Is It Possible to Fully Insulate Yourself from Personal Liability?

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The owners of any entity may think that by creating an entity, they are fully insulated from liability stemming from the entity's actions or illegal conduct. Generally, courts are reluctant to disregard the corporate entity and impose personal liability upon an entity's shareholders;[1] however, a corporate entity will be disregarded if there is, for example, undercapitalization or failure to observe corporate formalities. The creation of an entity does not in and of itself fully protect owners, officers, and other executives from liability under either common law or certain state laws. In the franchise context, state franchise statutes impose potential personal liability and in some cases, individuals can be held liable if they did not participate in the culpable conduct.

I. Background and State Law Liability

When franchising first became a popular mode of business expansion, some observers perceived that franchisors exercised their superior bargaining position and consistently took advantage of franchisees. In response to the perceived rampant abuse, many states enacted laws to protect their franchisees.[2] Courts have highlighted the purpose of these statutes in their decisions when holding for franchisee claimants.[3] Further, courts have interpreted state franchise statutes broadly in order to effectuate the purpose of the statute,

1. *See* Martin v. Pilot Indus., Inc., 632 F.2d 271 (4th Cir. 1980).
2. *Id.*
3. *See* Sponsor's Memorandum, 1980 NY Legis. Ann., at 286; Memorandum of Assembly Rules Comm, Bill Jacket, L 1980 ch 730 (noting that the New York Franchise Sales Act was enacted to combat abuses that have accompanied the growth of franchising and have resulted in losses for New York residents); *see also* Tankersley v. Lynch, No. 11-12847, 2012 WL 683384 (E.D. Mich. Mar. 2, 2012) (holding that the Michigan Franchise Investment Law should be "broadly construed to effectuate its purpose of providing protection to the public" (citing Little Caesar Enters. v. Dep't of Treasury, 575 N.W.2d 562 (Mich. Ct. App. 1997) (quoting MICH. COMP. LAWS § 445.1501)).

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namely, to protect franchisees.[4] Prior to the availability of claims under state franchise statutes, franchisees were merely left with common law claims, such as fraud or negligent misrepresentation, and with claims under certain consumer protection statutes. Under this regime franchisees faced, and continue to face, significant difficulties in pleading fraud and similar claims due to the requirement to comply with heightened pleading requirements.[5] To successfully defeat an initial motion for summary judgment as to a fraud claim, a franchisee must "plead with particularity" the facts surrounding the fraud claim by specifying the fraudulent statements, identifying the speaker, stating where and when the statements were made and why the statements were fraudulent.[6] As such, franchisees have a difficult time passing the summary judgment phase due, in part, to the inclusion of standard disclaimer language in franchise agreements.[7] In response, states began implementing state franchise statutes to provide franchisees with additional remedies and causes of action under which to plead their case.

The first place to look, then, for potential personal liability of certain officers, directors, and other personnel (collectively, the nonfranchisor defendants) of a franchisor is under the various state franchise statutes that specifically outline the joint and several liability of the franchisor's representatives. At this time, fourteen states provide for joint and several liability for certain nonfranchisor defendants, including California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Washington, and Wisconsin.[8] The language of each statute varies slightly but many of the statutes are similar to the New York Franchise Sales Act (NYFSA), which states that:

> A person who directly or indirectly controls a person liable under the NYFSA, a partner in a firm so liable, a principal executive officer or director of a corporation so liable, a person occupying a similar status or performing similar functions, and an employee of a person so liable, who materially aids in the act of transaction constituting the violation, is also liable jointly and severally with and to the

4. *Tankersley*, 2012 WL 683384.

5. *See, e.g.*, Schwartzco Enters. LLC v. TMH Mgmt., LLC, 60 F. Supp. 3d 331 (E.D.N.Y. 2014) (holding that a franchisee failed to plead the circumstances constituting the fraud with the requisite specificity).

6. *See, e.g.*, Berglund v. Cynosure, Inc., 502 F. Supp. 2d 949 (D. Minn. 2007) (holding that a franchisee's allegations of fraud in connection with purchase of a franchise failed to satisfy the particularity requirement for a fraud claim).

7. *See, e.g.*, Coraud LLC v. Kidville Franchise Co., LLC, 109 F. Supp. 3d 615 (S.D.N.Y. 2015) (holding that the disclaimer language contained in the franchise agreement sufficiently waived any possibility that the plaintiff relied on any misrepresentations outside of the franchise agreement or franchise disclosure document, precluding a claim for fraud).

8. CAL. CORP. CODE § 31302 (West 2017); HAW. REV. STAT. § 482E-9 (West 2009); 815 ILL. COMP. STAT. ANN. 705/26 (West 2008); IND. CODE ANN. § 23-2-2.5-29 (West 2009); MD. CODE ANN., BUS. REG. § 14-227(d)(1), (2) (West 2009); MICH. COMP. LAWS ANN. § 445.1532; MINN. STAT. ANN. § 80C.17(d); N.Y. GEN. BUS. LAW § 691 (McKinney 2009); N.D. CENT. CODE § 51-19-12(2) (2008); OR. REV. STAT. ANN. § 650.020 (West 2009); R.I. GEN. LAWS § 19-28.1-21(b) (2008); S.D. CODIFIED LAWS § 37-5B-49 (2009); WASH. REV. CODE ANN. §§ 19.100.010, 19.100.190 (West 2009); WIS. STAT. ANN. § 553.51 (West 2009).

> same extent as the controlled person, partnership, corporation or employer. It shall be a defense to any action based upon such liability that the defendant did not know or could not have known by the exercise of due diligence the facts upon which the action is predicated.[9]

These state franchise statutes provide for joint and several liability for violations of the registration, disclosure, and anti-fraud provisions of each statute. In addition to the above-listed states, courts in Florida have noted that nonfranchisor defendants could be held individually liable if they are an "active participant" in the illegal conduct even if the statute does not explicitly provide for joint and several liability, as discussed later in this article.[10] As a preliminary matter, a franchisee must successfully prove that the franchisor violated the state franchise statute in order to hold a nonfranchisor defendant jointly and severally liable.[11] However, this does not mean that the franchisee must have been successful in obtaining a judgment against the franchisor for violation of a state franchise statute to hold the nonfranchisor defendant liable.[12]

A. *Who Is Held Liable Jointly and Severally?*

At the outset, it is important to highlight which nonfranchisor defendants are subject to personal liability under state franchise statutes. Most have two categories of personnel who may be held jointly and severally liable. The first category includes certain employees of the franchisor. The second category includes principal executive officers, directors, partners, any person exerting direct or indirect control over the franchisor, or any person occupying a similar position (collectively, the control people).

Courts universally agree that in order for a franchisor's employees to be held personally and severally liable, the employee must have materially aided in the culpable conduct.[13] It logically follows that courts would require franchisees to proffer more significant involvement to hold employees personally liable because it is likely that the employees will not exert control over the franchisor's day-to-day activities. It may be the case that a franchisor's employees may not have any knowledge that the franchisor is even engaging in fraudulent behavior or violations of state franchise statutes.

A court applying Michigan law has even gone so far as to say that an independent contractor holding itself out as an employee of a franchisor is per-

9. N.Y. GEN. BUS. LAW § 691(3) (McKinney 2009).

10. KC Leisure, Inc. v. Haber, 972 So. 2d 1069, 1074 (Fla. Dist. Ct. App. 2008).

11. Hacienda Mexican Rest. of Kalamazoo Corp. v. Hacienda Franchise Grp., Inc., 641 N.E.2d 1036 (Ind. Ct. App. 1994).

12. *See* Courtney v. Waring, 191 Cal. App. 3d 1434 (1987) (holding that a franchisee does not have to successfully sue the franchisor in order to obtain remedies against a secondary seller but only must establish that the franchisor could have been liable under the California Franchise Investment Law).

13. *See, e.g.*, Shipman v. Case Handyman Servs., L.L.C., 446 F. Supp. 2d 812 (N.D. Ill. 2006) (holding that employees of franchisor entities are liable only if they materially aided in the act or transaction constituting the violation).

sonally liable for its conduct.[14] In *Lofgren v. AirTrona Canada*, Brian Lofgren brought suit against AirTrona Canada and a nonfranchisor defendant for rescission of its franchise agreement and restitution for the harm caused by the lack of disclosure under a proper Franchise Disclosure Document (FDD).[15] Here, Lofgren had initially purchased a car deodorizing franchise from AirTrona Green Technologies, AirTrona Canada's predecessor.[16] After the creation of AirTrona Canada, its representative, Sam Barberio, presented Lofgren with a new business plan to update his current franchise.[17] He paid $35,000 Canadian dollars for the right to operate this updated franchise in Michigan.[18] Lofgren was also required to spend $28,000 Canadian dollars on updated equipment.[19] Neither AirTrona Canada nor Barberio provided Lofgren with an updated FDD in connection with this purchase.[20] During the negotiations, Barberio promised to secure three full-line automobile dealerships that would agree to use Lofgren's franchise for their deodorizing services as a stream of revenue.[21] Barberio failed to deliver on this promise, and Lofgren was forced to shut down his franchise after which he filed suit.[22]

First, the Sixth Circuit held that the second purchase constituted an additional franchise requiring proper disclosure with a new FDD.[23] Barberio's argument that AirTrona Canada did not prescribe a "marketing plan" under the updated franchise failed to pass muster as the court focused on the fact that Lofgren was reliant on Barberio and AirTrona Canada to provide support, training, equipment, and guidance on the new business model.[24] Further, the court noted that the $35,000 payment constituted a franchise fee that was not connected to the purchase of new equipment because Lofgren made a clear second payment for the new equipment.[25] The second issue the court determined was whether Barberio was an employee of AirTrona Canada, subjecting him to personal liability under the Michigan Franchise Investment Law (MFIL).[26] Barberio argued that he was an independent contractor and consultant of AirTrona Canada but the court disagreed.[27] The court examined the totality of the circumstances surrounding Barberio's association with AirTrona Canada, noting that the president of AirTrona Canada had named him chief executive officer and chief operating officer. Barberio admitted that he provided advice to AirTrona Canada with respect to franchise management,

14. Lofgren v. AirTrona Canada, 677 F. App'x 1002 (6th Cir. 2017).
15. *Id.* at 1006.
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.* at 1007.
22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.* at 1008.
26. *Id.*
27. *Id.*

Barberio held himself out as an employee of AirTrona Canada, and Barbiero represented AirTrona Canada in negotiations with franchisees.[28] The court held that the evidence therefore supported his designation as an employee and that Barbiero could not rely on the employee safe harbor provision to plead ignorance of law as a shield from personal liability.[29] As such, Barberio was jointly and severally liable for AirTrona Canada's violation of the MFIL because he materially aided in the illegal conduct by failing to properly provide Lofgren with a FDD and making fraudulent statements regarding the updated franchise.[30]

Generally, courts have imposed personal liability on those executives who have control over a franchisor's decisions regarding the operation of the franchise system and those individuals who control the franchise sales process. In California and Michigan, courts have imposed liability on a person serving as an officer and director who had responsibility for franchise sales.[31] In New York, the member-managers and controlling principals of a franchisor entity were held jointly and severally liable.[32]

Despite the fact that the language of several state franchise statutes is substantially similar, there is a divide in the interpretation of this language. Specifically, some states require that each individual materially aid in the violations of the state franchise statutes in order to be held liable for the franchisor's violations.[33] Other states have held that control people do not have to materially aid in the violations of state franchise statutes to be liable unless the person involved had no knowledge of the circumstances constituting a violation of a state franchise statute.[34]

B. *Applicability of the Material Aid Standard*

Many states have yet to address what side of the material aid argument they land on. To further compound the problem, three states have arrived at both sides of this debate. Although cases in New York have primarily held that a control person must materially aid in the violation, a recent outcome in New York may signify a shift.

An analysis of applicable New York case law begins with *A.J. Temple Marble & Tile, Inc. v. Union Carbide Marble Care, Inc.*[35] In this case, A.J. Temple Marble & Tile, Inc. filed a suit against Union Carbide Marble Care, Inc. and

28. *Id.* at 1009.
29. *Id.*
30. *Id.*
31. Dollar Sys., Inc. v. Avcar Leasing Sys., Inc., 890 F.2d 165 (9th Cir. 1989); Tankersley v. Lynch, No. 11-12847, 2012 WL 683384 (E.D. Mich. Mar. 2, 2012).
32. *In re* Butler, Bankr. No. 10-32030, 2012 WL 6106586 (Bankr. W.D.N.C. Dec. 10, 2012).
33. *See, e.g.*, Cherrington v. Wild Noodles Franchise Co., LLC, No 04-4572, 2006 WL 170431 (D. Minn. June 15, 2006); Ellering v. Sellstate Realty Sys. Network, Inc., 801 F. Supp. 2d 834 (D. Minn. 2011); Coraud LLC v. Kidville Franchise Co., LLC, 109 F. Supp. 3d 615 (S.D.N.Y. 2015).
34. *See, e.g.*, *Dollar Sys.*, 890 F.2d 165; Tankersley v. Lynch, No. 11-128472012 WL 683384 (E.D. Mich. Mar. 2, 2012).
35. 663 N.E.2d 890 (N.Y. 1996).

other nonfranchisor defendants for violation of the anti-fraud provision of the NYFSA.[36] As noted above, the language in the NYSFA provides for joint and several liability of certain control people and employees of a franchisor entity that violate the provisions of the NYFSA requiring pre-sale registration of a franchise and disclosure with an FDD. Here, A.J. Temple claimed that Union fraudulently misrepresented certain facts regarding the franchise system. A.J. Temple sought to hold certain nonfranchisor defendants personally liable under the NYFSA provision providing for joint and several liability.[37] At issue in this case is whether the material aid standard applies to all or only some of the enumerated parties.[38] In overturning the New York Supreme Court's decision, the Court of Appeals of New York relied on the plain meaning of the statute in holding that the material aid standard applied to each category of people.[39] As such, the court held that the nonfranchisor defendant who assisted in the preparation of the fraudulent solicitation materials, prepared the concealed business plan, and directly participated in the unlawful franchise sales was jointly and severally liable.[40] The court further held that the other nonfranchisor defendants were not liable because the plaintiffs failed to establish that any of them materially aided in the fraudulent conduct.[41]

In further support of the proposition that the material aid standard applies to all categories of people, the U.S. District Court for the Southern District of New York in *Coraud LLC v. Kidville Franchise Company, LLC* arrived at a similar conclusion.[42] Here, Coraud LLC brought a claim against Kidville Franchise Company, LLC and certain nonfranchisor defendants for fraud, negligent misrepresentation, and violation of the NYFSA and the New Jersey Franchise Practices Act.[43] The court held that Coraud could not proceed on its common law claims for fraud and negligent misrepresentation due to the existence of disclaimer language in the franchise agreement.[44] However, those disclaimers cannot bar claims under the NYFSA.[45] Next, the court determined that two of the nonfranchisor defendants were jointly and severally

36. Section 687 of the NYFSA provides that it is unlawful for any person to engage in any "act, practice or course or business which operates . . . as a fraud or deceit upon a person." N.Y. GEN. BUS. LAW § 687(2)(c) (McKinney 2009).

37. *A.J. Temple*, 663 N.E.2d 890.

38. *Id.*

39. In an additional indication that future courts may shift their interpretation of what categories of people to which the materially aid standard applies, Chief Judge Kaye noted in her concurring opinion that "interpretation may impose secondary liability on such a limited class of individuals to render it essentially meaningless." *Id.* at 896.

40. *Id.* at 895.

41. *Id.*

42. 109 F. Supp. 3d 615 (S.D.N.Y. 2015)

43. *Id.* at 619.

44. The court held that the disclaimer language contained in the franchise agreement sufficiently waived any possibility that Coraud relied on any misrepresentations outside of the franchise agreement or franchise disclosure document. *Id.*

45. *Id.* at 620.

liable and two of the nonfranchisor defendants were not liable.[46] Here, the court said that those employees who actually used inaccurate misrepresentations in the recruitment of Coraud and swore to the representations contained in the FDD were jointly and severally liable.[47] However, the conduct of the two nonfranchisor defendants who generally encouraged the purchase of the franchise, approved unspecified sales materials, and drafted the franchise agreement did not rise to the level of material aid.[48] The court went on to note that, although the preparation of a franchise agreement may be sufficient to rise to the level of material aid, it did not here because the alleged misrepresentations were not contained in the franchise agreement.[49]

We contrast the above cases with *Schwartzco Enterprises LLC v. TMH Management, LLC* in the U.S. District Court for the Eastern District of New York.[50] Here, Schwartzco Enterprises LLC brought a claim against TMH Management, LLC and certain nonfranchisor defendants for fraud, fraudulent inducement, negligent misrepresentation, breach of fiduciary duty, gross negligence, violation of the NYFSA (registration provision and antifraud provision), and unlawful deceptive business acts or practices.[51] Here, the court determined that Schwartzco satisfied its burden to survive dismissal of its claims under the NYFSA with respect to the nonfranchisor defendants.[52] Schwartzco claimed that all of the defendants made materially false representations and/or omissions, generated fraudulent financial spreadsheets, and failed to supply sufficient disclosures to Schwartzco or register the franchise with the New York Attorney General's Office.[53] With regard to the nonfranchisor defendants, the court focused on each person's active involvement independent of TMH in the provision of the fraudulent information.[54] Because the nonfranchisor defendants had access to the accurate information that would establish the falsity of the provided information, the court held that this evidence was enough to state a claim upon which relief can be granted, especially given that the language of the NYFSA provides for control person liability "merely by virtue of their position in an entity liable for NYFSA violations."[55] This is a departure from the holdings in *Coraud* and *A.J. Temple*.

46. *Id.* at 623.
47. *Id.*
48. *Id.*
49. *Id.*
50. 60 F. Supp. 3d 331 (E.D.N.Y. 2014).
51. The court dismissed each claim except for the claims of negligent misrepresentation and claims under the NYFSA. For the negligent misrepresentation claim, the court held that the determination of whether a special relationship exists between parties requires a fact-sensitive inquiry and it was inappropriate to make a determination at this initial motion to dismiss phase. *Id.* at 351.
52. *Id.* at 358.
53. *Id.*
54. *Id.*
55. *Id.*

In Illinois, a control person, initially, had to materially aid in the violation in order to be held liable.[56] However, there appears to have been a shift in the rule of law with court decisions stating that "control persons, who, because they are in a position to prevent a violation, are liable unless they had no knowledge . . . and employees . . . are liable only if they materially aided in the act or transaction constituting the violation."[57] Similarly, in Minnesota, an officer could only be jointly and severally liable if that person "materially aids in the act or transaction constituting the violation."[58] Consequently, a chief operating officer was not individually liable because he did not materially aid in the violation. Specifically, the court held that that "he must have been a control person at the time of the alleged violation, *or* must have materially participated in the violation–his status as COO, alone, does not establish liability."[59] This line of reasoning seems to suggest that a control person could be held liable even if he did not participate in the violation. Unfortunately, the only other case in Minnesota to address the issue did not reference either of the previous Minnesota cases in arriving at its conclusion and instead referenced securities laws in holding that the nonfranchisor defendant must have actually participated in the violations to be held liable.[60]

Last, the state franchise statutes of California, Maryland, Michigan, and Wisconsin similarly do not apply the material aid standard to control people. These state franchise statutes create a presumption that the control people are liable once the franchisee has stated a claim of violation based on the franchisor's conduct.[61] At that point, the burden then shifts to the control persons to invoke the defense that they had no knowledge of the facts supporting the violation of the state franchise statute.[62] In Indiana and Oregon, the language of each state's franchise statute is clear with respect to the requirement that in order to be liable, individuals have to participate in the culpable conduct.[63]

56. To-Am Equip. Co., Inc. v. Mitsubishi Caterpillar Forklift Am., 913 F. Supp. 1148, 1149–50 (N.D. Ill. 1995).

57. Shipman v. Case Handyman Servs., L.L.C., 446 F. Supp. 2d 812 (N.D. Ill. 2006).

58. Randall v. Lady of Am. Franchise Corp., No. Civ. 04-3394, 2005 WL 2709641, at *2 (D. Minn. Oct. 21, 2005).

59. Cherrington v. Wild Noodles Franchise Co., LLC, No 04-4572, 2006 WL 170431, at *5 (D. Minn. June 15, 2006) (emphasis added).

60. Berglund v. Cynosure, Inc., 502 F. Supp. 2d 949, 958 (D. Minn. 2007).

61. Dollar Sys., Inc. v. Avcar Leasing Sys., Inc., 890 F.2d 165, 176 (9th Cir. 1989).

62. *Id.*

63. Indiana's statute states that "[e]very person who materially aids or abets in an act or transaction constituting a violation of this chapter is also jointly and severally liable." IND. CODE ANN. § 23-2-2.5-29 (West 2009). Similarly, the Oregon statute imposes joint and several liability on "every person who participates or materially aids in the sale of a franchise." OR. REV. STAT. ANN. § 650.020 (West 2009).

C. *No Knowledge Affirmative Defense*

As noted above, once a plaintiff franchisee fulfills its burden of proving liability of the franchisor, it is then up to the nonfranchisor defendant to prove that he or she had "no knowledge or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist."[64] In the past, nonfranchisor defendants failed in proffering the required evidence to rebut the presumption; however, a recent case in Michigan sheds new light on this affirmative defense.

In *Tankersley v. Lynch*, the U.S. District Court for the Eastern District of Michigan examined whether certain nonfranchisor defendant officers could be held personally liable for an arbitration award obtained against a franchisor.[65] As background, Marian Tankersley obtained an arbitration award against Collision on Wheels International, L.L.C. (COW) for violation of the MFIL and filed suit against certain officers of COW (COW officers) to hold them jointly and severally liable for the arbitration award.[66] As determined in the arbitration proceeding, COW violated the MFIL by providing Tankersley with pro forma spreadsheets that contained earnings claims outside of the uniform franchise offering circular (UFOC).[67] Further, COW failed to provide accurate disclosures regarding the differences between the current franchise offering and the predecessor business.[68] Finally, COW failed to accurately disclose applicable environmental regulations.[69] Here, in its motion for summary judgment, the COW officers argued that Tankersley was prohibited from litigating their knowledge of the facts because that issue was already litigated in the arbitration proceeding.[70] The court disagreed and held that the issue of knowledge of the facts was not previously litigated to a necessary outcome for purposes of violation of the MFIL because the knowledge issue was raised in a different context.[71] In response to Tankersley's motion for summary judgment, the COW officers argued that they were entitled to re-litigate the issue of COW's liability under the MFIL because they were not parties to the arbitration proceeding.[72] The court again disagreed and held that the arbitrator's decision of COW's liability stands.[73] Further, the COW officers argued that they did not materially aid in the culpable conduct as required for liability under MFIL.[74] The court disagreed and held that the material aid standard applied to employees only and the only way for a control person to avoid liability is to prove he or

64. Tankersley v. Lynch, 2012 WL 683384, at *5 (citing MICH. COMP LAWS § 445.1532).
65. *Id.* at *2.
66. *Id.*
67. *Id.*
68. *Id.* at *3.
69. *Id.* at *5.
70. *Id.* at *6.
71. *Id.*
72. *Id.* at *9.
73. *Id.*
74. *Id.* at *10.

she had no knowledge of or reasonable grounds to believe the requisite facts.[75] Last, the COW officers argued that there was a genuine issue of material fact regarding their knowledge of facts.[76] Here, the court finally agreed.[77] In denying Tankersley's motion for summary judgment, the court determined that each of the COW officers proffered sufficient evidence signifying that he may not have had knowledge of the facts.[78] Specifically, each of the COW officers either offered affidavits stating his lack of knowledge of the facts or testified in deposition that he had no knowledge of the illegal spreadsheets or environmental regulations.[79] The court's final determination in this case could potentially open a new door for control people to escape personal liability by merely stating that they did not have knowledge of the circumstances.

In California, however, courts have been hesitant to give weight to this affirmative defense. In *Neptune Society Corp. v. Longanecker*, the California Court of Appeal determined that two nonfranchisor defendants were personally liable and that each did not correctly invoke the no knowledge exemption.[80] First, the court found that nonfranchisor defendant Charles Denning (Mr. Denning) sought out an attorney who confirmed the proposed arrangement was a franchise under the Federal Trade Commission Rule on Franchising (FTC Rule) and was advised to avoid this arrangement due to the level of paperwork necessary to comply with the California Franchise Investment Law (CFIL) and FTC Rule.[81] Even after such advice, Mr. Denning chose to proceed with the arrangement without providing a UFOC.[82] With respect to the second officer, Barbara Denning (Ms. Denning), the court held that she failed to submit sufficient evidence to sustain her burden.[83] Ms. Denning argued that the record was "completely silent" as to whether she had the requisite knowledge of the illegal conduct.[84] Ms. Denning was the secretary of the franchisor and provided the plaintiffs with the franchise agreement.[85] The court held that even though the evidence against Ms. Denning was "skimpy," she did not, as a matter of law, establish that she had no knowledge of the illegal conduct.[86] As such, the court held that the trial court properly ruled against the Dennings.[87] Based on these cases, there seems to be a small, but significant, distinction between arguing that the record is silent as to a nonfran-

75. *Id.*
76. *Id.* at *11.
77. *Id.* at *12.
78. *Id.*
79. *Id.*
80. 194 Cal. App. 3d 1233 (Cal. Ct. App. 1987).
81. *Id.* at 1244.
82. *Id.*
83. *Id.* at 1247.
84. *Id.*
85. *Id.*
86. *Id.* at 1248.
87. *Id.*

chisor defendant's knowledge of the facts and outright stating that nonfranchisor defendant did not have knowledge of the facts.

Further, multiple courts have refused to accept the defense that the nonfranchisor defendant lacked any knowledge of the applicable law as a defense.[88] In *Sterling Vision DKM, Inc. v. Gordon*, an officer of the franchisor claimed that he was not individually liable because the franchisee could not prove that the officer knew of the registration requirement under the Wisconsin Franchise Investment Law (WFIL).[89] The U.S. District Court for the Eastern District of Wisconsin noted that the particular section referenced knowledge of the *facts* by which the liability exists, not the underlying statute.[90] In dismissing the officer's argument, the court held that the "officer is presumed to know the law of the state in which he sells franchises."[91]

Similarly, in *Dollar Systems, Inc. v. Avcar Leasing Systems, Inc.*, two nonfranchisor defendants attempted to avoid personal liability because they were unaware of the requirements of the CFIL that the franchisor violated.[92] Again, the Ninth Circuit highlighted the fact that the "no knowledge" defense specifically references the *facts* surrounding the culpable conduct, not the law itself that provides for liability.[93] One of the individuals was an officer and director while the other was in charge of franchise sales.[94] The court held that these individuals were in the best position to know whether the franchisor had either registered or filed a notice of exemption in connection with its obligations under the CFIL.[95] As such, the defendants could not avoid personal liability under the CFIL.[96]

II. Common Law Claims and Other State Statutes

An additional remedy that may be available to franchisees is a claim under a state's consumer protection statute (CPS). CPSs were originally put in place to expand the FTC's mission in protecting consumers from "unfair or deceptive acts or practices."[97] Each state currently has some form of CPS; however, the CPSs vary widely in the conduct covered and the liability provided to claimants. Florida courts have examined the liability of a nonfranchisor defendant under Florida's CPS, the Florida Deceptive and Unfair Trade Practices (FDUTPA), and the Florida Franchise Act (FFA). Under the FFA, it is unlawful for a person to engage in certain fraudulent behavior and a person is defined as an "individual, partnership, corporation, association, or other entity

88. Sterling Vision DKM, Inc. v. Gordon, 976 F. Supp. 1194 (E.D. Wis. 1997).
89. *Id.* at 1198–99.
90. *Id.* at 1199.
91. *Id.*
92. Dollar Sys., Inc. v. Avcar Leasing Sys., Inc., 890 F.2d 165, 176 (9th Cir. 1989).
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
97. 42 U.S.C. § 45(a)(a) (2006).

doing business in Florida."[98] Florida courts have held that in order to be liable under the FFA, a nonfranchisor defendant must have personally participated in the culpable conduct.[99] Further, a contract person's position with the franchisor alone does not suffice to trigger personal liability.[100]

In *KC Leisure, Inc. v. Haber*, KC Leisure, Inc. (KC) brought suit against Lawrence Haber, an officer and shareholder of Relay Transportation, Inc. (Relay), for violations of the FDUTPA and the FFA for failure to provide KC with an FDD as required under the FTC Rule.[101] The complaint alleged that Haber advised Relay of the potential liabilities associated with failing to comply with the FTC Rule (and other state statutes) and advised Relay to structure the arrangement through a license agreement.[102] The trial court dismissed the claim under the FDUTPA because Haber was not a "seller" and dismissed the claim under the FFA because KC had failed to show that Haber was a direct participant in the culpable conduct.[103] The District Court of Appeal of Florida disagreed with these conclusions and reversed the decisions.[104] First, examining Haber's liability under the FDUTPA, the court held that an individual may be liable under the FDUTPA if the underlying corporate entity is liable and the individual "actively participated in or had some measure of control over the corporation's deceptive practices."[105] Here, the complaint sufficiently alleged that Haber knew of the requirements under the FTC Rule and willfully "cooked up the scheme" of treating the relationship as a license arrangement instead of a franchise arrangement.[106] Further, Haber assisted in the preparation of pro forma financial statements based on "conjecture and speculation," resulting in unsubstantiated and misleading representations to KC.[107] As such, the court held that this conduct demonstrated that Haber personally participated in the violations of the FDUTPA and FFA by Relay and that KC had therefore adequately pled a claim under the FDUTPA.[108]

III. Conclusion

One question that remains is whether more states will shift their interpretation of whether the "materially aids" standard applies to all categories of potential nonfranchisor defendants. It is difficult to predict the behavior of

98. FLA. STAT. § 817.416 (2005).
99. *See* SIG, Inc. v. AT&T Digital Life, Inc., 971 F. Supp. 2d 1178 (S.D. Fla. 2013).
100. *See* Checkers Drive-In Rests., Inc. v. Tampa Checkmate Food Servs., 805 So. 2d 941 (Fla. Dist. Ct. App. 2001).
101. KC Leisure, Inc. v. Haber, 972 So. 2d 1069 (Fla. Dist. Ct. App. 2008).
102. *Id.* at 1071.
103. *Id.* at 1072.
104. *Id.* at 1075.
105. *Id.* at 1074.
106. *Id.*
107. *Id.* at 1075.
108. *Id.*

the courts; however, control people should at all times be mindful of their potential personal liability stemming solely from their position within a franchisor's management team. It is advisable for those nonfranchisor defendants to seek the advice of counsel. A second remaining question is what direction the courts will take with respect to the development of the "no knowledge" affirmative defense and what facts the courts will accept as satisfying the nonfranchisor defendant's burden. Finally, another question that remains is whether more franchisees will continue to take advantage of the state franchise statutes providing for joint and several liability. The answer to this question is directly tied to the answer to the first two questions. If franchisees (and franchisee attorneys) continue to see control people held jointly and severally liable despite no participation in the offending conduct, or they continue to see that courts make relying on the "no knowledge" defense increasingly difficult, franchisees will continue to bring claims against the nonfranchisor defendants.