

Cause of Action Alchemy: Little FTC Act Claims Based on Alleged Disclosure Violations

*Bethany L. Appleby, Robert S. Burstein, and
John M. Doroghazi*

The Federal Trade Commission Franchise Rule (FTC Rule)¹ does not provide a private right of action,² but its detailed disclosure standards are a siren call for franchisees looking for a good cause of action. In the fifteen states with state franchise disclosure laws providing a private right of action, franchisees generally assert claims under



Ms. Appleby



Mr. Burstein

1. Federal Trade Commission, Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. § 436.

2. *See, e.g.*, Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities; Final Rule, 72 Fed. Reg. 15444, 15478, n.350 (Mar. 30, 2007) (providing FTC Statement of Basis and Purpose) (“We note that there is no private right of action to enforce the Franchise Rule.”); *Yumilicious Franchise, LLC v. Barrie*, No. 3:13-CV-4841-L, 2015 WL 2359504 (N.D. Tex. May 18, 2015) (no private right of action is available to franchisee for franchisor’s failure to furnish required information under FTC Rule), *aff’d*, 819 F.3d 170 (5th Cir. 2016); *A Love of Food I, LLC v. Maoz Vegetarian USA, Inc.*, 70 F. Supp. 3d 376, 382 (D.D.C. 2014) (same); *Robinson v. Wingate Inns Int’l, Inc.*, Civil Action No. 13-cv-2468, 2013 WL 6860723, at *2 (D.N.J. Dec. 20, 2013) (“It is well-settled that there is no private cause of action for violation of the FTC franchise disclosure rules.”); *Hidden Values, Inc. v. Wade*, No. 3:11-cv-1917-C, 2012 WL 1836087, at *7 (N.D. Tex. May 18, 2012) (collecting cases); *Vino 100, LLC v. Smoke on the Water, LLC*, 864 F. Supp. 2d 269, 281 (E.D. Pa. 2012) (same).



Mr. Doroghazi

Bethany L. Appleby (bappleby@wiggin.com) is co-chair of Wiggin and Dana LLP’s Franchise and Distribution Practice Group and is resident in the New Haven office. Robert S. Burstein (rburstein@wiggin.com) is counsel in the firm’s Franchise and Distribution Practice Group and is resident in the Philadelphia, Pennsylvania office. John M. Doroghazi (jdoroghazi@wiggin.com) is a partner and a member of the firm’s Franchise and Distribution Practice Group and is resident in the New Haven. The authors would like to acknowledge the assistance of Wiggin and Dana LLP associate Ivana Greco and summer associate Alex Arroyo.

those statutes.³ In states without their own disclosure laws, however, franchisors and other businesses have seen a recent proliferation of lawsuits alleging FTC Rule violations as the basis of a state law unfair trade practice claim, or “Little FTC Act” claim. Many of these claims assert that the failure to provide a compliant Franchise Disclosure Document (FDD) before entering into a franchise business relationship violated the FTC Rule, which in turn violated the state’s Little FTC Act. This article addresses state statutory claims, other than state disclosure law claims, predicated on a violation of the FTC Rule and some potentially powerful defenses to those claims. Part I briefly discusses the basics of the FTC Rule’s FDD requirement. Part II discusses the types of parties that commonly claim a violation. Part III discusses claims made under state Little FTC Acts for FTC Rule violations. It also addresses potential defenses and provides other practice tips for franchisors that find themselves the target of such claims. Part IV discusses whether a contract is “illegal,” and therefore void or voidable, when the franchisor fails to comply with the FTC Rule’s disclosure requirements.

I. The FTC Rule’S FDD Requirement

The FTC Rule requires that franchisors, among other things, provide an FDD to “prospective franchisees”⁴ at least fourteen days before the prospective franchisee signs a binding agreement or pays money to the franchisor or its affiliate.⁵ Under the FTC Rule, a “franchise” is defined as follows:

Franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

(1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark;

(2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee’s method of operation, or provide significant assistance in the franchisee’s method of operation; and

3. The fifteen states are California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. 1 FRANCHISE AND DISTRIBUTION LAW AND PRACTICE § 5A:45. The private right of action may apply only to certain claims under the disclosure law and not others, for example, claims based on fraud or misrepresentation but not a failure to disclose. *See, e.g., Maoz*, 70 F. Supp. 3d at 395 (New York provides a private cause of action for the selling of a franchise without timely disclosure of the offering prospectus where Maryland does not); *Cont’l Basketball Ass’n, Inc. v. Ellenstein Enters., Inc.*, 669 N.E.2d 134, 137 (Ind. 1996) (private right of action under the Indiana Franchise Disclosure Act arises only upon allegations of facts supporting an inference of fraud, deceit, or misrepresentation and not violations of disclosure provisions).

4. The FTC Rule defines “prospective franchisee” as “any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship.” 16 C.F.R. § 436.1(r).

5. 16 C.F.R. § 436.2(a).

(3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.⁶

Whether a particular business arrangement meets this franchise definition is not always clear because each element is subject to interpretation. The FTC Rule also has a number of exceptions to the FDD requirement, including where “required payments” are less than \$570,⁷ for fractional franchises,⁸ “leased departments,”⁹ relationships covered by the Petroleum Marketing Practices Act,¹⁰ franchises with initial investments of at least \$1,143,100 with a contemporaneous exemption acknowledgment,¹¹ sales to franchisees that have been in business for at least five years and have a net worth of at least \$5,715,500,¹² sales to certain categories of insiders,¹³ and oral franchise agreements.¹⁴

Analyzing the definition of “franchise” under the FTC Rule and state franchise registration and disclosure laws is beyond this article’s scope, but there are multiple sources that franchise litigators should review when one of their clients is sued or wants to sue. In addition to the FTC Rule itself, essential reference materials include the FTC 2007 Statement of Basis and Purpose;¹⁵ the FTC 2008 Compliance Guide;¹⁶ the FTC’s Amended Franchise Rule FAQs;¹⁷ the North American Securities Administrators Association, Inc. (NASAA) 2008 Franchise Registration and Disclosure Guidelines;¹⁸ the NASAA Commentary on the 2008 Franchise Registration and Disclosure Guidelines;¹⁹ and the NASAA’s Multi-Unit Commentary (adopted September 16, 2014).²⁰ Moreover, on October 1, 2015, NASAA requested comments

6. 16 C.F.R. § 436.1(h).

7. 16 C.F.R. § 436.8(a)(1) (indexed for inflation as of July 1, 2016); 16 C.F.R. § 436.8(b); the inflation adjustment for this exemption and two additional exemptions cited below is at 81 Fed. Reg. 31500 (May 19, 2016), https://www.ftc.gov/system/files/documents/federal_register_notices/2016/05/160519franchiserulefrn.pdf

8. 16 C.F.R. § 436.8(a)(2) (indexed for inflation as of July 1, 2016).

9. 16 C.F.R. § 436.8(a)(3).

10. 16 C.F.R. § 436.8(a)(4).

11. 16 C.F.R. § 436.8(a)(5)(i) (indexed for inflation as of July 1, 2016); 16 C.F.R. § 436.8(b).

12. 16 C.F.R. § 436.8(a)(5)(ii) (indexed for inflation as of July 1, 2016); 16 C.F.R. § 436.8(b).

13. 16 C.F.R. § 436.8(a)(6).

14. 16 C.F.R. § 436.8(a)(7).

15. 2007 Statement of Basis and Purpose, 72 Fed. Reg. 15444 (Mar. 30, 2007), <https://www.ftc.gov/sites/default/files/070330franchiserulefrnnotice.pdf>; *see also* 1978 Original Statement of Basis and Purpose, 43 Fed. Reg. 59674 (Dec. 21, 1978).

16. FRANCHISE RULE COMPLIANCE GUIDE, *available at* <https://www.ftc.gov/tips-advice/business-center/guidance/franchise-rule-compliance-guide>.

17. FTC Amended Franchise Rule FAQs, *available at* <https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs>.

18. NASAA 2008 Franchise Registration and Disclosure Guidelines (Amended and Restated UFOC Guidelines), *available at* <http://www.nasaa.org/wp-content/uploads/2011/08/6-2008UFOC.pdf>.

19. NASAA Commentary on the 2008 Franchise Registration and Disclosure Guidelines, *available at* http://www.nasaa.org/wp-content/uploads/2011/08/FranchiseCommentary_final.pdf.

20. NASAA Multi-Unit Commentary, *available at* <http://www.nasaa.org/wp-content/uploads/2011/08/Franchise-Multi-Unit-Commentary-effective-Adopted-Sept.-16-2014.pdf>.

on a document titled “Proposed Franchise Commentary on Financial Performance Representations.”²¹ After reviewing the comments it receives, NASAA is expected to revise the document and call for another round of comments on the revised version. When approved, the final commentary should contain important rules for the preparation and use of financial performance representations, formerly called “earnings claims,” in FDDs and in advertisements. Finally, cases decided under state law may be referenced when the state provision in question is similar to its FTC Rule counterpart.²²

II. Parties Claiming FTC Rule Violations

Different types of plaintiffs have asserted claims based on disclosure violations, and each has its own challenges and opportunities.

A. *Acknowledged Franchisees*

The first category of plaintiff is the undisputed franchisee—that is, everyone agrees that a franchise relationship existed. These plaintiffs generally focus their claims on whether the franchisor provided proper disclosure under the FTC Rule. A compliant FDD must follow a very specific format and adhere to many detailed requirements.²³ There are many traps for the unwary. A franchisee may not have received an FDD at all or may have received a deficient, inaccurate, or untimely FDD. That franchisee may decide to sue the franchisor if the business has failed or the relationship has soured, whether or not these problems were related in any way to the alleged FTC Rule violations.

B. *Unacknowledged, “Accidental,” or “De Facto” Franchisees*

The next type of plaintiff is one where there is disagreement about the plaintiff’s franchise status. This often occurs when distributors or licensees claim, after the fact, that their business relationships fell within the FTC Rule’s definition of “franchise” and that they were therefore entitled to an FDD.²⁴ Parties that never actually entered into an agreement may also attempt to claim that they were offered a franchise and that disclosure was therefore required.

21. Notice of Request for Comments Regarding a Proposed Franchise Commentary on Financial Performance Representations, *available at* <http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2015/10/FPR-Commentary-Request-For-Comments.pdf>.

22. 2007 Statement of Basis and Purpose, *supra* note 15 (recognizing that it may be appropriate to look to state law when interpreting the FTC Rule).

23. See 16 C.F.R. § 436.5 and NASAA 2008 Franchise Registration and Disclosure Guidelines, Part III.

24. Dale E. Cantone, Kim A. Lambert & Karen C. Marchiano, *So It Really Is a Franchise: Bringing Non-Compliant Franchisors into Compliance*, ABA 37th Annual Forum on Franchising, W-1 (2014); Dean Fournaris & Robert Burstein, *Licensing Against the Wave of Franchising—Avoiding the Hidden or Inadvertent Franchise*, 29:5 LICENSING J. 1 (May 2009). Mr. Burstein is one of this article’s authors, and Mr. Fournaris is a partner at the authors’ firm.

C. Spouses, Creditors, Investors, and Other Related Parties

Sometimes spouses, creditors, investors, and other indirectly related parties come out of the woodwork and assert claims based on alleged FTC Rule violations. In many cases, the franchisor, or putative franchisor, did not even know that these individuals or entities existed.²⁵ These plaintiffs operate from flawed assumptions and ignore that the fact that simply because a party benefitted from or claims an interest in a franchise does not mean that they should have received an FDD. As the FTC's 2007 Statement of Basis and Purpose explains:

Section 436.1(i): Franchisee

The original Rule defined "franchisee as: "any person (1) who participates in a franchise relationship as a franchisee . . . or (2) to whom an interest in a franchise is sold." The definition proposed in the Franchise [Notice of Proposed Rulemaking] was "any person who is granted an interest in a franchise." Section 436.1(i) of the final amended Rule adopts an even more precise version: "Franchisee means any person who is granted a franchise." This narrowing of the definition is in response to commenters who voiced concern that the phrase "an interest in a franchise" is too broad, arguably sweeping in shareholders of publicly traded companies and other investors. The amended definition's focus on the granting of a franchise (as opposed to an interest in a franchise) is also consistent with the states' approach, thereby reducing unnecessary inconsistencies.²⁶

This conclusion makes sense because for FDD disclosure purposes, "prospective franchisee" includes "any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss *the possible establishment of a franchise relationship.*"²⁷ The FTC originally created the FTC Rule in 1978 (effective in 1979, the FTC Rule was amended in 2007) to stop deceptive and unfair practices that occur when a *prospective franchisee* enters into a *franchise relationship* with a franchisor, not when a prospective franchisee declines to purchase a franchise.²⁸ This concept should apply with equal force where the party is an investor or creditor

25. Claims brought by franchise agreement non-signatories are discussed in Christine Jean-Louis, *Wait! You, Too? Litigation Brought by Nonsignatories to Franchise Agreements*, 34 *FRANCHISE L.J.* 17 (2014). Ms. Jean-Louis was an associate in the authors' law firm when she wrote this article.

26. 2007 Statement of Basis and Purpose, *supra* note 15, at 15460. Similarly, at least one court has held that a guarantor is not entitled to the protections of a state registration and disclosure law. *G&R Moojestic Treats Inc. v. Maggiemoo's Int'l, LLC*, No. 03 Civ. 10027 (RWS), 2004 WL 1110423, at *8 (S.D.N.Y. May 19, 2004) (guarantor of an ice cream shop franchise agreement lacked standing to bring a claim as a "franchisee" against a franchisor under the Maryland Franchise Registration and Disclosure Law).

27. 16 C.F.R. § 436.1(r) (emphasis added).

28. *See, e.g.*, FTC Statement on Franchise Rule, 43 Fed. Reg. 59614, 59627-39 (proposed Dec. 21, 1978) (discussing in detail four circumstances, each of which involves purchase by prospective franchisee of a franchise, for why rule is necessary); *see also* Final FTC Statement on FTC Rule, 44 Fed. Reg. 49966, 49966 (Aug. 24, 1979) ("In general, the rule addresses the problem of nondisclosure and misrepresentation which arise when prospective franchisees purchase franchises without essential and reliable information about them."); *Colo. Coffee Bean, LLC v. Peaberry Coffee Inc.*, 251 P.3d 9, 23 (Colo. Ct. App. 2010) (quoting FTC Statement on Amendments to Franchise Rule, 72 Fed. Reg. 15444, 15536 (Mar. 30, 2007) ("the [FTC Rule] seeks to

that never intended to become a franchisee or sign any franchise agreement because the franchisor would not have had to provide an FDD to that party.

These plaintiffs also forget that in order to comply with the requirement to provide an FDD to a “prospective franchisee,” it is sufficient to simply provide disclosure to an agent or representative of that prospective franchisee.²⁹ Indeed, the FTC Compliance Guide explicitly states that “[i]n the case of a corporate prospect, disclosures can be furnished to a company officer.”³⁰ Accordingly, giving an appropriate representative (such as the actual franchisee) an FDD should satisfy the franchisor’s FTC Rule obligations.

III. Little FTC Act Claims Based on Alleged FTC Rule Violation

As noted above, it is well established that there is no private right of action for FTC Rule violations. Accordingly, parties must shoehorn an FTC violation into another law. If the franchisor provides false disclosures, the plaintiff may assert a claim for fraud in the inducement or other related common law claims, irrespective of the FTC Rule.³¹ However, common law fraud claims often have high standards of proof and do not always come with the panoply of relief that statutory causes of action do. Thus, a plaintiff may prefer to assert an FTC Rule violation through an applicable state “Little FTC Act” by claiming that the FTC Rule violation is the “predicate” for a Little FTC Act violation. “Little FTC Act” is a commonly used name for state consumer protection statutes that are analogous to the FTC Act. Little FTC Act violations can be based on—or predicated on—violations of other statutes or regulations.³²

To succeed, a party alleging that an FTC Rule violation was the predicate for a state Little FTC Act violation must establish (1) an FTC Rule violation; (2) that a particular state’s Little FTC Act applies; (3) that an FTC Rule violation can serve as a predicate for a violation of the applicable Little FTC Act; (4) that the claim is timely; and (5) that each of the applicable Little FTC Act’s elements is met.³³ Franchisors defending against a claim should also investigate whether a disclaimer or release provides a defense in a par-

protect franchisees from unfair or deceptive practices.”). The authors are not aware of any precedent where a court has held that a non-franchisee can base a claim on an FTC Rule violation.

29. See FTC COMPLIANCE GUIDE, *supra* note 16, at 18.

30. *Id.*; see also Jean-Louis, *supra* note 25, at 27–28.

31. See, e.g., Cantone, *supra* note 24; Altresha Q. Burchett-Williams, Robert M. Einhorn & Paula J. Morency, *Claims Under the “Little FTC Acts” The High Stakes of Risk and Reward*, ABA 33rd Annual Forum on Franchising, W-6 (2010); John G. Parker & Angela M. Fifelski, *Claims Under Little FTC Acts*, ABA 28th Annual Forum on Franchising, W-4 (2005); Arthur L. Pressman, Ellen R. Lokker & Eric H. Karp, *The Use of State Little FTC Acts in Franchise Relationship Litigation*, 31ST ANNUAL INT’L FRANCHISE ASS’N LEGAL SYMPOSIUM (1998).

32. Robert Langer & Matthew W. Sawchak, *Business Torts as Little FTC Act Claims: Does the Difference Really Make a Difference?* ABA SECTION OF ANTITRUST LAW BUSINESS TORTS & RICO NEWS (2013), available at <http://www.wiggin.com/14583>. Mr. Langer is a partner at the authors’ law firm.

33. Although beyond the scope of this article, parties may similarly attempt to claim violation of the federal Business Opportunity Rule, 16 C.F.R. Part 37, as a Little FTC Act predicate.

ticular case. In addition, Little FTC Act remedies vary widely by state, and franchisors may be successful in limiting recovery even if the plaintiff ultimately proves a violation.

A. *Establishing an FTC Rule Violation*

The threshold issue, of course, is determining if an FTC Rule violation even occurred. For claims brought by acknowledged franchisees, the franchisor must “simply” review the FDD it provided and whether the FDD complied with the FTC Rule by being properly prepared; accurate; currently effective; registered with the appropriate state(s), if applicable; and timely given. Occasionally, one of the exceptions to the FTC Rule disclosure requirement may apply, and a common law fraud claim may then be the only potential action available. For a “de facto” or “accidental” franchisee, the defendant will have to analyze the facts carefully and determine whether the relationship was, in fact, a franchise under the FTC Rule and then consider whether an exemption could apply.

For spouses, creditors, investors, or other related entities or individuals, the franchisor must consider why they claim they should have received an FDD. What was their alleged relationship to the franchisee, and what were their interactions with the franchisor? If there was no obligation to provide an FDD to a particular individual or entity, no violation occurred, and there should be no viable cause of action based on FTC Rule violation.

B. *Which Little FTC Act Applies?*

If there is a plausible FTC Rule violation, a franchisor must determine which state’s Little FTC Act applies. This is an important determination because the acts vary significantly.³⁴ Although a plaintiff may plead in the alternative, eventually the plaintiff must choose, or the court or arbitrator will have to make that determination based on a choice of law analysis, which may also involve an analysis of the enforceability and effect of any contractual choice of law provision. The answer to the choice of law question, as explained below, could be dispositive. It is also important to keep in mind that some states do not apply their Little FTC Acts extraterritorially.³⁵

C. *Does the Applicable Little FTC Act Even Apply to Commercial Relationships or Otherwise Recognize an FTC Rule Violation as a Predicate Act?*

After the choice of law analysis, a franchisor’s next step is to determine whether the applicable state Little FTC Act would apply to the franchise relationship and whether a plaintiff could use an FTC Rule violation a requi-

34. Burchett-Williams et al., *supra* note 31, at 5–11.

35. Dennis R. LaFiura, Peter Lagarias & Victor Vital, *Comparison of the Trilogy: Common Law Fraud, Franchise Investment Laws, and Little FTC Laws Remedies for Misrepresentations and Omissions in the Offer and Sale of Franchises*, at 9, 34th ABA Forum on Franchising, W-9 (2011).

site predicate act. Some states' Little FTC Acts apply only to consumer or similar relationships and not to commercial relationships (like the franchise relationship). For example, Pennsylvania's Unfair Trade Practices and Consumer Protection Law (PUTPCPL) provides a private right of action to "[a]ny person who purchases or leases goods or services *primarily for personal, family or household purposes*."³⁶ PUTPCPL applies only when the purchase at issue was made for a primarily personal reason, not a commercial one. Therefore, a franchisee has no cause of action for an FTC Rule violation under PUTPCPL.³⁷ The Michigan Consumer Protection Act (MCPA) also does not provide a private right of action in commercial relationships, and therefore, a Little FTC Act claim based on a franchise agreement or franchise sale will fail.³⁸ Missouri's Merchandising Practice Act similarly limits private rights of action to disputes relating to items for household use.³⁹ Likewise, a court dismissed a franchisee's claim that the franchisor's alleged FTC Rule violation violated the Kentucky Consumer Protection Act (KCPA) because that act provides relief only for claims relating to goods and services purchased for household use, and a franchise is not a good or service.⁴⁰ Other states limiting Little FTC Act application to transactions involving goods or services for personal use include California,⁴¹ Georgia,⁴² Hawaii,⁴³ Mississippi,⁴⁴ Rhode Island,⁴⁵ and Virginia.⁴⁶

Some jurisdictions' Little FTC Acts apply only to the sale of goods or services generally, which has led some courts to hold that this limitation precludes claims relating to franchise sales because, in those courts' view, a franchise is not a good or service.⁴⁷ For example, in deciding this question, New Jersey determines whether its Little FTC Act applies to franchises on a case-by-case basis, and its case law strongly suggests that its Little FTC Act does not apply to most complex franchise transactions.⁴⁸

36. 73 PA. STAT. § 201-9.2(a) (emphasis added).

37. See, e.g., Family Wireless #1, LLC v. Auto. Techs., Inc., No. 15-CV-1310 (JCH), 2016 WL 183475, at *5 n.17 (D. Conn. Jan. 14, 2016) ("[T]he Pennsylvania Unfair Trade Practices and Consumer Protection Law . . . do[es] not apply to the sale of franchises."). The authors' law firm represented the defendant in this case.

38. MICH. COMP. LAWS ANN. § 445.902.

39. MO. ANN. STAT. § 407.025.

40. 859 Boutique Fitness LLC v. Cyclebar Franchising, LLC, No. 5:16-CV-018-KKC, 2016 WL 2599112, at *1 (E.D. Ky. May 5, 2016).

41. CAL. CIV. CODE § 1761.

42. GA. CODE ANN. § 10-1-392.

43. HAW. REV. STAT. ANN. § 480-1.

44. MISS. CODE ANN. § 75-24-15.

45. 6 R.I. GEN. LAWS ANN. § 6-13.1-5.2.

46. VA. CODE ANN. § 59.1-198.

47. Pressman et al., *supra* note 31, at 5-6.

48. See *J & R Ice Cream Corp. v. Calif. Smoothie Licensing Corp.*, 31 F.3d 1259, 1273 (3d Cir.1994); *Kavky v. Herbalife Int'l of Am.*, 820 A.2d 677, 685 (N.J. App. Div. 2003); *Morgan v. Air Brook Limousine, Inc.*, 510 A.2d 1197, 1198 (N.J. App. Law. Div. 1986). Similarly, West Virginia's case law suggests that franchises would not be considered "goods" or "services" because of the complex nature of the franchise transaction and the presence of significant regulation of the industry. *State ex rel. McGraw v. Bear, Stearns & Co.*, 618 S.E.2d 582, 587 (W. Va.

A plaintiff asserting a Little FTC Act claim must also have sufficient standing to bring the claim.⁴⁹ Some states require the plaintiff to be a “consumer,”⁵⁰ and twenty-one jurisdictions allow recovery only in consumer transactions.⁵¹ This raises the question of whether franchisees are “consumers,” which different jurisdictions determine differently.⁵²

Some states also require a showing that the alleged conduct injures the public as a whole. The Colorado Consumer Protection Act (CCPA) applies only to deceptive business practices that “may prove injurious, offensive, or dangerous to the public.”⁵³ Similarly, corporate entities can sue under New York’s deceptive trade practices statute as long as the general public is affected.⁵⁴ Depending on the situation, the franchisor may be able to argue that the franchise sale was a commercial transaction between two business parties and therefore unrelated to the general public’s interest. A Louisiana court has also held that in the absence of “fraud, misrepresentation, deception, or unethical conduct,” there is no unfair trade practice, and therefore “failure to comply with FTC disclosure regulations d[oes] not constitute an unfair trade practice.”⁵⁵

Finally, courts in other jurisdictions have simply concluded that, because there is no private cause action under the FTC Rule, parties should not be able to plead one under the state’s Little FTC Act.⁵⁶ As is evident from the discussion above, this view is not universally shared, and some courts

2005) (concluding that the West Virginia Consumer Credit Protection Act did not apply to “highly specialized and complex conduct involved in providing securities research and analysis as a component of investment banking”); *Wamsley v. LifeNet Transplant Servs. Inc.*, No. 2:10-CV-00990, 2011 WL 5520245, at *11 (S.D. W.Va. Nov. 10, 2011) (relying on presence of significant federal regulation to determine that WVCCPA did not apply to industry at issue).

49. *Burchett-Williams et al.*, *supra* note 31, at 11–16.

50. *Id.* at 11.

51. DAVID L. BELT, ROBERT M. LANGER & JOHN T. MORGAN, CONNECTICUT UNFAIR TRADE PRACTICES, BUSINESS TORTS AND ANTITRUST, App. K (2015–2016 ed). The following jurisdictions require a “consumer transaction”: Alabama, Arkansas, California, District of Columbia, Georgia, Indiana, Kentucky, Maryland, Michigan, Minnesota, Mississippi, Missouri, Montana, Ohio, Pennsylvania, Rhode Island, Texas, Utah, Vermont, Virginia, and the U.S. Virgin Islands; *see id.*, n. 38–48.

52. *See Burchett-Williams et al.*, *supra* note 31, at 12; *Bixby’s Food Sys., Inc. v. McKay*, 985 F. Supp. 802, 807 (N.D. Ill. 1997).

53. *Rhino Linings USA, Inc. v. Rocky Mountain Rhino Lining, Inc.*, 62 P.3d 142, 146 (Colo. 2003); *see also LaFiura et al.*, *supra* note 35.

54. *Securitron Magnalock Corp. v. Schnabolk*, 65 F.3d 256, 264 (2d Cir. 1995).

55. *LeBlanc v. Belt Ctr. Inc.*, 509 So. 2d 134, 137 (La. Ct. App. 1987).

56. *LaFiura et al.*, *supra* note 35 (citing *St. Martin v. KFC Corp.*, 935 F. Supp. 898, 907 (W.D. Ky. 1996) (“Because Congress did not intend to permit a private cause of action under the FTC Act and regulations, plaintiffs cannot invoke KRS 446.070 to create this type of private right.”); *cf. Morrison v. Back Yard Burgers, Inc.*, 91 F.3d 1184, 1187 (8th Cir. 1996) (“A plaintiff should not be permitted to plead violation of FTC regulations as part of a state common law fraud case. A decision to the contrary could be interpreted as substituting violation of FTC regulations for state law requirements, thereby effectively extending a private cause of action under the Federal Trade Commission Act.”).

have gone so far as to hold that an FTC Rule violation is a *per se* Little FTC Act violation.⁵⁷

D. *Is the Alleged FTC Rule Violation Beyond the Applicable Statute of Limitation?*

Little FTC Act statutes of limitation vary widely from one year⁵⁸ to six years.⁵⁹ States also vary in the method of calculating the commencement of the limitations period. For example, it may commence when the violation occurred⁶⁰ or not until discovery of the violation.⁶¹ At least for “non-discovery” states, the violation and injury generally would have occurred no later than the date of contract execution.⁶² In addition, many contracts contain limitations periods or notice requirements. Failure to comply with these requirements can result in the waiver of claims.⁶³ Contractual limitations period can be an extremely powerful defense because, unlike statutes of limitation, they may not be subject to equitable tolling doctrines.⁶⁴

E. *Can the Plaintiff Establish All of the Applicable Little FTC Act Elements?*

As discussed above, the relevant jurisdiction’s Little FTC Act may not even apply to franchise relationships, making further analysis unnecessary, while other states have gone so far as to determine that an FTC Rule violation is a *per se* Little FTC Act violation.

Even if the franchisor finds itself in a *per se* violation state, all may not be lost. A technical FTC Rule violation may be sufficient for an FTC enforcement action, but often not for a Little FTC Act claim with an FTC Rule violation as its predicate. That is because the plaintiff may not be able to establish the other requisite statutory elements, which may include ascertainable or actual damages flowing directly from the alleged violation (which is a common Little FTC Act requirement).

57. See LaFiura et al., *supra* note 35 (citing Nieman v. Dryclean USA Franchise Co., 178 F.3d 1126, 1128–29 (11th Cir. 1999); Morgan v. Air Brook Limousine, Inc., 510 A.2d 1197 (N.J. Super Ct. 1986); Rodopoulos v. Sam Piki Enters., Inc., 570 So. 2d 661 (Ala. 1990); Atl. Sport Boat Sales, Inc. v. Cigarette Racing Team, Inc., 695 F. Supp. 58 (D. Mass. 1988); Bailey Emp’t Sys., Inc. v. Hahn, 545 F. Supp. 62 (D. Conn. 1982), *aff’d*, 723 F.2d 895 (2d Cir. 1983); Aurigemma v. Arco Petroleum Prods. Co., 734 F. Supp. 1025, 1027 (D. Conn. 1990).

58. See e.g., ALA. CODE § 8-19-14 (one year statute of limitation).

59. See e.g., Gabriel v. O’Hara, 534 A.2d 488 (Pa. Super. Ct. 1987) (Pennsylvania Little FTC Act has six-year statute of limitation).

60. See, e.g., CONN. GEN. STAT. § 42-110g(f).

61. Burchett-Williams et al., *supra* note 31, at 17.

62. In states that begin the limitations period upon violation alone, the franchisor may be able to argue successfully that the limitations period began on the date that the franchisor was allegedly obligated to provide the FDD, which would have been earlier than contract execution.

63. See, e.g., Air Brake Sys., Inc. v. TUV Rheinland of N. Am., Inc., 699 F. Supp. 2d 462, 470 (D. Conn. 2010) (collecting cases for the proposition that Connecticut and federal “jurisprudence has recognized that parties to a contract may require a specific period of time within which to assert their respective claims, and that longer statutes of limitation do not prevent such agreements as a matter of principle”).

64. *Id.*

Florida's Little FTC Act, the Florida Deceptive and Unfair Trade Practices Act (FDUTPA)⁶⁵ is an illustrative example. To establish a FDUTPA claim, a plaintiff must prove three elements: (1) a deceptive act or unfair practice, (2) causation, and (3) actual damages.⁶⁶ Florida federal courts have made it clear that each of these elements must be met,⁶⁷ even when claiming a *per se* FDUTPA violation based on FTC Rule violation. As the U.S. District Court for the Middle District of Florida recently explained:

[A] plaintiff must show not only that the conduct complained of was unfair, unconscionable, or deceptive, but also that it has suffered actual damages proximately caused by the unlawful conduct." *Hanson Hams, Inc. v. HBH Franchise Co.*, LLC, No. 03-61198-CIV, 2004 WL 5470401, at *4 (S.D. Fla. Dec. 21, 2004). "Actual damages" under FDUTPA must directly flow from the alleged deceptive act or unfair practice. *Hennegan Co. v. Arriola*, 855 F. Supp. 2d 1354, 1361 (S.D. Fla. 2012). FDUTPA does not provide for the recovery of nominal damages, speculative losses, or compensation for subjective feelings of disappointment.⁶⁸

Accordingly, "liability under the Franchise Rules, and thus the Florida Deceptive and Unfair Trade Practices Act, requires more than a mere technical violation. . . ." ⁶⁹ This holding was based on the Eleventh Circuit's interpretation of FDUTPA, which requires, in addition to a technical FTC Rule violation, that "a party must also prove that the alleged deceptive or unfair practice was likely to deceive a consumer acting reasonably in the same circumstances."⁷⁰

If the applicable little FTC Act requires the plaintiff to establish reliance, causation, or damages, it is important to establish what information the plaintiff claims was not properly disclosed or not disclosed at all and how that affected the plaintiff. Did the plaintiff know the correct or allegedly missing information anyway, either from prior experience or other sources? If so, then perhaps he or she cannot establish causation or reliance. If the plaintiff had known the correct or allegedly missing information, would he

65. FLA. STAT. ANN. § 501.203.

66. *Bookworld Trade, Inc. v. Daughters of St. Paul, Inc.*, 532 F. Supp. 2d 1350, 1364 (M.D. Fla. 2007).

67. *Id.* (making clear that each Florida Deceptive and Unfair Trade Practices Act (FDUTPA) element must be met); *see also* *Parr v. Maesbury Homes, Inc.*, No. 609CV-1268-ORL-19GJK, 2009 WL 5171770, at *8 (M.D. Fla. Dec. 22, 2009) ("However, regardless of whether a statute is a *per se* FDUTPA predicate or alleged to proscribe an unfair or deceptive practice and therefore serve as an implied FDUTPA predicate, a plaintiff is still required to plead the remaining two elements, causation and damages, in order to properly state a claim for a FDUTPA violation.").

68. *Britt Green Trucking, Inc. v. FedEx Nat'l, LTL, Inc.*, Case No. 8:09-cv-445-T, 2014 WL 3417569, at *11-12 (M.D. Fla. July 14, 2014); *see also* FLA. STAT. ANN. § 501.211 ("In any action brought by a person who has *suffered a loss* as a result of a violation of this part, such person may recover actual damages, plus attorney's fees and court costs as provided in s. 501.2105.") (emphasis added).

69. *Hetrick v. Ideal Image Dev. Corp.*, 758 F. Supp. 2d 1220, 1231 (M.D. Fla. 2010) (denying motion for summary judgment because an issue of fact remained about whether statements allegedly violating 16 C.F.R. § 436.9 were likely to deceive).

70. *Id.* (citing *Cold Stone Creamery, Inc. v. Lenora Foods I, LLC*, 332 F. App'x 565, 567 (11th Cir. 2009)).

or she have acted differently or been in a better position today? If not, then he or she may not be able to establish the requisite loss or damage. Finally, in the few states that require evidence of some form of “scienter” or knowledge of the wrongdoing to prove a Little FTC Act claim,⁷¹ the lack of such knowledge or intent evidence could doom a franchisee’s claim.

F. *Has the Claim Been Released?*

Franchisors often require franchisees to sign releases in connection with particular transactions, such as when the franchisor provides a royalty reduction, supplemental advertising or marketing funds or other benefits, on renewal of franchise rights, or when a multi-unit owner buys or sells a store. If the franchisee signs a release after entering into an agreement for which there was allegedly deficient disclosure, a release potentially could bar a Little FTC Act claim based on an FTC Rule violation.⁷² The franchisor should always check all agreements with a franchisee, regardless of the subject matter, to determine whether there are any potentially applicable releases (or other helpful contractual terms).

G. *What Are the Possible Remedies?*

If the franchisor is unsuccessful in defending a Little FTC Act claim, the franchisee will be entitled to various remedies. Although these remedies vary by state, monetary damages are generally available, if proven. Some states do not allow recovery of certain kinds of economic damages.⁷³ Other jurisdictions provide for statutory damages.⁷⁴ Statutory provisions may include a guaranteed money recovery, treble damages, or the possibility of punitive damages.⁷⁵ Plaintiffs may also seek rescission of the franchise contract. Franchisors should also note that certain state Little FTC Acts may impose personal liability on owners, officers, and employees who participate in a violation.⁷⁶

IV. Is the Contract “Illegal” if the FTC Rule was Violated?

Plaintiffs also occasionally seek to rescind or otherwise avoid their contractual obligations by arguing that their contracts were “illegal” and therefore void or otherwise unenforceable because of FTC Rule violations. Under

71. LaFiura, et al., *supra* note 35, at 15; *see also* KAN. STAT. ANN. § 50-626.

72. Franchisors have successfully used releases to defeat fraud claims in other contexts. *See, e.g., Coral Gables Imported Motorcars, Inc. v. Fiat Motors of N. Am., Inc.*, 673 F.2d 1234, 1238 (11th Cir.), *opinion modified on reh’g*, 680 F.2d 105 (11th Cir. 1982); LaFiura et al., *supra* note 35, at 30.

73. *See, e.g., Five for Entm’t v. Rodriguez*, 877 F. Supp. 2d 1321, 1331 (S.D. Fla. 2010) (stating that “it [also] remains well-settled in Florida that consequential damages in the form of lost profits are not recoverable under FDUTPA.”).

74. LaFiura et al., *supra* note 35, at 21.

75. Carolyn L. Carter, *Consumer Protection in the United States* at 7 (2009), available at https://www.nclc.org/images/pdf/udap/report_50_states.pdf.

76. LaFiura et al., *supra* note 35, at 36.

common law, illegal contracts can be deemed unenforceable and rescinded.⁷⁷ In these instances, the court may award restitution⁷⁸ or reliance damages to put the injured party back in its original pre-contractual position.⁷⁹ Sometimes such remedies are limited. For example, under Connecticut law, the successful plaintiff can seek either rescission of a contract and restitution *or* can opt to enforce the contract and recover damages for breach.⁸⁰ The plaintiff cannot request both.⁸¹

However, rescission on the basis of “illegality” may not be available for FTC Rule violations. As the U.S. District Court for the Western District of Pennsylvania explained in *Palermo Gelato, LLC v. Pino Gelato, Inc.*:

It appears that every court that has confronted the issue has determined, with persuasive reasoning, that a violation of the disclosure requirements of the Franchise Rule does not provide the basis to render a subsequent agreement void as illegal or contrary to public policy. See *Vino 100, LLC v. Smoke on the Water, LLC*, 864 F. Supp. 2d 269, 281 (E.D. Pa. 2012); *Holiday Hospitality Franchising, Inc. v. 174 West St. Corp.*, No. 05-149, 2006 WL 2466819, at *13 (N.D. Ga. July 19, 2006); *Crawford*, 600 F. Supp. at 846. . . . Among the reasons enumerated in those opinions include the fact that the defendants’ alleged failures to provide the Franchise Rule disclosures occurred outside of the formation of the contract and its terms, and thus any violation would not go to the validity of the contract; that because the Franchise Rule is a regulation and not a Congressional statute, violations of it do not provide as potent a force to unwind a contract; that there were no indications that their respective states had incorporated the FTC’s regulations as so central to their own public policy as to render them void, and that the plaintiffs were essentially seeking to circumvent the bar on private actions to enforce the FTC Act. See *Vino 100*, 864 F. Supp. 2d at 280–81; *Holiday Hospitality*, 2006 WL 2466819, at *5–6; *Crawford*, 600 F. Supp. at 845–46.⁸²

Accordingly, the plaintiff is unlikely to be able to undo or rescind a franchise agreement based on FTC Rule violation “illegality.” The plaintiff may, however, be able to rescind if he or she can establish a violation of a Little FTC Act that permits rescission as a possible remedy.

V. Conclusion

Even though the FTC Rule does not provide a private right of action, state Little FTC Acts can sometimes do the trick. Prosecuting or defending against these claims must begin with a careful choice of law analysis and thoughtful consideration of the elements and other requirements of the applicable Little FTC Act. Due to the lack of uniform standards under Little FTC Acts for when disclosure violations may provide a cause of action, litigation in this area will continue to be hotly contested for the foreseeable future.

77. RESTATEMENT (SECOND) OF CONTRACTS § 8 (1981).

78. RESTATEMENT (SECOND) OF CONTRACTS § 345.

79. RESTATEMENT (SECOND) OF CONTRACTS § 8.

80. *Little Mountains Enters., Inc. v. Groom*, 64 A.3d 781, 786–87 (Conn. Ct. App. 2013).

81. *Id.*

82. No. 2:12-cv-00931, 2013 WL 285547, *7 (W.D. Pa. Jan. 24, 2013).

