BLOGS

Fraud/Misrepresentation

Michigan Federal Court Rules Against Franchisee on Most Fraud Claims

A federal court in Michigan has relied upon contractual disclaimers to reject most of the fraud-related claims asserted by a failed massage franchisee, but did award damages amounting to the initial franchisee fee based upon the franchisor's misrepresentations in its FDD regarding the number of closed units. *MTR Capital, LLC v. LaVida Massage Franchise Dev., Inc.*, 2020 WL 6536954 (E.D. Mich. Nov. 6, 2020). MTR Capital brought common law and statutory claims against LaVida based upon allegedly false financial performance representations. Although no Item 19 disclosures were provided in the FDD, Joaquin Esquivia, the owner of MTR, received a spreadsheet that modelled income and expenses. Esquivia also reviewed a press release and LaVida's website, both of which touted the franchise's growth potential. After exchanging questions and answers, which included a specific warning from LaVida that it could not guarantee MTR's profitability, MTR entered into the franchise agreement with LaVida. Within a year, MTR sued LaVida for fraudulent inducement and misrepresentation, negligent misrepresentation, violation of Florida's Deceptive and Unfair Trade Practices Act, and violation of the Florida Franchise Act.

After a full trial, the court found in favor of MTR on its Florida Deceptive and Unfair Trade Practices Act violation but in favor of LaVida on all other claims and, importantly, on all claims based upon financial performance representations. LaVida's failure to accurately state the number of closed franchises in Item 20, even though unintentional, violated the FTC Rule and therefore violated the Florida statute. The court also determined, however, that the presence of an integration and disclaimer provision in the franchise agreement undermined MTR's claim that it relied upon the spreadsheet model to project its potential profitability. The provision required MTR to agree that it had received no income projections or representations, that it was not guaranteed any success, that it understood there was a high degree of risk in investing in a franchise, that it had conducted its own independent investigation, and that it had been asked at the time of signing the franchise agreement to identify any financial performance representations it was relying upon in entering into the franchise agreement. At the time of signing, MTR identified no such representations and even initialed the relevant page signifying it had been read. The court held that these facts precluded any claim of reliance. With respect to the FDD misstatements, the evidence showed LaVida had poor recordkeeping and not that LaVida intended to deceive MTR. Lastly, MTR did not convince the court that LaVida's website and

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press release were more than puffery. Ordinary diligence required MTR to investigate further before relying on the press release or website.