SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 12

----------x

JAE HONG ANE and HYUN JOO KIM,

Plaintiffs,

-against-

CAFFE BENE, LTD., *et al.*,

Defendants.

----------x

Index No. 651225/16

Motion seq. no. 001

DECISION AND ORDER

BARBARA JAFFE, J.:

For plaintiffs:
Sukjin Henry Cho, Esq.
2160 N. Central Rd. #405
Fort Lee, NJ 07024
201-886-0200

For defendant Caffebene Inc.:
Brett A. Nadler, Esq.
729 Seventh Ave., 17th fl.
New York, NY 10019
212-575-7900

By notice of motion, defendant Caffebene Inc. (movant) moves pursuant to section 3 of the Federal Arbitration Act and CPLR 7503(a) and 2201 for an order compelling the arbitration of plaintiffs' claims against movant in this action, and staying the action until the conclusion of the arbitration. Plaintiffs oppose.

According to movant, it and plaintiff Ane entered into a franchise agreement, whereby movant granted Ane the right to establish and operate a Caffebene store in Manhattan. Movant and plaintiff Kim entered into a separate franchise agreement whereby Kim would establish and operate a Caffebene store at a different location in Manhattan. (NYSCEF 6).

Each franchise agreement contains the same boilerplate provisions including, as pertinent here, that

> In the event of any dispute arising out of or in connection with this Agreement or the relationship of the parties hereto, including without limitation any claim related to the termination or expiration of this Agreement and any claim for damages and/or compensation related thereto, the parties agree to submit the matter to mediation under the American Arbitration Association Commercial Mediation Rules.

. . .

> Except as otherwise provided in this Agreement, if the mediation is not successful, any controversy, claim, cause or action or dispute arising out of, or relating to the Caffebene Store or this Agreement including, but not limited to (i) any claim by Franchisee . . . concerning the entry into, performance under, or termination of, this Agreement or any other agreement entered into by Franchisor, or its subsidiaries or affiliates, and Franchisee . . . (iii) any claim of breach of this Agreement, and (iv) any claims arising under state or federal laws, shall be submitted to final and binding arbitration as the sole and exclusive remedy for any such controversy or dispute.

. . .

> The right and duty of the parties to this Agreement to resolve any disputes by arbitration shall be governed exclusively by the Federal Arbitration Act, as amended, and arbitration shall be conducted pursuant to the then-prevailing Commercial Arbitration Rules of the AAA . . . Any dispute as to the arbitration of any controversy, claim, cause of action or dispute shall also be determined by arbitration.

(NYSCEF 7, 8).

In this action, plaintiffs assert causes of action for fraudulent inducement and fraud under specific provisions of the New York General Business Law (GBL) relating to franchises (the Franchise Sales Act) with respect to their purchase of the two franchises. They allege that defendants represented that the franchises would generate a certain amount of income in daily sales, that the representations were false and known to be false by defendants, that defendants made the representations with the intent that plaintiffs rely on them, and that plaintiffs reasonably relied on the misrepresentations in deciding to buy the franchises. (NYSCEF 2).

Plaintiffs maintain that Ane did not receive a franchise agreement or disclosures about the

franchise until October 20, 2013, and was not given time to review the agreement before signing it that day, and that in June 2014, plaintiff Kim was given a franchise agreement for the other franchise and told to sign it without giving her time to review it. (NYSCEF 2).

Plaintiffs thus contend that defendants violated GBL 687 by making false representations related to the profitability of the franchises; violated GBL 683(2)(o) by failing to provide plaintiffs with required documents, including representations of estimated or projected earnings or income and offering prospectuses, within specified timeframes, and that defendants did so intentionally and knowingly in order to defraud plaintiffs; and that the individual defendants violated GBL 691(2) which imposes joint and several liability of GBL violations on persons who materially aid in the act or transaction constituting the violation. (*Id.*).

By affidavit dated July 13, 2016, Ane states that in 2013, defendants' sales director told him that he had a franchise location available and would provide him with total support as a franchisee, and that based on the representations, Ane paid him $34,000 as a deposit, without being offered any documentation regarding the franchise. When a location on 23rd Street became available in Manhattan, Ane signed the franchise agreement on the same day he received it and paid an investment of $500,000. Despite being promised that daily sales at the location would total approximately $5,000, the sales were actually $2,000 per day, and Ane closed the business ten months after it opened as he was unable to sustain it financially. (NYSCEF 12).

Kim, Ane's wife, states that she met with defendants' representative in June 2014, and was told to sign the franchise agreement for a location on 32nd Street in Manhattan without being given a chance to review it. (NYSCEF 14). Ane states that he and Kim were told that the daily sales for that location would be $10,000, but are actually $3,000 per day, and that although they

have increased the sales to $5,000 per day, the business is not economically viable. (NYSCEF 12).

II. CONTENTIONS

Movant argues that as plaintiffs' claims relate to the circumstances under which they entered into the franchise agreements, they must be arbitrated. (NYSCEF 6).

Plaintiffs contend that an arbitration agreement will not be enforced if there is fraud permeating the entire agreement, and that here, defendants' entire dealings with plaintiffs were fraudulent, and there were no "arms length" negotiations as defendants failed to provide plaintiffs with required disclosures and information before they signed the agreements or paid the investments, in violation of the Franchise Sales Act. (NYSCEF 15).

III. ANALYSIS

An agreement to arbitrate is a contract and, when clear, is to be enforced according to its terms. Thus, parties who clearly and expressly agree to arbitrate must to do so. (*Matter of Exercycle Corp. [Maratta]*, 9 NY2d 329, 334 [1961]; *Gomez v Brill Sec., Inc.*, 95 AD3d 32, 37 [1st Dept 2012]). A party may challenge the enforcement of such an agreement "on any basis that could provide a defense to or grounds for the revocation of any contract, including fraud, unconscionability, duress, overreaching conduct, violation of public policy, or lack of contractual capacity." (*Matter of Teleserve Sys. [MCI Telecom. Corp.]*, 230 AD2d 585, 592 [4th Dept 1997]).

Even if an agreement is induced by fraud, the fraud will only affect the validity of the arbitration provision if the fraud relates to the provision itself or was part of a "grand scheme that permeated the entire contract." (*Markowits v Friedman*, 144 AD3d 993, 997 [2d Dept 2016],

quoting *Matter of Weinrott (Carp)*, 32 NY2d 190 [1973]).

In *Markowits*, the Court held that the parties' arbitration agreement was enforceable, as it was not a free-standing document but part of several documents comprising a larger agreement, and the plaintiffs' fraudulent inducement claim related to the entire agreement and not the arbitration agreement itself. Thus, plaintiffs' claim would have to be decided by the arbitrator. (144 AD3d at 997).

In *Ntl. Union Fire Ins. Co. of Pittsburgh v St. Barnabas Community Enter., Inc.*, the Appellate Division, First Department, found that as the defendant made "no specific allegations of being fraudulently induced into agreeing to arbitration," the claim of fraudulent inducement had to be resolved at the arbitration. (48 AD3d 248, 249 [1st Dept 2008]). And in *O'Neill v Krebs Communications Corp.*, the Court rejected the petitioner's argument that the entire signed agreement, which included an arbitration clause, was void and unenforceable and he could not thus be compelled to arbitrate as the agreement was forged or altered after he signed it, holding that the petitioner did not allege that the arbitration clause was changed or that the agreement he signed did not have an arbitration clause, and there were no allegations of forgery related to the clause itself. (16 AD3d 144 [1st Dept 2005], *lv denied* 5 NY3d 708).

Here, plaintiffs do not allege that the arbitration clause itself was induced by fraud or that it was specifically incorporated in the franchise agreements in order to defraud them. Rather, they contend that they were induced to enter into the agreements as a whole by defendants' fraudulent misrepresentations, which is insufficient to render the arbitration agreement unenforceable. (*See McDonald v McBain*, 99 AD3d 436 [1st Dept 2012], *lv denied* 21 NY3d 854 [2013] ["the assertion that the agreement between (the parties) is invalid on account of the fact

that plaintiff was fraudulently induced to enter into the agreement is not a ground to invalidate the arbitration provision, but rather presents a question for the arbitrator to determine"]; *Triangle Equities Inc. v Listokin*, 13 AD3d 269 [1st Dept 2004] [as arbitration clause compelled arbitration of all disputes related to employment agreement, court properly rejected plaintiff's argument that its claim of fraudulent inducement is not covered by arbitration clause]; *Stellmack Air Conditioning & Refrigeration Corp. v Contractors Mgt. Systems of NH Inc.*, 293 AD2d 956 [3d Dept 2002] [plaintiff's allegations that defendant engaged in fraudulent scheme in order to induce plaintiff to enter into agreement, and that thus fraud permeated entire agreement and invalidated arbitration provision, found conclusory and insufficient to demonstrate that fraud permeated entire contract including arbitration provision, and thus fraud in inducement claim had to be submitted to arbitration]).

Moreover, the party asserting fraud must demonstrate that the agreement "was not the result of an arm's length negotiation, or the arbitration clause was inserted into the contract to accomplish a fraudulent scheme." (*Ferrarella v Godt*, 131 AD3d 563, 566-567 [2d Dept 2015], *lv denied* 26 NY3d 913). Plaintiff relies on *EV Scarsdale Corp. v Engel & Voelkers N. E. LLC*, 48 Misc 3d 1019 (Sup Ct, New York County 2015), for the proposition that defendants' failure to comply with the Franchise Sales Act renders their negotiation not "arms length" and thus invalidates the arbitration provision in the franchise agreements. There, the plaintiff-franchisees sued the franchisors for, *inter alia*, fraudulent inducement, and on the defendants' motion to dismiss, the court denied the motion to dismiss certain of the plaintiffs' claims, finding that factual issues precluded dismissal. The court did not address, nor did it have reason to address, the enforcement of an arbitration provision in a franchise agreement, nor did it determine

whether a violation of the Franchise Sales Act constitutes a negotiation that is not arms length.

Plaintiffs offer no authority for the proposition that a violation of the GBL, in general or specifically the Franchise Sales Act, creates a negotiation that is not arms length. Rather, it has been held that notwithstanding a franchisor's failure to comply with the Act and the franchisee's allegations that the offer to sell the franchise was thus unlawful and the franchise agreement was void ab initio, the arbitration clause contained within the franchise agreement was enforceable, and the issue of whether the agreement was illegal and/or void was to be resolved by the arbitrator. (*Rubin v Sona Intl. Corp.*, 457 F Supp 2d 191 [SD NY 2006]; *see also TKO Fleet Enter., Inc. V Elite Limousine Plus, Inc.*, 286 AD2d 436 [2d Dept 2001] [franchisor's failure to comply with Act did not preclude franchisor from asserting claims based on franchise agreements]).

It has also been determined that the Franchise Sales Act "does not purport to regulate the contractual relationship at all, or authorize the Attorney General to do so." (*Southland Corp. v Abrams*, 148 Misc 2d 390, 396 [Sup Ct, New York County 1990]; *see also TKO Fleet Enter., Inc.*, 184 Misc 2d 460, 463-4 [Sup Ct, Queens County 2000], *affd* 286 AD2d 436 [2d Dept 2001] [Act "provides a remedy for aggrieved franchisees, and is not intended to regulate the parties' actual contractual relationship"]). Thus, it is unclear whether a violation of the Act has any effect on the validity of a franchise agreement.

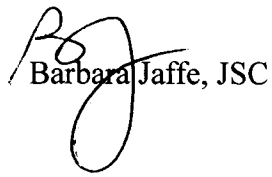
IV. CONCLUSION

Accordingly, it is hereby

ORDERED, that defendant Caffebene Inc.'s motion to compel arbitration and stay the action pending the conclusion of arbitration is granted in its entirety; and it is further

ORDERED, that any party may apply by order to show cause to vacate or modify this stay upon the final determination of the arbitration.

ENTER:



Barbara Jaffe, JSC

DATED: March 1, 2017
New York, New York