

NOTICE

Decision filed 05/15/15. The text of this decision may be changed or corrected prior to the filing of a Petition for Rehearing or the disposition of the same.

2015 IL App (5th) 130581-U

NO. 5-13-0581

IN THE

APPELLATE COURT OF ILLINOIS

FIFTH DISTRICT

NOTICE

This order was filed under Supreme Court Rule 23 and may not be cited as precedent by any party except in the limited circumstances allowed under Rule 23(e)(1).

JOHN MCGILL, SUSAN MCGILL, and
SJ MCGILL, INC.,

Plaintiffs-Appellees,

v.

ERIC WORTHAM, MICHELLE WORTHAM,
PIZZA WORLD USA FRANCHISE CORP., and
WOOD RIVER PIZZA, INC.,

Defendants-Appellants.

) Appeal from the
) Circuit Court of
) Madison County.

) No. 11-L-1190

) Honorable
) Thomas W. Chapman,
) Judge, presiding.

JUSTICE CHAPMAN delivered the judgment of the court.
Presiding Justice Cates and Justice Schwarm concurred in the judgment.

ORDER

¶ 1 *Held:* Arbitrator's conclusion that the exemption to the Franchise Disclosure Act's disclosure requirements did not apply was not a gross error of law where the franchisor and franchisee were controlled by the same individual and entered into a franchise agreement when that individual was already in negotiations to sell the franchise to another party.

¶ 2 This appeal involves the sale of a pizza franchise by the defendants, Eric Wortham and two business entities owned and controlled solely by Wortham, to the plaintiffs, John and Susan McGill and SJ McGill, Inc., a company owned by the McGills. One of Wortham's companies was a franchisor of Pizza World Restaurants. However, it was not

registered to sell franchises in Illinois from 2006 until it reregistered during negotiations with the plaintiffs. Wortham's other company owned and operated a Pizza World restaurant. During negotiations for the sale of the restaurant, Wortham reregistered the franchising company, which in turn entered into a franchise agreement for the restaurant. After the sale, the restaurant went out of business. The parties submitted their ensuing disputes to arbitration. An arbitrator found that the plaintiffs were entitled to rescission of the agreement based on Wortham's failure to comply with the requirements of the Illinois Franchise Disclosure Act of 1987 (Franchise Disclosure Act) (815 ILCS 705/1 *et seq.* (West 2010)). In reaching this conclusion, she specifically rejected the defendants' contention that this sale came within an exclusion applicable to the transfer of an existing franchise by the franchisee if the sale "is not effected by or through [the] franchisor" (815 ILCS 705/7 (West 2010)). The circuit court confirmed the award. The defendants appeal, arguing that (1) a recent amendment to the Uniform Arbitration Act (Arbitration Act) (710 ILCS 5/1 *et seq.* (West 2010)) expands the scope of judicial review of arbitration awards; and (2) the arbitrator's conclusion was erroneous and not supported by the evidence. We affirm.

¶ 3 On March 10, 2011, plaintiffs John and Susan McGill entered into discussions with defendant Wortham to purchase a Pizza World restaurant owned and operated by defendant Wood River Pizza, Inc., a company under Wortham's sole ownership and control. Wortham did not disclose to the McGills the fact that Wood River Pizza did not have a valid franchise agreement at that time. As noted earlier, defendant Pizza World USA Franchise Corp. (the franchise company), which was also owned and controlled

solely by Wortham, had not been registered to sell franchises in Illinois since October 2006. The Pizza World restaurant was operated under a "limited licensing agreement" between Wood River Pizza and a third entity called Pizza World USA, Inc., which was also owned and controlled solely by Eric Wortham. The licensing agreement was dated February 2010 and signed on behalf of both parties by Wortham.

¶ 4 During negotiations with the plaintiffs, Wortham provided a franchise disclosure document dated March 30, 2008; however, no franchise agreement for the restaurant existed in 2008. On March 25, 2011, the franchise company became reregistered to sell franchises in Illinois. On March 31, it entered into a franchise agreement with Wood River Pizza. The agreement called for Wood River Pizza to pay the franchise company a franchise fee of \$9,500; however, this amount was never paid. In addition, the franchise company did not comply with the requirement that it provide a franchise disclosure document to prospective franchisee Wood River Pizza at least 14 days prior to executing the franchise agreement. See 815 ILCS 705/5(2) (West 2010). Indeed, it was impossible to comply with this requirement because only six days elapsed between the day the franchise company became registered to sell franchises and the day its agreement with Wood River Pizza was signed.

¶ 5 On April 9, the plaintiffs entered into an asset purchase agreement with Wood River Pizza for the sale of the restaurant. On April 26, the plaintiffs entered into a franchise agreement with the franchise company. On May 23, 2011, the parties closed on the sale of the restaurant and its assets, and Wood River Pizza assigned its franchise agreement to the plaintiffs.

¶ 6 After the transfers were complete, the plaintiffs began operating the restaurant. According to the plaintiffs, they quickly discovered that the defendants overstated the restaurant's earnings and understated its labor costs. In addition, they found that some of the restaurant's equipment was not in working order. The plaintiffs demanded that Wortham rescind the agreement and refund the money they paid him for the purchase, but Wortham refused. Within a few months, the plaintiffs closed the restaurant and went out of business.

¶ 7 In November 2011, the plaintiffs filed a lawsuit against the defendants, alleging fraudulent inducement and violations of the Illinois Franchise Disclosure Act. They alleged that the defendants made numerous false statements, including statements that (1) the restaurant was earning \$2,000 per month in profit; (2) all the equipment was in good working order; and (3) labor costs were approximately \$30,000 per year lower than they actually were. They further alleged that the defendants did not provide them with a valid franchise disclosure document as required by the Franchise Disclosure Act. See 815 ILCS 705/5(2) (West 2010). The defendants filed a suit against the plaintiffs, seeking payment of \$22,000 remaining on the purchase price, royalties due under the franchise agreement, and damages for items of personal property that the plaintiffs removed from the restaurant after it went out of business. The two suits were consolidated, and the matter was submitted to arbitration pursuant to a provision in the agreement.

¶ 8 The matter came for an arbitration hearing in October 2012. Wortham admitted in his testimony that he did not comply with the requirements of the Franchise Disclosure Act. He argued, however, that the requirements did not apply to the transaction at hand

because Wood River Pizza was a franchisee that transferred an existing franchise to the plaintiffs. See 815 ILCS 705/7 (West 2010).

¶ 9 The arbitrator issued her award on December 19, 2012. She specifically found that no valid franchise existed at the time of the transfer. She later clarified this finding in a modified award. In the modified award, the arbitrator found that there was no "credible evidence" of a franchise agreement, explaining that the "only credible agreement" in evidence was the limited licensing agreement. In the initial award, the arbitrator further found that there was evidence that entities owned by Eric Wortham had offered and sold franchises in Illinois on previous occasions in spite of the fact that they were not registered to do so. Additionally, she found that Wortham "used himself and his various entities interchangeably without distinction to purposefully evade the franchise disclosure laws."

¶ 10 The arbitrator concluded that the exclusion found in section 7 of the Franchise Disclosure Act (815 ILCS 705/7 (West 2010)) was not applicable for two reasons. First, she explained, the exclusion "is intended to cover the sale of a franchise through an arm's length transaction between parties *not affiliated [with] and controlled by the franchisor.*" (Emphasis added.) Second, she noted that Wortham admitted in his testimony that there was no Pizza World franchise in effect when the sale to the McGills took place.

¶ 11 In addition, the arbitrator found that the plaintiffs "presented substantial evidence of other material misrepresentations and omissions of fact to satisfy the elements of fraud in the inducement." However, she found it unnecessary to discuss this evidence in light of her conclusion that the franchise disclosure violations were sufficient to entitle the

plaintiffs to rescission of the agreements and recovery of damages. She found in favor of the plaintiffs on all issues with the exception of the defendants' claim that the plaintiffs improperly removed items of personal property from the restaurant. The arbitrator found that it would be inequitable to allow the plaintiffs to retain those items (three flat-screen televisions and two cash registers) without paying for them. The arbitrator further found that Eric Wortham's wife, Michelle Wortham, had no involvement in any of Wortham's actions.

¶ 12 On January 16, 2013, the arbitrator issued a modified award clarifying the December 19 award as discussed above. The modified award included no other changes.

¶ 13 The plaintiffs filed in the circuit court a motion to confirm the award, and the defendants filed a motion to modify the award. Before the court, the defendants argued, as they do in this appeal, that a 2011 amendment to the Arbitration Act allowed for more expansive judicial review of arbitration awards. They asserted that, under the amendment, courts should review an arbitration award using the standards applicable to proceedings under the Administrative Review Law. In a footnote in its order, the court noted that appellate decisions issued subsequent to the amendment did not support the defendants' argument; however, the court did not resolve the question, instead finding that the arbitrator's award would be upheld under either standard.

¶ 14 The court agreed with the defendants that the arbitrator was incorrect in finding that no franchise agreement existed *at the time of the transfer* because a franchise agreement came into effect during the negotiations. The court explained that the franchise company's failure to provide a disclosure document to Wood River Pizza did

not invalidate the March 31 franchise agreement; it merely gave Wood River Pizza the right to seek rescission of that agreement. See 815 ILCS 705/26 (West 2010). The court also found, however, that both the franchise company's failure to comply with the disclosure requirements and Wood River Pizza's failure to pay the franchise fee supported the arbitrator's finding that Wortham used these business entities interchangeably and her conclusion that the subsequent transfer of the franchise to the McGills was a transfer by or through the franchisor.

¶ 15 The court confirmed the arbitration award without modification. The defendants filed a posttrial motion, which the court denied. This appeal followed.

¶ 16 Judicial review of arbitration awards is very limited. *Hawrelak v. Marine Bank, Springfield*, 316 Ill. App. 3d 175, 178 (2000). The Arbitration Act expressly provides that courts may modify an arbitration award only if (1) the arbitrator miscalculated figures or made a mistake in the description of any person or thing referred to in the award; (2) the arbitrator made an award on a matter not submitted to her; or (3) the award is imperfect in a matter of form that does not affect the merits. 710 ILCS 5/13(a) (West 2012). Courts may vacate an arbitration award if (1) the award was "procured by corruption, fraud or other undue means"; (2) there was evident bias on the part of the arbitrator; (3) the arbitrator exceeded her authority; (4) the arbitrator failed to consider relevant evidence or refused to allow a reasonable request for a continuance; or (5) there was no agreement to arbitrate. 710 ILCS 5/12(a) (West 2012).

¶ 17 In addition, Illinois courts have held that an arbitration award may be set aside if there was a gross error of law or gross mistake of fact evident on the face of the award.

Beatty v. Doctors' Co., 374 Ill. App. 3d 558, 563 (2007). A gross error is one that is so serious that a reviewing court may presume that had the arbitrator been apprised of her mistake, her ruling would have been different. *Sloan Electric v. Professional Realty & Development Corp.*, 353 Ill. App. 3d 614, 621 (2004). The error must appear on the face of the award itself, not merely in the arbitrator's opinion. *Beatty*, 374 Ill. App. 3d at 563. An error of law or mistake of fact that does not rise to this level or is not apparent in the award itself does not provide a basis to modify or vacate an arbitration award. *Advocate Financial Group v. Poulos*, 2014 IL App (2d) 130670, ¶ 50; *Beatty*, 374 Ill. App. 3d at 563. This is because the parties have chosen to have their dispute settled by an arbitrator (*Hawrelak*, 316 Ill. App. 3d at 179) subject to the arbitrator's interpretation of applicable law (*Beatty*, 374 Ill. App. 3d at 563 (quoting *Board of Education of the City of Chicago v. Chicago Teachers Union, Local No. 1*, 86 Ill. 2d 469, 477 (1981))).

¶ 18 The defendants do not contend that any of the statutory grounds to modify or vacate an arbitration award are present in this case. Rather, they argue that (1) a recent amendment to the Arbitration Act expands judicial review of arbitration awards; (2) the arbitrator's finding that there was no existing franchise agreement to transfer to the plaintiffs was not correct; and (3) the arbitrator's conclusion that Wortham used his entities interchangeably to evade the franchise disclosure requirements was supported by "zero evidence." We find none of these arguments persuasive.

¶ 19 In support of their contention that the scope of judicial review of arbitration awards has been expanded, the defendants focus on a 2011 amendment to section 8 of the Arbitration Act (710 ILCS 5/8 (West 2012)). The amendment added language to the

statute providing that arbitrators must decide disputes in accordance with the choice of law designated by the parties and in accordance with the terms of their contract, taking into account applicable trade usages. 710 ILCS 5/8(c) (West 2012); see Pub. Act 96-1476, § 5 (eff. Jan. 1, 2011) (adding subsection (c) to section 8). The defendants point to an article that appeared in the newsletter of the Illinois State Bar Association's Construction Law Section in 2011. In that article, the author predicted that the amendment would require courts "to review the record to determine whether the arbitrator followed the rule of law" and give a party seeking to challenge an arbitration award "additional arrows for its quiver." Bruce H. Schoumacher, "Recent Amendment Guts Arbitration Act," Newsletter of the ISBA's Section on Construction Law, May 2011, vol. 1, no. 1 (<http://www.isba.org/sections/construction/newsletter/2011/05/recentamendmentgutshearbitrationac>, last visited May 6, 2015). However, the defendants do not cite any legal authority to support their contention. See Ill. S. Ct. R. 341(h)(7) (eff. June 1, 2008) (providing that an appellant's brief must contain arguments supported by appropriate authority). Moreover, subsequent to the amendment, Illinois courts have not altered our interpretation of the Arbitration Act's limited scope of review. See, e.g., *Advocate Financial Group*, 2014 IL App (2d) 130670, ¶¶ 49-50. As such, we decline to depart from our established precedent limiting the scope of judicial review of arbitration awards.

¶ 20 The defendants next argue that the arbitrator's finding that there was no arbitration agreement was in error and her conclusion that Wortham used his business entities interchangeably to evade the franchise disclosure requirements was not supported by any

evidence. We first note that the defendants do not explicitly argue that either of these errors was a gross error of law or gross mistake of fact. As such, they are beyond the purview of our review. See *Beatty*, 374 Ill. App. 3d at 564 (declining to conduct an independent analysis of an insurance contract to determine whether the arbitrator's interpretation was correct). However, they do argue that the arbitrator's findings are supported by no evidence whatsoever, which would be a fairly serious error. Nevertheless, assuming we may read into this argument an implicit contention that the alleged errors constitute gross errors of law or mistakes of fact, we disagree with the defendants.

¶ 21 As the defendants contend and the trial court pointed out, the franchise agreement between the franchise company and Wood River Pizza was subject to rescission by the franchisee—Wood River Pizza—but was not invalid from its inception. See 815 ILCS 705/26 (West 2010) (providing rescission as a remedy for failure to comply with any requirements of the Franchise Disclosure Act). Thus, the arbitrator's finding that there was no existing franchise agreement was not correct. We need not determine whether this mistake amounted to a gross error of law or gross mistake of fact, however, because it was not the only basis on which the arbitrator found the exemption inapplicable.

¶ 22 As discussed previously, the arbitrator also found that the exemption was inapplicable because this was the sale of a franchise by a party that was "not affiliated or controlled by the franchisor." As noted, the defendants argue that there was no evidence to support this finding. However, they acknowledge that Wortham reregistered the Pizza World franchise company only *after* entering into discussions with the McGills to sell

them a restaurant they believed to be a Pizza World franchise. The defendants further acknowledge that the franchise company and Wood River Pizza, both of which were owned and controlled exclusively by Wortham, entered into a franchise agreement six days later, and that Wood River Pizza did not pay the franchise fee required under the agreement. Thus, the franchisor had an active and essential role in effectuating the sale of the franchise to the plaintiffs. We find no gross error of law or gross mistake of fact in the arbitrator's award.

¶ 23 Finally, we note that the parties address the issue of whether the evidence in the record was sufficient to support a finding of fraud in the inducement. In light of our conclusion that the arbitration award may be upheld on the basis of the defendants' failure to comply with franchise disclosure requirements, we need not address these arguments.

¶ 24 For the reasons stated, we affirm the order of the circuit court confirming the arbitration award without modification.

¶ 25 Affirmed.