ANDREWS LITIGATION REPORTER

THOMSON WEST

Franchise & Distribution

COMMENTARY

REPRINTED FROM VOLUME 6, ISSUE 1 / OCTOBER 2008

Violation of the California and Illinois Franchise Laws by a Franchisor

Opposing a Franchisor's Motion for Summary Judgment In Federal Court

By Mitchell J. Kassoff, Esq.

This article explains how a franchisee who files a federal court action alleging violations of California and Illinois franchise laws should respond to a franchisor's motion for summary judgment.

The laws discussed are the California Franchise Investment Law, the California Franchise Relations Act and the Illinois Franchise Disclosure Act of 1987.

The principal executive officers and directors of the defendant franchisor will state that they have acted in their corporate capacity and are not personally liable for anything concerning the defendant franchisor. To counter this argument, the plaintiff franchisee should cite the California Franchise Investment Law, Cal. Corp. Code § 31302, and Section 705/26 of the Illinois Franchise Disclosure Act of 1987, which provide for this personal liability under certain circumstances.

In most cases the plaintiff franchisee also will allege breach of the franchise agreement, breach of the covenant of good faith, fraud and possibly other counts. These issues will be addressed in a future article.

The California Franchise Investment Law

The plaintiff franchisee is entitled to bring a civil action against both the corporate franchisor and the franchisor's principal executive officers and directors pursuant to the California Franchise Investment Law, which states:

> *Every person* who directly or indirectly controls a person liable under Section 31300 [offers or sells a franchise] or 31301 [offers or sells a franchise by means of written or oral communications that have untrue facts or material statements or contain omissions], every partner in a firm so liable, every principal executive officer or director of a corporation so liable, every person occupying a similar status or performing similar functions, every employee of a person so liable who materially aids in the act or transaction constituting the violation, *are also liable jointly and severally* with and to the same extent as such person, unless the other person who is so liable had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist. (Emphasis added.)

Section 31005 of the CFIL defines a franchise as a "contract or agreement, either expressed or implied, whether oral or written, between two or more persons," by which:

- A franchisee is granted the right to engage in the business of offering, selling or distributing goods

© 2008 Thomson Reuters/West.

or services under a marketing plan or system prescribed in substantial part by a franchisor; and

- The operation of the franchisee's business pursuant to such plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising or other commercial symbol designating the franchisor or its affiliate; and
- The franchisee is required to pay, directly or indirectly, a franchise fee.

As stated in CFIL Sections 31001 and 31105, the protections of the law apply to all franchisees located in California. The plaintiff franchisee should show that the defendant franchisor's franchise was sold and/or is located in the state.

For California law to apply the plaintiff franchisee should show that it is located in the California and that the protections of the CFIL therefore apply. This will demonstrate that the defendant franchisor's business is a franchise pursuant to Section 31005 and is liable pursuant to the provisions of the law.

Section 31012 states that "fraud" and "deceit" are not limited to common-law fraud or deceit. The plaintiff franchisee should show that the defendant franchisor offered and sold it the franchise in the state of California pursuant to CFIL Section 31013. If the defendant franchisor made an offer to sell a franchise in California, as defined in Section 31013 or 31018, the defendant franchisor is therefore subject to the provisions of the CFIL.

The plaintiff franchisee should show that the defendant franchisor violated Section 31200 by making an untrue statement of a material fact in its "uniform franchise offering circular/franchise disclosure document."

The plaintiff franchisee should show that the defendant franchisor violated Section 31201 by making an untrue statement of a material fact and omitted a material fact to the plaintiff franchisee.

The California Franchise Relations Act

In many cases, when the defendant franchisor is sued it will terminate the plaintiff franchisee's franchise.

If it did so as a result of the initiation of litigation, the plaintiff should show that the defendant's improper termination of the franchise and the franchise agreement violated the California Franchise Relations Act, Cal. Bus. & Prof. Code § 20020.

The franchisee should remember that Section 20037 of the law permits it to sue pursuant to any other law, including damages for the improper termination of the franchise. Based on this provision, other counts should be alleged in the plaintiff franchisee's complaint if they are applicable.

The Illinois Franchise Disclosure Act of 1987

The plaintiff should demonstrate that the defendant's franchise falls under the definition of franchise in Section 705/3 of the Illinois Franchise Disclosure Act of 1987 as a "contract or agreement, either expressed or implied, whether oral or written, between two or more persons," by which:

- A franchisee is granted the right to engage in the business of offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor; and
- The operation of the franchisee's business pursuant to such plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising or other commercial symbol designating the franchisor or its affiliate; and
- The franchisee is required to pay, directly or indirectly, a franchise fee of $500 or more.

The plaintiff franchisee is entitled to bring a civil action against both the corporate franchisor and the franchisor's principal executive officers and directors pursuant to Section 705/26 of the IFDA, which states:

> Every person who directly or indirectly controls a person liable under this [section], every partner in a firm so liable, every principal executive officer or director of a corporation so liable, every person occupying a similar status or performing similar functions, and every employee of a person so liable, who materially aids in the act or transaction constituting the violation, is also liable jointly and severally with and to the same extent as such person, unless said person who otherwise is liable had no knowledge or reasonable basis to have knowledge of the facts, acts or transactions constituting the alleged violation.

The IFDA also permits the recovery of attorney fees if the plaintiff franchisee is successful in its litigation pursuant to the provisions of Section 705/26, which states that "every franchisee in whose favor judgment is entered in an action brought under this section shall be entitled to the costs of the action including, without limitation, reasonable attorney fees."

© 2008 Thomson Reuters/West.

The plaintiff franchisee should show that the defendant violated Section 705/5 by making an untrue statement of a material fact in its uniform franchise offering circular.

The plaintiff should show that the defendant violated Section 705/6 by making an untrue statement of a material fact or omitted a material fact to the franchisee.

The plaintiff should inform the court that pursuant to Section 705/43 the provisions of the statute are to be liberally construed.

The plaintiff franchisee should show that the defendant franchisor's improper termination of the franchise (especially if this occurred shortly after the plaintiff initiated litigation) and the franchise agreement violated Section 705/19.

Standards for a Motion for Summary Judgment

The U.S. Supreme Court held in *Associated Press v. United States*, 326 U.S. 1 (1945), *reh'g denied,* 326 U.S. 802 (1945):

> Rule 56 [of the Federal Rules of Civil Procedure] should be cautiously invoked to the end that parties may always be afforded a trial where there is a bona fide dispute of facts between them. *Sartor v. Ark. Natural Gas Corp*., 321 U.S. 620 [1944].

Summary judgment is a tool to be used sparingly, and trial judges should be slow in disposing of a case of any complexity on a motion for summary judgment. *S.J. Groves & Sons Co. v. Ohio Tpk. Comm'n*, 315 F.2d 235 (6th Cir. 1963), *cert. denied,* 375 U.S. 824 (1963); *Tee-Pak Inc. v. St. Regis Paper Co*., 491 F.2d 1193 (6th Cir. 1974).

Summary judgment is a lethal weapon, and courts must be mindful of its aims and targets and beware of overkill in its use. *Brunswick Corp. v. Vineberg*, 370 F.2d 605 (5th Cir. 1967).

Summary judgment pursuant to Rule 56 is ordinarily not a proper vehicle for resolution of a dispute concerning states of mind and interpretations of perceived events. *Schmidt v. McKay*, 555 F.2d 30 (2d Cir. 1977).

The plaintiff franchisee should show the court that the facts presented thus far in the case do not meet the standard for a motion for summary judgment. The plaintiff should specifically show that there are material and numerous disputed issues of facts. Testimony by the defendant franchisor during depositions can provide very convincing proof as to the factual conflicts in the case.

By taking a step-by-step approach, a plaintiff franchisee should be able to demonstrate enough facts to show that the California and Illinois franchise laws have been violated to defeat a motion for summary judgment.

Mitchell J. Kassoff, Esq. *has been representing both franchisors and franchisees as an attorney, counselor, advisor and Expert Witness in litigation, business and corporate matters throughout the United States since 1979. He is a frequent Continuing Legal Education lecturer on Franchise Law. Mr. Kassoff has published numerous articles on Franchise Law. He is a former tenured Professor of Law at Pace University. His website, which is exclusively devoted to Franchising, is www.franatty.cnc.net. He may be reached at (973) 762-1776 or franchiselawyer@verizon.net for consultations.*

© 2008 Thomson Reuters/West.