclose material facts" concerning franchise offerings. *See Id. at* ¶¶ 6305, 6309. State and federal regulators began to study the situation in the late 1960s and concluded that the sale of franchises was similar to the unregulated sale of securities in the 1920s.

Over the course of the 1970s, the Federal Trade Commission ("FTC") undertook to study misleading practices by franchisors in connection with franchisors' sale of franchises. *See* Bus. Franchise Guide (CCH) ¶ 6301. As reflected in the FTC's *Statement of Basis and Purpose Relating to Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*, the FTC made the following material findings:

- "[M]isrepresentations and failure to disclose material facts are widespread in franchising." Bus. Franchise Guide (CCH) ¶ 6305.

- "On the basis of the record in this proceeding, the Commission concludes that franchises have been marketed through (A) misrepresentation of material facts relevant to the nature and value of the franchise; (B) unsubstantiated claims regarding the potential sales, income, gross or net profit of franchises; (C) unfair refusal by franchisors to honor refund provisions and (D) failure to disclose material facts about the franchise offering." *Id.*

- Many franchisors had made a practice of making "get rich quick" claims in advertisements and other promotional materials, and "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." *Id.* at ¶ 6304.

- "[T]he record also discloses that many franchisors have highlighted the atypical success of a few franchisees without disclosing the non-representative nature of these claims. Such representations are an unfair and deceptive trade practice." *Id.* at ¶ 6307.

- That said, "For most prospective franchisees there is quite simply no source other than the franchisor for much of the information necessary to make an informed investment decision." *Id.* at ¶ 6304.

- "The record establishes that prospective franchisees are at an informational disadvantage with respect to the franchisor in evaluating the franchise offering because of the setting in which franchises are sold. Because of this informational imbalance prospective franchisees do not have information about material aspects of the franchise and frequently are not even aware that they lack such information. Without such information, however, prospective franchisees cannot evaluate the value of the franchise offering. The record establishes that franchisors take advantage of the informational imbalance to sell franchises without disclosure of material facts." *Id.* at ¶ 6309.

- "Without such information, prospective franchisees lack material information concerning the prices, the risks, the potential profitability, and even the nature and contents of the franchise offering." *Id.*

- "[T]he item being offered – the franchise opportunity – is complex, and the information necessary to test the accuracy of representations lies almost solely within the possession of the franchisor. Indeed, even if available, the search costs in obtaining such information would be prohibitive. Accordingly, prospective franchisees, of necessity, have to rely on the accuracy of the representation of the franchisor as to the profitability of the franchise." *Id.* at ¶ 6307 (emphasis added).

- "The failure to disclose material facts concerning the franchise offering, where the prospective franchisee is at an informational disadvantage, violates public policy encouraging informed consumer purchasing decisions." *Id.* at ¶ 6309.

- "Disclosure requirements are effective means of curbing the 'half-truth' and the failure to disclose used in marketing franchises because they provide prospective franchisees with at least the minimal information

needed to make an informed decision whether to enter the franchise relationship. By specifying the type of information which should be provided, the rule prevents franchisors from selectively disclosing only the information which is favorable to them." *Id.* at ¶ 6312.

- Going forward, "If franchisors choose to make representations concerning profits, income or sales to prospective franchisees or in the media," franchisors should be required to make "certain disclosures which are intended to give the prospective franchisee information which will enable him or her to evaluate the merits of the franchisor's claim." *Id.*

See the Federal Trade Commission's "*Statement of Basis and Purpose Relating to Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures,"* Bus. Franchise Guide (CCH) ¶ 6300, *et seq*.

As a result, by the late 1970s, the sale of franchises came to be regulated in much the same fashion as the sale of securities under SEC Rule 10b-5.[1] In 1979, the FTC adopted a trade regulation rule governing the sale of franchises that is roughly modeled on the SEC Act. *See* 16 C.F.R. Part 436 (the "FTC Franchise Rule"). The FTC Franchise Rule requires a franchisor to provide a prospective franchisee with certain disclosures, contained in a written offering circular (not unlike a prospectus), prior to the purchase of the franchise.

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[1] Rule 10b-5 of the Securities and Exchange Commission (codified at 17 C.F.R. 240.10b-5) is one of the most important rules targeting securities fraud by the SEC, pursuant to its authority granted under section 10(b) of the Securities Exchange Act of 1934. The rule prohibits any act or omission resulting in fraud or deceit in connection with the purchase or sale of any security. Rule 10b-5 provides that it shall be unlawful for any person, in connection with the purchase or sale of any security, "(a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."

B. States Legislatures Have Followed the FTC's Lead in Establishing Regulatory Frameworks Governing Franchisors' Sales of Franchises.

Certain states, including Indiana and Illinois, have parallel legislation and provide franchisees with the right to civil remedies if a franchisor, or its principals, fail to make required disclosures, or make misleading statements or omissions in connection with a franchise sale.[2] *See, e.g.,* the Indiana Franchise Act, Ind. Code § 23-2-2.5, *et seq*. The Indiana Franchise Act is expressly modeled on the anti-fraud rules which govern the sale of securities. *See* Ind. Code § 23-2-2.5-27.[3]

C. During the Relevant Time Period, Franchisors were Obligated to Make Written Disclosures in Compliance with the UFOC Guidelines.

Through July 1, 2008, the FTC permitted franchisors to make the required disclosures through a document called the Uniform Franchise Offering Circular or

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[2] Because the franchise sales involved in this case took place in Indiana and Illinois, Plaintiffs are entitled to the protections of the statutes governing the sale of franchises to residents of those two states.

[3] The anti-fraud provision of the Indiana Franchise Act mirrors SEC Rule 10b-5, and provides that: "It is unlawful for any person in connection with the offer, sale or purchase of any franchise, or in any filing made with the commissioner, directly or indirectly: (1) to employ any device, scheme or artifice to defraud; (2) to make any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of circumstances under which they are made, not misleading; or (3) to engage in any act which operates or would operate as a fraud or deceit upon any person."

"UFOC."[4] *See* 16 C.F.R. Part 436. The Midwest Securities Commissioners Association adopted the so-called "UFOC Guidelines" in 1974.[5]

At all times relevant hereto, the franchisor's disclosure obligations to prospective franchisees under federal and state law could be satisfied by providing the prospective franchisee with an offering circular known as the UFOC – but only so long as the franchisor complied with the disclosure obligations contained in the "UFOC Guidelines," a standard set of disclosure protocols accepted by the FTC and state regulatory authorities for purposes of franchise disclosure. *See* Bus. Franchise Guide (CCH) ¶¶ 5751-5782 and 6227.[6]

The UFOC Guidelines require a franchisor to make disclosure with respect to 23 different "Items" of information, including the nature of the franchise; the principals who own and run it; the costs of obtaining or operating the franchise; the existence of litigation in which the franchisor has been involved; the material terms of the contract; the existence of other franchisees and their locations; and, if the franchisor chooses to

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[4] On January 22, 2007, the FTC amended its requirements related to disclosure. The Amended Rule became effective on July 1, 2007, however, permission to use the FTC Franchise Rule and UFOC Guidelines formats continued through June 30, 2008. The revised disclosure document, formerly known as the UFOC, is now referred to as the Franchise Disclosure Document ("FDD"). At the time of the disclosures required herein, the FTC Franchise Rule controlled, and the disclosure document required was the UFOC.

[5] The North American Securities Administrators Association now administers the UFOC Guidelines.

[6] The FTC "determined that, in the aggregate, the disclosures required by the UFOC format provide protection to prospective franchisees which is equal to or greater than that provided by the [FTC Franchise] rule. As a result, and in an effort to minimize compliance burdens, the Commission will permit the UFOC to be used in lieu of the disclosure requirements" of the FTC Franchise Rule, however, "[e]ither the rule or the UFOC disclosure format must be used in its entirety." *See* Bus. Franchise Guide (CCH) ¶ 6227.

provide information on the financial performance of its outlets, a fair presentation of those figures, and the factual bases therefor.

1. Any Franchisor Electing to Make "Earnings Claims" is Obligated to Do So in Accordance with the "Instructions" Governing Disclosures Captured in Item 19.

Item 19 of the UFOC Guidelines governs both: (a) the manner in which a franchisor may disclose information about the revenues or profitability of its existing franchised units, and (b) the manner in which a franchisor may fashion projections of the performance of yet-to-be-established franchises. A franchisor's disclosure of such claims and information – referred to as "earnings claims" under the UFOC Guidelines – is governed by the black-letter "Instructions" identified within the UFOC Guidelines relating to the preparation of an Item 19 disclosure. *See* Bus. Franchise Guide (CCH) ¶ 5771.

A franchisor's Item 19 disclosure "is one of the most important sections [of the UFOC] to franchisees"[7] because it deals with the question most frequently posed by prospective franchisees, "How much money can I make?" Because this question and its corollaries (*e.g.*, what can I expect my sales to be; what are my costs likely to be; what kind of profits do franchisees like me typically experience?") are so important, the way in which a franchisor can lawfully answer these questions is the most heavily regulated part of the franchise sales process.

The FTC, in the Statement of Basis and Purpose that was promulgated with the FTC Rule, specifically recognized the dangers of earnings claims, noting:

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[7] Dave Thomas and Michael Seid, *Franchising for Dummies* 90 (2000).

> The record indicates that franchisors have often made deceptively glowing earnings projections or forecasts to prospective franchisees without having information which constituted a reasonable basis in fact for making such claims ... Also, a number of the complaints contained in the public record indicate that some franchisors used data concerning franchisees with atypical earnings to represent the potential profitability of the franchise being offered.

Bus. Franchise Guide (CCH) ¶ 6307 (emphasis added).

The UFOC Guidelines' Item 19 Instructions broadly define an "earnings claim" as follows:

> "Earnings claim" means information given to a prospective franchisee by, on behalf of or at the direction of the franchisor or its agent, from which a specific level or range of actual or potential sales, costs, income or profit from franchised or non-franchised units may be easily ascertained.
>
> A chart, table or mathematical calculation presented to demonstrate possible results based upon a combination of variables (such as multiples of price and quantity to reflect gross sales) is an earnings claim subject to this item ...

See UFOC Guidelines to Item 19, Instruction (i). Earnings claims include both "formal" representations of revenues or profits in dollar figures, such as *pro formas*, but also indirect representations, such as a hotel's occupancy rate and informal statements, such as "You'll make enough to buy a Porsche." *Commercial Prop. Invs. v. Quality Inns Int'l, Inc.*, 938 F.2d 870, 872 (8th Cir. 1991); Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures; Promulgation of Final Interpretive Guidelines, 44 Fed. Reg. 49,982 (August 24, 1979).

The Item 19 Instructions, likewise, define a "supplemental earnings claim" – *i.e.*, a financial performance claim not set forth within Item 19 – as follows:

> If a franchisor has made an earnings claim in accordance with this Item 19, the franchisor may deliver to a prospective franchisee a supplemental earnings claim directed to a particular location or circumstance, apart from the offering circular. The supplemental earnings claim must be in writing,

> explain the departure from the earnings claim in the offering circular, be prepared in accordance with this item 19, and be left with the prospective franchisee.

See Bus. Franchise Guide (CCH) ¶ 5771, UFOC Guidelines to Item 19, Instruction (ii) (emphasis added).[8]

a. Franchisors are Under No Obligation to Make an "Earnings Claim."

As an initial matter, a franchisor is under no obligation to make an "earnings claim" for purposes of its UFOC disclosures. Item 19 of the UFOC Guidelines makes clear that a franchisor is under no obligation to make an earnings claim. *See* Bus. Franchise Guide (CCH) ¶ 5771, the UFOC Guidelines to Item 19, Instruction (iii) (stating "An earnings claim is not required in connection with the offer of franchises; if made, however, its presentation must conform with this Item 19. If an earnings claim is not made, then negative disclosure 19 (below) must be used.").[9]

b. Franchisors That Choose to Make an "Earnings Claim" Must do so Only in Compliance with the UFOC Guidelines for Item 19.

If the franchisor does elect to make an earnings claim, it must do so only in compliance with the UFOC Guideline Instructions with respect to the presentation of a disclosure pursuant to Item 19. The format and requirements for the presentation of any

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[8] Accordingly, any earnings claim information prepared by Ace which did not appear within the UFOC at Item 19 also needed to "be prepared in accordance with … Item 19." As more fully explored below, Ace did not make any meaningful effort to comply with Item 19's requirements for purposes of the *pro forma* projections crafted by Ace.

[9] If a franchisor elects *not to make an earnings claim* as part of its Item 19 UFOC disclosures, the franchisor is obligated to make a "negative disclosure" within Item 19 that reads: "[Franchisor] does not furnish or authorize its salespersons to furnish any oral or written information concerning the actual or potential sales, costs, income or profits of a [franchised unit]. Actual results vary from unit to unit and [Franchisor] cannot estimate the results of any particular franchise." *See* UFOC Guideline Instructions to Item 19(A).

"earnings claim" information which a franchisor may elect to present are governed by black-letter rules. *See* Bus. Franchise Guide (CCH) ¶ 5771.

Ace was not obliged to make any "earnings claim" (other than making the "negative disclosure" described in footnote 9) in order to comply with its Item 19 disclosure obligations. However, because Ace affirmatively elected to make an earnings claim, Ace was obligated to prepare both the Item 19 earnings claim (which appeared in the UFOCs presented to Plaintiffs) and the supplemental earnings claims (appearing in the *pro formas* presented to Plaintiffs) according to the precise requirements of the UFOC Guidelines relating to Item 19 earnings claims.

Ace elected to utilize the UFOC Guidelines format to make disclosure to Plaintiffs. Consequently, Ace was obliged to honor the UFOC Guidelines in both: (a) the earnings claim that appeared in Item 19 of Ace's UFOC documents; and (b) the *pro formas* presented to Plaintiffs. As more fully set forth below, Ace failed to meet its obligations in both respects.

i. Any earnings claim must have a "reasonable basis."

The UFOC Guidelines for Item 19(A) require that any earnings claim must have a "reasonable basis," stating that: "An earnings claim made in connection with an offer of a franchise must be included in full in the offering circular and must have a reasonable basis at the time it is made. If no earnings claim is made, Item 19 of the offering circular must contain the negative disclosure prescribed in the instruction."

What is regarded as a "reasonable basis" for a financial performance projection by a franchisor? As reflected in the FTC's "Interpretive Guides" for Item 19, in order to conclude that a franchisor has a "reasonable basis" for its earnings claim:

> The data must reasonably support the claim as it is likely to be understood by a reasonable prospective franchisee. For example, a representation that franchisees earn a net profit of $30,000 per year implies that such figure is representative of the usual experience of the system's franchisees. The claim would not have a reasonable basis if, in fact, only a small minority of the franchisees earn such amount or if profits were due to nonrecurring conditions or if the franchisees used inconsistent systems for reporting profit. Moreover, the franchisor would not have a reasonable basis for the claim if the only facts to support it were the income statements of a disproportionately small percentage of the system's franchisees.

See Bus. Franchise Guide (CCH) ¶ 6255 (emphasis added).[10]

In the UFOCs prepared by Ace, however, Ace represented that its earnings claim (allegedly) captured the financial performance of only 37-41% of Ace's franchised units (*see* A. 141 and 372). And, in the *pro formas* crafted by Ace, Ace likewise failed to identify the percentage of units "in operation" which enjoyed the financial results described in the *pro formas*.

By definition, Ace's earnings claim cannot be said to have a "reasonable basis" given that "only a small minority of the franchisees earn[ed]" the amounts identified in Ace's Item 19 earnings claims. Accordingly, the Circuit Court erred by dismissing Plaintiffs' claims rather than concluding that Ace had failed to identify a "reasonable basis" for its Item 19 and *pro forma* earnings claims.

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[10] The Instructions for Item 19(A)(iv) also specify that: "A statement or prediction of future performance that is prepared as a forecast or projection in accordance with the statement on standards for accountants' services on prospective financial information (or its successor) issued by the American Institute of Certified Public Accountants, Inc., is presumed to have a reasonable basis." *See* Bus. Franchise Guide (CCH) ¶ 5771. Note, however, that Ace has never alleged that the *pro forma* projections prepared by Ace were prepared in compliance with accounting standards promulgated by the AICPA.

ii. Any earnings claim must include a description of its factual basis, along with four "basic disclosures" catalogued under Item 19, Instruction (B)(ii).

The UFOC Guidelines for Item 19(B) provides that: "An earnings claim shall include a description of its factual basis and the material assumptions underlying its preparation and presentation." *See* Bus. Franchise Guide (CCH) ¶ 5771.

A "factual basis" is defined as including:

> significant matters upon which a franchisee's future results are expected to depend. This includes, for example, economic or market conditions which are basic to a franchisee's operation and encompass matters affecting, among other things, franchisee's sales, the cost of goods or services sold and operating expenses. In the absence of an adequate operating experience of its own, a franchisor may base an earnings claim upon the results of operations of a substantially similar business of a person affiliated with the franchisor or franchisees of that person; provided that disclosure is made of any material differences in the economic or market conditions known to, or reasonably ascertainable by, the franchisor.

See Bus. Franchise Guide (CCH) ¶ 5771 at "Instructions" for Item 19(B)(i).

The UFOC Guideline "Instructions" for Item 19(B) expressly provide that the earnings claim disclosure must also, for purposes of identifying its factual basis, include certain "basic disclosures" including all of the following:

a. a description of the material assumptions, other than matters of common knowledge, underlying the claim;

b. a concise summary of the basis for the claim, including a statement of whether the claim is based upon actual experience of franchised units and, if so, **the percentage of franchised outlets in operation for the period covered by the earnings claim that have actually attained or surpassed the stated results**;

c. a conspicuous admonition that a new franchisee's individual financial results are likely to differ from the results stated in the earnings claim; and

d. **a statement that substantiation of the data used in preparing the earnings claim will be made available to the prospective franchisee on reasonable request.**

See Bus. Franchise Guide (CCH) ¶ 5771 at "Instructions" for Item 19(B)(ii)(a)-(d) (emphasis added).

A franchisor must comply with <u>all</u> of the above-described requirements if the franchisor elects to make an Item 19 earnings claim. Yet, while Ace arguably complied with its obligation to conspicuously admonish that Plaintiffs' "financial results are likely to differ from the results stated in the earnings claims" as set forth in the UFOCs and *pro formas*, Ace cannot credibly claim to have complied with all of the foregoing Item 19(B)(ii) requirements.

As an initial matter, Ace did not identify "the percentage of franchised outlets in operation for the period covered by the earnings claim that have actually attained or surpassed the stated results." Ace, instead, identified only the Ace Vision 21 Stores, a subset of franchised units, from which Ace allegedly received financial performance data. Upon electing to make an earnings claim, Ace was obligated to identify what percentage of all units in operation were enjoying the (alleged) financial performance documented in Item 19 and the *pro formas*. Ace, instead, merely identified the percentage of franchised units from which Ace had allegedly sourced financial information. As a result, Ace failed to make the "basic disclosure" required by Item 19 Instruction (B)(ii)(b).

Ace also failed to comply with its obligation to make the "basic disclosure" required by Item 19 Instruction (B)(ii)(d). In neither its UFOCs nor its *pro formas* did Ace include "a statement that substantiation of the data used in preparing the earnings claim will be made available to the prospective franchisee on reasonable request." At

best, Ace may be characterized as having offered the following: "Individual store data is confidential, but summary data used in preparing the Statements of Average Store Performance will be made available to prospective franchisees upon reasonable request." (*See* the UFOCs at A. 142 and 373; Ace's *pro formas* included no similar statements.)

Ace's offer to provide "summary data" flies in the face of the express requirements of Item 19 Instruction (B)(ii)(d). As expressed by the FTC in its Interpretive Guide with respect to Item 19 disclosures, "the data upon which the franchisor bases its claims must be capable of independent examination and verification." *See* Bus. Franchise Guide (CCH) ¶ 6255. Ace affirmatively expressed its unwillingness to allow the Plaintiffs to independently verify Ace's data by characterizing its franchisees' financial performance data as "confidential."

To the extent that Ace wished to protect its franchisees' identities, the FTC had affirmatively counseled franchisors that: "In order to protect franchisees from unwarranted disclosure of sensitive financial information the franchisor may delete any identifying information from which the identity of the franchisee can be obtained by the prospective franchisee." *See* Bus. Franchise Guide (CCH) ¶ 6256. Ace, instead, chose to ignore the FTC's recommendation and characterize all of the underlying financial performance data as "confidential" rather than allowing Plaintiffs to review such underlying data (albeit presented without any name identification of the franchisees which enjoyed such financial performance).

The Circuit Court's dismissal of Plaintiffs' claims should be reversed because, had Ace complied with its disclosure obligation, Plaintiffs might never have been persuaded to make a franchise purchase in the first instance.

iii. Ace should not be rewarded for its wide-ranging failures to prepare its earnings claims in compliance with the UFOC Guidelines for Item 19.

Ace failed to honor its disclosure obligations under the UFOC Guidelines for Item 19 in at least six ways, including:

(a) Making an Item 19 earnings claim (within the UFOCs) in the absence of a "reasonable basis" for doing so;

(b) Making an earnings claim in the *pro formas* in the absence of a "reasonable basis" for doing so;

(c) Making an Item 19 earnings claim (within the UFOCs) regarding the revenue generated by a subset of existing franchisees in Item 19 without identifying the "percentage of franchised outlets in operation for the period covered by the earnings claim that have actually attained or surpassed the stated results" as required by UFOC Guideline 19(A);

(d) Making an earnings claim in the *pro formas* regarding the revenue generated without identifying the "percentage of franchised outlets in operation for the period covered by the earnings claim that actually attained or surpassed the stated results" as required by UFOC Guideline 19(A);

(e) Failing to include in the UFOCs "a statement that substantiation of the data used in preparing the earnings claim will be made available to the prospective franchisee on reasonable request;"[11] and

(f) Failing to include in the *pro formas* "a statement that substantiation of the data used in preparing the earnings claim will be made available to the prospective franchisee on reasonable request."

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[11] Ace, instead, incorporated in the UFOCs presented to Plaintiffs a passage stating that: "Individual store data is confidential, but summary data used in preparing the Statements of Average Store Performance will be made available to prospective members upon reasonable request." (*See* A. 142 and A. 373.) Stated differently, Ace made only the summary data available to Plaintiffs and categorically refused to provide Plaintiffs the underlying data received from that limited subset of franchisees that purportedly submitted "confidential" financial performance data to Ace. Qualifying the opportunity to request the underlying financial data is not in keeping with the UFOC Guideline Instructions for the preparation and presentation of an Item 19 disclosure. Making only the summary data available to Plaintiffs deprived Plaintiffs of the opportunity to perform the sort of additional due diligence that the UFOC Guidelines with respect to Item 19 requires.

While it is true that Ace did include the "conspicuous admonition" contemplated in the UFOC Guideline Instructions for Item 19(B)(ii)(c) – requiring admonishment that franchisee may not do as well as suggested by the earnings claim – this limited compliance alone cannot shield Ace from liability for the flagrant manner in which Ace, otherwise, disregarded its discovery obligations. Any contrary ruling by this Court would effectively swallow the rule by allowing a franchisor to make otherwise-misleading earnings claims so long as the "conspicuous admonition" language is included somewhere in the financial information presented by the franchisor.[12]

The better result, here, would be to reverse the Circuit Court and allow the Plaintiffs' statutory and common law claims to be resolved based on the facts as developed in discovery.

D. Plaintiffs Reasonably Relied on the Material Financial Information that Ace Provided to Them, which Information Contained Key Misrepresentations and Omissions.

"All prospective franchisees want to know how much money they will make if they invest in a franchise. Who is better suited to tell them than the franchisor?" Dave Thomas and Michael Seid, *Franchising for Dummies* 93 (2000). As recognized by the FTC, "information necessary to test the accuracy of [the franchisor's] representations lies almost solely within the possession of the franchisor." *See* Bus. Franchise Guide (CCH) ¶ 6,307. Because financial performance information is *per se* material, and the franchisor is in the best position to provide accurate financial performance information, it is imperative that the franchisor provide full and fair disclosure, including having a

[12] It simply does not follow that the "conspicuous admonition" required under the UFOC Guidelines can completely negate any reliance by the prospective franchisee on the remainder of the representation when the focus of the UFOC is to provide the prospective franchisee with reliable information upon which to base its decision.

reasonable basis for the information. *See FTC v. Minuteman Press*, 53 F. Supp. 2d 248, 258 (E.D.N.Y. 1998) (providing that making false gross sales and profit claims are material misrepresentations); UFOC Guidelines for Item 19(A), Bus. Franchise Guide (CCH) ¶ 5771 (requiring the franchisor to have a reasonable basis for the earnings claim).

Because of the materiality of such information, the presentation of such financial performance information is highly regulated. If the Circuit Court's decision stands, it would eviscerate the protections specifically promulgated to prevent such conduct. Allowing the Circuit Court's decision to stand would act as a license for franchisors to flat out lie, as long as the franchisor did not present the lie as a "guarantee" of the franchisee's financial performance. Because the Circuit Court's decision runs afoul of the UFOC Guidelines, applicable statutory protection, common law, and public policy, the decision should be reversed.

E. The Circuit Court Erred in Determining that Plaintiffs' Reliance on the Financial Information in the UFOC was Unreasonable.

Given that a UFOC is a legally-required disclosure document under both federal and state law, it was inherently reasonable for Plaintiffs to rely upon the financial information in the UFOC. *Motor City Bagels, L.L.C. v. Am. Bagel Co.*, 50 F. Supp. 2d 460, 473 (D. Md. 1999) ("[P]laintiffs could prove that their reliance was reasonable as the factual misrepresentation occurred in [franchisor's] official disclosure document, which is required under both state and federal law."); *Carousel's Creamery, L.L.C. v. Marble Slab Creamery, Inc.*, 134 S.W.3d 385, 395 (Tex. App. 2004) (The court reasoned that the plaintiff had relied on the cover page of the UFOC which stated that the FTC had set rules and regulations requiring that the information contained in the UFOC be

truthful, accurate, and concise; accordingly, it was reasonable for the plaintiff to expect that the UFOC would be accurate and not presented in a misleading fashion).

Indeed, in 2007, the FTC expressly amended its Franchise Rule to prohibit franchisors from disclaiming franchisees' reliance on representations made in the UFOC (now referred to as a "Franchise Disclosure Document"). 16 C.F.R. § 436.9(h); Bus. Franchise Guide (CCH) ¶ 6019. The Amended FTC Franchise Rule states it is an unfair and deceptive trade practice for a franchisor to:

> Disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments. Provided, however, that this provision is not intended to prevent a prospective franchisee from voluntarily waiving specific contract terms set forth in his or her disclosure document during the course of franchise sales negotiations.

16 C.F.R. § 436.9(h); Bus. Franchise Guide (CCH) ¶ 6019. While this provision was not expressly stated in the FTC Franchise Rule at the time Ace provided the UFOCs to the Plaintiffs, such an amendment illustrates the intent behind the Rule. Thus, what was implicit before has now been made explicit.

Moreover, contrary to the Circuit Court's statement, Plaintiffs *did not* warrant that they were not relying on any of the financial information provided in the *pro forma* statements or UFOCs. (A. 06.) Instead the agreements merely provide that: (1) Plaintiffs conducted an independent investigation; (2) no representations were made that were contrary to any disclosure document (*i.e.*, the UFOC); and (3) Plaintiffs were not relying upon any *guarantee* of the sales, revenues, profits or success of the business venture (A. 283 at ¶ 11; A. 284 at ¶ 9; A. 455 at ¶ 11; A. 463 at ¶ 9 (emphasis added).)

Plaintiffs' representation that they conducted an independent investigation does not mean that Plaintiffs did not rely on what Ace represented. Franchisors are in the best

position to know what Ace stores are realizing in terms of revenues, expenses, and cash flows — not prospective franchisees. Plaintiffs do not claim that the information they received is contrary to the disclosure document; rather, Plaintiffs have stated that they are relying upon the disclosure document — *i.e.*, the UFOC, which also contemplated the provision of a *pro forma* (*e.g.*, A. 142 "Pro forma income statements are used internally by us, primarily to review and determine the creditworthiness of the prospective Member …. These pro forma financial statements constitute supplemental earnings claims."). Furthermore, Plaintiffs do not contend that they understood the UFOC or *pro formas* to constitute a *guarantee*. They did, however, understand them to present financial information in a full, complete, non-misleading manner that accurately reflected the typical, historical performance of similarly-situated Ace Vision 21 Stores.

Because the laws regulating the sale of franchises require a franchisor to make full and fair disclosures regarding the opportunity being sold, it was inherently reasonable for Plaintiffs to rely on the financial information in Item 19 as complete and accurate information related to the "average" store performance. Unfortunately, such information turned out to be misleading because the averages were based upon cherry-picked, successful stores. Ace should not be allowed to escape liability for presenting such misleading information based on disclaimers in the UFOCs and Franchise Agreements, because such a result would be contrary to the fundamental purpose of the laws enacted to prevent such abuses. *See Statement of Basis and Purpose*; Bus. Franchise Guide (CCH) ¶ 6307 (The FTC Franchise Rule was aimed, in part, at addressing "complaints contained in the public record indicate that some franchisors used data concerning franchisees with *atypical earnings* to represent the potential profitability of the franchise

being offered") (emphasis added). Finally, because the disclaimers in the UFOC and Membership and Brand Awareness Agreements do not state that Plaintiffs were not relying on the UFOC or *pro formas* to be an accurate reflection of existing facts, the disclaimers do not negate reasonable reliance.

F. The Circuit Court Erred in Determining that the *Pro Formas* Could Not Form the Basis for a Fraud Claim Because They Were Future Projections.

"A false representation and promise as to what will result in the future, when made by one professing to have superior knowledge, based on experience, may support allegations of fraud, and a statement of a matter in the future, if affirmed as a fact, may constitute a fraudulent misrepresentation…." 19A Ill. Law and Practice, Fraud § 21 (citing *Phil Dressler & Assocs., Inc. v. Old Oak Brook Inv. Corp.*, 192 Ill. App. 3d 577, 139 Ill. Dec. 629 (2d Dist. 1989) ; *Duhl v. Nash Realty Inc.*, 102 Ill. App. 3d 483, 57 Ill. Dec. 904 (1st Dist. 1981) ; *Louis v. Louis*, 124 Ill. App. 2d 325 (1st Dist. 1970)). *Pro formas* can serve as the basis for a fraud claim "if they failed to reflect past or present facts." *Berg v. Xerxes-Southdale Office Bldg. Co.*, 290 N.W.2d 612, 615 (Minn. 1980).

Plaintiffs allege that the *pro formas* did not accurately project the performance of their stores, because Ace knew, based on the past performance of actual, similar existing stores, that the *pro formas* painted an overly rosy picture of what Plaintiffs were likely to experience. (A. 11) Furthermore, Ace represented the *pro formas* "as fact." (A. 11 at ¶ 2, "Ace claimed that it could predict performance of Vision 21 stores with over ninety percent accuracy. Utilizing data it represented reflected actual store performance and what it represented were tried and true methods of making accurate projections, Ace represented that Vision 21 stores would generate positive cash flows in their first year of operation.") *See FTC v. Minuteman Press*, 53 F. Supp. 2d 248, 258 (E.D.N.Y. 1998)

(Defendants violated the FTC Franchise Rule by "making false gross sales and profitability claims to prospective … franchisees. Such misrepresentations — which tend to bear directly on the economic viability of the transaction under consideration — are both likely to deceive and material").

Because the *pro formas* were presented as if they were "fact," and the *pro formas* did not accurately reflect existing fact – what similarly situated Ace Vision 21 Stores had actually, historically experienced – the *pro formas* appropriately form the basis of common law and statutory fraud claims.

G. The Disclaimers Do Not Negate Reasonable Reliance Because They Were Not Specifically Tailored to Contradict the Claimed Misrepresentations.

Disclaimers may only preclude Plaintiffs from establishing reasonable reliance on Ace's misrepresentations if the disclaimers are specifically tailored to contradict the claimed misrepresentations. *Lucas v. Downtown Greenville Investors Ltd. P'ship*, 284 Ill. App. 3d 37, 49 (2d Dist. 1996). When the disclaimers that Ace relies upon to defeat Plaintiffs' claims are carefully dissected, it becomes apparent that the disclaimers simply provided that: (1) there was no "guarantee" that Plaintiffs would achieve the financial performance; (2) the investment involves business risk; (3) the projections were only "estimates"; and (4) that there were no assurances that Plaintiffs would do as well as the earnings claims representations.

Importantly, Plaintiffs did not understand the financial information in Item 19 or the *pro formas* to be a "guarantee" or "assurance" that they would realize those results. Instead, Plaintiffs expected that the Item 19 financial performance representation reflected the actual averages that Ace stores were experiencing — and not just what the highest performing stores were experiencing. (A. 11.) Similarly, Plaintiffs also

understood the *pro formas* to project what their stores were likely to do based on the historical performance of similar, existing stores. (A. 11.)

The disclaimers did *not* provide that: (1) the Item 19 disclosures painted an overly rosy picture of how Ace stores were performing based on the cherry picking of certain successful stores and that such disclosures were not an accurate reflection of what the "average" financial performance of Ace stores actually was; or (2) the *pro formas* were based on manipulated numbers to show a positive cash flow, were not reflective of the actual, historical operating performance of typical Ace stores, and that Plaintiffs were not likely to achieve them based on Ace's knowledge of the past performance of existing, similar stores.

Moreover, Plaintiffs never signed a disclaimer stating that Plaintiffs were aware that Ace was not complying with applicable federal and state law and that Plaintiffs were waiving such non-compliance with applicable law (which waiver, nevertheless, would have been void under the applicable state Acts due to the Acts' anti-waiver provisions). Similarly, Plaintiffs never signed a disclaimer stating that they knew Ace was omitting material pieces of information, including failing to present material information required by federal and state law, for example, failing to identify the percentage of units "in operation" which enjoyed the financial results described in the *pro formas*.

Since these types of direct, specifically tailored disclaimers were not made, such disclaimers cannot negate justifiable reliance as a matter of law.

H. The Circuit Court Erred in Misapplying the Bespeaks Caution Doctrine.

The "bespeaks caution" doctrine "stands for the proposition that statements made in securities offerings must be analyzed in context." *Lucas*, 284 Ill. App. 3d at 49. Only

if the cautionary statements are sufficiently substantive and specifically tailored to the projections can the misrepresentations and omissions be considered "immaterial." *Id.* As noted above, the disclaimer clauses were not sufficiently tailored to the projections, nor sufficiently substantive, to make the misrepresentations and omissions immaterial. In no way did the disclaimers provide that the averages in the Item 19 disclosure were significantly inflated by the fact that certain successful stores were cherry picked while failing stores were specifically excluded, nor did the disclaimers state that the numbers on the *pro forma* were not representative of what other similarly situated Ace stores had historically experienced.

The Circuit Court applied the bespeaks caution doctrine to both the Item 19 earnings claims and the *pro formas*. The Circuit Court should not have applied the doctrine to either of these sets of financial information.

With regard to the Item 19 earnings claims, such financial information regarded the *past* performance of certain cherry-picked Ace stores. The bespeaks caution doctrine applies "only to misstatements relating to economic projections, estimates of *future performance*, and similar optimistic statements contained in the prospectus." *Lucas*, 284 Ill. App. 3d at 49 (emphasis added).

As to the *pro formas*, the Circuit Court also erred in its application because "the bespeaks caution doctrine does not protect forward-looking statements made with actual knowledge of their falsity at the time they are made." *Payne v. DeLuca*, 433 F. Supp. 2d 547, 561 (W.D. Pa. 2006). Ace knew that the *pro formas* were not an accurate depiction of the past performance of similarly situated stores, which Ace claimed the projections were based upon.

In sum, the Circuit Court erred in applying the bespeaks caution doctrine because: (1) the disclaimers were not sufficiently substantive and specifically tailored to the projections; (2) the doctrine only applies to forward-looking statements, and the UFOC Item 19 disclosure was about historical operating results; and (3) the doctrine is inapplicable to even forward looking statements if the representations are based on actual knowledge of their falsity, and Ace knew that the *pro formas* did not accurately reflect the actual, historical operating results of similarly situated Ace stores.

I. As a Matter of Public Policy, Franchisors Should Not Be Able to Provide False and Misleading Financial Performance Representations and then Escape Liability Based on Cleverly Drafted Disclaimers.

The Circuit Court erred when it dismissed Plaintiffs' claims under the Illinois Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505/1, *et seq.*, and the Indiana Franchise Act, Ind. Code. §23-2-2.5-1 *et seq*.

The Illinois Consumer Fraud and Deceptive Business Practices Act ("Illinois Act") expressly states it "shall be liberally construed." 815 Ill. Comp. Stat. 505/11a. This led an Appellate Court in this District to state that it must be "acutely mindful of the Act's broad, remedial nature and accordingly afford it liberal construction to effectuate its intended purposes." *Johnston v. Anchor Org. for Health Maint.*, 250 Ill. App. 3d 393, 396 (1st Dist. 1993). The legislature intended the Illinois Act to expand the rights of plaintiffs and provide greater protection than a common law claim of fraud. *Totz v. Cont'l Du Page Acura*, 236 Ill. App. 3d 891, 901 (2d Dist. 1992). Indeed, Section 505/11a has been construed as a "clear mandate" that courts must use the Illinois Act "to the greatest extent possible to eliminate all forms of deceptive or unfair business practices." *Id.*

Similarly, the Indiana Franchise Act states that:

> all provisions of this chapter … shall be liberally construed to the end that the practice or commission of fraud may be prohibited and prevented, disclosure of sufficient and reliable information in order to afford reasonable opportunity for the exercise of independent judgment of the persons involved may be assured, in connection with the issuance, barter, sale, purchase, transfer or disposition of franchises in this state.

Ind. Code § 23-2-2.5-47. The remedial nature of the Indiana Franchise Act, as directly stated in the statute, leads to the conclusion that it must be construed so that not only the letter of the statute but also the spirit of the statute (*i.e.*, full, accurate disclosure) must be followed.

Allowing a franchisor to selectively disclose financial performance of certain franchisees and negate any wrongful behavior through a general disclaimer goes against the liberal construction to be afforded both the Illinois Act and the Indiana Franchise Act. Certainly, the "clear mandate" cannot be effectuated if a general disclaimer can be used to negate any wrongful act on the part of a franchisor.

Further, the Indiana Franchise Act contains an anti-waiver provision that prohibits a franchisor from "[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. . . ." Ind. Code § 23-2-2.7-1(5). Likewise, the Illinois Act contains an anti-waiver provision that provides: "Any waiver or modification of the rights, provisions, or remedies of this Act shall be void and unenforceable." 815 ILCS 505/10c.

In the case of *Randall v. Lady of Am. Franchise Corp.*, 532 F. Supp. 2d 1071, 1088 (D. Minn. 2007), the court analyzed the effect of a similar anti-waiver provision under the Minnesota Franchise Act ("MFA") and ultimately concluded that disclaimers and integration clauses cannot be used to negate reasonably reliance because allowing

such clauses to negate reasonable reliance would have *the effect* of waiving a franchisee's claims.

In *Randall*, a group of individual franchisees sued their franchisor and alleged, among other things, that the franchisor had violated the MFA by making pre-sale misrepresentations in violation of Minn. Stat. § 80C.13. 532 F. Supp. 2d at 1074-75. The franchisor then moved for summary judgment, arguing that the disclaimers[13] in the FDD and the franchise agreement prevented the franchisees from establishing that they reasonably relied on the franchisor's misrepresentations. *Id.* In denying the franchisor's motion for summary judgment on the MFA claims, the court had this to say about the relationship between Minn. Stat. § 80C.21 and the franchisor's use of disclaimers:

> The plain language of § 80C.21 is consistent with the broad scope intended by the legislature and advocated by plaintiffs. Section 80C.21 voids anything in a contract that explicitly waives compliance with a provision of the [MFA] or that has the <u>*effect*</u> of waiving compliance with a provision of the [MFA]. One such provision that cannot be waived is § 80C.13's prohibition of material false statements.
>
> Section 80C.13's scope is clear. The provision would, for example, prohibit a dishonest franchisor from telling a franchisee that all existing franchise locations had gross annual sales of at least $1 million, when in fact no location had gross sales over $250,000. And it is equally clear that, under § 80C.21, the dishonest franchisor could not avoid § 80C.13's prohibition by including the following in the franchise agreement: "I may have misrepresented the revenues of existing franchises. You waive your right to hold me liable for those misrepresentations under § 80C.13 of the [MFA]." Such a provision would plainly be invalid under § 80C.21.
>
> Under § 80C.21, any provision that has the same "effect" as this waiver would also be invalid. Suppose, for example, that the dishonest franchisor

[13] The franchisor in *Randall* required its prospective franchisees to sign a host of disclaimers, including disclaimers stating that the franchisor had not made any representations to the prospective franchisees "concerning the actual or potential sales, costs, income or profits of your Franchise." 532 F. Supp. 2d at 1075. Despite making this representation, the evidence showed that the franchisor did, in fact, make representations (which turned out to be false) concerning actual or potential sales, costs, income and profits to the franchisees. *Id.*

> included in the franchise agreement not the express waiver provision quoted in the preceding paragraph, but rather the following: "I did not make any representations about the revenues of existing franchises. If you disagree, I hereby disclaim any representations that you believe I made. You cannot rely on them." Why should such a disclaimer, for purposes of Minnesota's franchise law, be treated any differently from the express waiver? The disclaimer cannot change the historical facts; if the dishonest franchisor made misrepresentations, then he made misrepresentations, no matter what the franchise agreement says. Thus, the disclaimer can only be an attempt to change the <u>*legal effect*</u> of those misrepresentations. That is precisely what § 80C.21's anti-waiver language forbids.

Id. at 1088-89 (emphasis in original).

The *Randall* court then concluded that "franchisor[s] cannot use contractual provisions to protect themselves from being sued for misrepresentation under the [MFA]" because such provisions have the <u>*effect*</u> of waiving compliance with the MFA and are, therefore, void under Minn. Stat. § 80C.21. *Id*. at 1089; *see also Arnold v. Nat'l Aniline & Chemical Co.*, 20 F.2d 364, 369 (2d Cir. 1927) ("[I]t would defeat the securities laws if parties could escape liability for their own deliberate misrepresentations by inserting boilerplate disclaimers into offering materials"); *Cousins Subs Sys., Inc. v. Better Subs Dev., Inc.*, No. 09-C-0336, 2011 WL 4585541 (E.D. Wis. Sept. 30, 2011) (refusing to grant summary judgment to franchisor on franchisee's fraud claim, despite presence of disclaimer, no-reliance, and integration clauses); *D.T. Woodard, Inc. v. Mail Boxes Etc., Inc.*, No. B228990, 2012 WL 90084 (Cal. Ct. App. Jan. 12, 2012) ("A party to a contract who has been guilty of fraud in its inducement cannot absolve itself from the effects of its fraud by any stipulation in the contract that no representations have been made."); *Besett v. Basnett*, 389 So.2d 995, 998 (Fla. 1980) ("A person guilty of fraud should not be permitted to use the law as his shield. Nor should the law encourage negligence. However, when the choice is between the two—fraud and negligence—negligence is less objectionable than fraud. Though one should not be inattentive to one's business affairs,

the law should not permit an inattentive person to suffer loss at the hands of a misrepresenter”) (emphasis added).

In two very recent decisions, two courts have largely followed the analysis in the *Randall* decision. In the case of *Long John Silver's Inc. v. Nickleson*, Civil Action No. 3:11-CV-93-H, 2013 WL 557258 (W.D. Ky. Feb. 12, 2013), the court explained:

> [A] franchisee aware of the MFA's anti-waiver provision and the inconsistent treatment of disclaimers by Minnesota courts, may reasonably believe that a disclaimer would not be upheld in court. Given there could be multiple, plausible degrees of reliance that are entirely subjective to the franchisee, the Court rules Defendant's reliance was not unreasonable as a matter of law.

Id. at *7.

Similarly, in the case of *Hanley v. Doctors Express Franchising, LLC*, Civil Action No. ELH-12-795, 2013 WL 690521 (D. Md. Feb. 25, 2013), interpreting the Maryland Franchise Act, the court found the reasoning in the *Randall* court persuasive and stated:

> With respect to the alleged representations and omissions in communications made before the execution of the Franchise Agreement and in the FDD, plaintiffs respond that Doctors Express's argument is foreclosed by B.R. § 14–226. As noted, that provision of the Maryland Franchise Law states: “As a condition of the sale of a franchise, a franchisor may not require a prospective franchisee to agree to a release, assignment, novation, waiver, or estoppel that would relieve a person from liability under this subtitle.” I agree with plaintiffs that B.R. § 14–226 precludes Doctors Express's reliance on the disclaimers and integration clause to defeat liability, at least at the motion to dismiss stage.

Id. at *27.

Given the remedial nature of both the Illinois Act and the Indiana Franchise Act, the Circuit Court erred in dismissing Plaintiffs’ statutory claims because allowing a franchisor to selectively disclose the financial performance of certain franchisees and

make projections not rooted in fact (and actually ***contrary*** to existing fact) and negate such dishonest behavior through general disclaimers runs afoul of the liberal construction to be afforded both the Illinois Act and the Indiana Franchise Act, as well as the public policies embodied in the anti-waiver provisions.

V. CONCLUSION

The Circuit Court erred by grant of Defendant's Motion to Dismiss because it (1) held the disclaimer contained in the UFOCs negated any reasonable reliance by the Plaintiffs, contrary to the purpose and intent of the statutes and rules requiring disclosure documents; (2) found the disclaimer negated the effect of the Illinois Act and Indiana Franchise Act, contrary to their remedial nature and anti-waiver provisions; and (3) found the bespeaks caution doctrine applicable. Accordingly, this Court should reverse the Circuit Court's grant of Defendant's Motion to Dismiss and remand this case.

Dated: 7/11/13

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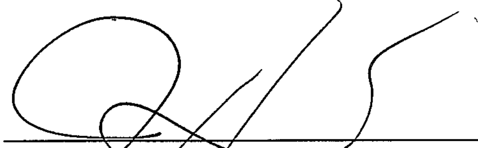
CERTIFICATE OF COMPLIANCE WITH SUPREME COURT RULE 341(c)

I certify that this brief conforms to the requirements of Rules 341(a) and (b). The length of this brief, excluding the pages containing the Rule 341(d) cover, the Rule 341(h)(1) statements of points and authorities, and Rule 341(c) certificate of compliance, the certificate of service, and those matters to be appended to the brief under Rule 342(a), is 33 pages.



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