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# Judiciary Addresses Key Franchise Act Issues

Two integral provisions of the New York Franchise Act came under judicial scrutiny of late: the penalties to be imposed upon a franchisor which fails to furnish disclosure to a franchisee within the time prescribed by the act and when the act's "isolated franchise sales" exemption from registration may be invoked.

## Penalties for Late Disclosure

Cases in the past two years address what judicially countenanced damages, if any, may arise from a franchisor's failure to register and/or furnish a franchise disclosure document to a prospective franchisee within the time frame mandated by the New York Franchise Act. (This is not a complete failure to disclose, just late disclosure.)

Section 683(8) of the act states: A franchise which is subject to registration under this article shall not be sold without first providing to the prospective franchisee a copy of the offering prospectus... at the earlier of (a) the first personal meeting between the franchisor or its agent and the prospective franchisee, (b) at least ten business days prior to the execution of a binding franchise or other agreement, or (c) at least ten days prior to the receipt of any consideration in connection with the sale or proposed sale of a franchise. For the purposes of this chapter, the words... "first personal meeting" shall mean the first face to face meeting between a franchisor or franchisor's agent or any representative or employee thereof and a prospective franchisee which is held for the purpose of discussing the sale or possible sale of a franchise...

In *A Love of Food I v. Maoz Vegetarian USA*,<sup>1</sup> a franchisee brought

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an action against its franchisor in federal court in Maryland alleging that the franchisor violated both New York and Maryland's franchise statutes. Both parties filed cross-motions for summary judgment. In this action, plaintiff-franchisee claimed that it was entitled to rescission of its franchise agreement because its franchisor neither registered its franchise disclosure document with the New York Attor-

ney General (as required by the act) nor furnished it to the franchisee at the "first personal meeting" between them.

Applying New York law, the court held that the franchisor violated the New York Franchise Act's registration requirement—but that no damages would be awarded to the plaintiff-franchisee since it "...has not proffered any evidence that demonstrates that [the franchisor's] technical registration violation caused [the franchisee's] business losses...."<sup>2</sup>

The court similarly denied the franchisee's demand for rescission of the franchise agreement based on the alleged "willful and material" nature of the franchisor's statutory violation since "...even if [the franchisor's] failure to register was willful, this court concludes that no reasonable jury could find that the violation was material to [the franchisee's] investment decision."<sup>3</sup>

What damages may arise from a franchisor's failure to register and/or furnish a franchise disclosure document to a prospective franchisee within the time frame mandated by the New York Franchise Act?

With respect to the franchisor's alleged late delivery of its franchise disclosure document to the franchisee, the court—while noting that the franchisor clearly had failed to comply with the "first personal meeting" disclosure requirement imposed by the act—nevertheless concluded that the franchisee was not entitled to any monetary damages as a result of the franchisor's failure. "[I]t is undisputed that [the franchisor] provided a copy of the offering prospectus at some point prior to the execution of the franchise agreement...so at most there was a slight delay in providing [the franchisee] with the requisite information (i.e., a nominal violation), and no reasonable jury could find that [the franchisee's] significant business losses were the result of untimely disclosure, as the [New York Franchise Act] requires," held the court.<sup>4</sup>

It is clear beyond cavil that [the franchisee] cannot have it both ways: It cannot maintain that it relied heavily on the offering prospectus, on the one hand, and suggest, on the other, that the disclosure of the same document was so tardy that [the franchisee] did not have time to review it, causing compensable damages...[T]his court finds as a matter of law that plaintiff will be unable to prove causation. Thus, despite the technical [New York Franchise Act] violation, [the franchisee] is not entitled to damages.<sup>5</sup>

A slightly different result pertained in *EV Scarsdale Corp. v. Engel Voelkers North East*.<sup>6</sup> (The author's firm represents the defendant-franchisor in this ongoing action.) In *EV Scarsdale*, as in *Maoz*, the franchisee contended, inter alia, that the franchisor-defendant failed to furnish its franchise disclosure document at their "first personal meeting." Denying this branch of the franchisor-defendant's motion to dismiss (which relied on *Maoz* for the proposition that no proximately caused damages could have been suffered by the franchisee-plaintiff because it received a franchise

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# Franchise

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disclosure document prior to signing the subject franchise agreement), the court observed that before it were a different set of circumstances:

The Maoz court was relying on a robust record of undisputed

domiciled in this state or has filed with the Department of Law its consent to service of process on the form prescribed by the department.

In *Maoz*, the franchisor-defendant argued that the act's registration requirement should be waived under the above-quoted "isolated sales exemption" which, the court noted, "...plainly permits

when the franchisor limits itself to selling *one franchise*.<sup>10</sup>

The court, citing this author's New York Law Journal franchise column of February 2012, observed: "This is not to say that a franchisor who has sold an unregistered franchise under the isolated sales exemption can never again offer to sell a franchise in New York; [it] can, but it must register first. And it must be able to demonstrate to the attorney general why its previous 'isolated sale' was distinct from the general offer of franchises to effectuate pursuant to its franchise registration."<sup>11</sup>

Noting that the franchisor in *Maoz* "is the owner of the multiple restaurants and was formed for the express purpose of selling franchises and supporting franchisees" and that "[the franchisor's] plan of franchise expansion hardly renders [the franchisee's] franchise an 'isolated' occurrence," the court held that the New York Franchise Act's "isolated sales exemption" did not apply to the franchisor or relieve it from registering its disclosure document with the attorney general of New York before offering or selling the franchise to the plaintiff-franchisee.

The Maoz court held that the New York Franchise Act's "isolated sales exemption" did not apply to the franchisor or relieve it from registering its disclosure document with the attorney general of New York before offering or selling the franchise to the plaintiff-franchisee.

facts, made possible through discovery. Here, on this motion to dismiss, no such record is before the court. It, therefore, is prematurely concluded that the [franchisee-plaintiffs] could not have suffered damages from defendants' failure to provide them with an FDD prior to their first personal meeting.<sup>7</sup>

## Isolated Sales Exemption

The application of the New York Franchise Act's "isolated sales" exemption from registration also came under judicial review in *Maoz*.<sup>8</sup>

Section 684(3)(c) relieves a franchisor from the registration obligations imposed by the act if:

The transaction is pursuant to an offer directed by the franchisor to not more than two persons...[if] the franchisor is

a franchisor to waive otherwise applicable registration requirements in the context of the sale of a single franchise accomplished pursuant to an offer directed by the franchisor to not more than two persons.<sup>9</sup>

The court found existing case law on the subject largely "less than illuminating," but cited this author's McKinney's New York Statutes Practice Commentary on the New York Franchise Act as establishing that:

The drafter of the [New York Franchise Act] has stated that Section [684(3)(c)] was intended to be interpreted narrowly, and does not mean that if a franchisor only sells franchises one at a time, and offers each such franchise to no more than two persons, it need never register its offering prospectus....Rather, the exemption should only apply

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1. 70 F.Supp.3d 376 (D. Md. 2014).
  2. *Id.* at 409.
  3. *Id.*
  4. *Id.* at 412.
  5. *Id.* at 412.
  6. 48 Misc.3d 1019, 13 N.Y.S.3d 805 (N.Y. Cty. 2015).
  7. *Id.* at \*7.
  8. *Supra.* at fn 1.
  9. *Id.* at 406.
  10. *Id.* at 408 (emphasis in original) (internal citations and quotation marks omitted).
  11. *Id.* at 407 (citing David J. Kaufmann, "Exemptions Under The New York Franchise Act," NYLJ, Feb. 28, 2012).