Protecting Your Franchise Agreement: Understanding Exceptions to the Parol Evidence Rule

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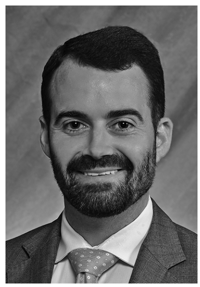

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Mark Celsi entered into a franchise agreement with H&R Block in 1999 to open a franchise store in Eureka, California.[1] Celsi additionally executed an addendum to the franchise agreement giving him the exclusive right to operate an H&R Block franchise in nearby McKinleyville, California.[2] After a year of success with his H&R Block franchises, Celsi requested the franchisor allow him to open another franchise location in Arcata, a town nestled between Eureka and McKinleyville on California's northern coast where Celsi had built a book of business.[3] H&R Block declined to extend another franchise to Celsi and instead granted the Arcata franchise to a third party.[4]

Nearly a decade after first executing the franchise agreement and addendum, Celsi filed suit against H&R Block alleging, among other things, that the franchisor breached the franchise agreement and committed fraud

1. Celsi v. H&R Block Tax Servs. LLC, No. A132634, 2012 WL 2914293, at *1 (Cal. Ct. App. July 17, 2012) (unpublished opinion).
2. *Id.* at *1.
3. *Id.* at *2.
4. *Id.*

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by refusing him the Arcata franchise.[5] To support his claim, Celsi alleged that he received multiple oral assurances regarding his right to eventually open an H&R Block franchise in Arcata during the negotiation of the franchise agreement and addendum.[6]

In any typical situation where a franchisor and franchisee have reduced an agreement to a written document, and especially where the agreement includes an integration or merger clause, courts employ the parol evidence rule (the Rule) to block the admission of extrinsic oral and written evidence concerning the terms or nature of the agreement. The Rule's rationale is simple—in cases like the one between Celsi and H&R Block, the terms of a proposed agreement often vary greatly over the course of the parties' negotiations; therefore, the written franchise agreement in which the parties memorialized their intentions provides the best evidence of the agreement the parties actually intended to make.[7]

Celsi, however, hoped to take advantage of one of the Rule's well-known exceptions—the exception for fraud. Many jurisdictions allow a party to introduce oral and written evidence that directly contradicts the terms of a contract to show fraud in the contract itself or that one of the parties fraudulently induced the other to enter into the agreement in the first place. In this instance, the relevant statute of limitations precluded Celsi's claim and saved the tax-preparation giant from having to defend against allegations of nearly ten-year-old oral misrepresentations.[8] Nevertheless, Celsi's fraud claim gives but one illustration of how the Rule's exceptions create vulnerabilities for franchisors.[9]

In situations where a franchise relationship breaks down, and in other disputes where the terms of a franchise agreement are at issue, the parol evidence rule serves as a helpful shield for franchisors that must defend themselves against allegations their actions led to the failure of the franchise or harmed the franchisee. The Rule works with well-drafted integration and merger clauses as an important first step to protecting the terms of a fran-

5. *Id.*

6. *Id.* at *3.

7. Town Bank v. City Real Estate Dev., LLC, 793 N.W.2d 476, 486 (Wis. 2010) (explaining that the parol evidence rule's "principle stems from basic contract law: if the contract is unambiguous, the court's attempt to determine the parties' intent ends with the language of the contract, without resort to extrinsic evidence").

8. *Celsi*, 2012 WL 2914293, at *3. The court pointed out that the California Franchise Investment Law requires that fraud claims be brought within two years of when the alleged misrepresentation was made. Celsi unsuccessfully tried to argue that H&R Block's promises that he could open an Arcada franchise location only became fraudulent once H&R Block actually refused his request for a franchise. Notably, shortly after *Celsi*, the California Supreme Court broadened the application of the fraud exception to the Rule in *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Ass'n*, 291 P.3d 316, 324 (Cal. 2013).

9. Courts in many states admit parol evidence to prove fraudulent inducement. *See*, *e.g.*, Carousel's Creamery, L.L.C. v. Marble Slab Creamery, Inc., 134 S.W.3d 385, 395 (Tex. App. 2004), *case dismissed* (Aug. 19, 2005) (quoting Dallas Farm Mach. Co. v. Reaves, 307 S.W.2d 233 (Tex. 1957) ("[A] merger clause can be avoided based on fraud in the inducement and . . . the parol evidence rule does not bar proof of such fraud.")).

chise agreement. However, as useful as the parol evidence rule may be for franchisors, courts recognize some major exceptions to the Rule. Additionally, some courts and legislatures have limited the parol evidence rule's application and reach, leaving even careful franchisors exposed to disgruntled franchisees' claims. Given these limitations, franchisors must carefully draft franchise agreements that include all important provisions, agreements, understandings, and representations.

This article will review the parol evidence rule and its application to franchise relationships. The article will first provide an overview of the Rule. Next, it will consider the major exceptions to the Rule and when parol evidence has been admitted by courts. Third, the article will consider other limitations, including statutory issues, to the Rule. Fourth, the article will outline some steps that franchisors can take to protect themselves in light of these limitations.

I. The Parol Evidence Rule: An Overview

A franchise agreement is a contract like any other. The franchise agreement seeks to memorialize and give precise terms to the agreement and business relationship between the franchisor and franchisee. Franchise agreements often are the result of significant negotiations and deliberations between the parties. After the bargaining and shifting positions of negotiations, the process of memorializing an agreement gives an element of finality to and establishes the boundaries of the parties' understanding. Courts interpreting franchise agreements employ the ordinary substantive rules, tools of construction, and rules of interpretation that they would for any other type of contract.[10]

The Rule is a long-standing, court made rule that provides extrinsic evidence cannot be introduced to contradict or explain the provisions of a written contract because the written contractual document itself provides the best evidence of its terms and the parties' intentions.[11] In 1857, the Supreme Court explained, "[i]t is admitted that the general rule of the common law is, that it is not competent by parol evidence to alter, vary, or change a written instrument in its essential terms[.]"[12] The Rule applies to exclude extrinsic evidence only if the contract at issue is integrated—if it manifests the com-

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10. *See* Restatement (Second) of Contracts § 213 (1981) (explaining that the parol evidence rule is not a rule of evidence or interpretation, but one of substantive law).

11. *See* Bank of U.S. v. Dunn, 31 U.S. 51, 57 (1832) ("This court, in the case of Renner v. The Bank of Columbia, 9 Wheat. 587, in answer to the argument that the admission of proof of the custom or usage of the bank would go to alter the written contract of the parties, say, 'if this is the light in which it is to be considered, there can be no doubt that it ought to be laid entirely out of view: for there is no rule of law better settled, or more salutary in its application to contracts, than that which precludes the admission of parol evidence, to contradict or substantially vary the legal import of a written agreement.'").

12. Brown v. Wiley, 61 U.S. 442, 443 (1857).

plete and final expression of the agreement.[13] A contract is "fully integrated" when the written document agreed to by the parties supersedes the parties' earlier agreements.[14]

Parties desire an integrated contract for a simple reason: it clarifies the expectations, desires, rights, and responsibilities of the parties and distills them into a single source. Additionally, these boundaries make the contractual agreement much harder to attack later in the event the parties' relationship or the circumstances have changed. For these reasons, franchisors regularly include clauses stipulating the parties intend to form a fully integrated agreement.

To signal that contracts, including franchise agreements, constitute the parties' fully integrated agreement, parties regularly use contractual provisions called "integration" or "merger" clauses.[15] Parties employ these clauses to achieve simple ends: to protect agreements from later attack with parol evidence by limiting consideration of evidence in a contractual dispute to the written agreement signed by the parties.[16] An integration or merger clause achieves this by stipulating that the entirety of a particular agreement is included in the contractual document.[17] As one court explained, these clauses "prohibit the introduction of parol evidence introduced to revise or contradict the terms of a written contract. . . . [They] bar evidence of earlier agreements because the law presumes that a contract represents the final expression of the parties' bargaining."[18] Courts have also described merger clauses as acting to eviscerate "collateral agreements or understandings between two parties that are not expressed in a written contract."[19] Although a few courts require that these provisions be specific to the parties and not simply "boilerplate" additions to the franchise agreement, courts reliably en-

13. Williams v. Spitzer Autoworld Canton, L.L.C., 913 N.E.2d 410, 415 (Ohio 2009) ("The parol evidence rule provides that absent fraud, mistake or other invalidating cause, the parties' final written integration of their agreement may not be varied, contradicted or supplemented by evidence of prior or contemporaneous oral agreements, or prior written agreements.") (citation omitted).

14. *See* 6 Corbin on Contracts § 25.7 (rev. ed. 2009).

15. *Black's Law Dictionary* defines an integration clause as: "A contractual provision stating that the contract represents the parties' complete and final agreement and supersedes all informal understandings and oral agreements relating to the subject matter of the contract." *Black's* also suggests that merger clauses are synonymous. *See Integration Clause*, Black's Law Dictionary (10th ed. 2014).

16. *See, e.g.*, Keller v. A.O. Smith Harvestore Prods., 819 P.2d 69, 72–73 (Colo. 1991) ("Integration clauses generally permit contracting parties to limit future contractual disputes to issues relating to the reciprocal obligations expressly set forth in the executed document.").

17. Restatement (Second) of Contracts § 210 (1981) ("(1) A completely integrated agreement is an integrated agreement adopted by the parties as a complete and exclusive statement of the terms of the agreement.").

18. Abbo v. Wireless Toyz Franchise, LLC, No. 304185, 2014 WL 1978185, at *5 (Mich. Ct. App. May 13, 2014); *see also* KFC Corp. v. Darsam Corp., 543 F. Supp. 222, 225 (W.D. Ky. 1982) (merger clauses generally operate to preclude evidence offered "for the purpose of varying or contradicting the writing").

19. L.A. Ins. Agency Franchising, LLC v. Montes, No. CV 14-14432, 2016 WL 922948, at *9 (E.D. Mich. Mar. 11, 2016) (quoting Star Ins. Co. v. United Commercial Ins. Agency, Inc., 392 F. Supp. 2d 927, 928–29 (E.D. Mich. 2005)).

force integration and merger clauses.[20] The U.S. District Court for the Western District of Wisconsin artfully described the burden that a party seeking to introduce parol evidence faces when confronted with an unambiguous integration clause: "[t]he franchise agreement's pellucid integration clause confronts defendants' breach of contract claim like a hors catégorie climb on a 'fixie.'"[21] Said differently, franchisees seeking to attack a fully integrated franchise agreement with parol evidence face a steep hill to climb.

Because integration or merger clauses stipulate that all prior understandings and agreements between the contracting parties are merged into the contract at issue, their inclusion in a franchise agreement can prevent a party from showing that extra-contractual promises or agreements ever existed. In *Stone Motor Co. v. General Motors Corp.*, for example, the Eighth Circuit held that due to a franchise agreement's unambiguous merger clause, pre-franchise documents, including the franchise application, were inadmissible parol evidence.[22] As a result, the court refused to allow the franchisee to introduce the franchise application as evidence that the franchisor promised to provide it particular types and numbers of vehicles.[23] However, because the Rule only bars evidence that addresses the same subject matter as the written franchise agreement, a merger clause will not always block evidence of collateral or additional agreements.[24]

II. Exceptions to the Parol Evidence Rule

A. *Overview*

As noted, the Rule exists to protect the parties' bargained-for agreement by broadly disallowing oral and written extrinsic evidence to contradict the written agreement or interpret its meaning.[25] However, courts continue to recognize several long-standing exceptions to the Rule to ensure equitable results in disputes between parties to a contract. As the Supreme Court explained in 1823,

> [i]t is a general rule, that an agreement in writing, or an instrument carrying an agreement into execution, shall not be varied by parol testimony, stating conver-

20. *See, e.g.*, Ramada Franchise Sys., Inc. v. Tresprop, Ltd., 188 F.R.D. 610, 615–16 (D. Kan. 1999).

21. ERA Franchise Sys., LLC v. Hoppens Realty, Inc., No. 12-CV-594-SLC, 2013 WL 3967869, at *6 (W.D. Wis. July 31, 2013) (explaining that when a court encounters a contract containing an unambiguous merger or integration clause, the court is barred from considering evidence of any prior or contemporaneous understandings or agreements between the contracting parties. This principle extends to the issue of integration itself.).

22. 293 F.3d 456 (8th Cir. 2002).

23. *Id.* at 466.

24. Domino's Pizza LLC v. Deak, 383 F. App'x 155, 159 (3d Cir. 2010) (citing *In re* Estate of Hall, 535 A.2d 47, 55 (Pa. 1987)).

25. *See, e.g.*, Restatement (Second) of Contracts § 213 (1981) ("(1) A binding integrated agreement discharges prior agreements to the extent that it is inconsistent with them. (2) A binding completely integrated agreement discharges prior agreements to the extent that they are within its scope.").

> sations or circumstances anterior to the written instrument. . . . This rule is recognised in Courts of equity as well as in Courts of law; but Courts of equity grant relief in cases of fraud and mistake, which cannot be obtained in Courts of law. In such cases, a Court of equity may carry the intention of the parties into execution, where the written agreement fails to express that intention.[26]

The most common court-made exceptions to the Rule are in cases where (1) one of the parties alleges fraud (including fraudulent concealment); (2) the written document is deemed to be ambiguous in certain ways; or (3) the parol evidence is used to show a mistake or error made by the parties. Professor Corbin's treatise notes that "[i]t is widely agreed that oral testimony is admissible to prove fraud or misrepresentation, mistake, or illegality. This exception to the parol evidence rule applies even if the testimony contradicts the terms of a completely integrated writing."[27] The logic of these exceptions is that they provide evidence helpful to show the true intention of the parties and the nature of the agreement they meant to form. Courts should not fear admitting parol evidence in these circumstances because "[w]hen incidents of fraud, innocent misrepresentation or mistake precede an integration, they clearly were not bargained over, and thus proof of them should never be barred by a merger clause or other application of parol evidence."[28] Importantly, the Rule does not prevent the admission of parol evidence for purposes that do not intend to explain or contradict the written agreement.[29] The following sections explore the application of these various exceptions to the Rule in the franchise context.

B. *Fraud*

It is not uncommon for aggrieved franchisees to assert fraud-related claims against franchisors. These claims come in a variety of forms, but generally share a common theme—the franchisor made promises, statements, or implications, or failed to disclose certain facts, and thereby induced the franchisee to enter into the franchise agreement. Most fraud claims involve both the alleged wrongful action by the franchisor and some sort of detrimental reliance by the franchisee.[30] As one court explained, the Rule exists to protect the actual agreement that the parties negotiated for—that the parties do not negotiate for fraud justifies the fraud exception.[31]

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26. Hunt v. Rousmanier's Adm'rs, 21 U.S. 174, 211 (1823).
27. 6 Corbin on Contracts § 25.20[A] (rev. ed. 2009).
28. *Id.* § 25.20[B][3].
29. *See, e.g.*, Cox v. Doctor's Assocs., Inc., 613 N.E.2d 1306, 1321 (Ill. App. Ct. 1993) (holding that the trial court did not err in admitting parol evidence of promises made to the franchisee by the franchisor that did not contradict the franchise offering circular, the promotional brochure, or the franchise agreement).
30. *See, e.g.*, Abbo v. Wireless Toyz Franchise, LLC, No. 304185, 2014 WL 1978185, at *4 (Mich. Ct. App. May 13, 2014) (citing Hord v. Envtl. Research Inst., 617 N.W.2d 543 (Mich. 2000) (proving silent fraud requires establishing that the franchisor "(1) suppressed or concealed the truth by employing false or misleading words, (2) with the intent to defraud or deceive, (3) while having a duty to disclose factually accurate information")).
31. *Id.* at *7 (quoting 6 Corbin on Contracts § 25.20[B][3]) (rev. ed. 2009)).

Different jurisdictions treat the fraud exception to the Rule differently. Until recently, for example, California did not allow the admission of parol evidence to prove fraud if the evidence directly contradicted the written agreement.[32] Jurisdictions also differ on whether the Rule applies to claims for fraud in the inducement.[33] Some courts refuse to recognize an exception for a fraud in the inducement claim, but readily admit parol evidence when the franchisee is making a fraud in factum claim.[34] Other courts additionally require a showing that the franchisee's reliance on the alleged fraudulent misrepresentation or concealment of fact was reasonable or justified.[35] In Colorado, for example, the franchisee must show both that it relied on the franchisor's misrepresentation and also that it was justified in doing so.[36]

Franchisors frequently defend themselves from fraudulent misrepresentation claims founded on the materials and information exchanged prior to executing a fully integrated franchise agreement. Generally, these claims state that the franchisor made false representations of fact that induced the franchisee to enter into the franchise agreement. In *Cottman Transmission Systems, LLC v. Kershner*, for example, a franchisee accused Cottman of making mis-

32. *See*, *e.g.*, Traumann v. Southland Corp., 842 F. Supp. 386 (N.D. Cal. 1993) (holding, "[t]he Traumanns' fraud claims are barred by the parol evidence rule. Under California law, 'if the false promise relates to the matter covered by the main agreement and contradicts or varies the terms thereof, any evidence of the false promise directly violates the parol evidence rule and is inadmissible.'" [citation omitted]). *But see* Riverisland Cold Storage, Inc. v. Fresno-Madera Prod. Credit Ass'n, 291 P.3d 316, 324 (Cal. 2013). In *Riverisland*, the California Supreme Court broadened the fraud exception to the Rule to allow parol evidence proving fraud, even if that parol evidence directly contradicted the written agreement. The court explained that "[w]hen fraud is proven, it cannot be maintained that the parties freely entered into an agreement reflecting a meeting of the minds." *Id.* California's current application of the fraud exception now matches most jurisdictions in this sense and the court referred to its previous precedent as an "aberration." *Id.*

33. *See*, *e.g.*, Keller v. A.O. Smith Harvestore Prods., 819 P.2d 69, 73 (Colo. 1991) (fraud in the inducement claims are generally not subject to the Rule); L.A. Ins. Agency Franchising, LLC v. Montes, No. CV 14-14432, 2016 WL 922948, at *9 (E.D. Mich. Mar. 11, 2016) (citing Custom Data Solutions, Inc. v. Preferred Capital, Inc., 733 N.W.2d 102, 105 (Mich. Ct. App. 2006) ("This case, then, is governed by the rule that the presence of a merger clause in a written contract will not preclude a claim for fraud in the inducement where the plaintiff can show that it would have avoided the agreement entirely had it known that the defendant's fraudulent misrepresentations in fact were false.")).

34. *See* Yocca v. Pittsburgh Steelers Sports, Inc., 854 A.2d 425, 437 (Pa. 2004) ("Notably, while parol evidence may be introduced based on a party's claim that there was fraud in the execution of the contract, i.e., that a term was fraudulently omitted from the contract, parol evidence may not be admitted based on a claim that there was fraud in the inducement of the contract, i.e., that an opposing party made false representations that induced the complaining party to agree to the contract.").

35. *See* Ayu's Global Tire, LLC v. Big O Tires, LLC, No. B236930, 2013 WL 2298585 (Cal. Ct. App. May 24, 2013); *see also* Star Ins. Co. v. United Commercial Ins. Agency, Inc., 392 F. Supp. 2d 927, 929 (E.D. Mich. 2005) ("The key element in cases involving a merger clause is whether one justifiably relied on the representations of another when the parties' written agreement clearly stated that by signing the document they were agreeing that the document made up the parties' entire agreement regarding the terms of the contract and its performance standards.").

36. *Ayu's Global Tire*, 2013 WL 2298585, at *4 (citing Barfield v. Hall Realty, Inc., 232 P.3d 286, 290 (Colo. Ct. App. 2010)).

representations in its Uniform Franchise Offering Circular (UFOC).[37] Specifically, the franchisees claimed the franchisor "misrepresented the average profit made by franchise store owners, the number of Cottman franchise stores that had closed in the past, the experience necessary to operate a franchise, and the average sales of franchise stores."[38] The court ultimately rejected the franchisee's attempt to use the UFOC to substantiate its fraud claim because the franchise agreement included a merger clause stipulating that the franchisees were not relying on any representations made outside the contract.[39] Similarly, courts are more likely to reject fraud claims where the franchise agreement itself addresses the same subject matter as the alleged misrepresentations predating the agreement.[40] Some courts provide that it is unreasonable to rely on a pre-contractual fraudulent misrepresentation regarding a particular topic when the fully integrated franchise agreement authoritatively provides information on that topic.[41]

With claims of silent fraud or fraudulent concealment, franchisees often allege that the franchisor failed to disclose or suppressed important or crucial information that the franchisee should have known prior to entering into the franchise agreement.[42] The Michigan Court of Appeals described silent fraud as involving "information that has been deliberately and deceptively withheld by one of the contracting parties."[43] In *Abbo v. Wireless Toyz Franchise, LLC*, the court of appeals affirmed the admission of parol evidence of the franchisor's deliberate suppression of information related to the UFOC.[44] However, the court noted that silent fraud may include failing to meet a duty to disclose.[45] The court reasoned that the franchisor had a duty to disclose data to correct otherwise misleading information in the UFOC and that the franchisor's non-disclosure constituted fraud.[46] Despite a merger clause in the parties' franchise agreement, the fraud warranted an exception to the Rule and the admission of the UFOC: "merger clauses do not mechanically eliminate from consideration *all* precontractual state-

37. 536 F. Supp. 2d 543, 552 (E.D. Pa. 2008).

38. *Id.*

39. *Id.* at 554. *But see* Sherman v. Ben & Jerry's Franchising, Inc., No. 1:08-CV-207, 2009 WL 2462539, at *4–5 (D. Vt. Aug. 10, 2009) (rejecting the defendant franchisor's motion to dismiss the franchisee's claim based on the use of parol evidence despite the presence of a general merger clause).

40. *See, e.g.*, AAMCO Transmissions, Inc. v. Wirth, No. CIV.A. 11-4250, 2011 WL 6088671 (E.D. Pa. Dec. 7, 2011) (citing Atl. Pier Assoc., LLC v. Boardakan Rest. Partners, 647 F. Supp. 2d 474, 489 (E.D. Pa. 2009) and *Yocca*, 854 A.2d at 438).

41. *Id.*

42. Abbo v. Wireless Toyz Franchise, LLC, No. 304185, 2014 WL 1978185, at *4 (Mich. Ct. App. May 13, 2014); *see* Colorado Coffee Bean LLC v. Peaberry Coffee Inc., 251 P.3d 9 (Colo. Ct. App. 2010) (franchisee claims that franchisor's failure to disclose losses at existing stores and franchisor's own losses constituted fraudulent nondisclosure).

43. *Abbo*, 2014 WL 1978185, at *5.

44. *Id.* at *4–6.

45. *Id.* at *4 ("[T]he term 'suppression' implies deliberate action. But fraud may also result from inaction—silence—when there is a duty to speak.").

46. *Id.* at *5.

ments or representations. A party may present evidence that deceit induced a contract, thereby rendering the agreement void."[47]

Courts also distinguish between the types of representations that are within the contract's scope (and are therefore protected by a merger clause) and those that are outside of the contract's scope.[48] As the U.S. District Court for the Eastern District of Michigan explained, "a party could still justifiably rely upon representations made by another party regarding things outside the scope of the contractual terms, such as the other party's solvency, indebtedness, experience, clientele, client retention rate, business structure, etc. If these representations are false when they are made, not merely opinion and not future promises, they could constitute fraud in the inducement."[49]

C. *Ambiguity*

Another common exception to the Rule occurs when a contract contains an ambiguity. Courts may deem a contract or a provision of a contract ambiguous when "a reasonably intelligent person viewing the contract objectively could interpret the language in more than one way."[50] In such cases, courts may admit extrinsic evidence to resolve the ambiguity. However, courts are reluctant to find contractual ambiguity if the language of the contract can provide its own explanation.[51] In *Bayit Care Corp. v. Tender Loving Care Health Care Services*, for example, the U.S. District Court for the Eastern District of New York rejected a franchisee's insistence that allegedly inconsistent language in a five-year extension agreement displaced the renewal provision in the original franchise agreement.[52] Instead, the court determined that the original franchise agreement was clear on its face with respect to the disputed provision and applied the original franchise agreement.[53]

Conversely, in a conflict regarding royalty rates in *Coyote Portable Storage, LLC v. PODS Enterprises, Inc.*, the U.S. District Court for the Northern District of Georgia admitted parol evidence after the court found an ambiguity in the parties' intent concerning the definition of "net sales" and its calculation.[54] The court observed that conflicts in language between an original

47. *Id.* (citing Custom Data Solutions, Inc. v. Preferred Capital, Inc., 733 N.W.2d 102 (Mich. Ct. App. 2006) (emphasis in original)).

48. Star Ins. Co. v. United Commercial Ins. Agency, Inc., 392 F. Supp. 2d 927, 930 (E.D. Mich. 2005).

49. *Id.*

50. Topps Co., Inc. v. Cadbury Stani S.A.I.C., 526 F.3d 63, 68 (2d Cir. 2008).

51. *See* Bayit Care Corp. v. Tender Loving Care Health Care Servs., No. 11-CV-3929 DRH, 2012 WL 1079042, at *7 (E.D.N.Y. Mar. 30, 2012) (quoting Garza v. Marine Transp. Lines, Inc., 861 F.2d 23, 26-27 (2d Cir. 1988) ("The parol evidence rule aims to ensure some measure of stability in commercial relations. . . . In the absence of the ambiguity, the effect of admitting extrinsic evidence would be to allow one party to substitute his view of his obligations for those clearly stated.")).

52. *Bayit Care Corp.*, 2012 WL 1079042, at *7.

53. *Id.*

54. No. 1:09-CV-1152-AT, 2012 WL 12948862, at *23 (N.D. Ga. Mar. 29, 2012) (applying Florida law and citing Lemon v. Aspen Emerald Lakes Assocs., Ltd., 446 So. 2d 177 (Fla. Dist. Ct. App. 1984)).

franchise agreement and its addendum created an ambiguity as to the intent of the parties, justifying the admission of parol evidence.[55] Similarly, in *Stuller, Inc. v. Steak 'n Shake Enterprises*, the U.S. District Court for the Central District of Illinois considered whether a franchise agreement's provision allowing the franchisor to revise "the System" included the ability to set menu prices at the franchises.[56] The court found that the phrase "the System" in the franchise agreement was ambiguous and admitted parol evidence, including previous agreements, negotiations, and UFOCs.[57]

D. *Mistake, Accident, and Party Admission Exceptions*

Mistake is another longstanding exception to the Rule.[58] When a franchise agreement fails to capture the parties' intent, courts will admit parol evidence for the purpose of identifying the intent. "In addition, where the actual intent of the parties is disputed or it is alleged that the language, while clear on its face, was the result of a mutual mistake of the parties, parol evidence is admissible to determine the true intent of the parties."[59] In *Patton v. Mid-Continent Systems*, for example, the Seventh Circuit held that despite a franchise agreement's integration clause, parol evidence from the parties' negotiations was admissible to resolve a territorial dispute when the scope of the territory was accidentally left out of the franchise agreement by the parties.[60]

Some states also recognize an "admissions" exception to the Rule. Generally, the Rule blocks the admission of extrinsic evidence that is contrary to the written agreement, but as the Third Circuit explained, that rule does not apply if a party admits that the written contract does not set forth the whole of the agreement.[61] In *Domino's Pizza v. Deak*, the court weighed whether the franchisee should be allowed to introduce the testimony of a former Domino's executive. In her testimony, the former executive explained that a separate oral agreement, entitling the franchisee to continue to renew its franchise agreement, existed.[62] Notwithstanding Domino's oppo-

55. *Id.* (citing Danforth Orthopedic Brace & Limb, Inc. v. Florida Health Care Plan, Inc., 750 So. 2d 774, 776 (Fla. Dist. Ct. App. 2000)).

56. 877 F. Supp. 2d 674 (C.D. Ill. 2012).

57. *Id.* at 692–94.

58. *See, e.g.*, Hunt v. Rousmanier's Adm'rs, 21 U.S. 174, 216 (1823) ("We find no case which we think precisely in point; and are unwilling, where the effect of the instrument is acknowledged to have been entirely misunderstood by both parties, to say, that a Court of equity is incapable of affording relief.").

59. Coyote Portable Storage, LLC v. PODS Enters., Inc., No. 1:09-CV-1152-AT, 2012 WL 12948862, at *17 (N.D. Ga. Mar. 29, 2012) (citing McKeever v. Rushing, 41 So. 3d 920, 923 (Fla. Dist. Ct. App. 2010)).

60. 841 F.2d 742, 746 (7th Cir. 1988).

61. Domino's Pizza LLC v. Deak, 383 F. App'x 155, 159 (3d Cir. 2010) (explaining, "[t]he parol evidence rule bars the admission of material contrary to the express terms of the written agreement, 'unless it is admitted that the whole of the agreement is not set forth in the writing.' . . . The admission of incompleteness must have been made or alleged to have been made at a time subsequent to entering into the agreement.").

62. *Id.*

sition, the court held the franchisee should be allowed to submit and that the district court should consider the admission evidence.[63]

III. Further Limitations to the Parol Evidence Rule

Statutory measures may weaken the protection provided to franchisors by the Rule. Specifically, in an effort to level the playing field between parties to franchise agreements, some state statutes include provisions that may nullify the integration, merger, or non-reliance clauses included in the agreements. Thus, despite including such clauses in their agreements, franchisors cannot ensure that courts will not later admit evidence of other materials or representations made during pre-agreement negotiations.

In *Atchley v. Pepperidge Farm*, for example, the U.S. District Court for the Eastern District of Washington fielded claims for negligent misrepresentation and violations of Washington's Franchise Investment Protection Act (FIPA).[64] FIPA imposes an affirmative duty on franchisors to avoid inducing a franchisee's reliance on untrue oral or written statements or omissions of material facts.[65] In *Atchley*, the plaintiff franchisee accused the defendant franchisor of making oral misrepresentations. Although the court noted that the Rule potentially barred evidence of the alleged oral misrepresentations for purposes of the negligent misrepresentation claim, the court also pointed out that this evidence could be admissible for a claim under FIPA.[66] The court even implied that the statute's non-waiver provision potentially stripped away the integration and non-reliance clauses that the franchisor built into the franchise agreement: "to the extent Defendant holds out the contractual integration and non-reliance clauses to immunize itself against liability for any misleading oral misrepresentations or omissions, FIPA may void those contractual provisions for attempting to waive Defendant's obligations under [the statute]."[67]

63. *Id.* (To justify admitting the parol evidence for an otherwise integrated contract, the Third Circuit pointed to Pennsylvania's interpretation of the Rule: "the parol evidence rule has never barred the introduction of clear, precise, and convincing evidence to show that the party who seeks to enforce the written agreement according to its tenor has admitted and acknowledged that the agreement as written did not express what the parties intended and what the parties intended was omitted from the agreement by mistake or accident." (quoting Scott v. Bryn Mawr Arms, Inc., 312 A.2d 592, 595 (Pa. 1973))).

64. No. CV-04-452-EFS, 2012 WL 12951707 (E.D. Wash. Oct., 25, 2012).

65. *See* WASH. REV. CODE § 19.100.170 ("It is unlawful for any person in connection with the offer, sale, or purchase of any franchise or subfranchise in this state directly or indirectly: (1) To make any untrue statement of a material fact in any application, notice, or report filed with the director under this law or willfully to omit to state in any application, notice or report, any material fact which is required to be stated therein or fails to notify the director of any material change as required by RCW 19.100.070(3).").

66. *Atchley*, 2012 WL 12951707, at *2.

67. *Id.* (citing Rutter v. BX of Tri-Cities, Inc., 806 P.2d 1266, 1268 (Wash. Ct. App. 1991)).

Other states have adopted similar statutory schemes that are designed to give franchisees a stronger position vis-à-vis their franchisors.[68] Like Washington, Michigan imposes certain duties on franchisors.[69] The Michigan Franchise Investment Law (MFIL) "imposes on franchisors a statutory obligation to refrain from making material misrepresentations and omitting pertinent information from any disclosures."[70] In addition to the mandatory informational disclosures required by the statute, the MFIL also includes a list of void and unenforceable provisions that may not be included in a franchise agreement.[71] California's Franchise Investment Law imposes similar duties on the franchisor.[72] If the franchisor violates any of the provisions in the California statute, including making fraudulent misrepresentations or failing to make required disclosures, the statute subjects the franchisor to liability to the franchisee.[73] In some circumstances, states have even adopted industry-specific franchise statutes. Missouri, for example, is one of many states that has a motor vehicle franchise practices statute.[74]

However, even in states that have adopted robust franchise statutory schemes, not all of them are as franchisee-friendly as the Washington statute. The Florida Franchise Act, for example, does not contain an anti-waiver provision, which means that parties may contract around the protections provided by the statute.[75] Considering the variety of statutory schemes throughout American jurisdictions, franchisors seeking to include strong protections against parol evidence in their franchise agreements should ensure that the desired provisions are enforceable in their jurisdiction.

68. *See, e.g.*, Virginia Retail Franchise Act, VA. STAT. § 13.1-558 (explaining Virginia's public policy to "correct as rapidly as practicable such inequities as may exist in the franchise system"); *see also* Illinois Franchise Disclosure Act (IFDA), 815 ILL. COMP. STAT. 705/1 et seq.

69. MICH. COMP. LAWS ANN. § 445.1501 et seq.

70. Abbo v. Wireless Toyz Franchise, LLC, No. 304185, 2014 WL 1978185, at *8 (Mich. Ct. App. May 13, 2014); *see also* MICH. COMP. LAWS ANN. § 445.1508 (imposing a statutory duty on franchisors to disclose statements and other information along with certain franchise agreements).

71. MICH. COMP. LAWS ANN. § 445.1527.

72. *See* CAL. CORP. CODE § 31000 et seq.

73. CAL. CORP. CODE § 31201 (covering particular misrepresentations or omissions); *see also* CAL CORP. CODE § 31301 ("[A]ny person who violates section 31201 shall be liable to any person (not knowing or having cause to believe that such statement was false or misleading) who, while relying upon such statement shall have purchased a franchise, for damages, unless the defendant proves that the plaintiff knew the facts concerning the untruth or omission or that the defendant exercised reasonable case and did not know (or if he had exercised reasonable case would not have known) of the untruth or omission.").

74. *See* Motor Vehicle Franchise Practices Act, MO. REV. STAT. § 407.810-835 (1997); Stone Motor Co. v. Gen. Motors Corp., 293 F.3d 456 (8th Cir. 2002) ("The purpose of the MVFPA is to level the contractual playing field between local franchisees and motor vehicle manufacturers.").

75. *See* FLA. STAT. § 817.416; Cottman Transmission Sys., LLC v. Kershner, 536 F. Supp. 2d 543 (E.D. Pa. 2008) ("Because the Franchise Act contains no anti-waiver provision, Florida franchisees may choose to contract around the Act. In other words, Florida's policy is to provide a franchisee with as much protection as he or she contracts to receive.")

IV. What Can Franchisors Do?

To start, franchisors can avoid at least some of their franchisees' claims by complying with state and federal franchise disclosure requirements. As discussed above, multiple states regulate franchising through a variety of statutory schemes. These statutory regimes generally provide what disclosures must be made to prospective franchisees, and many of these states require that pre-franchise agreement materials be provided to a state regulatory agency.[76] Importantly, these state statutes often provide to franchisees a private right of action against a franchisor that fails to properly comply with the required disclosures.[77] Additionally, franchisors are similarly bound by federal regulation to provide prospective franchisees with the appropriate disclosures.[78] The federal disclosure requirements, promulgated by the Federal Trade Commission, supplement any existing state laws directing disclosure. Although the FTC Rule does not provide a private right of action like the state statutes, it does serve as "a siren call for franchisees looking for a good cause of action."[79] In other words, franchisees may use a violation of the FTC Rule as the basis for a claim in states that do not have a statute regulating disclosures.[80]

Outside of the disclosures required by statute or regulation, if a franchisor wants to make certain representations or provide significant information to a potential franchisee prior to executing the franchise agreement, the franchisor should assess the necessity of this information. When communicating with potential franchisees, franchisors should take affirmative steps to ensure that potential franchisees have access to adequate and accurate information about the franchise. By supplying prospective franchisees with more information, franchisors can prevent later claims of fraudulent concealment, or silent fraud, and fraudulent misrepresentation. This is especially true in states that require a plaintiff franchisee to prove reasonable reliance.[81]

In providing pre-agreement materials for prospective franchisees, franchisors should include disclaimers that urge the prospective franchisees not to rely on the given data and to conduct their own due diligence. In *Colorado Coffee Bean LLC v. Peaberry Coffee Inc.*, for example, a franchisor issued a

76. Bethany L. Appleby, Robert S. Burstein & John M. Doroghazi, *Cause of Action Alchemy: Little FTC Act Claims Based on Alleged Disclosure Violations*, 36 FRANCHISE L.J. 429, 430 (2017) (citing 1 FRANCHISE AND DISTRIBUTION LAW AND PRACTICE § 5A:45).

77. *Id.* at 430 n.3.

78. The Federal Trade Commission rule, for example, requires franchisors to provide a Franchise Disclosure Document to prospective franchisees ahead of any franchise agreement. *See* 16 C.F.R. § 436.2.

79. Appleby et al., *supra* note 76, at 430.

80. *Id.*

81. *See, e.g.*, Ayu's Global Tire, LLC v. Big O Tires, LLC, No. B236930, 2013 WL 2298585, at *5 (Cal. Ct. App. May 24, 2013) (citing Balkind v. Telluride Mountain Title Co., 8 P.3d 581 (Colo. Ct. App. 2000) (Under Colorado's inquiry notice doctrine, "a party to a contract cannot show reasonable reliance on misrepresentations regarding the contract when the party had full access to the relevant facts.")).

UFOC disclosing gross sales at established stores, but warned that it made no guarantee of profitability and provided no data regarding profits.[82] The UFOC also encouraged prospective franchisees to conduct their own independent financial analyses.[83] The franchisee ultimately brought a fraudulent nondisclosure claim, alleging the franchisor should have disclosed losses at existing franchise stores.[84] Because of the language in the UFOC and the clear language in the franchise agreement, the Colorado Court of Appeals held that the franchisee failed to prove reasonable reliance on the purported fraudulent nondisclosures.[85]

When drafting an integration or merger clause, or other franchise agreement disclaimers, franchisors should ensure that the clauses are broad enough to exclude the pre-contractual statements and negotiations between themselves and their franchisees. In *Abbo*, for example, the Michigan Court of Appeals parsed the language in a merger clause and allowed parol evidence substantiating that the franchisor "fraudulently concealed" damaging information.[86] The court first observed that although the merger clause in the franchise agreement applied to "any and all prior or contemporaneous agreements" and "all previous written and oral agreements or understandings between the parties," it did not apply to any prior "representations" or "inducements."[87] Citing the plain language of the merger clause, the court admitted the parol evidence, pointing out that it did not contradict the terms of the franchise agreement.[88]

Conversely, the franchisor in *Maaco Franchising, Inc. v. Tainter* included an integration clause sufficiently broad enough to protect a franchise agreement's forum selection clause from attack with parol evidence.[89] The franchise agreement provided that "[n]o representations, inducements, promises, or agreements, oral or otherwise, not embodied herein or attached hereto (unless of subsequent date) are made to either party, and none shall be of any force or effect with reference to this Agreement or otherwise."[90] The court found that this language negated a separate franchise disclosure document that the franchisor gave to the franchisee before the execution of the franchise agreement, which suggested that some California law may supersede certain terms of the agreement.[91]

82. Colorado Coffee Bean LLC v. Peaberry Coffee Inc., 251 P.3d 9, 15–18 (Colo. Ct. App. 2010).
83. *Id.*
84. *Id.* at 18.
85. *Id.* at 20.
86. Abbo v. Wireless Toyz Franchise, LLC, No. 304185, 2014 WL 1978185, at *6 (Mich. Ct. App. May 13, 2014).
87. *Id.*
88. *Id.*
89. No. CIV.A. 12-5500, 2013 WL 2475566 (E.D. Pa. June 10, 2013).
90. *Id.* at *1–2.
91. *Id.* at *4.

When drafting the franchise agreement, franchisors should keep a few other considerations in mind. First, where possible, franchisors should seek to avoid "boilerplate" integration and merger clause language in the franchise agreement and should instead opt for language tailored to the parties' needs. Kansas courts, for example, have held that boilerplate integration clauses fail to bar parol evidence of oral representations made by a franchisor during negotiations.[92] Second, franchisors should include disclaimers in the franchise agreement that limit the franchisee's reliance on any representations that are not made in the franchise agreement itself.[93] Lastly, separate closing acknowledgments may also help bolster the integration and merger clauses in a franchise agreement.[94]

Taking a few preventative steps during the negotiation and drafting of the franchise agreement helps franchisors defend the terms of the franchise agreement from attack with parol evidence.

V. Conclusion

Franchise agreements are intended to fully define the franchisor's and franchisee's relationship and designate their rights and responsibilities. As with most contracts, franchise agreements typically aim to serve as the fully integrated agreement between the parties. The Rule serves to protect these agreements from later attack by the franchisee. Whether it is because the circumstances surrounding the franchise and/or the franchise relationship have changed or because one of the parties later seeks more favorable terms than those outlined by the franchise agreement, the Rule plays an important role in preserving the original intention of the contracting parties.

However, long-standing and significant exceptions to the Rule provide tools for courts to ensure equity and fairness in the franchise relationship. By providing exceptions for fraud, ambiguity, and mistake, courts can effectuate the parties' intent and ensure fair dealing in franchise agreements. Ad-

92. *See* Ramada Franchise Sys., Inc. v. Tresprop, Ltd., 188 F.R.D. 610, 615–16 (D. Kan. 1999); *see also* Genesis Health Clubs, Inc. v. LED Solar & Light Co., No. 13-CV-1269, 2013 WL 5276150, at *5 (D. Kan. Sept. 18, 2013). In Vermont, courts have similarly explained that "boilerplate integration clauses and disclaimers will not, as a rule, preclude a claim of fraudulent inducement based on statements not contained in the contract." *See* Sherman v. Ben & Jerry's Franchising, Inc., No. 1:08-CV-207, 2009 WL 2462539, at *3 (D. Vt. Aug. 10, 2009) (citing Negyessy v. Strong, 556 A.2d 81, 83 (Vt. 1978)).

93. *See Sherman*, 2009 WL 2462539, at *4. As the court explained, "[w]here a seller expressly disclaims any express or implied warranty concerning *specific* representations, and a buyer *expressly* acknowledges the disclaimer and the need to conduct an independent investigation, that party may not sue on a claim she was defrauded into entering the contract in reliance on those very representations."

94. *See*, *e.g.* Ayu's Global Tire, LLC v. Big O Tires, LLC, No. B236930, 2013 WL 2298585, at *7 (Cal. Ct. App. May 24, 2013) (franchisee executed a separate closing acknowledgment that stated "I am not relying on any promises of [franchisor] which are not contained in the Big O franchise agreement." (citing Sugarline Assocs. v. Alpen Assocs., 586 A.2d 1115 (Vt. 1990))).

ditionally, the adoption of robust franchise statutory schemes potentially weakens the shield that the Rule provides to franchise agreements.

Well-drafted integration and merger clauses provide franchisors with an important first line of defense for the franchise agreement. Yet, in view of the Rule's significant exceptions, franchisors must be careful to ensure that the franchise agreement sets forth all important provisions, agreements, understandings, and representations. Franchisors may also mitigate the possibility of conflict by including certain disclaimers in pre-contractual documents and by producing consistent representations in UFOCs and in the franchise agreement itself. These and other steps help alleviate the vulnerabilities created by the exceptions to the Rule.