Buchalter

Blogs

APRIL 28, 2026 | FRANCHISE FRONTLINES

Rumson Wellness v. Fountainhead SBF: Court Rejects Attempt to Shift Failed Franchise Investment Losses to SBA Lender

April 28, 2026 | United States District Court for the District of New Jersey | Unpublished Opinion

Executive Summary

In an unpublished decision, Judge Michael A. Shipp of the United States District Court for the District of New Jersey granted a motion to dismiss claims brought by franchise investors and their entity against an SBA lender, a loan assignee, and a loan servicer after the plaintiffs' Water Station Technology franchise investment allegedly collapsed as part of a broader Ponzi scheme. Plaintiffs alleged that they borrowed approximately $923,000 through an SBA 7(a) loan to finance the startup operations of a WST franchise business and later discovered that the vending-machine collateral and operating franchise did not exist as represented. Plaintiffs argued that the lender should have detected the alleged fraud during underwriting, that the lender's SBA expertise and marketing statements created a duty of care, and that the assignee and servicer acted improperly by enforcing the loan after the alleged fraud came to light. Defendants argued that the lender-borrower relationship remained arm's-length, that SBA procedures did not create a private duty to the borrowers, and that defendants provided the financing contemplated by the loan documents. The court agreed with defendants and dismissed all claims, holding that plaintiffs failed to plead a lender duty, bad faith, unjust enrichment, or an independent basis for declaratory relief.

Relevant Background

Rumson Wellness LLC entered into a purchase order agreement with Water Station Technology to purchase water vending machines in connection with a WST franchise. According to the amended complaint, WST represented that the machines would be installed at viable locations and would generate revenue for Rumson Wellness. Plaintiffs Dylan Ross and Taylor Ross invested $170,000 for twenty water vending machines and obtained an SBA 7(a) loan through Fountainhead SBF LLC in the principal amount of $923,000, with most of the loan proceeds allegedly intended to finance an additional one hundred machines.

The loan agreement allegedly identified the loan's purpose as "long term financing for the start-up operations of a [WST] Franchise business." The loan was secured by the vending-machine collateral and a lien on the Ross residence in Rumson, New Jersey. Plaintiffs later alleged that WST was a Ponzi scheme, that WST misrepresented machine installations and profits, and that after they investigated the locations where their machines supposedly had been placed, they discovered that no machines existed.

Plaintiffs alleged that Fountainhead, as a sophisticated SBA lender, should have detected WST's alleged fraud before approving the loan. They pointed to SBA Standard Operating Procedures and alleged that Fountainhead failed to verify franchise eligibility, document due diligence, conduct prudent credit analysis, scrutinize financials, assess collateral adequacy, verify machine installations, confirm access to monitoring technology, or confirm the existence of the equipment collateral. Plaintiffs also alleged that Fountainhead's website touted its SBA lending experience, responsiveness, personalized service, and attention to detail.

Fountainhead later assigned the loan to Community Bank & Trust – West Georgia, with Phoenix Lender Services, LLC serving as servicing agent. Plaintiffs alleged that Community Bank and Phoenix continued to enforce the loan despite actual or constructive knowledge of WST's alleged fraud. In April 2025, plaintiffs sought a reduction of the loan principal, a lump-sum payoff, and release of the lien on the Ross residence. Phoenix, on behalf of Community Bank, rejected the request, and plaintiffs ultimately paid off the loan in full. Plaintiffs alleged that Rumson Wellness paid approximately $1.4 million on the loan but received no operational franchise or equipment collateral.

Plaintiffs asserted claims for negligent misrepresentation, breach of the implied covenant of good faith and fair dealing, unjust enrichment, and declaratory judgment. Defendants moved to dismiss the amended complaint in its entirety.

Decision

The court first addressed negligent misrepresentation. Under New Jersey law, the court explained, a negligent misrepresentation claim requires an incorrect statement negligently made, justifiable reliance, and injury resulting from that reliance. The plaintiff also must plead that the defendant owed a duty of care. That duty requirement controlled the analysis.

The court held that plaintiffs failed to plead a duty. New Jersey law generally treats the lender-borrower relationship as an arm's-length contractual relationship in which the lender does not owe the borrower a duty of care when acting in its conventional role as a lender. Plaintiffs tried to invoke the "special circumstances" exception, arguing that Fountainhead's SBA lending experience, website statements, and alleged diligence obligations created a relationship of trust and reliance. The court rejected that theory.

The court found that Fountainhead's general website statements about SBA lending expertise did not create the type of special circumstances required under New Jersey law. Plaintiffs did not allege that Fountainhead had actual knowledge of WST's alleged fraud at loan origination, gave plaintiffs specific advice about the transaction, actively encouraged plaintiffs to rely on its advice, or concealed a self-interest in promoting the transaction. Instead, plaintiffs alleged that Fountainhead failed to detect fraud as part of its due diligence. That was not enough to convert an arm's-length lender-borrower relationship into a special relationship giving rise to tort duties.

The court also relied on plaintiffs' own allegations about their diligence. Plaintiffs alleged that they spent significant time with WST's founder, performed reference checks, spoke to current franchise owners, physically examined water vending technology installed for other franchise owners, and scouted locations for machines. Those allegations undercut the inference that plaintiffs reasonably relied on Fountainhead to vet the WST franchise opportunity for them. The court further noted that plaintiffs did not allege that defendants represented they would discover fraud or represented that WST was not committing fraud.

The court also rejected plaintiffs' reliance on the SBA Standard Operating Procedures. Although plaintiffs alleged that Fountainhead failed to comply with SBA procedures when underwriting the loan, the court held that such alleged failures did not create the special circumstances necessary to establish a lender duty to borrowers. The court therefore dismissed the negligent misrepresentation claim without reaching defendants' remaining arguments, including economic loss and holder-in-due-course issues.

The court next dismissed the implied covenant claim. Plaintiffs alleged that the loan's purpose was to finance a functioning WST franchise business capable of generating revenue to repay the loan, and that defendants acted in bad faith by depriving plaintiffs of that benefit. The court found those allegations conclusory.

Plaintiffs alleged that defendants accepted a delayed collateral list, failed to verify equipment collateral, failed to conduct site visits or UCC searches, and enforced the loan after WST's alleged fraud came to light. But the court concluded that the alleged frustration of the loan's purpose arose from WST's alleged Ponzi scheme, not from bad-faith conduct by the lender, assignee, or servicer. Plaintiffs did not plead facts showing that defendants acted with the objective of preventing plaintiffs from receiving the benefits of the loan agreement.

The court also dismissed unjust enrichment. Plaintiffs alleged that defendants received a benefit through the loan payoff. But the court held that defendants provided the remuneration plaintiffs were entitled to receive from them: funding of the loan. The operational franchise, machines, and revenue opportunity were expected from WST, not from defendants. Because plaintiffs did not adequately allege that defendants failed to provide the expected benefit owed by defendants, the unjust enrichment claim failed.

Finally, the court dismissed the declaratory judgment claim. Declaratory relief is a remedy, not a stand-alone cause of action. Because the court dismissed all substantive claims, there was no remaining claim to support declaratory relief. The court granted defendants' motion to dismiss in full.

Looking Forward

This decision offers a useful franchise-finance lesson for franchisors, lenders, and franchise investors, but it should be framed carefully. The court did not bless fraud, excuse inaccurate franchise sales representations, or minimize the harm caused when a franchise investment fails. The decision addressed a narrower issue: whether borrowers could shift losses from an allegedly fraudulent franchise opportunity to their SBA lender, loan assignee, and loan servicer based on alleged underwriting failures, general lender marketing statements, and post-discovery loan enforcement. On the facts alleged, the court said no.

For franchisors, the case illustrates the importance of separating financing from franchise validation. SBA financing may help a franchise system grow, but lender approval does not necessarily mean that the lender has endorsed the franchise model, verified every operational representation, confirmed every asset, or assumed responsibility for the franchisor’s performance. Franchisors should avoid suggesting otherwise in sales discussions, financing materials, or development communications. A lender’s willingness to finance a transaction should not be characterized as a substitute for the prospective franchisee’s own diligence or the franchisor’s own disclosure obligations.

For lenders, the decision reinforces the traditional arm’s-length framework governing lender-borrower relationships under New Jersey law. The court did not impose a general duty on the lender to protect borrowers from the risk that the underlying franchise opportunity would fail or prove fraudulent. The court also did not treat SBA lending experience, website marketing language, or alleged SOP noncompliance as enough to create a borrower-facing duty of care. That aspect of the ruling may be valuable for financial institutions facing borrower claims after a financed business venture deteriorates.

The decision also provides a practical reminder about reliance. Plaintiffs alleged that they conducted their own diligence into WST, including reference checks, discussions with existing franchise owners, review of installed technology, and location scouting. Those allegations made it more difficult to plead that they were relying on the lender to vet the franchise opportunity for them. In the franchise context, diligence remains a distinct responsibility. Prospective franchisees should review the FDD, speak with current and former franchisees, evaluate the franchisor’s financial condition, understand the business model, and consult their own advisors. Franchisors and lenders should both be careful not to blur those roles.

For franchise systems, the more sensitive point is sales messaging. This decision may help lenders defend against efforts to recast financing approval as business-opportunity validation, but franchisors should not take comfort from that distinction if their own communications overstate lender involvement. A franchisor that tells prospects that SBA approval, lender participation, or available financing confirms the strength of the franchise system may create a different record. Franchise sales teams should avoid implying that lender approval proves viability, profitability, collateral value, or operational readiness.

The case also highlights the importance of collateral and operational verification in franchise-finance transactions. Plaintiffs alleged that the loan was secured in part by water vending machines that did not exist and that the lien on their residence became the practical source of repayment. The court did not hold that these allegations were unimportant. It held that, as pleaded, they did not create viable claims against these lender-side defendants. In future cases, different representations, direct advice, actual knowledge, or more specific lender involvement could present a different risk profile.

This decision should therefore be read as a fact-specific lender-liability ruling, not a broad statement about franchise fraud or franchise-system responsibility. It is most useful for the proposition that a failed franchise investment does not automatically transform an SBA lender into a guarantor of the franchise's viability. The contractual and factual record will matter. Courts may distinguish between a lender that funds a loan in the ordinary course and a party that actively promotes, validates, or participates in the underlying franchise opportunity.

Taken together, Rumson Wellness is a useful crossover decision for the franchise and banking communities. It reinforces that franchise investment risk, lender underwriting obligations, SBA financing requirements, and franchisor disclosure duties occupy related but distinct lanes. Franchisors should maintain clean sales practices and avoid overstating financing signals. Lenders should preserve the arm's-length nature of the lending relationship and avoid providing business-opportunity advice unless they intend to assume that role. And all parties should treat franchise financing as an important transaction requiring independent diligence, not as a guarantee that the underlying franchise opportunity will succeed.

This article is based solely on the opinion of the Court in this matter. The author has not conducted any independent investigation into the facts. For the avoidance of doubt, each statement related to the law and facts in this article is drawn from the Court's opinion in this case.

Thomas O'Connell is a Partner at Buchalter LLP and Chair of the firm's Franchise Practice Group. For questions about this article or media inquiries, you can contact Tom at toconnell@buchalter.com.

This communication is not intended to create, and does not create, an attorney-client relationship or any other legal relationship. No statement herein constitutes legal advice, nor should it be relied upon or interpreted as such. This communication is for general informational purposes only and is not a substitute for legal counsel. Readers should not act or refrain from acting based on any information provided without seeking appropriate legal advice specific to their situation. For more information, visit www.buchalter.com.

PRIMARY CONTACTS

Thomas M. O'Connell

Partner

Orange County, San Diego

619.219.6330

toconnell@buchalter.com

Biography

Buchalter

OFFICES

Atlanta
Chicago
Dallas
Denver
Los Angeles
Napa Valley
Nashville
Orange County
Portland
Sacramento
Salt Lake City
San Diego
San Francisco
Scottsdale
Seattle