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BLOGS

Fraud/Misrepresentation

Franchisor's Failure to Disclose Amounts Received From Affiliate Did Not Constitute Fraud

A federal court in Maryland granted a franchisor's motion to dismiss franchisees' counterclaims in an interesting case challenging the adequacy of the franchisor's disclosure regarding payments from its affiliate. *The Cleaning Authority, Inc. v Neubert*, 2011 U.S. Dist. LEXIS 13949 (D. Md. Feb. 11, 2011). Franchisor TCA had filed separate actions against each of the defendants for termination of their franchise agreements. The franchisees countersued, alleging that they were fraudulently induced to enter into the franchise agreements because the Uniform Franchise Offering Circular at the time of sale allegedly failed to disclose payments TCA received from an affiliate that supplied the defendants with direct mail advertisement services. One franchisee also alleged that the pre-sale UFOC did not comply with the FTC Franchise Rule.

The court reviewed the UFOC and sided with TCA. It found that by disclosing that all franchisees must purchase the mailers from the affiliate (including providing the costs of such mailers), the "obvious implication of that disclosure was that TCA's affiliate, S&T, would derive revenue from those purchases. No further disclosure was necessary." The court also stated that what the affiliate did with the money it received from franchisees' purchases of mailers was not material, "[w]hat was material was how much franchisees would have to pay for advertising services, . . ." and the defendants were fully informed of that.