# "But They Were Not My Client": The Prospect of a Franchisor's Outside Counsel Being Liable to an Aggrieved Franchisee

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Next year (i.e., 2022) marks the thirty-fifth anniversary of the 1987 California Court of Appeal decision that "sent a chill through the franchise bar."[1] In *Courtney v. Waring*,[2] the California Court of Appeal determined that franchisees could advance a claim of negligence against franchisor counsel with respect to the preparation of an offering circular,[3] which is the predecessor of today's federally mandated Franchise Disclosure Document (FDD).[4]

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Although the *Courtney* decision was limited to whether the franchisees' complaint sufficiently set forth a claim of negligence and not whether franchisor counsel was truly liable for the alleged wrongs,[5] the decision is the foundation for numerous legal treatises and secondary sources that opine that franchisor counsel could be liable to a franchisee that entered into a franchise transaction based on a flawed prospectus or disclosure document. For example, *American Jurisprudence* cites *Courtney* for the following proposition:

> Attorneys who negligently prepare a franchise prospectus which fails to disclose material information known to them but unknown to potential franchisees may

1. Alexander M. Meiklejohn, *UFOCs and Common Law Claims Against Franchise Counsel for Negligence*, 25 Franchise L.J. 45, 62 (2005).
2. Courtney v. Waring, 191 Cal. App. 3d 1434 (1987).
3. *See* Meiklejohn, *supra* note 1, at 61–62.
4. *See* 16 C.F.R. §§ 436, 437.
5. *See* Meiklejohn, *supra* note 1, at 62.

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> be subject to legal malpractice claims by franchisees who purchased their franchises on the basis of such prospectus where the attorneys know that the prospectus will be shown to such prospective franchisees and that the information contained in it will be used to induce these persons to purchase franchises.[6]

Notably, that same treatise also advances a second, similar legal proposition based on the Maryland case of *Bagel Enterprises, Inc. v. Baskin & Sears*,[7] which relates to a subfranchisor/master franchisee relationship: "A law firm may be negligent in not knowing and informing a subfranchisor of state franchise registration laws."[8] Thus, at least some commentary suggests that franchisor counsel may be held liable in negligence to an aggrieved franchisee, based upon counsel's representation of the franchisor.

While case law on this topic is relatively sparse, as discussed below, it is nevertheless incumbent upon franchisor counsel to appreciate the duties and potential liabilities that such counsel owes to prospective and existing franchisees. In a 2018 *Franchise Law Journal* article, entitled "Walking the Line: When Are the Franchisor's In-House Counsel's Communications or Advice to a Franchisee An Ethical Violation?", the authors generally explored this topic as it relates to those attorneys employed directly by a franchisor.[9] This article seeks to expand upon that 2018 article and explore the topic of franchisor counsel liability in a broader sense—with particular focus on claims and potential liability involving attorneys and law firms that serve as *outside* counsel to franchisors.

This article discusses (1) the duties and responsibilities, if any, that a franchisor's outside counsel owes to a prospective franchisee; (2) the impact of any state franchise laws on the relationship between franchisor's outside counsel and a prospective franchisee; (3) potential causes of actions a franchisee could assert against a franchisor's outside counsel; (4) defenses to commonly asserted claims against franchisor's outside counsel; (5) policy considerations attendant to the relationship between franchisor counsel and prospect; and (6) best practices that outside counsel should employ to eliminate or reduce the risk of such claims.

## I. What Duties, If Any, Do Franchisor's Outside Counsel Owe to a Prospective Franchisee?

A franchisor's outside counsel should primarily be guided by applicable state rules of professional conduct, and the related American Bar Association's Model Rules of Professional Conduct, for guidance on how to conduct themselves in interactions with both prospective and current franchisees.

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6. *See* 62B Am. Jur. 2d *Private Franchise Contracts* § 139 (1990) (citing *Courtney*, 191 Cal. App. 3d 1434).

7. *See* Bagel Enters., Inc. v. Baskin & Sears, 467 A.2d 533 (Md. Ct. Spec. App. 1983).

8. *See* Am. Jur. 2d, *supra* note 6.

9. *See* James Mulcahy & Douglas Luther, *Walking the Line: When Are the Franchisor's In-House Counsel's Communications or Advice to a Franchisee an Ethical Violation?*, 37 Franchise L.J. 571 (2018).

Although a franchisor's outside counsel have a duty to zealously represent the interests of their own client (i.e., the franchisor), courts have often concluded that these duties to one's own client are not absolute. For example, the Superior Court of Connecticut has meaningfully observed:

> The practice of law is a profession, not just a business of winning. It is a profession that requires highly trained men and women to strive for impeccable judgment and unquestioned integrity. Lawyers are required by the rules that govern them and their clients to sacrifice their own interest and even that of their clients when the integrity of the legal system demands it.[10]

Accordingly, a franchisor's outside counsel's duty of loyalty to a client (i.e., a franchisor) is not unconditional or absolute, as the attorney's zealous advocacy is confined by the bounds of both state rules of professional conduct and the related Model Rules.[11]

Model Rule of Professional Conduct 1.2(d) provides that:

> A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.[12]

Counsel is also explicitly forbidden from engaging in "conduct involving dishonesty, fraud, deceit or misrepresentation."[13] Further, attorneys are barred from knowingly making "a false statement of material fact or law to a third person" and failing to "disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client."[14]

In light of these ethical obligations and restrictions, franchisor's outside counsel must proceed very carefully and conservatively when it comes to their interactions and communications with prospective and current franchisees, and with respect to their involvement in the preparation of a client's FDD.

To comply with the Federal Trade Commission's (FTC) Franchise Rule, the franchisor and, by extension, its outside counsel, must not omit essential, material information that is mandated for disclosure to a prospective franchisee prior to the sale of a franchise unit.[15] The FTC Franchise Rule, like securities laws related to the preparation of a prospectus, have as a goal and intended outcome the disclosure of material information before

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10. Amity Regional School Dist. No. 5 v. Atlas Const. Co., 2001 WL 273145, at *3 (Conn. Super. Ct., Mar. 1, 2001).

11. *See id.*

12. Model Rule Prof. Conduct r. 1.2(d) (Am. Bar Ass'n 1983).

13. *See id.* r. 8.4(c).

14. *Id.* r. 4.1(a)–(b).

15. *See*, *e.g.*, Arruda v. Curves Int'l, Inc., 2020 WL 4289380, at *5 (W.D. Tex. July 27, 2020) ("[T]he purpose of the FTC Franchise Rule is to give prospective purchasers of franchises the material information they need in order to weigh the risks and benefits of such an investment.") (internal quotations and citations omitted); *see also* A Love of Food I, LLC v. Maoz Vegetarian USA, Inc., 70 F. Supp. 3d 376, 382 (D.D.C. 2014) ("The purpose of these state laws is identical to the purpose of the Franchise Rule: both aim to protect franchisees.").

the consummation of a transaction in order to enable prospective buyers to make informed decisions.[16] Thus, outside franchisor counsel who knowingly omits key information or drafts an FDD in a deceptive manner faces possible exposure to claims of wrongdoing and liability.[17]

Again, drawing on the related securities context, liability for outside counsel involved in the drafting or preparation of a prospectus or other securities document may be imposed under 17 C.F.R. § 240.10b-5 as well as common law (such as fraud or negligent misrepresentation). Rule 10b-5(b) explains that attorneys may be liable for making any "untrue statement of a material fact or . . . omit[ting] to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." Comparable sentiment appears to be finding its way into the franchise context. For example, a commentator in the Winter 2020 *Franchise Law Journal* noted: "It is unlawful in offering or selling a franchise to leave out an important fact that is necessary to make the statements made, in the circumstances, not misleading."[18]

However, Rule 10b-5 outlines specific standards for alleging liability against the prospectus drafters. To state a claim under Rule 10b–5, "plaintiffs must properly allege primary liability by the attorneys . . . who participated in drafting the prospectus."[19] To assert a claim against outside counsel, plaintiffs are not required to show a duty of disclosure on the part of outside counsel who participated in preparing prospectuses or other securities documents that contain material omissions.[20] In these (and other) ways, securities

16. *Compare* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976) ("The Securities Act of 1933 (1933 Act) . . . was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing."), *with* FTC v. Transnet Wireless Corp., 506 F. Supp. 2d 1247, 1268–69 (S.D. Fla. 2007) ("The Franchise Rule or Business Opportunity Rule. . . requires the franchisor to provide prospective franchisees or purchasers with a complete and accurate basic disclosure document containing twenty categories of information . . . .").

17. *See* 16 C.F.R. § 436.6(a) (providing, in part, as follows: "It is an unfair or deceptive act or practice in violation of Section 5 of the FTC Act for any franchisor to fail to include the information and follow the instructions for preparing disclosure documents set forth in subpart C (basic disclosure requirements) and subpart D (updating requirements) of part 436."); *see also* David Gurnick, *Franchise Law Jury Instructions*, 39 Franchise L.J. 289, 323 (2020) ("It is unlawful to omit from the Franchise Disclosure Document (or FDD) any material fact which is required to be stated therein.").

18. Gurnick, *supra* note 17, at 327.

19. Employers Ins. of Wausau v. Musick, Peeler, & Garrett, 871 F. Supp. 381, 388 (S.D. Cal. 1994) (holding that the plaintiffs pled a sufficient case for primary liability under section 10(b) against attorneys and accountants who were chief architects of the prospectus and registration statements).

20. *See* Powell v. H.E.F. P'ship, 835 F. Supp. 762, 768 (D. Vt. 1993) ("While it is true that several cases in other circuits refuse to impose aiding or abetting liability for inaction except when there exists an independent duty to disclose, this is not a case of inaction. Contrary to [defendant's] assertions, drafting a document that contains material omissions is not "inaction" as the term is used in the case law."); *see also* S.E.C. v. Seaboard Corp., 677 F.2d 1301, 1312 (9th Cir. 1982) ("Misrepresentation in the prospectus is a manipulative and deceptive device within the meaning of the rule. An accountant may be liable for direct violation of the rule if its participation in the misrepresentation is direct and if it knows or is reckless in not knowing that the

laws are far more protective of potential investors than franchise laws are with respect to protecting prospective franchisees, even though both sets of laws, as indicated above, have a nearly identical goal and purpose.

## II. What Causes of Action Can a Franchisee Assert, and What Remedies Are Available, If a Franchisee Believes It Was Misled or Lied to by Franchisor's Outside Counsel When Purchasing the Franchise?

As a preliminary matter, case law with respect to actions by franchisees against franchisor counsel is rather limited for two principal reasons.

*First*, law firms and attorneys that are named as defendants in a malpractice lawsuit typically settle the case before it proceeds to a full-blown trial.[21]

*Second*, those "franchisee vs. franchisor counsel" battles are "a really uphill dispute" for franchisees, as noted by franchisee counsel Howard Bundy in the March 2012 *Franchise Times* article. As Bundy further explained:

> "It's a very high standard to prove, and it has to go beyond just a technical issue with the FDD" or there's not much of a case, Bundy said. "There has to be some sort of active participation in the wrong-doing, such as knowing your signing off on an FDD that is 180-degrees inconsistent with a letter you wrote 40 days earlier," he said. . . .[22]

There appears to be only one appellate decision in the last decade that involves claims brought by franchisees against their franchisor, the parent company of the franchisor, and the law firm that served as the parent company's franchise counsel. That case, *Colorado Coffee Bean, LLC v. Peaberry Coffee Inc.*,[23] went up to the Colorado Court of Appeals on a number of issues, including whether the trial court's decision to dismiss the fraudulent nondisclosure, aiding and abetting fraudulent nondisclosure, and negligent misrepresentation claims against the defendant-law firm should be vacated.[24] As to the law firm, the Colorado Court of Appeals remanded the fraudulent nondisclosure and aiding and abetting claims, explaining that common law claims are not preempted by the FTC Rule and regulations. In other words, the FTC Rule and regulations do not provide a "safe harbor" from a finding

facts reported in the prospectus materially misrepresent the condition of the issuer. An accountant may be liable as an aider and abettor if it knows, or is reckless in not knowing, that its client has committed a primary violation, and it substantially aids the client in the overall enterprise.").

21. *See* Steven Pease, *Targeting Attorneys*, Franchise Times, Mar. 2012, at 48–49, http://www.onlinedigitalpubs.com/publication/?m=9035&i=101687&p=48&article_id=982763&ver=html5 (last visited May 13, 2021) (noting, in part: "Lawyers or firms often settle a malpractice case brought by a franchisee before it goes to trial."). Other examples include *Dream Dinners Capital Region v. Dream Diners, Inc.*, Cause No. 08-2-04004-4 (Snohomish Cnty. Sup. Ct.), a legal malpractice case relating to sales of franchises and believed to be resolved in late 2010, and *Turner v. Dream Dinners, Inc.*, Cause No. 08-2-02623-8 (Snohomish Cnty. Sup. Ct.), filed in Washington State in 2008 and also believed to be resolved as part of the same settlement of the other *Dream Dinners* case.

22. Pease, *supra* note 21.

23. Colo. Coffee Bean, LLC v. Peaberry Coffee Inc., 251 P.3d 9 (Colo. App. 2010).

24. *See id.* at 14, 30.

of liability under common law.[25] However, the Colorado Court of Appeals affirmed the dismissal of the negligent misrepresentation claim, in part because under Colorado law, a negligent misrepresentation pertains to what was "affirmatively represented" and not what was "undisclosed."[26]

The claims advanced by the franchisees in *Colorado Coffee Bean, LLC* are discussed below in the context of how such claims could generally be asserted in any "franchisee vs. franchise counsel" legal battle.

### A. *Duties Owed by Franchisor Counsel to Prospective Franchisees*

A franchisor's outside counsel may be an enticing target for damaged franchisees seeking recovery from as many "responsible" parties as possible. Since an attorney's duties are not solely limited to their clients under the Rules of Professional Conduct, non-clients, including both prospective and existing franchisees, can assert claims stemming from the duties franchisor's outside counsel allegedly owed them.[27] For obvious reasons, however, the prospect of extending duties to non-clients is especially worrisome for counsel who have ethical and contractual responsibilities to represent the legal interests of their own clients.

So how far can a franchisee push the boundaries in extending liability to a franchisor's outside counsel? The *Restatement (Third) of the Law Governing Lawyers* §§ 51–98 provides relevant guidance as to the extent to which a franchisor's outside counsel owes duties to prospective and existing franchisees.

Under *Restatement* § 51, attorneys owe a duty of care to a non-client in the following situations: (1) the attorney invites the non-client to rely on his opinion or provision of his legal services, on which the non-client relies; (2) the non-client is not too remote from the attorney to be entitled to protection; (3) the attorney knows that one of his client's primary objectives in hiring the attorney is that the lawyer's services benefit the non-client; and (4) the attorney knows that he or she assisted or is assisting in a breach of the fiduciary duty that the attorney's client owes to the non-client.

As the Supreme Court of New Jersey observed in *Petrillo v. Bachenberg*,

> We also recognize that attorneys may owe a duty of care to non-clients when the attorneys know, or should know, that non-clients will rely on the attorneys' representations and the non-clients are not too remote from the attorneys to be entitled to protection. The Restatement's requirement that the lawyer invite or acquiesce in the non-client's reliance comports with our formulation that the lawyer know, or should know, of that reliance. No matter how expressed, the point is to cabin the lawyer's duty, so the resulting obligation is fair to both lawyers and the public.[28]

25. *See id.* at 22–24, 30–31.
26. *See id.* at 31.
27. *See* Davin, LLC v. Daham, 746 A.2d 1034, 1044 (N.J. Super. Ct. App. Div. 2000) ("[A]ttorneys may owe a duty of care to non-clients in situations in which the attorneys know or should know that the non-client would rely on the attorney's representations, and the non-client is not too remote from the attorney to be entitled to protection.").
28. Petrillo v. Bachenberg, 655 A.2d 1354, 1359–60 (N.J. 1995).

Under *Restatement* § 98, attorneys are prohibited from (1) knowingly making a false statement of material fact or law to a non-client; (2) making a statement that is prohibited by law; or (3) failing to make disclosures of information that are required by law. Franchisor's outside counsel may expose themselves to claims given their involvement in the drafting and revisions of the franchisor's FDD and franchise agreements. Hence, there are situations in which a franchisor's outside counsel's liability extends to prospective and/or existing franchisees—as exemplified by the claims discussed below.

### B. *Causes of Action That a Franchise Purchaser Can Assert Against Its Franchisor's Outside Counsel*

The following are the principal claims that a current or prospective franchisee may assert against its franchisor's outside counsel.

#### 1. Negligent Misrepresentation

Despite the lack of attorney-client relationship between the current or prospective franchisee and the franchisor's outside counsel, most states permit franchisees to bring negligent misrepresentation claims against the franchisor's outside counsel. Specifically, the majority of jurisdictions have adopted *Restatement (Second) of Torts* § 552 (1977) regarding negligent misrepresentation actions, which provides:

> One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.[29]

Under Tennessee law, for instance, a plaintiff must plead the following elements: "(1) the defendant is acting in the course of his business, profession, or employment, or in a transaction in which he has a pecuniary (as opposed to gratuitous) interest; and (2) the defendant supplies faulty information meant to guide others in their business transactions; (3) the defendant fails to exercise reasonable care in obtaining or communicating the information; and (4) the plaintiff justifiably relies upon the information."[30] Other states have adopted substantially similar elements.[31]

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29. *See also* Cromeans v. Morgan Keegan & Co., 69 F. Supp. 3d 934, 939 (W.D. Mo. 2014) (recognizing that "the national trend to recognize negligent misrepresentation claims against lawyers by non-clients and the consistent application of § 552 to other professionals, the Court predicts that Missouri courts will likewise recognize such a claim against lawyers by non-clients so long as the requirements of § 552 are satisfied").

30. *In re* Big Heart Pet Brands Litig., 2019 WL 8266869, at *24 (N.D. Cal., Oct. 4, 2019) (citing John Martin Co. v. Morse/Diesel, Inc., 819 S.W.2d 428, 431 (Tenn. 1991)).

31. *See*, *e.g.*, MSC Safety Sols., LLC v. Trivent Safety Consulting, LLC, 2020 WL 4271703, at *10 (D. Colo., July 24, 2020); Vaith v. Gen. Motors, LLC, 2018 WL 3489600, at *5 (D. Minn., June 28, 2018); Axis Oilfield Rentals, LLC v. Mining, Rock, Excavation & Constr., LLC, 223 F. Supp. 3d 548, 558 (E.D. La. 2016); Patel v. Univ. of Toledo, 95 N.E.3d 979, 988 (Ohio Ct. App. 2017).

Within the franchise context, a prospective franchisee could assert a claim for negligent misrepresentation by arguing that the franchisor's outside counsel was acting in the course of his or her profession, counsel was heavily involved in the drafting of an FDD that contains material omissions, counsel failed to exercise reasonable care, and the prospective franchisee justifiably relied on the information contained within the FDD when deciding to enter into a franchise relationship.[32]

### 2. Fraudulent Concealment

Similar to negligent misrepresentation, a franchisee could assert that its franchisor's outside counsel intentionally concealed material information from the franchisee, causing damages. Under Maryland law, for example, the elements of a fraudulent concealment claim are the following:

> (1) the defendant owed a duty to the plaintiff to disclose a material fact; (2) the defendant failed to disclose that fact; (3) the defendant intended to defraud or deceive the plaintiff; (4) the plaintiff took action in justifiable reliance on the concealment; and (5) the plaintiff suffered damages as a result of the defendant's concealment.[33]

Other states have adopted substantially similar elements.[34]

A franchisee may bring a fraudulent concealment claim even where the franchisor's counsel argues that no fiduciary relationship exists between the parties. As the U.S. District Court for the District of Maryland observed in *My National Tax & Insurance Services, Inc. v. H & R Block Tax Services, Inc.*,

> Absent a fiduciary relationship, [the Court of Appeals of Maryland] has held that a plaintiff seeking to establish fraudulent concealment must prove that the defendant took affirmative action to conceal the cause of action and that the plaintiff could not have discovered the cause of action despite the exercise of reasonable diligence.[35]

### 3. Aiding and Abetting

A franchisor's outside counsel may also be vulnerable to a claim that he or she aided and abetted a breach of a fiduciary duty as a number of states—including Arizona, Missouri, South Dakota, and Utah—acknowledge that a fiduciary duty may arise between the franchisor and franchisee.[36]

32. Aside from *Colorado Coffee Bean, LLC v. Peaberry Coffee Inc.* there are no reported cases of a franchisee asserting negligent misrepresentation and fraudulent concealment against franchisor's counsel.

33. My Nat'l Tax & Ins. Servs., Inc. v. H & R Block Tax Servs., Inc., 839 F. Supp. 2d 816, 820 (D. Md. 2012) (quoting Green v. H & R Block, Inc., 735 A.2d 1039, 1059 (1999)).

34. *See MSC Safety Sols.*, 2020 WL 4271703, at *10; *Vaith*, 2018 WL 3489600, at *5; *Axis Oilfield Rentals*, 223 F. Supp. 3d at 558; *Patel*, 95 N.E.3d at 988.

35. *My Nat'l Tax & Ins. Servs.*, 839 F. Supp. 2d at 820 (internal citations and quotations omitted).

36. *See* Keg Rests. Ariz., Inc. v. Jones, 375 P.3d 1173, 1185 (Ariz. Ct. App. 2016); ABA Distribs., Inc. v. Adolph Coors Co., 542 F. Supp. 1272, 1286 (W.D. Mo. 1982); Arnott v. Am. Oil Co., 609 F.2d 873, 884 (8th Cir. 1979); Gen. Bus. Machs. v. Nat'l Semiconductor Datachecker/DTS, 664 F. Supp. 1422, 1425 (D. Utah 1987).

In general, there are three elements of a claim for aiding and abetting a breach of fiduciary. Under Massachusetts law, "(1) there must be a breach of fiduciary duty; (2) the defendants must know of the breach; and (3) the defendants must have actively participated or substantially assisted in or encouraged the breach to such a degree that they could not reasonably have been acting in good faith."[37] Some states apply a similar but different standard whereby the three elements of a claim for aiding and abetting a breach of fiduciary are "(1) breach by a fiduciary of a duty owed to a plaintiff, (2) a defendant's knowing participation in the breach, and (3) damage."[38]

## III. Defenses to Claims of Misleading or Defrauding a Franchisee or Other Misconduct in Connection with the Purchase of a Franchise

The first line of defense to a claim that franchisor's outside counsel breached certain duties owed to a prospective or existing franchisee is to argue that no duties are owed, because the franchisee is not the attorney's client. Arguably, franchisor's outside counsel's duty remains solely with his/her own clients and his/her duty to the franchisor should not be limited by any perceived duties to non-clients.[39]

In *Eurycleia Partners, LP v. Seward & Kissel, LLP*,[40] the Appellate Division of the New York Supreme Court held that a non-client plaintiff's claim against counsel for recklessness and gross negligence failed because defendant counsel was not plaintiff's counsel and therefore owed no duty to the plaintiff. However, the case law is mixed on the issue of whether an attorney owes a duty to non-clients.

For example, in *Petrillo v. Bachenberg*, the New Jersey Supreme Court held that whether an attorney owes a duty to a non-client third party depends on balancing an attorney's duty to represent clients vigorously with his duty to not provide misleading information on which third parties will foreseeably rely.[41] Therefore, the nature of the relationship between the franchisor's

37. Baker v. Wilmer Cutler Pickering Hale & Dorr LLP, 81 N.E.3d 782, 792 (Mass. App. Ct. 2017).

38. RCHFU, LLC v. Marriott Vacations Worldwide Corp., 2018 WL 1535509, at *11 (D. Colo. Mar. 29, 2018); *see also* Mid Atlantic Framing, LLC v. AVA Realty Ithaca, LLC, 2018 WL 1605567, at *13 (N.D.N.Y. Mar. 29, 2018); ClubSpecialists Int'l, LLC v. Keeneland Ass'n, Inc., E.D. Ky., No. 5:16-CV-345-KKC (May 2, 2018); Church of God v. Estes, 2018 WL 491262, at *2 (S.C. App., Jan. 17, 2018); Lightbox Ventures, LLC v. 3rd Home Limited, 2017 WL 5312187, at *14 (S.D.N.Y. Nov. 13, 2017).

39. *See* Nobis v. Belmonte, 2018 WL 6542248, at *4 (N.J. Super. Ct. App. Div. Dec. 13, 2018) ("The duty owed by counsel to a non-client requires close scrutiny—balancing the attorney's duty to represent clients vigorously, with the duty not to provide misleading information on which third parties foreseeably will rely. . . .").

40. Eurycleia Partners, LP v. Seward & Kissel, LLP, 849 N.Y.S. 2d 510 (App. Div. 2007).

41. Petrillo v. Bachenberg, 655 A.2d 1354 (N.J. 1995); *see also* Banco Popular N. Am. v. Gandi, 876 A.2d 253, 265 (N.J. 2005) ("If the attorney's actions are intended to induce a specific non-client's reasonable reliance on his or her representations, then there is a relationship between the attorney and the third party. Contrariwise, if the attorney does absolutely nothing to induce reasonable reliance by a third party, there is no relationship to substitute for the privity

outside counsel and the current or prospective franchisee should be closely scrutinized. A court must weigh and balance "the relationship of the parties; the nature of the attendant risk; the opportunity and ability to exercise care; and the public interest in the proposed solution."[42]

The state of Washington applies a modified balancing test in certain types of legal actions that considers the extent to which the transaction was intended to benefit the plaintiff; the foreseeability of the harm; the degree of certainty that the plaintiff suffered harm; the closeness of the connection between the defendant's conduct and the injury; the policy of preventing future harm; and the extent to which the profession would be unduly burdened by a finding of liability.[43]

Interestingly, under Texas law, if an independent duty to the non-client exists based on the attorney's manifest awareness of the non-client's reliance on the misrepresentation and the attorney's intention that the non-client rely on the statement, then an attorney may be liable for negligent or fraudulent misrepresentation.[44] Similarly, a cause of negligent misrepresentation under Michigan law runs to those persons that one could reasonably foresee would rely on the accuracy of the information provided.[45] As explained by the U.S. Court of Appeals for the Sixth Circuit in *Molecular Technology Corp. v. Valentine*:

> *Polgar* does not require that the plaintiff have "a link . . . such as privity, a bond approaching privity or a fiduciary relationship" with the defendant in order for a duty of reasonable care to exist. . . . *Polgar* imposes a duty in favor of all those third parties who defendant knows will rely on the information *and* to third parties who defendant should reasonably foresee will rely on the information.[46]

In attempting to defend against claims of liability, franchisor's outside counsel can argue that there was no intent for the franchisee to be a third-party beneficiary of the services outside counsel is/was providing to the franchisor.[47] Additionally, franchisor's outside counsel can also argue that the plaintiff cannot demonstrate causation in that the franchisee's damages were caused by franchisee's own negligence in failing to operate (or investigate) the franchise properly or effectively, not by anything the franchisor's outside counsel did or did not do or disclose.[48]

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requirement."). Note that the issue of "[p]rivity, [n]ear [p]rivity, and the [t]hird-party [b]eneficiary [d]octrine" are fully discussed in Meiklejohn, *supra* note 1, at 65–67.

42. Davin, LLC v. Daham, 746 A.2d 1034, 1043 (N.J. Super. Ct. App. Div. 2000).

43. *See* Strait v. Kennedy, 13 P.3d 671 (Wash. Ct. App. 2000).

44. *See* Alpert v. Crain, Caton & James, P.C., 178 S.W.3d 398 (Tex. App. 2005).

45. *See* Williams v. Polgar, 391 Mich. 6, 21 (1974).

46. Molecular Tech. Corp. v. Valentine, 925 F.2d 910, 916 (6th Cir. 1991) (citation omitted).

47. *See* Kirschner v. K & L Gates LLP, 46 A.3d 737 (Pa. Super. 2012); Boranian v. Clark, 20 Cal. Rptr. 3d 405 (Ct. App. 2004); Spinner v. Nutt, 631 N.E.2d 542 (Mass. 1994); Angel, Cohen & Rogovin v. Oberon Inv., N.V., 512 So. 2d 192 (Fla. 1987).

48. *See* Corceller v. Brooks, 347 So. 2d 274 (La. Ct. App. 1977); Clark v. Rowe, 701 N.E.2d 624 (Mass. 1998); Gustavson v. O'Brien, 274 N.W.2d 627 (Wis. 1979).

## IV. What Are the Potential Implications of Relevant State Franchise Laws?

Some state franchise statutes contain a provision whereby counsel may be found jointly and severally liable with the franchisor for tort or other claims under certain circumstances. For example, under Minnesota's Franchise Act, joint and several liability can be imposed under the following provision:

> Every person who directly or indirectly controls a person liable under subdivision 1, every partner in a firm so liable, every principal executive officer or director of a corporation so liable, every person occupying a similar status or performing similar functions and every employee of a person so liable who materially aids in the act or transaction constituting the violation is also liable jointly and severally with and to the same extent as such person, unless the person who would otherwise be liable hereunder had no knowledge of or reasonable grounds to know of the existence of the facts by reason of which the liability is alleged to exist.[49]

Substantially comparable language can be found in other state franchise statutes.[50] Although no cases bringing a claim against franchisor's outside counsel under these statutes have yet been reported, nothing in these statutes prevents a franchisee from bringing such a cause of action in the future.

## V. Policy Considerations

The potential implications of and risks associated with negotiating a franchise transaction raise the policy question of whether the law should impose a more formal and definitive duty on franchisor's outside counsel to be truthful in his or her interactions with the prospective franchisee. This duty may also prohibit counsel from engaging in any conduct or taking any actions that would harm the prospective franchisee. Courts could employ a balancing test or other comprehensive analysis to determine whether such a duty applied, taking into account the representation of the parties and relative negotiating positions.

There are various arguments in favor—and against—imposing such an obligation and duty by law.[51] *From one perspective*, the intent of the FTC Franchise Rule is best served if attorneys involved in the franchise transaction engage in truthful communications to enable the franchisee to be fully informed when making a decision whether to enter into a franchise relationship. Prospective franchisees, who are often very eager to become

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49. Minn. Stat. § 80C.17 subd. 2.

50. Md. Code Ann., Bus. Reg. § 14-227; Mich. Comp. Laws § 445.1532; 815 Ill. Comp. Stat. 705/26; N.Y. Gen. Bus. Law § 691(3) (McKinney); N.D. Cent. Code Ann. § 51-19-12(2); 19 R.I. Gen. Laws Ann. § 19-28.1-21(b); Wis. Stat. § 553.51(3).

51. *See* Meiklejohn, *supra* note 1, at 63–65 (providing a robust discussion of the "pros" and "cons" associated franchise counsel liability). Note that Meiklejohn and others are cited in a 2014 *San Diego Law Review* article in connection with the position that "[l]awyers [s]hould [n]ot [b]e [l]iable to [n]onclient [f]ranchisees." *See* Robert W. Emerson, *Fortune Favors the Franchisor: Survey and Analysis of the Franchisee's Decision Whether to Hire Counsel*, 51 San Diego L. Rev. 709, 759–65 (2014).

independent business owners,[52] are often not represented by their own counsel and therefore rely heavily on the statements and information provided by the franchisor and its counsel. This set-up creates a situation of great disparity that has shown itself to be ripe for abuse.[53] Hence, franchisees might argue that explicit duties and obligations should be imposed on franchisor's outside counsel in order to help protect prospective franchisees who are particularly vulnerable and lack considerable business experience in the beginning stages of establishing franchise relationships.

*From the opposing perspective*, one might argue that imposing a duty to a party that is at least potentially adverse to counsel's client almost certainly creates a conflict, or at least the appearance of a conflict, and creates an ethical dilemma. Further, that dilemma could easily be manipulated to require resignation of counsel, thereby imposing upon the franchisor's well-regarded right to select the counsel of its choosing. Moreover, such a formal and rigid duty should not be imposed, and, instead, each situation and claim should be analyzed on a case-by-case basis using a balancing test. Each franchise transaction brings with it its own unique circumstances that arguably should be considered when determining what information a franchisor's outside counsel is required to, or should, disclose to a current or prospective franchisee. For example, the level of a franchisor's outside counsel's involvement in the transaction and corresponding level of knowledge varies considerably based on each transaction. Franchisor's counsel must also consider the duties of loyalty and confidentiality he/she owes to his/her own client when determining what information must be disclosed by the franchisor's outside counsel to a franchisee or a prospective franchisee.

## VI. Best Practices for Outside Counsel

Regardless of whether an explicit duty is imposed on franchisor's outside counsel with respect to their dealings and communications with a prospective or current franchisee, franchisor's outside counsel can and should take several steps and employ certain methods or techniques in order to reduce the risk of a franchisee asserting a claim for legal malpractice, fraud, or any of the other claims discussed above.

*First*, counsel should effectively communicate and memorialize in writing to the franchisee that the franchisor's outside counsel represents the franchisor, and not the franchisee.

52. A discussion regarding why prospective franchisees may choose not to retain legal counsel may be found at Emerson, *supra* note 51, at 716–27.

53. *See* Sachi v. Mobil Oil Corp., 1979 WL 1728, at *2 (E.D.N.Y. Nov. 20, 1979) (recognizing the "disparity of bargaining power which exists between the franchisor and the franchisee, and that such inequality frequently leaves the franchisee vulnerable to the abuse of power by the franchisor. . . "); *see also* Southland Corp. v. Abrams, 560 N.Y.S.2d 253, 256 (Sup. Ct. 1990) (observing that the "prospective franchisee was vulnerable because, in assessing an offer, it was, for the most part, forced to rely upon representations made by the franchisor concerning matters largely within the exclusive knowledge and control of the franchisor").

*Second*, counsel should suggest, if not strongly encourage, that the franchisee retain his own independent counsel to advise him with respect to the transaction. This approach could perhaps be incorporated, in a prominent manner, into the Franchisee Questionnaire that many franchisors use before a franchise agreement is signed to ask franchisees to confirm that have had the opportunity to consult with independent counsel and also that they have had an opportunity to conduct an independent investigation or due diligence and are not relying on any representations by franchisor or its counsel.

*Third*, counsel should ensure any communications regarding material facts and questions are in writing.

*Fourth*, counsel must make it clear that the information being provided is factual and historical and does not constitute legal advice or opinions.

*Finally*, counsel should make sure that any information that the attorney is providing to the franchisee or prospective franchisee, including, but not limited to financial information, is accurate, and counsel should be careful not to pass along any information the attorney does not know to be true or has not had an opportunity to verify.

These steps are some, though by no means an exhaustive list, of the ways that outside franchisor counsel can reduce the risk of being found liable to a franchisee in the event of a dispute. No one method is fool-proof, and each would be subject to scrutiny should a claim be asserted.