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Interesting Developments in Franchising

On March 29, 2011, the 7th Circuit Court of Appeals (US) handed down its decision in Faulkenberg, et al vs. CB Tax Franchise Systems, LP, et al (Case No. 09-1874), illustrating not only the importance of having clear disclosures and contractual provisions, but also of getting franchisees to sign ancillary documents such as the Disclosure Acknowledgement Statement confirming that they have read and understand what they are signing. It is also a reminder to franchisors who want to resolve disputes in their home jurisdiction to consider requiring arbitration under their franchise agreements.

In this case, the court upheld the provisions of a franchise agreement under which a Texas franchisor and Missouri franchisees agreed to arbitrate their disputes in Texas despite the fact that one of the franchised units was located in Illinois. In making its decision, the court noted that, since the unit was operated in Illinois, the Illinois Franchise Disclosure Act applies to the franchise relationship. The court further noted that, while the Illinois Franchise Disclosure Act voids "any provision in a franchise agreement that designates jurisdiction in a forum outside this State [of Illinois]," it expressly allows the parties to "provide for arbitration outside of this State." The court, therefore, decided that the franchisees' lawsuit in Illinois was correctly dismissed for improper venue based on the parties' agreement to arbitrate in Texas.

In attempting to escape the arbitration provision, the franchisees argued that they were fraudulently induced to sign the franchise agreement and, therefore, the agreement (including the arbitration provision) was void and unenforceable. In rejecting their argument, the court affirmed that, for franchisees' argument to succeed, the arbitration clause itself must have been fraudulently induced (in other words, the fraud must have gone to the making of the agreement to arbitrate as opposed to the making of the contract as a whole). The court noted that, under Illinois law, a party who signs a contract is charged with knowledge of and assent to what he or she is signing. The franchisees, therefore, "had a duty before signing the franchise agreement to read and understand its contents." The court was further swayed by the fact that the franchisees acknowledged having received a copy of the franchise disclosure document, that the disclosure document clearly disclosed in several places that all disputes were to be resolved by arbitration in Texas, and that the franchisees signed "numerous exhibits" indicating that they read and understood the franchise agreement and agreed to be bound by it. The court found, therefore, that there was no fraud in connection with the agreement to arbitrate and upheld its validity as a basis to dismiss the franchisees' case, forcing them to either arbitrate or file a lawsuit, in either case, in the franchisor's backyard.

For more information, call or email us.

Cheng Cohen LLC
311 N. Aberdeen Street,
Suite 400
Chicago, Illinois
60607

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redesigned
website.
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information:
email
[Michael R. Daigle](#)

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