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Conflicting Guidance on Non-Reliance Disclaimers and Anti-Waiver Provision

By **David J. Kaufmann**

A number of conflicting decisions over the past year and a half concerning whether provisions prohibiting waiver of duties or liabilities under the New York Franchise Act prohibit franchisors from interposing franchisee "non-reliance" franchise agreement disclaimers when confronting fraud actions brought under the act makes clear that this critical area of law will remain muddied until New York's appellate courts, and conceivably the Court of Appeals, decisively rule on the subject. "Non-reliance" franchise agreement disclaimers are provisions in a franchise agreement, pre-signing questionnaire or separate writing (letter, franchisee "acknowledgement" or franchisee attestation) in which a franchisee acknowledges that, other than representations set forth in the franchisor's Franchise Disclosure Document and franchise agreement, the franchisee did not rely on any representations which may have been made in the franchise sales process regarding a specific subject or subjects, most commonly financial performance representations (how much money, on average, franchised or company-owned units gross or net) or guarantees of success.

Activity and Confusion

The anti-waiver provision of the New York Franchise Act is found in Section 687(5) thereof, which states:

> It is unlawful to require a franchisee to assent to a release, assignment, novation, waiver or estoppel which would relieve a person from any duty or liability imposed by this article.

This anti-waiver provision has over the years prompted much judicial activity and confusion. But it was believed that this confusion had been lifted by the decision of Chief Judge Loretta Preska of the U.S. District Court for the Southern District of New York in *Governara v. 7-Eleven*.[1] (The author's firm represented defendant 7-Eleven, Inc. in this action).

Reversing earlier rulings and the purported logic of both the Appellate Division, First Department, and the Southern District involving the same franchisee claims, the same franchise agreement, the same franchisor and the same arguments the court in *Governara* held that a franchise agreement's non-reliance disclaimer does not violate the "anti-waiver" provisions of Section 687(5) of the New York Franchise Act. (The author's firm did not represent defendant 7-Eleven, Inc. in this prior action.)

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Twice before, courts answered this question in an opposite fashion, holding that, in fact, franchisee contractual disclaimers violated the "anti-waiver" provisions of Section 687(5) of the act. See *Emfore Corp. v. Blimpie Associates*[2] and *Solanki v. 7-Eleven*.[3] (The author's firm represented amicus curiae International Franchise Association in the Emfore action.)

In *Governara*, the court had before it the same type of contractual disclaimer as that present in *Solanki* and *Emfore* to the effect that the franchisee did not rely on any financial performance representations other than those set forth in the subject franchisor's Franchise Disclosure Document. Confronted with a Second Amended Complaint in which a 7-Eleven franchisee complained that it received and relied on financial performance representations outside of the 7-Eleven Franchise Disclosure Document, 7-Eleven moved to dismiss. The court granted that branch of 7-Eleven's motion contending that a contractual disclaimer of non-reliance did not violate the New York Franchise Act and, in fact, precluded a New York Franchise Act action alleging such reliance. The court held:

> While Plaintiffs do properly allege misstatements attributable to Defendant, Plaintiffs failed to state a claim under §687 because they could not have reasonably relied on those alleged misstatements... [P]arties who specifically disclaim reliance upon a particular representation cannot subsequently claim reasonable reliance upon it.
>
> Because the [New York Franchise Act] does not give franchisees the statutory right to purchase a franchise *while relying on verbal representations outside of a written contract* [emphasis in original], the Agreement's non-reliance disclaimer is not proscribed per se by the [New York Franchise Act] (citation omitted). Moreover...Plaintiffs do not allege that they were compelled or "require[d]...to assent to a release, assignment, novation, waiver or estoppel...".

Plaintiffs' arguments also contravene the basic principles of contract law, which are to "protect the expectations of the parties and provide certainty where the future would otherwise be uncertain".... Refusing to enforce non-reliance disclaimers would violate the sanctity of contracts and discourage their use. Ironically, this would undermine the goals of the [New York Franchise Act],

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Anti-Waiver

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since non-reliance disclaimers help franchisors "root out dishonest sales personnel and avoid sales secured by fraud... by requesting franchisees to disclose whether a franchisor's representatives made statements concerning the financial prospects for the franchise during the sales process" (citation omitted).

Accordingly, the court in *Governara* held that the 7-Eleven franchise agreement's disclaimer must be given effect and, consequentially, that plaintiff-franchisees could not successfully allege the element of reasonable reliance. Thus, they failed to state a claim for relief under Section 687 of the New York Franchise Act.

A Different Course

But less than a year after *Governara* was decided, in a case involving the same franchisor, 7-Eleven, the same contractual non-reliance disclaimer language and the same factual setting of a franchisee alleging a New York Franchise Act cause of action arising from the very alleged misrepresentations that the franchisee disclaimed in its franchise agreement, the Eastern District of New York in *7-Eleven v. Minhas*[4] decided exactly the reverse, holding that the franchisee's fraud claims were not barred by the non-reliance disclaimers in its franchise agreement:

> GBL §687(4) and (5) depart from the common law rule that parties who disclaim reliance upon an oral representation in writing cannot subsequently rely upon it. Since [the franchisee's] fraud claims are specifically brought pursuant to the anti-fraud provisions in the [New York] Franchise Act, they are not barred by the Disclaimer Provisions he signed...However, whether [the franchisee] relied upon 7-Eleven pre-contractual representations is still an element [of] fraud that he must prove to the jury by a preponderance of the evidence...Therefore, the Disclaimer Provisions—just like the rest of the contract documents [the franchisee] signed—are relevant to determining whether [the franchisee] relied upon 7-Eleven's allegedly fraudulent representations.[5]

Interestingly, the court in *Minhas*, while earlier giving full exposition to Chief Judge Preska's decision in *Governara*, instead grounded its decision in earlier, contrary decisions. The court gave no explanation as to why it did so and why it chose to ignore the ruling and logic of *Governara*.

Also less than a year after *Governara* was decided, another judge in the same court, the Southern District, decided the issue in an entirely opposite fashion. In *Coraud LLC v. Kidville Franchise Company*,[6] the Southern District had before it a child-care center franchisee bringing an action inter alia alleging violations of the New York Franchise Act. It alleged misrepresentations regarding initial investment costs which were specifically disclaimed by the franchisee in its franchise agreement. The franchisor moved to dismiss this branch of the franchisee's New York Franchise Act cause of action, citing to *Governara*, but the court denied this branch of defendant's motion. (The author's firm represented all defendants in this action.)

The decision in *Coraud* is fascinating, in that U.S. District Judge Jed Rakoff specifically held that because of the franchisee-plaintiff's franchise agreement disclaimers, it "...cannot prevail on its common law claims because [the franchisee], when it signed the Franchise Agreement, expressly disclaimed any reliance on statements made outside of the FDD [Franchise Disclosure Document]." Thus, the plaintiff-franchisee's common law fraud claims were dismissed.

However, not so the very same claims framed as New York Franchise Act violations:

> The Court arrives at a different result with respect to [the franchisee's] fraud claim brought pursuant to the [New York Franchise Act]...Reliance is an element of a fraud claim under the Franchise Act... [D]efendants, therefore, advance the same disclaimer-based argument here as they did in moving to dismiss [the franchisee's] common law claims.
>
> The disclaimers, however, cannot bar a fraud action under Section 687 [of the act].[7]

The court in *Coraud* declined to follow *Governara's* lead, instead holding that, "...the disclaimer, if given effect in the manner defendants here request and that *Governara* allowed, accomplishes what Section 687(4) [of the act] aims to prevent, namely, freedom from compliance with the [New York Franchise Act's] anti-fraud provision. Moreover, the holding of an intermediary appellate state court...is not to be disregarded by a federal court unless it is convinced by other persuasive data that the highest court of the state would decide otherwise."[8]

The court here was referring to the above-referenced decision of the Appellate Division, First Department, in *Emfore Corp. v. Blimpie Associates*,[9] which held that franchise agreement disclaimer provisions, while not violative of the New York Franchise Act, nevertheless could not be interposed by a franchisor-defendant defending a New York Franchise Act fraud claim. The court in *Coraud* held that "[a] straightforward application of *Emfore* requires the Court to deny the motion to dismiss."

The court went on to support its decision by referring to a 1966 U.S. Court of Appeals for the First Circuit decision involving disclosure in the securities arena. But in the case in question, *Rogen v. Ilikon Corp.*,[10] the disclaimer at issue pertained to both the obligation to make full disclosure under the Securities Exchange Act as well as purported misrepresentations. Observed the court in *Rogen*:

> ...[T]he available evidence of non-reliance is impressive... [P]laintiff signed an agreement in which he specifically acknowledged his full familiarity with the business and prospects of [defendant], his non-reliance on any duty to disclose on the part of defendants, and its having made all necessary investigation. This array of evidence might very well persuade a trier of fact that plaintiff was not injured by any non-disclosure on the part of defendants...[T]here is enough possibility of a finding for plaintiff on the reliance issue to foreclose our finding non-reliance as a matter of law.[11]

The court in 'Minhas,' while earlier giving full exposition to Chief Judge Preska's decision in 'Governara,' instead grounded its decision in earlier, contrary decisions. The court gave no explanation as to why it did so.

However, Judge Rakoff disregarded the much more recent U.S. Court of Appeals for the Second Circuit case in *Harsco Corp. v. Segui*,[12] in which the court negatively addressed the Rogen decision:

> There is nothing in the First Circuit's detailed opinion which suggests the presence in *Rogen* of anything like [the disclaimers before the court]. In this case [plaintiff] was apparently content that the detailed disclosures and representations of [the subject contract] were sufficiently complete. [Plaintiff] further protected itself by negotiating for two weeks of confirmatory due dili-

gence—the purpose of which was to confirm the accuracy of [defendant's] disclosures... In short there is nothing in the Complaint or the Agreement that indicates that [plaintiff] was duped into waiving the protections of the securities laws...[P]laintiff specifically agreed that representations not made in [the subject agreement] were not made...[Plaintiff] has not waived its rights to bring any suit resulting from this deal...In different circumstances (e.g., if there were but one vague seller's representation) a "no other representations" clause might be toothless and run afoul of §29(a) [of the Securities Exchange Act]. But not here.[13]

Accordingly, the Second Circuit affirmed the dismissal of plaintiff's complaint in *Harsco*. And the last sentence of its decision quoted above, I believe, should have been germane to the District Court's decision in *Coraud*—after all, plaintiff in that action did acknowledge receiving a quite lengthy franchise disclosure document replete with all sorts of detailed representations.

Judge Rakoff did, in fact, note in a footnote to his decision that the Second Circuit has declined to follow *Rogen* but suggested therein "...that the Second Circuit might reach a different result in the circumstances that the [New York Franchise Act], generally, was enacted to govern." Rakoff also noted in a footnote that: "The Court does not reach, at least at this juncture, whether it is appropriate to consider the contractual disclaimer at all when assessing the reasonableness of [plaintiff-franchisee's] alleged reliance."

Other Perspectives

Rounding out the series of decisions addressing whether franchisee disclaimers of reliance violate the anti-waiver provisions of Section 687(5) of the act is *EV Scarsdale Corp. v. Engel & Voelkers North East*.[14] (The author's firm represented all defendants in this action.)

As with the other cases I have reviewed herein, *EV Scarsdale Corp.* involved plaintiffs-franchisees who, notwithstanding the presence of elaborate non-reliance disclaimers in the franchise agreement, brought an action under the New York Franchise Act complaining of the very alleged misrepresentations on which the franchisee had disclaimed reliance. Denying defendants' motion to dismiss this branch of plaintiff-franchisee's action, the court noted that: "Ordinarily, outside of the franchise context, there is no question that a plaintiff could not maintain a claim for fraudulent inducement of a commercial contract in the face of the non-reliance disclaimers present in this case."[15]

However, noted the Supreme Court, New York County, plaintiffs-franchisees argued that their disclaimers are invalid and unenforceable by virtue of Section 687(5) of the act, an argument which the court observed was based on the First Department's decision in *Emfore*. The court cited and quoted Chief Judge Preska's U.S. District Court decision in *Governara* at length, but nevertheless then proceeded to hold:

> Whether this court agrees with *Governara* is irrelevant...While federal district court judges have discretion to not follow persuasive Appellate Division precedent, this court does not have the same luxury...It is axiomatic that the Supreme Court is bound to apply the law as promulgated by the Appellate Division within its particular Judicial Department...That being said, the reasoning set forth in *Governara* is worthy of serious consideration by our state appellate courts...For now, as this court is bound by *Emfore*, the [franchisees-plaintiffs'] §687 claims survive dismissal.[16]

As we have tried to convey in earlier columns, the Appellate Division in *Emfore* actually reversed its earlier holding that a franchisor's use of a pre-sale questionnaire containing franchisee disclaimers violated the "anti-waiver" provisions of the New York Franchise Act—but, nevertheless, proceeded to hold that the questionnaire responses subscribed by the franchisor's then-prospective franchisee could not be utilized by the franchisor in defense of that franchisee's New York Franchise Act claim.[17] Instead, held the court:

> We agree with defendant that the questionnaire to which plaintiff responded is not violative of General Business Law §687(4) and (5) on its face. Indeed, by requesting franchisees to disclose whether a franchisor's representatives made statements concerning the financial prospects for the franchise during the sales process, franchisors can effectively root out dishonest sales personnel and avoid sales secured by fraud. However, defendant, in direct contravention of the laudatory goal it claims to be advancing, is asking this court to construe the representations made by plaintiff in the questionnaire as a waiver of fraud claims. Such waivers are barred by the Franchise Act. Accordingly, defendant's attempt to utilize the representations as a defense must be rejected.

We are thus left with the following conundrum: *Emfore*, so relied on by the courts over the past year as standing for the proposition that franchisee disclaimers of reliance violate the anti-waiver provisions of the New York Franchise Act, actually says the opposite. In fact, as the above-quoted section of the Emfore decision makes clear, the Appellate Division actually held that the use of such franchisee non-reliance disclaimers (which, in *Emfore*, came in the form of a questionnaire) did not at all violate the anti-waiver provisions of the New York Franchise Act.

But the Appellate Division in *Emfore* exhibited confusion between lawful franchisee non-reliance disclaimers barring a franchisee from proceeding with the New York Franchise Act fraud action (since reasonable reliance must be demonstrated to maintain such an action) and the Appellate Division's confusing Emfore suggestion that such non-reliance disclaimers constitute a waiver of New York Franchise Act fraud claims.

Nobody has ever suggested that franchisee non-reliance disclaimers constitute a franchisee's waiver of fraud claims. It is only argued, as Chief Judge Preska agreed in *Governara*, that a franchisee's non-reliance disclaimers prohibit those claims from successfully proceeding due to the franchisee's inability to assert its legally required reliance on the alleged franchisor misrepresentations.

1. 2014 WL 4476534 (S.D.N.Y. 2014).
2. 51 A.D.3d 434, 860 N.Y.S.2d 12 (1st Dept. 2008).
3. 2014 WL 320236 (S.D.N.Y. 2014).
4. 2011 WL 3794475 (E.D.N.Y. 2015).
5. Id. at *5.
6. 2015 WL 3651423, --F. Supp.--(S.D.N.Y. 2015).
7. Id. at *4 (internal citations and quotation marks omitted).
8. Id. at *4 (internal citations and quotation marks omitted).
9. 51 A.D.3d 434, 860 N.Y.S.2d 12 (1st Dept. 2008).
10. 361 F.2d 260 (1st Cir. 1966).
11. Id. at 267 (internal citations and quotation marks omitted).
12. 91 F.3d 337 (2d Cir. 1996).
13. Id. at 344 (internal citations and quotation marks omitted).
14. 13 N.Y.S.3d 805 (Sup. Ct. N.Y. Co. 2015).
15. Id. at 816.
16. Id. at 816-818.
17. *Emfore Corp. v. Blimpie Associates, Ltd.*, 51 A.D.3d 434, 860 N.Y.S.2d 12 (1st Dept. 2008).