

A yellow triangle pointing downwards, located to the left of the 'BLOGS' header.

BLOGS

State Franchise and Dealer Laws

California Court Refuses to Apply Chosen Law of Franchisor's Home State

In *It's Just Lunch International LLC. v. Island Park Enterprise Group, Inc.*, 2008 WL 4683637 (C.D. Cal. Oct. 21, 2008), a federal district court in California decided not to enforce a Nevada choice of law provision set forth in the franchise agreement in the face of a franchisee's counterclaims under the California Franchise Investment Law (CFIL) and the New York Franchise Sales Act (NYFSA). This case shows the difficulty franchisors have in enforcing choice of law provisions as to claims brought by franchisees under the CFIL and NYFSA – especially where the franchisors and/or franchisees reside or do business in these states.

In this case, the franchisor, a dating service franchise system incorporated in Nevada, had filed suit against a New York franchisee in federal court in California for failing to pay franchise fees and otherwise violating the terms of their franchise agreements. The franchisees counterclaimed, alleging violations of the CFIL and (in the alternative) the NYFSA, asserting that the franchisor had made fraudulent statements in connection with the sale of the franchises with respect to expected sales and profits. The franchisor moved to dismiss the counterclaims on the grounds that they were barred by the choice of law provision designating Nevada law. The court applied a California choice of law analysis in determining whether Nevada had a substantial relationship to the parties, whether Nevada law was contrary to a fundamental policy of California, and, if there was a fundamental conflict with California law, whether California had a materially greater interest than Nevada in determining the issue.

The court found that the franchisor had a substantial relationship with Nevada because it was incorporated in that state. However, the court refused to apply the choice of Nevada law to either the CFIL and NYFSA claims because the expressed fundamental policies of California and New York provide "a heightened degree of protection to prospective franchisees regarding misrepresentations about a franchise system." Because the counterclaimants were "franchisees claiming the need for protection against a franchisor's misrepresentations and other unfair practices," the court determined that Nevada law (which did not provide the protections established by California and New York) should not be applied to their claims. In addition, the court found that the franchisor failed to meet its burden in demonstrating that California and New York did not have materially greater interests in enforcing their laws than did Nevada with respect to the CFIL and NYFSA counterclaims. It reached that conclusion because, while the franchisor was incorporated in Nevada, it had its offices in California, two other counterdefendants resided in California, and the counterclaimants themselves operated the franchise in New York.