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Complaint Highlights Importance of a Carefully Drafted Item 19

A complaint filed recently in Washington state court (*DTD Pizza LLC, et al. v. Papa Murphy's International LLC, et al.*) reiterates the importance of looking behind the data when drafting Item 19 financial performance representations. In this case, about 20 Papa Murphy's franchisees allege that they suffered more than \$20 million in damages, in part, because Item 19 of the franchisor's FDD was allegedly misleading.

The plaintiff franchisees intended to develop their units in Arkansas, Florida, Georgia, Kansas, Louisiana, Missouri, Tennessee, and Texas. In its Item 19, the franchisor disclosed system-wide annual sales. It then divided the units into three equal tiers and, for each tier, disclosed the range of sales, the average sales, and the number of units that exceeded the tier average. While this type of disclosure is not out of the ordinary, the plaintiff franchisees allege that what made the disclosure misleading is what lies behind the data. Specifically, they allege that the franchisor failed to disclose that the majority of the units in the *highest-performing tier* were clustered in the Pacific Northwest (where the franchisor is headquartered) and in the Northeast (where there are several large population centers), and, importantly, that the majority of the units in the *lowest-performing tier* were in the same geographic region where the plaintiffs intended to develop their units.

While it is far from clear - and the court certainly has not held - that the omission forming the basis of the complaint in this case should support a liability finding, the case is nevertheless a reminder to consider what lay behind the numbers when preparing an Item 19 disclosure.

Look for future client alerts on this topic as this case moves forward.

For more information on this or other topics of interest to franchisors, please contact us.

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Contacts

Amy Cheng
Fredric A. Cohen
Michael R. Daigle

Contact Information

312-243-1716 or amy.cheng@chengcohen.com
312-243-1717 or fredric.cohen@chengcohen.com
312-957-8366 or michael.daigle@chengcohen.com

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