

# Franchise Relationship Laws

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*This chapter provides an overview of the laws governing the franchise relationship after the franchise agreement has been signed.<sup>1</sup> Franchise regulation relating to the sale of franchises is covered in Chapters 3 and 4.*

*The appendices to this chapter provide more specific information regarding state franchise relationship laws, including statutory examples of good cause for termination, procedural requirements for termination and nonrenewal, and examples of unlawful practices not covered in the body of this chapter.*

1. This chapter is based on the article by Thomas M. Pitegoff, *Franchise Relationship Laws: A Minefield for Franchisors*, 45 BUS. LAW. 289 (1989).

# I. Brief History and Overview of Franchise Relationship Laws

## A. Abuses

In the 1950s and 1960s, the early period of modern business format franchising, abuses were common. These abuses were exacerbated by the retrenchment and vertical integration in the motor vehicle fuel industry following the OPEC oil embargo in 1973. Franchisees argued that these abuses were not adequately addressed by common law or antitrust remedies. The result was the passage of both franchise registration and relationship laws, mostly in the 1970s. The abuses at which relationship laws are aimed include:

- **Unjust Terminations:** Either by contract or by economic or other pressures, the franchisor would attempt to terminate the franchise relationship, thereby depriving the franchisee of the fruits of his labor and investment.
- **No Renewal Rights:** The franchise agreement typically was short-term, with no renewal opportunity, or, contractual renewal opportunities would be unjustly frustrated, allowing the franchisor to capture the benefits of the business that the franchisee had developed once the stated term of the agreement had expired.
- **No Right to Assign:** The franchisor would prohibit the franchisee from transferring all or a portion of his interest in the franchise to a bona fide purchaser, or perhaps to a qualified member of his family, depriving the franchisee of the opportunity to liquidate the equity in the franchised business.
- **Other Abuses:** The franchisor would place another unit (either company-owned or franchised) in close proximity to an existing franchised unit. This placement, known as encroachment, would result in the franchisee's business being "cannibalized"—sales diverted to the new location. Franchisors also engaged in other practices objectionable to franchisees, such as restricting the right of free association among franchisees, discriminating among franchisees, and imposing unreasonable standards of performance on franchisees.

## B. Federal Legislation

No franchise relationship law of general application exists at the federal level. While a federal franchise relationship law of general application was proposed as early as 1971, no such law has ever been adopted. Instead, the FTC issued its Rule on Fran-

chising<sup>2</sup> (the FTC Rule), which became effective in 1979. The FTC Rule requires pre-sale disclosure but contains no requirements regarding termination, renewal, or assignment. Its only “relationship” provision is a mandate that refunds of fees be made in accordance with the promise. In 2007, in connection with proposed revisions to the Franchise Rule, the FTC again considered but rejected federal regulation of the franchise relationship except to prohibit contract integration clauses that might preclude reference to a disclosure document in a later dispute.

While broad legislative efforts failed at the federal level, dealers in certain industries were successful in obtaining legislation addressing specific needs. The first federal law specifically regulating franchising was the Automobile Dealer’s Day in Court Act,<sup>3</sup> enacted in 1956. This statute basically requires automobile manufacturers to deal in good faith with dealers. More comprehensive laws governing the relationship between automobile manufacturers and dealers exist at the state level in most states.

In 1978, Congress adopted the Petroleum Marketing Practices Act (the PMPA),<sup>4</sup> which sets forth procedures that a gas station franchisor must follow before it may terminate or refuse to renew a dealer. The PMPA is of particular interest because it preempts state law in the areas of franchise termination and renewal. Therefore, the substantive protection provided by the states was abrogated by the federal act, which historically has not been viewed by many practitioners as being pro-dealer/franchisee and which is more procedural than substantive in content. The case law under the PMPA supports this view.<sup>5</sup>

The Sherman Act and other federal antitrust laws significantly influenced the early development of franchising arrangements, particularly with respect to vertical restrictions such as tying arrangements and exclusive territories. Since the late 1970s, however, antitrust laws have become less of an issue, as courts have allowed franchisors to impose reasonable vertical restrictions. See Chapter 6 for a full discussion of antitrust law related to franchising.

### C. State Legislation

Franchisees have achieved greater success at the state level than at the federal level in creating protection against franchisor abuse. Statutes have been enacted to deal with specific problems in various industry sectors. The most common industry-specific statutes relate to the automotive, beer and wine, farm equipment, and construction equipment industries.<sup>6</sup>

2. 16 C.F.R. pt. 436. *See* Chapter 3 for a discussion of the FTC Rule.

3. 15 U.S.C. §§ 1221-1225.

4. 15 U.S.C. §§ 2801-2806.

5. *See generally* Lewis G. Rudnick, *The Franchise Relationship: A Look Back in Time*, I Tab 5 at 15, 11th ANNUAL ABA FORUM ON FRANCHISING (1988).

6. The industry-specific statutes are collected in *Bus. Franchise Guide* (CCH) at ¶¶ 4000 *et seq.*

In 1964, Puerto Rico became the first U.S. jurisdiction to pass a law protecting local dealers without regard to industry. The California Franchise Investment Law, enacted in 1970, was the first registration and disclosure law governing franchise sales. A number of other states also enacted franchise registration and disclosure laws during the 1970s. Most of the state franchise relationship laws also were enacted in the 1970s, either separately or as part of the registration and disclosure laws.

Eighteen states have laws of general applicability that govern the franchise relationship.<sup>7</sup> These laws were promulgated only after hard-fought battles in the legislative arenas. In seven of these states, the franchise relationship laws are part of the state franchise registration or disclosure law. Three other states have both disclosure and relationship laws. The remaining states have relationship laws but not disclosure laws. A state-by-state breakdown is set forth in Appendix B. The remainder of this chapter deals with state franchise relationship laws of general applicability.

The areas of primary concern under state relationship laws are the termination, renewal, and transfer of franchise rights. This chapter will focus on these issues. Some state laws, notably Washington, Michigan, Indiana, and Iowa, go well beyond these issues. Franchise relationship laws in various states prohibit a number of other practices of franchisors, such as:

1. Restricting free association among franchisees;
2. Discriminating between franchisees;
3. Prohibiting changes in management without good cause;
4. Encroaching on the franchisee's exclusive territory;

7. Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, Rhode Island, Virginia, Washington, and Wisconsin. Puerto Rico and the U.S. Virgin Islands also have relationship laws. *See* Appendix A.

The South Dakota Division of Securities also has policies for registration that include a requirement that the franchise agreement afford the franchisee 30 days' notice of termination and an opportunity to cure. *Bus. Franchise Guide (CCH) ¶ 5410.01. See also S.D. CODIFIED LAWS § 37-5A-51*, referring to rules of the Division of Securities. No rules have yet been issued.

The Maryland Fair Distribution Act, which became effective October 1, 1995, applies to wholesale distributors of commercial goods who maintain an inventory of such goods for resale. This act specifically does not apply to franchises and business opportunities that fall under the state's registration and disclosure laws.

A few states have statutes affecting, in limited respects, distributorships; Alaska (*Bus. Franchise Guide (CCH) ¶ 4020* (inventory repurchase)); Idaho (*Bus. Franchise Guide ¶ 4120.01* (voids waivers of jurisdiction and venue)); Louisiana (*Bus. Franchise Guide (CCH) ¶ 4181* (Louisiana law must be applicable; Louisiana courts must have jurisdiction)); Maryland (*Bus. Franchise Guide (CCH) ¶ 4200*); North Dakota (*Bus. Franchise Guide (CCH) ¶ 4341* (inventory repurchase)).

5. Receiving payments from third parties based on the business dealings of such parties with franchisees; or
6. Requiring litigation or arbitration outside the franchisee's state.

Examples of these prohibitions, with a breakdown by state, are listed in Appendix E.

The question of the effect of a contractual "choice of governing law" clause on the applicability of state relationship laws arises frequently. The effect of an attempt by a franchisor to avoid a franchise relationship statute by the contractual choice of law of another state is unpredictable.<sup>8</sup> In many states, a waiver of compliance with the relationship laws will be ineffective, and the selection of the law of another state will be held contrary to the fundamental policy of the franchisee's state.<sup>9</sup> In other cases, the selection of the laws of the franchisor's state will avoid the franchise relationship law of the franchisee's state, particularly where there is an equality of bargaining power.<sup>10</sup>

In a state in which the relationship requirements are part of the registration and disclosure law, the use of a franchise agreement that is contrary to the relationship requirements and is not qualified by reference to the local law may delay registration.

## **II. Definition of "Franchise" Under State Relationship Laws**

### **A. Breadth of Definition**

The definition of a "franchise" varies widely among the relationship laws. The coverage of the franchise relationship laws, however, is often far broader than that of the registration and disclosure laws, and in some cases, "franchises" are swept up in a much broader statutory definition of covered dealerships.

While each state relationship law has a different definition of the term "franchise," most definitions require that the following three elements be present:

1. The relationship must involve the use of a trademark;

8. See Thomas M. Pitegoff, *Choice of Law in Franchise Relationships: Staying Within Bounds*, 14 FRANCHISE L.J. 89 (Spring 1995); Thomas M. Pitegoff, *Choice of Law in Franchise Agreements*, 9 FRANCHISE L.J. 1 (Summer 1989).

9. See, e.g., *Instructional Sys., Inc. v. Computer Curriculum Corp.*, 35 F.3d 813 (3d Cir. 1994).

10. See *Modern Computer Sys., Inc. v. Modern Banking Sys., Inc.*, 871 F.2d 734 (8th Cir. 1989) (holding that the franchise relationship law of Minnesota, the state in which the franchise was located, did not apply, citing the parties' choice of Nebraska law).

2. There must be either a “community of interest” between the franchisor and the franchisee, or the franchisor must provide the franchisee with a “marketing plan”; and
3. The franchisor must charge the franchisee a fee.

The franchise laws of a few states cover not just franchises, but many dealerships and distribution arrangements as well.<sup>11</sup> Manufacturers and suppliers who enter into agreements with distributors, wholesalers or retailers in Arkansas, Connecticut, Missouri, New Jersey, Rhode Island, or Wisconsin must be particularly careful. The relationship laws of these states define the term “franchise” without a fee element.

Some franchise laws cover only franchises that include a trademark license. A manufacturer or supplier can avoid the franchise relationship laws of Missouri and New Jersey, for example, by ensuring that agreements with its distributors in those states contain no implication of a grant of a license to use a trade name, trademark or service mark, or anything that might be characterized as such.

The Arkansas Franchise Practices Act simply requires the grant of a license to use a trademark or service mark within an exclusive or non-exclusive territory to sell or distribute goods or services. There is no requirement of a franchise fee, a marketing plan, or a community of interest. This definition is extremely broad.

## **B. A Closer Look at the Elements of a Franchise**

### **Marketing Plan**

The term “marketing plan” refers to a grant of the right to engage in business under a marketing plan or system prescribed in substantial part by the franchisor.<sup>12</sup>

11. See Kenneth H. Slade, *Applicability of Franchise and Business Opportunity Laws to Distribution and Licensing Agreements*, 15 *AIPPLA Q.J.* 1 (1987); H. Bret Lowell & John F. Dienelt, *Drafting Distribution Agreements: The Unwitting Sale of Franchises and Business Opportunities*, 11 *DEL. J. CORP. L.* 725 (1986). See *Charts v. Nationwide Mut. Ins. Co.*, 397 F. Supp. 2d 357, *Bus. Franchise Guide* (CCH) ¶ 13,200 (D. Conn. 2005) (holding that an independent insurance agent was a “franchise” under the Connecticut Franchise Act).

12. Under the California Franchise Relations Act, for example, “‘franchise’ means a contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which:

1. A franchisee is granted the right to engage in the business of offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor.
2. The operation of the franchisee’s business pursuant to that plan or system is substantially associated with the franchisor’s trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate.
3. The franchisee is required to pay, directly or indirectly, a franchise fee.”

CAL. BUS. & PROF. CODE § 20001.

Generally speaking, a marketing plan exists whenever the franchisor presents the group of franchised outlets to the public as a unit, with the appearance of some centralized management and uniform standards.<sup>13</sup> This might be done, for example, through one of the following:

1. Advertising by the franchisor;
2. Requirements regarding site selection, appearance of the premises, uniforms, or hours of operation;
3. Limitations on products, services or customers;
4. Providing training;
5. Requiring approval of advertising and signage; and
6. The use of an operations manual.

While most franchise laws consider the marketing plan element to be present only when the franchisee is required to use the franchisor's marketing plan,<sup>14</sup> one court has held that the marketing plan element is satisfied under Illinois law merely when the franchisee has a right but not an obligation to use the plan.<sup>15</sup>

### **Community of Interest**

Some of the franchise laws have a definitional requirement that the franchisor and franchisee have a "community of interest" in the marketing of the goods or ser-

13. The Illinois Franchise Disclosure Act of 1987, for example, provides as follows:

'Marketing plan or system' means a plan or system relating to some aspect of the conduct of a party to a contract in conducting business, including but not limited to (a) specification of price, or special pricing systems or discount plans, (b) use of particular sales or display equipment or merchandising devices, (c) use of specific sales techniques, and (d) use of advertising or promotional materials or cooperation in advertising efforts. . . .

ILL. COMP. STAT. 121½, ¶ 1703, § 3(18). For a broad interpretation, *see* *Petereit v. S.B. Thomas, Inc.*, 853 F. Supp. 55, Bus. Franchise Guide (CCH) ¶ 10,379 (D. Conn. 1993), *aff'd in part, rev'd in part*, 63 F.3d 1169 (2d Cir. 1995) (Connecticut law).

14. *Charts v. Nationwide Mut. Ins. Co.*, 397 F. Supp. 2d 357, Bus. Franchise Guide (CCH) ¶ 13,200 (D. Conn. 2005); *Edmands v. Cumo, Inc.*, 892 A.2d 938, Bus. Franchise Guide (CCH) ¶ 13,302 (Conn. 2006). *See, e.g.*, *Hartford Elec. Supply Co. v. Allen-Bradley Co.*, Bus. Franchise Guide (CCH) ¶ 11,685 (Conn. Sup. Ct. 1999) (Connecticut law); *In the Matter of The Kis Corp.*, Bus. Franchise Guide (CCH) ¶ 8731 (Wis. Comm. of Sec. 1986).

15. *To-Am Equip. Co. v. Mitsubishi Caterpillar Forklift Am., Inc.*, Bus. Franchise Guide (CCH) ¶ 11,134 (N.D. Ill. 1997) (Illinois law).

vices.<sup>16</sup> The community of interest element usually is far broader than the marketing plan element.

In Wisconsin, for example, a community of interest exists where the parties have a continuing financial interest and a degree of interdependence.<sup>17</sup> The Supreme Court of Wisconsin has articulated ten factors to be considered by courts in determining whether a dealer has a community of interest within Wisconsin. The factors include, but are not limited to, the percentage of sales within Wisconsin, the length of the relationship, relationship-specific investments not easily used for other purposes, the obligations imposed on the dealer, the extent of territory within Wisconsin, personnel devoted to the Wisconsin market, and other similar items.

In New Jersey, the courts have construed “community of interest” more narrowly, looking to “the nature of the interdependence between the parties,” and requiring a degree of control by the franchisor. In effect, there must be sufficient inequality between the parties such that termination of the relationship by the stronger party would shock the court’s sense of equity.<sup>18</sup> In one case, the court

16. In Wisconsin, for example,

‘Dealership’ means . . . [a] contract or agreement, either expressed or implied, whether oral or written, between 2 or more persons, by which a person is granted the right to sell or distribute goods or services, or use a trade name, trademark, service mark, logotype, advertising or other commercial symbol, in which there is a community of interest in the business of offering, selling or distributing goods or services at wholesale, retail, by lease, agreement or otherwise.

WIS. STAT. § 135.02(3).

See Joseph J. Fittante, *Community of Interest: Clarity or Confusion?*, 22 FRANCHISE L.J. 160 (Winter 2003).

17. Cases discussing the community of interest requirement in Wisconsin include: *Dodgeland Ag-Sys., Inc. v. Knight Mfg. Corp.*, Bus. Franchise Guide (CCH) ¶ 10,368 (1993); *Cajan of Wis., Inc. v. Winston Furniture Co.*, 817 F. Supp. 778, Bus. Franchise Guide (CCH) ¶ 10,219 (E.D. Wis. 1993), *aff’d*, 21 F.3d 430, Bus. Franchise Guide (CCH) ¶ 10,458 (7th Cir. 1994); *Ziegler Co. v. Rexnord, Inc.*, 139 Wis. 2d 593, 407 N.W.2d 873, Bus. Franchise Guide (CCH) ¶ 8882 (Wis. 1987); *Lakefield Tel. Co. v. N. Telecom, Inc.*, 696 F. Supp. 413, Bus. Franchise Guide (CCH) ¶ 9249 (E.D. Wis. 1988), *aff’d*, 970 F.2d 386, Bus. Franchise Guide (CCH) ¶ 10,064 (7th Cir. 1992); *Baldewein Co. v. Tri-Clover, Inc.*, 233 Wis. 2d 57, 606 N.W.2d 145 (Wis. 2000). *Bearing Distributors, Inc. v. Rockwell Automation, Inc.*, Bus. Franchise Guide (CCH) ¶ 13,348 (N.D. 2006); *Home Protective Svcs., Inc. v. ADT Sec. Svcs. Inc.*, 438 F.3d 716, Bus. Franchise Guide (CCH) ¶ 13,266 (7th Cir. 2006); *Conrad’s Sentry, Inc. v. Supervalu, Inc.*, 357 F. Supp. 2d 1086 Bus. Franchise Guide (CCH) ¶ 13,024 (W.D. Wis. 2005); *Cent. Corp. v. Research Prods. Corp.*, 681 N.W.2d 178, Bus. Franchise Guide (CCH) ¶ 13,560 (Wis. 2004).

18. *Pride Techs., Inc. v. Sun Microsystems Computer Corp.*, Bus. Franchise Guide (CCH) ¶ 10,407 (N.D. Cal. 1994); *Instructional Sys., Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 614 A.2d 124, Bus. Franchise Guide (CCH) ¶ 10,119 (1992); *New Jersey Am., Inc. v. Allied Corp.*, 875 F.2d 58, Bus. Franchise Guide (CCH) ¶ 9395 (3d Cir. 1989); *Colt Indus., Inc. v. Fidelco Pump & Compressor Corp.*, 844 F.2d 117, Bus. Franchise Guide (CCH) ¶ 9095 (3d Cir. 1988).

concluded that “the unequal bargaining power . . . in the franchise context arises when the relation between licensee and licensor has incidents that induce or require the licensee to invest in skills or assets that have no continuing value to the licensee if the license is terminated.”<sup>19</sup> Another relevant factor under New Jersey law is whether the public perceives the putative franchisee and franchisor as “one and the same.”<sup>20</sup> At least one court, however, has construed “community of interest” under New Jersey law more broadly to include a distribution arrangement under which the distributor was required to make substantial investments specific to the franchised business.<sup>21</sup>

In Minnesota, the payment of a volume-based royalty fee satisfies both the “franchise fee” element and the “community of interest” element of the definition of a franchise.<sup>22</sup>

## Trademark

The trademark element of the state relationship laws will always be satisfied if the franchisee is licensed to do business under the franchisor’s name or mark. Most of the marketing plan franchise laws, however, do not require a license. In some of these states, the operation of the franchisee’s business must be “substantially associated” with the franchisor’s trademark. In other states, the trademark element is satisfied where the franchisor’s trademark or service mark identifies the goods or services sold, rather than the business itself. This would include many ordinary dealerships and distributorships.<sup>23</sup> If the relationship involves something less than a formal trademark license, the practitioner should examine the trademark element carefully.<sup>24</sup> For example, under Iowa law, this element is satisfied if the

19. *Cassidy Podell Lynch, Inc. v. SnyderGeneral Corp.*, 944 F.2d 1131, 1142, *Bus. Franchise Guide (CCH)* ¶ 9885 (3d Cir. 1991).

20. *Instructional Sys., Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 614 A.2d 124, *Bus. Franchise Guide (CCH)* ¶ 10,119 (1992); *Freedman Truck Ctr., Inc. v. Gen. Motors Corp.*, 784 F. Supp. 167, *Bus. Franchise Guide (CCH)* ¶ 9971 (D. N.J. 1992).

21. *Atl. City Coin & Slot Serv. Co. v. IGT*, 14 F. Supp. 2d 644, *Bus. Franchise Guide (CCH)* ¶ 11,481 (D. N.J. 1998).

22. *Martin Investors, Inc. v. Vander Bie*, 269 N.W.2d 868 (Minn. 1978).

23. For discussions of the trademark requirement, *see Hartford Elec. Supply Co. v. Allen-Bradley Co.*, *Bus. Franchise Guide (CCH)* ¶ 11,685 (Conn. Sup. Ct. 1999) (Connecticut law); *Colt Indus., Inc. v. Fidelco Pump & Compressor Corp.*, 844 F.2d 117, *Bus. Franchise Guide (CCH)* ¶ 9095 (3d Cir. 1988) (New Jersey law); *Am. Bus. Interiors, Inc. v. Haworth, Inc.*, 798 F.2d 1135, 1140, *Bus. Franchise Guide (CCH)* ¶ 8642 (8th Cir. 1986) (Missouri law).

24. A grant of limited use of a trademark can sometimes operate to avoid satisfaction of this element. *See, e.g., Smith v. Rainsoft Water Conditioning Co.*, 848 F. Supp. 1413, *Bus. Franchise Guide (CCH)* ¶ 10,447 (E.D. Wis. 1994); *Pride Techs., Inc. v. Sun Microsystems Computer Corp.*, *Bus. Franchise Guide (CCH)* ¶ 10,407 (N.D. Cal. 1994) (New Jersey law).

franchisor merely “allows” the business to be associated with its mark.<sup>25</sup> The same is true in Minnesota. In one California case, the court held this element satisfied even though ultimate end-users of the franchisees’ services had no knowledge of the franchisor’s name or mark.<sup>26</sup> Under the Connecticut Act, the putative franchisee must be dependent upon the franchisor; thus, where a sales representative only derived 40 percent of its profits from a manufacturer, there was no franchise because it was not substantially associated with the franchisor’s mark.<sup>27</sup>

## Fee

The fee element of the definition of a franchise generally means any fee or charge that the franchisee is required to pay for the right to do business under the franchise agreement. This payment does not have to be in the form of a franchise fee. It also may be royalties on sales. Most trademark license agreements contain provisions that would satisfy this requirement, as do most technology and “know-how” licenses. The “fee” may be a required payment for rent, advertising assistance, equipment and supplies, training or other items. However, it generally does not include payment for a reasonable quantity of goods for resale at a bona fide wholesale price.<sup>28</sup> Under the Indiana Act, a fee must be actually required by the franchisor and not recoverable by the franchisee.<sup>29</sup>

Courts interpreting California and Washington law have held that a fleet surcharge that a car rental company deducted from the commissions it paid to an agency operator was not a franchise fee because the agency operator received something of value in exchange for the surcharge, namely the use of the cars and the opportunity to receive a commission on them. Likewise, a fuel surcharge per-

25. IOWA CODE § 523 H.1.3.a (1) (c).

26. *Kim v. Servosnax, Inc.*, 10 Cal. App. 4th 1346, 13 Cal. Rptr. 2d 422, Bus. Franchise Guide (CCH) ¶ 10,124 (1992).

27. *Rudel Mach. Co. v. Giddings & Lewis, Inc.*, Bus. Franchise Guide (CCH) ¶ 11,716 (D. Conn. 2000).

28. Cases discussing the fee requirement include: *Upper Midwest Sales Co. v. Ecolab, Inc.*, Bus. Franchise Guide (CCH) ¶ 11,385 (Minn. Ct. App. 1998) (Minnesota law); *Cont’l Basketball Ass’n, Inc. v. Ellenstein Enters., Inc.*, 640 N.E.2d 705, Bus. Franchise Guide (CCH) ¶ 10,541 (Ind. Ct. App. 1994) (Indiana law); *Bryant Corp. v. Outboard Marine Corp.*, Bus. Franchise Guide (CCH) ¶ 10,604 (W.D. Wash. 1994); *Wright-Moore Corp. v. Ricoh Corp.*, Bus. Franchise Guide (CCH) ¶ 10,111 (7th Cir. 1992) (Indiana law); *Boat & Motor Mart v. Sea Ray Boats, Inc.*, 825 F.2d 1285, Bus. Franchise Guide (CCH) ¶ 8846 (9th Cir. 1987) (California law); *Cambee’s Furniture, Inc. v. Doughboy Recreational, Inc.*, 825 F.2d 167, Bus. Franchise Guide (CCH) ¶ 8888 (8th Cir. 1987) (South Dakota law); *Inland Printing Co. v. A.B. Dick Co.*, Bus. Franchise Guide (CCH) ¶ 8997 (W.D. Mo. 1987) (Illinois law); *Am. Parts Sys., Inc. v. T & T Auto., Inc.*, 358 N.W.2d 674, Bus. Franchise Guide (CCH) ¶ 8262 (Minn. Ct. App. 1984) (Minnesota law).

29. *Best Distrib. Co. v. Seyfert Foods, Inc.*, 714 N.E.2d 1196 (Ind. Ct. App. 1999), *vacated*, 735 N.E. 2d 227 (Ind. 2000).

centage split did not constitute a franchise fee.<sup>30</sup> Another court held that a “one percent stale policy” in a bakery distributorship did not constitute a hidden fee under Washington law.<sup>31</sup>

Similarly, a Michigan court held that there was no indirect franchise fee under Michigan law, even though the gasoline company allegedly required a gas station owner to buy excess inventory, meet an increased sales quota, pay a deposit, make improvements to the gas station, attend training seminars, and pay a fee for equipment lent to him.<sup>32</sup>

In one case narrowly construing the meaning of a franchise fee for purposes of the Minnesota franchise law, the court held that minimum purchase requirements, required fees for advertising and training and to process warranty work, and a charge of 50 percent over the suggested sale price did not constitute franchise fees because they were ordinary expenses of any business.<sup>33</sup> But in three other cases, Minnesota courts have broadly construed the law to reach *any* payment (not specifically excluded in the statute) that is required as a condition of entering into the business relationship.<sup>34</sup> Likewise, the Seventh Circuit held that the required purchase of manuals constituted a franchise fee under Illinois law.<sup>35</sup>

### **III. “Good Cause” for Termination**

#### **A. Statutory “Good Cause” Requirements**

Most franchise relationship laws require the franchisor to have “good cause” before terminating a franchise agreement. “Good cause” is defined in Minnesota, Nebraska, New Jersey, Rhode Island, and Wisconsin as failure by the franchisee to substantially comply with the requirements imposed by the franchisor. In New

30. *Adees Corp. v. Avis Rent-a-Car Systems, Inc.*, Bus. Franchise Guide (CCH) ¶ 13,157 (9th Cir. Sept. 16, 2005); *Jon K. Morrison, Inc. v. Avis Rent-a-Car Systems, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,701 (W.D. Wash. 2003).

31. *Atchley v. Pepperidge Farm, Inc.*, Bus. Franchise Guide (CCH) ¶ 13,338 (E.D. Wash. Mar. 20, 2006).

32. *Hamade v. Sunoco Inc.*, Bus. Franchise Guide (CCH) ¶ 13,356 (Mich. Ct. App. May 25, 2006).

33. *Brawley Distribution Co. v. Polaris Indus.*, Bus. Franchise Guide (CCH) ¶ 9388 (D. Minn. 1989).

34. *Unlimited Horizon Mktg., Inc. v. Precision Hub, Inc.*, 533 N.W.2d 63 (Minn. Ct. App. 1995); *Current Tech. Concepts, Inc. v. Irie Enters., Inc.*, 530 N.W.2d 539 (Minn. 1995); *Pool Concepts, Inc. v. Watkins, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,249 (D. Minn. 2002).

35. *To-Am. Equip. Co. v. Mitsubishi Caterpillar Forklift Am., Inc.*, Bus. Franchise Guide ¶ 11,456 (7th Cir. 1998).

Jersey, good faith may also be required.<sup>36</sup> Iowa defines good cause as “a legitimate business reason” and, uniquely, requires that the termination not be arbitrary or capricious when compared to the franchisor’s acts in similar circumstances.

In the relationship laws of other states, the term “good cause” is not defined, except by way of example. The failure of the franchisee to substantially comply with the requirements imposed by the franchisor is just one example of good cause in these states.

The Virginia Retail Franchising Act prohibits termination without “reasonable cause.” The Delaware Franchise Security Law prohibits “unjust” termination, which means termination without good cause or in bad faith. Mississippi and Missouri do not have a good cause requirement for termination, but do have notice requirements.<sup>37</sup>

Other specific statutory grounds for termination are listed in Appendix C.

## **B. Cases Interpreting Good Cause**

### **Damage to Franchisor’s Reputation**

Egregious behavior by a franchisee that tarnishes the brand’s reputation sometimes justifies termination. In Minnesota, termination was found to have been lawful where the franchisee had engaged in consumer fraud, damaging the franchisor’s reputation.<sup>38</sup> The New Jersey Franchise Practices Act has been held to permit termination where the franchisee violated the law.<sup>39</sup> The California Franchise Relations Act was held to permit a franchisor to terminate upon learning that the franchisee pled no contest to a felony.<sup>40</sup>

In Minnesota, one court found good cause for termination where a franchisee sold competing products and palmed off unauthorized products under the franchisor’s trademark.<sup>41</sup> In Illinois, the franchisee’s abandonment of a franchise was also found to constitute good cause for termination.<sup>42</sup>

36. *Gen. Motors Corp. v. New A.C. Chevrolet, Inc.*, 263 F.3d 296, *Bus. Franchise Guide (CCH)* ¶ 12,151 (3d Cir. 2001).

37. *But see ABA Distribs., Inc. v. Adolph Coors Co.*, 542 F. Supp. 1272, *Bus. Franchise Guide (CCH)* ¶ 7872 (W.D. Mo. 1982) (Missouri law).

38. *AAMCO Indus., Inc. v. DeWolf*, 250 N.W.2d 835 (Minn. 1977). In this case, the court also excused noncompliance with the law’s procedural notice requirements, due to the severity of the breach, with resulting consumer fraud, and the “futility” of offering a cure period.

39. *Amerada Hess Corp. v. Quinn*, 143 N.J. Super. 237, 362 A.2d 1258 (1976); *Anderson v. Amoco Oil Co.*, *Bus. Franchise Guide (CCH)* ¶ 8790 (D. N.J. 1987).

40. *Shieh v. Kumon N. Am., Inc.*, *Bus. Franchise Guide (CCH)* ¶ 13,245 (Dist. Ct. Jan. 6, 2006).

41. *Great Licks, Inc. v. Baskin-Robbins, U.S.A. Co.*, *Bus. Franchise Guide (CCH)* ¶ 9252 (D. Minn. 1988).

42. *Zeidler v. A&W Restaurant Inc.*, *Bus. Franchise Guide (CCH)* ¶ 13,557 (7th Cir. Feb. 15, 2007).

## Sale of Competing Products

A commercial conflict of interest can justify termination if the franchise agreement so provides. The sale by a franchisee of a competing line was held to be good cause for termination under New Jersey,<sup>43</sup> Illinois,<sup>44</sup> and Wisconsin law.<sup>45</sup> Sale of a competing line was not good cause for termination under Connecticut law, however, when the distributorship agreement did not require exclusive dealing.<sup>46</sup>

## Failure to Maintain Standards

Breach of other material contract requirements usually supports termination. An Illinois court found McDonald's to have had good cause to terminate where the franchisee failed to maintain the required standards of cleanliness, quality, and service.<sup>47</sup> In Delaware, a franchisor was found to have had good cause to terminate a franchise agreement when the franchisee failed to execute a renewal lease requiring additional rent for the possible installation of environmental control equipment.<sup>48</sup> An automobile dealer's failure to build a separate showroom facility was good cause under the New Jersey Act.<sup>49</sup>

## Failure to Meet Sales and Other Requirements

Minimum performance standards can be enforced by termination. The Wisconsin Fair Dealership Law has been held to permit termination where the dealer failed to meet reasonable sales goals,<sup>50</sup> or where the dealer became insolvent or unprofit-

43. *Maple Shade Motor Corp. v. KIA Motors of Am., Inc.*, 384 F. Supp. 2d. 770, Bus. Franchise Guide (CCH) ¶ 13,189 (D. N.J. 2005).

44. *Inland Printing Co. v. A.B. Dick Co.*, Bus. Franchise Guide (CCH) ¶ 8997 (W.D. Mo. 1987).

45. *Dade v. Day Food Co.*, 138 Wis. 2d 525, 406 N.W.2d 170, Bus. Franchise Guide (CCH) ¶ 8835 (Wis. Ct. App. 1987); *but see Reinders Bros., Inc. v. Rain Bird E. Sales Corp.*, 627 F.2d 44, Bus. Franchise Guide (CCH) ¶ 7544 (7th Cir. 1980).

46. *Power Draulics-Nielsen, Inc. v. Libby Owens Ford Co.*, Bus. Franchise Guide (CCH) ¶ 9075 (S.D. N.Y. 1988).

47. *Dayan v. McDonald's Corp.*, 125 Ill. App. 3d 972, 466 N.E.2d 958, Bus. Franchise Guide (CCH) ¶ 8223 (1984).

48. *Tulowitzki v. Atl. Richfield Co.*, 396 A.2d 956 (Del. 1978).

49. *Maple Shade Motor Corp. v. KIA Motors of Am., Inc.*, 384 F. Supp. 2d. 770, Bus. Franchise Guide (CCH) ¶ 13,189 (D. N.J. 2005).

50. *Brown Dog, Inc. v. Quizno's Franchise Co.*, Bus. Franchise Guide (CCH) ¶ 13,229 (W.D. Wis. Dec. 27, 2005); *Aring Equip. Co. v. Link-Belt Constr. Equip. Co.*, Bus. Franchise Guide (CCH) ¶¶ 8906 (Wis. Cir. Ct. 1987); *L-O Distribs., Inc. v. Speed Queen Co.*, 611 F. Supp. 1569, Bus. Franchise Guide (CCH) ¶ 8430 (D. Minn. 1985); *Al Bishop Agency, Inc. v. Lithonia Div. of Nat'l Serv. Indus. Inc.*, 474 F. Supp. 828 (E.D. Wis. 1979).

able.<sup>51</sup> The New Jersey Franchise Practices Act has been held to permit termination in one case in which the franchisee failed to sell in its entire territory, as required under the agreement,<sup>52</sup> and another in which the franchisee intentionally underpaid royalties.<sup>53</sup> The latter termination was permitted even though the hold-back occurred as a result of a legitimate commercial dispute between the franchisor and franchisee. A court interpreting the Puerto Rico Dealers' Act reached a contrary result and refused to permit termination for failure to meet sales goals and sale of competing goods where the evidence showed that the deficiencies were caused, at least in part, by the franchisor's nearby competing outlet.<sup>54</sup> Under the Connecticut Act, failure to achieve sales objectives and to otherwise conform to the franchisor's business standards must be consistent with economic conditions and the franchisor's treatment of other franchisees.<sup>55</sup> In a dispute over whether a franchise was terminated before or after there was a binding agreement, a court held that the franchisor had good cause to terminate under the Illinois Franchise Disclosure Act based on the prospective franchisee's lack of capital.<sup>56</sup>

### **Underreporting Sales or Failure to Report Sales or Pay Royalties**

Failure to pay fees almost always justifies termination. The New Jersey Franchise Practices Act and the Virginia Retail Franchising Act have been held to permit termination where the franchisee underreported sales.<sup>57</sup> The Wisconsin Fair Dealership Law has been held to permit termination where the dealer deliberately failed to report income.<sup>58</sup> The Mississippi franchise law has been interpreted to permit termination without notice in the event of submission of false credit information, incorrect purchase prices and down payments, and listing of fictitious trade-ins.<sup>59</sup> The

51. *Lee Beverage Co. v. I.S.C. Wines of Cal., Inc.*, 623 F. Supp. 867, Bus. Franchise Guide (CCH) ¶ 8509 (E.D. Wis. 1985); *Open Pantry Food Marts v. Garcia's Five, Inc.*, Bus. Franchise Guide (CCH) ¶ 8113 (Wis. Cir. Ct. 1984).

52. *Carlo C. Gelardi Corp. v. Miller Brewing Co.*, 421 F. Supp. 237 (D. N.J. 1976).

53. *Jiffy Lube Int'l, Inc. v. Weiss Bros., Inc.*, 834 F. Supp. 683, Bus. Franchise Guide (CCH) ¶ 10,388 (D. N.J. 1993).

54. *Newell P.R., Ltd. v. Rubbermaid Inc.*, 20 F.3d 15, Bus. Franchise Guide (CCH) ¶ 10,413 (D. P.R. 1994).

55. *Hartford Elec. Supply Co. v. Allen-Bradley Co.*, 250 Conn. 334 (Conn. 1999).

56. *Smith v. Molly Maid, Inc.*, 415 F. Supp. 2d 905, Bus. Franchise Guide (CCH) ¶ 13,273 (N.D. Ill. 2006).

57. *Dunkin Donuts of Am., Inc. v. Middletown Donut Corp.*, 100 N.J. Super. 166, 495 A.2d 66, Bus. Franchise Guide (CCH) ¶ 8408 (1985); *Jackson Hewitt, Inc. v. Greene*, 865 F. Supp. 1199, Bus. Franchise Guide (CCH) ¶ 10,591 (E.D. Va. 1994).

58. *Open Pantry Food Marts v. Howell*, Bus. Franchise Guide (CCH) ¶ 8072 (Wis. Cir. Ct. 1983).

59. *Crosthwait Equip. Co. v. John Deere Co.*, 992 F.2d 525, Bus. Franchise Guide (CCH) ¶ 10,364 (5th Cir. 1993).

Michigan Franchise Investment Law and the Indiana Deceptive Franchise Practices Act have been held to allow termination when the franchisee fails to pay royalties and advertising fees and fails to file monthly sales reports.<sup>60</sup> Similarly, consistent late payments constituted good cause for termination under California law.<sup>61</sup> If, however, a franchisee in good faith disputes amounts owed to the franchisor, the franchisor may be liable for wrongful termination under the Virginia Retail Franchise Act if it terminates the franchisee for failure to pay the disputed amounts.<sup>62</sup>

### **Market Withdrawal by the Franchisor**

When a franchisor discontinues business either entirely, in a particular line of products, or in a particular geographic area, the question of whether ensuing terminations are for “good cause” requires careful and detailed analysis. Some states, such as Wisconsin, look to whether the supplier withdraws *completely* from selling its products or services on a nondiscriminatory basis; a change in distribution methods alone does not constitute good cause.<sup>63</sup> Other states look only to whether the franchisor or supplier has sound business reasons for the change, such as a failing market for a product line.<sup>64</sup> In some states a franchisor’s business reasons for termination that do

60. *Two Men and a Truck/Int’l Inc. v. Two Men and a Truck/Kalamazoo, Inc.*, 949 F. Supp. 500, Bus. Franchise Guide (CCH) ¶ 11,170 (W.D. Mich 1996).

61. *Hiromoto v. Evans*, Bus. Franchise Guide (CCH) ¶ 10,943 (Cal. Super. Ct., Los Angeles Cty., 1996).

62. *G.M. Garrett Realty v. Cent. 21 Real Estate Corp.*, 169, No. 00-1747, 2001 WL 980558, Bus. Franchise Guide (CCH) ¶ 12,149 (4th Cir. Aug. 28, 2001).

63. *See, e.g., Morely-Murphy Co. v. Zenith Elecs. Corp.*, Bus. Franchise Guide (CCH) ¶ 11,378 (7th Cir. 1998); *Slowiak v. Hudson Foods, Inc.*, Bus. Franchise Guide (CCH) ¶ 10,006 (W.D. Wis. 1992), *aff’d*, 987 F.2d 1293, Bus. Franchise Guide (CCH) ¶ 10,180 (7th Cir. 1993); *St. Joseph Equip. v. Massey-Ferguson, Inc.*, 546 F. Supp. 1245, Bus. Franchise Guide (CCH) ¶ 7895 (W.D. Wis. 1982); *Kealey Pharmacy & Home Care Serv., Inc. v. Walgreen Co.*, 539 F. Supp. 1357, Bus. Franchise Guide (CCH) ¶ 7841 (W.D. Wis. 1982), *aff’d in relevant part*, 761 F.2d 345, Bus. Franchise Guide (CCH) ¶ 8351 (7th Cir. 1985); *Hubbard Auto Ctr., Inc. v. Gen. Motors Corp.*, Bus. Franchise Guide (CCH) ¶ 13,458 (N.S. Ind. Mar. 31, 2006) (Indiana law).

64. *Schott Motorcycle Supply, Inc. v. Am. Honda Motor Co.*, 976 F.2d 58, Bus. Franchise Guide (CCH) ¶ 10,091 (1st Cir. 1992) (Maine law); *Gen. Motors Corp. v. Gallo GMC Truck Sales, Inc.*, 711 F. Supp. 810, Bus. Franchise Guide (CCH) ¶ 9544 (D. N.J. 1989); *Freedman Truck Ctr., Inc. v. Gen. Motors Corp.*, 784 F. Supp. 167, Bus. Franchise Guide (CCH) ¶ 9971 (D. N.J. 1992) (New Jersey law); *Medina & Medina v. Country Pride Foods, Ltd.*, 858 F.2d 817, Bus. Franchise Guide (CCH) ¶ 9245 (1st Cir. 1988) (Puerto Rico law). *But see Harter Equip., Inc. v. Volvo Constr. Equip. N. Am., Inc.*, Bus. Franchise Guide (CCH) ¶ 12,651 (D. N.J. 2003) (New Jersey law); *see also Sound of Music Co. v. Minn. Mining & Mfg. Co.*, Bus. Franchise Guide (CCH) ¶ 13,553 (7th Cir. Feb. 13, 2007).

not amount to market withdrawal have been sustained as constituting good cause.<sup>65</sup> On the other hand, one court held that market withdrawal does not constitute good cause for termination in Arkansas because it is not one of the eight reasons expressly enumerated in the Arkansas Franchise Practices Act.<sup>66</sup>

### **Unfair Actions by Franchisors**

A franchisor may not terminate in Wisconsin if it intends to replace a franchised outlet with its own store in the same marketing area as that of the franchisee after the franchisee has helped establish the franchisor's reputation<sup>67</sup> or, apparently, for failure to maintain standards determined to be minor or ancillary.<sup>68</sup> Similarly, courts have held, under the laws of both New Jersey and Connecticut, that a manufacturer may not transform an exclusive distributorship into a nonexclusive one, thereby putting itself in a position to compete directly with the distributor.<sup>69</sup> Such a transformation was held to constitute termination for purposes of these laws. Under Arkansas law, a franchisor may not attempt to force a franchisee out of business as part of the franchisor's consolidation plan to reduce the number of distributors in the state.<sup>70</sup>

### **Termination upon Transfer by the Franchisee**

Cases dealing with termination upon transfer of a franchise are discussed in Section VIII below.

65. *Edmands v. CUNO, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,146 (Conn. Super. Ct. 2001) (termination for distributor's failure to adopt new business practices upheld).

66. *Volvo Trademark Holding Aktiebolaget v. AIS Constr. Equip. Corp.*, 416 F. Supp. 2d 404, Bus. Franchise Guide (CCH) ¶ 13,279 (W.D. N.C. 2006).

67. *Kealey Pharmacy & Home Care Servs., Inc. v. Walgreen Co.*, 761 F.2d 345, Bus. Franchise Guide (CCH) ¶ 8351 (7th Cir. 1985). *See also* *Techmaster, Inc. v. Compact Automation Prods., LLC*, 462 F. Supp. 932 (W.D. Wis. 2006).

68. *Tiesling v. White Hen Pantry Div., Jewel Cos.*, Bus. Franchise Guide (CCH) ¶ 8175 (Wis. Cir. Ct.), *rev'd*, Bus. Franchise Guide (CCH) ¶ 8279 (Wis. Ct. App. 1984).

69. *Carlos v. Philips Bus. Sys., Inc.*, 556 F. Supp. 769, Bus. Franchise Guide (CCH) ¶ 7949 (E.D.N.Y.), *aff'd*, 742 F.2d 1432 (2d Cir. 1983) (New Jersey and Connecticut law); *Executive Bus. Sys., Inc. v. Philips Bus. Sys., Inc.*, Bus. Franchise Guide (CCH) ¶ 7703 (E.D. N.Y. 1981) (New Jersey law).

70. *Miller Brewing Co. v. Ed Roleson, Jr., Inc.*, Bus. Franchise Guide (CCH) ¶ 13,239 (Ark. Jan. 19, 2006). *See also* *Southeastern Distributing Co. v. Miller Brewing Co.*, Bus. Franchise Guide (CCH) ¶ 13,379 (Ark. June 15, 2006).

## IV. Procedural Requirements for Termination

### A. Statutory Procedural Requirements

Assuming the franchisor has good cause to terminate the agreement, the franchisor must then comply with the procedural requirements for termination. This often means doing all of the following:

1. Giving written notice of termination the required number of days in advance;
2. Including in the notice all of the reasons for termination;
3. Including in the notice how much time, if any, the franchisee has to cure the default; and
4. Continuing to comply with the franchisor's obligations during the notice period.

The relationship laws of California, Illinois, Michigan, and Washington require that the franchisor give the franchisee notice of termination and a reasonable opportunity to cure, which in no event need be more than 30 days.

The Washington relationship law provides that if the default cannot be cured within 30 days, the franchisee can void the termination by initiating within 30 days "substantial and continuing action to cure such default." Washington also allows termination without prior notice and opportunity to cure in certain cases.

Other jurisdictions have specific minimum cure periods. Minnesota and Wisconsin require that the franchisee be given 60 days to cure, except in certain specified cases. In Arkansas, the franchisor generally must allow the franchisee 30 days to cure. Arkansas permits a 10-day cure period for repeated breaches within a 12-month period or failure by the franchisee to act in good faith and in a commercially reasonable manner. Iowa requires at least 30 days to cure, but the cure period need not be more than 90 days. Hawaii prohibits termination unless the franchisee is given notice and an opportunity to cure "within a reasonable period of time." Rhode Island requires at least 90 days' notice and a 60-day cure period.

Some statutes provide that no cure period is required in the case of voluntary abandonment, criminal conviction, insolvency, or bankruptcy, and certain other cases. The franchise relationship law of Virginia has no cure requirement and no minimum required notice period.

As a practical matter, if a franchisor's first notice of termination is deficient for some reason, a subsequent notice will be upheld if it is adequate.<sup>71</sup>

71. *Dunkin' Donuts Inc. v. Donuts, Inc.*, No. 99-cv-1141, 2000 U.S. Dist LEXIS 17927, Bus. Franchise Guide (CCH) ¶ 11,989 (N.D. Ill. 2000).

The specific state procedural requirements for termination are set forth in more detail in Appendix D.

Many franchise agreements purport to give the franchisor the right to terminate, often without notice or cure, upon a franchisee's bankruptcy. Some state laws also allow such termination. Section 365 of the Federal Bankruptcy Code, however, nullifies these provisions in most cases when the franchisee becomes the subject of a bankruptcy proceeding under the federal laws.

## **B. Cases Interpreting Procedural Requirements**

### **Compliance with Notice Requirements**

Failure to comply with the notice requirements in and of itself may constitute a violation of the law, regardless of whether the franchisor had good cause to terminate.<sup>72</sup> Where the franchisor does not give the required statutory notice, the franchisor may be required to reinstate the relationship and, if appropriate, give the requisite statutory notice, even though the franchise agreement permits a shorter period.<sup>73</sup>

### **Franchisor Compliance During Notice Period**

After notice of termination has been given but before the effective date of termination, the franchisor must continue to do business with the franchisee and comply with its obligations under the franchise agreement. A refusal by a franchisor to provide pricing information during this period was held in one case to be a violation of the Missouri franchise relationship law.<sup>74</sup>

### **Giving Reasons for Termination**

In some states, the termination notice must contain all of the reasons for termination. This requirement can cause later difficulties for franchisors. It forces the franchisor to take a position at the time that the franchisor gives notice of termination and acts as an estoppel with respect to any reasons not contained in the notice. In a case interpreting Missouri law, for example, the franchisor was precluded from introducing evidence at trial concerning reasons for termination not contained in the notice.<sup>75</sup>

72. *Designs in Medicine, Inc. v. Xomed, Inc.*, 522 F. Supp. 1054, Bus. Franchise Guide (CCH) ¶ 7733 (E.D. Wis. 1981) (Wisconsin law).

73. *Maude v. Gen. Motors Corp.*, 626 F. Supp. 1081, Bus. Franchise Guide (CCH) ¶ 8577 (W.D. Mo. 1986) (Missouri law).

74. *Am. Bus. Interiors, Inc. v. Haworth, Inc.*, 798 F.2d 1135, Bus. Franchise Guide (CCH) ¶ 8642 (8th Cir. 1986).

75. *ABA Distribs., Inc. v. Adolph Coors Co.*, 542 F. Supp. 1272, Bus. Franchise Guide (CCH) ¶ 7872 (W.D. Mo. 1982).

## Insolvency

The Wisconsin Fair Dealership Law does not require prior notice and an opportunity to cure if the reason for termination is the dealer's insolvency. Even if the franchisee is insolvent, however, the franchisor is not excused from the notice and cure requirements if it did not know of the insolvency at the time of termination,<sup>76</sup> or if insolvency was not the reason for termination as stated in the notice.<sup>77</sup>

## Incurable Breaches

What must a franchisor do when the breach cannot be cured within the statutory cure period? Examples include failure to attain minimum sales, misuse of the franchisor's trademark, or damage to the franchisor's goodwill, as discussed below. Reported cases dealing with chronic default (repeated breaches and cures) by a franchisee do not appear to exist.

In Wisconsin, one court enjoined a franchisor from terminating the franchise agreement even though the requisite 90-day notice was given and the franchisee was given 60 days to cure, as required by the statute, holding that the notice was "wholly inadequate in a practical sense."<sup>78</sup> Although the franchisee had failed to meet its minimum sales goals and was given the required notice and opportunity to cure, the court issued an injunction, holding that it would have been impossible for the franchisee to bring its whole year's sales up to the required level in only 60 days. In such a situation, complete cure by the franchisee may not be necessary. Reasonable steps by the franchisee to rectify the claimed deficiencies were held to be adequate to void the termination.

On the other hand, the Supreme Court of Minnesota has held that the statutory cure period was not required where the franchisee already had damaged the franchisor's goodwill, and giving the franchisee an opportunity to cure would have been a "futile gesture."<sup>79</sup> In that case, the Minnesota Attorney General's office had brought an action against an AAMCO franchisee for consumer fraud. The franchisor terminated upon notice with immediate effect, notwithstanding the statutory requirement of a 24-hour cure period. Courts interpreting Illinois law and California law have held that no cure period is required when the franchisee commits a crime.<sup>80</sup>

76. *Bruno Wine & Spirits, Inc. v. Guimarra Vineyards*, 573 F. Supp. 337, *Bus. Franchise Guide (CCH)* ¶ 8081 (E.D. Wis. 1983).

77. *Hammil v. Rickel Mfg. Corp.*, 719 F.2d 252, *Bus. Franchise Guide (CCH)* ¶ 8074 (7th Cir. 1983).

78. *Al Bishop Agency, Inc. v. Lithonia Div. of Nat'l Serv. Indus., Inc.*, 474 F. Supp. 828, 834 (E.D. Wis. 1979).

79. *AAMCO Indus., Inc. v. DeWolf*, 250 N.W.2d 835, 840 (Minn. 1977). *See also* *Smith v. Latham*, *Bus. Franchise Guide (CCH)* ¶ 9259 (D. Minn. 1988).

80. *Dunkin' Donuts, Inc. v. Tejany & Tejany, Inc.* *Bus. Franchise Guide (CCH)* ¶ 13,250 (N.D. Ill. Jan. 18, 2006) (Illinois law); *Shieh v. Kumon N. Am., Inc.* *Bus. Franchise Guide (CCH)* ¶ 13,245 (Dist. Ct. Jan. 6, 2006) (California law).

## V. Nonrenewal

### A. Statutory Renewal Requirements

The provisions of the franchise relationship laws that restrict franchisors from refusing to renew franchise agreements are diverse.

The franchise relationship laws of Delaware, Hawaii, Iowa, New Jersey, Rhode Island, and Wisconsin require good cause for nonrenewal by the franchisor. The Iowa statute requires six months' notice of the franchisor's intention not to renew. In addition, the franchisor must have good cause to refuse to renew, unless the parties agree to the nonrenewal, or the franchisor completely withdraws from the geographic market served by the franchisee and agrees not to enforce a covenant not to compete. The Iowa statute also permits franchisors to condition renewal on a requirement that the franchisee meet the franchisor's then-current requirements for franchises and that the franchisee execute a new agreement containing the then-current terms and fees for new franchises.

Other states generally require good cause for nonrenewal but specifically allow nonrenewal in certain cases as well. California permits nonrenewal upon 180 days' notice for specified reasons, including failure by the franchisee to agree to the standard terms of the renewal franchise. In Arkansas, the franchisor may fail to renew as long as the nonrenewal is in accordance with a policy that is not arbitrary or capricious. In Connecticut, the franchisor is permitted not to renew if the franchisor sells the premises on which the franchise is located or converts it to another use, or the lease to the franchisee expires. In Indiana and Nebraska, the franchisor may refuse to renew if the agreement provides that it is not renewable upon expiration or that it is renewable only if the franchisee meets certain conditions specified in the agreement.

In Minnesota, nonrenewal is permitted if the franchisee has been given an opportunity to operate the franchise over a sufficient period of time to enable the franchisee to recover the fair market value of the franchise as measured from the date of the failure to renew.

Illinois, Michigan, and Washington require renewal only in specified cases. Illinois requires renewal or repurchase of the franchise where there is a noncompete requirement. In Michigan, a franchisor may not refuse to renew without fairly compensating the franchisee by repurchase or other means if the agreement is for a term of less than five years and there is a noncompete requirement. In Washington, renewal or repurchase is required unless the franchisor agrees in writing not to enforce any covenant not to compete and gives the franchisee one year's notice of nonrenewal.<sup>81</sup> Iowa prohibits enforcement of the post-term restrictive covenant if

81. See *Thompson v. Atl. Richfield Co.*, 649 F. Supp. 969, Bus. Franchise Guide (CCH) ¶ 8805 (W.D. Wash. 1986).

the nonrenewal is occasioned by market withdrawal.

Mississippi and Missouri have notice requirements regarding nonrenewal of the franchise agreement, but no substantive requirements. In California and Iowa, the franchisor must give the franchisee at least 180 days' notice of the franchisor's intention not to renew. In Washington, the franchisor must give the franchisee a full year's notice, and the franchisor must permit the franchisee to compete after the end of the term. Most other states require 90 days' notice or less. These requirements are set forth in Appendix D.

## **B. Cases Dealing with Nonrenewal**

California law does not require that the franchisor's notice of nonrenewal include a reason for nonrenewal as long as it complies in other respects with the statutory requirements.<sup>82</sup> Although good cause is required for nonrenewal in Wisconsin, the Wisconsin Supreme Court has held that a franchisor may fail to renew a franchise agreement if the franchisee refuses to agree to changes in the franchisor's method of doing business, provided that such changes are "essential, reasonable and non-discriminatory."<sup>83</sup> The anti-discrimination provisions of the Michigan law have been interpreted to mean that franchisors must have legitimate, nondiscriminatory reasons for failing to renew a franchisee when compared to all similarly situated franchisees, not only to renewed franchisees.<sup>84</sup>

Several state courts have held that nondiscriminatory, necessary changes to the franchise agreement do not constitute either terminations or a failure to renew.<sup>85</sup> But the result may be the opposite if the franchisor uses threats of nonrenewal or termination to induce acceptance of the new agreement.<sup>86</sup>

Franchisees also must comply with the contractual renewal requirements. In one case under the Puerto Rico Dealers' Act, the franchisee failed to give notice of

82. *Dale Carnegie & Assocs., Inc. v. King*, 31 F. Supp. 2d 359, Bus. Franchise Guide (CCH) ¶ 11,576 (S.D. N.Y. 1998).

83. *Ziegler Co. v. Rexnord, Inc.*, 147 Wis. 2d 308, 314, 433 N.W.2d 8, 11, Bus. Franchise Guide (CCH) ¶ 9317 (Wis. 1988).

84. *Gen. Aviation, Inc. v. The Cessna Aircraft Co.*, 13 F.3d 178, Bus. Franchise Guide (CCH) ¶ 10, 362 (6th Cir. 1993) (Michigan law).

85. *Craig D. Corp v. Atl. Richfield Co.*, 122 Wash. 2d 574, 860 P.2d 1015, Bus. Franchise Guide (CCH) ¶ 10,436 (Wash. 1993) (Washington law); *Cent. GMC, Inc. v. Gen. Motors Corp.*, 946 F.2d 327, Bus. Franchise Guide (CCH) ¶ 9896 (4th Cir. 1991) (Maryland law); *Wis. Music Network, Inc. v. Muzak Ltd. P'ship*, 5 F.3d 218, Bus. Franchise Guide (CCH) ¶ 10,283 (7th Cir. 1993); *Remus v. Amoco Oil Co.*, 794 F.2d 1238, Bus. Franchise Guide (CCH) ¶ 8607 (7th Cir. 1986) (Wisconsin law); *Ziegler Co. v. Rexnord, Inc.*, 147 Wis. 2d 308, 433 N.W.2d 8, Bus. Franchise Guide (CCH) ¶ 9317 (Wis. 1988) (Wisconsin law).

86. *See, e.g., Kansas City Trailer Sales v. Holiday Rambler Corp.*, Bus. Franchise Guide (CCH) ¶ 10,395 (W.D. Mo. 1994) (Missouri law).

intent to renew as required under the agreement, and the court held that the franchisee was not entitled to renew the agreement.<sup>87</sup>

## VI. The Perpetual Agreement Issue

### A. The Problem

State laws that require good cause for termination and nonrenewal, such as laws in New Jersey and Wisconsin, have the potential, if read literally and strictly, of turning franchise relationships into perpetual relationships, absent an intervening breach giving rise to good cause to terminate.

The franchisee may argue that he should not be deprived of the goodwill he has developed during the course of the relationship. He may contend that the goodwill will either accrue to the franchisor if the franchisor takes over operation of the business or simply dissipate if the business is closed down.

The franchisee's position has appeal in some cases. However, the definition of a "franchise" in these laws is so broad that statutory protection is bound to extend to dealers who may not really need it. A "franchise" under these laws may be any arrangement, from a simple dealership that represents several suppliers to a tightly controlled business format franchise in which the franchisee must leave the premises and not compete with the franchisor upon termination of the franchise agreement. A dealership, on the other hand, may be under an agreement of indefinite term, or no agreement at all, and the dealer may carry multiple lines and products, so that a termination of one line will not shut down its operations.

### B. Types of Agreements

Franchise agreements usually have a fixed term, often 10 or 20 years, and may or may not include a right of renewal. These agreements may require high initial fees.

Fixed-term agreements usually do not permit termination during the contract term except for reasons specified in the contract, such as failure to cure a breach. These reasons often will constitute good cause under the franchise laws.

Most franchise agreements contain renewal provisions. In some instances, only one renewal may be permitted, but it may be for a lengthy period. A few offer either an unstated, indefinite term or successive renewal opportunities.

87. Nike Int'l Ltd. v. Athletic Sales, Inc., 689 F. Supp. 1235, Bus. Franchise Guide (CCH) ¶ 9297 (D. P.R. 1988).

A fixed-term agreement that does not provide for renewal would expire in accordance with its terms under the common law.<sup>88</sup> It is not clear whether the good cause requirement of some franchise laws mandates renewal of a fixed-term agreement, even one that clearly and explicitly provides that there will be no renewal.<sup>89</sup> Do these franchise laws cover agreements that the parties clearly intended to run for a limited period of time, with a well-defined expiration date? If so, the result could be an essentially perpetual agreement.

Many dealership agreements have an indefinite term, particularly if they are not in writing. Such agreements generally are terminable at common law by either party upon reasonable notice after the arrangement has been in existence for a reasonable period of time.<sup>90</sup> Some of these agreements specifically provide for termination at any time on 60 days' notice, or some similar notice period, without cause.<sup>91</sup>

These agreements generally require no initial franchise fee, and some are not in writing. Because many such agreements require a considerably smaller investment than a franchise, there is less need from a public policy point of view to protect the dealer than a franchisee.

A supplier of a dealer in New Jersey or Wisconsin, however, with an agreement of indefinite term, terminable by either party on 60 or 90 days' notice, may find that the agreement essentially is perpetual. One court has held that an unwritten 12-month course of dealing, in contemplation of a franchise agreement, constituted a relationship governed by the Puerto Rico Franchise Act and subject to its notice provisions.<sup>92</sup>

88. See, e.g., *Zuckerman v. McDonald's Corp.*, 35 F. Supp. 2d 135, Bus. Franchise Guide (CCH) ¶ 11,584 (D. Mass. 1999); *Elliott & Frantz, Inc. v. Svedala Indus., Inc.*, Bus. Franchise Guide (CCH) ¶ 11,310 (D. Pa. 1997); *Valley Juice Ltd. v. Evian Waters of France, Inc.*, Bus. Franchise Guide (CCH) ¶ 10,959 (2d Cir. 1996).

89. "In the rare, but by no means unheard-of, case where the parties actually have intended, from the beginning of their relationship, to have that relationship end with no possibility of continuation at the end of the specified term, it is neither desirable as a matter of policy nor necessary as a matter of fidelity to the legislature's intent to hold that the refusal to extend that relationship at the end of that term is a violation of section 135.03." MICHAEL A. BOWEN & BRIAN E. BUTLER, *THE WISCONSIN FAIR DEALERSHIP LAW* § 7.8 (State Bar of Wis. 2003).

90. U.C.C. § 2-309(2). See *Jespersen v. Minn. Mining & Mfg. Co.*, Bus. Franchise Guide (CCH) ¶ 11,180 (Ill. App. Ct. 1997); *Häagen-Dazs Co. v. Masterbrand Distribs., Inc.*, Bus. Franchise Guide (CCH) ¶ 9570 (S.D. Ga. 1989), *aff'd*, 918 F.2d 183 (11th Cir. 1990); *Delta Servs. and Equip., Inc. v. Ryko Mfg. Co.*, 908 F.2d 7, Bus. Franchise Guide (CCH) ¶ 9668 (5th Cir. 1990). See also *U.S. Surgical Corp. v. Or. Med. & Surgical Specialties, Inc.*, 497 F. Supp. 68, Bus. Franchise Guide (CCH) ¶ 7580 (S.D. N.Y. 1980) (holding that a declaration by the licensor that a contract without an expressed duration had *expired* by reason of the passage of a "reasonable" period of time was not a "termination" requiring good cause under Minnesota law).

91. See, e.g., *Consumers Int'l, Inc. v. SYSCO Corp.*, Bus. Franchise Guide (CCH) ¶ 11,309 (Ariz. Ct. App. 1997).

92. *R.W. Int'l Corp. v. Welch Foods, Inc.*, Bus. Franchise Guide (CCH) ¶ 10,386 (1st Cir. 1994).

At common law, an agreement that expressly provides that it may be terminated at any time without cause by giving the required notice generally can be terminated in accordance with its terms.<sup>93</sup> However, if the supplier or franchisor attempts to terminate on grounds that are not enumerated in the agreement, it may be unable to do so.<sup>94</sup> Moreover, such a provision would not be enforceable in those states whose relationship laws require good cause for termination by the franchisor.

In contracts of indefinite duration, the good cause requirement arguably is analogous to the good cause requirement of some states in an employment context. This analogy may apply when the franchisee is an individual and the contract does not permit assignment by the franchisee. The analogy breaks down, however, where the franchisee is a corporation or where assignment is permitted by contract or required by law.

### C. The Franchisor's Position

The concept of perpetual renewal, absent contractual language to the contrary, is troublesome to franchisors, in part because franchise agreements usually are of lengthy duration, market circumstances can change over time, and franchisors feel that they need to be able to adjust their distribution methods over time.

Franchisors and suppliers object to good cause requirements as intrusions on their right to contract freely. Franchisors also need to exercise quality control. Franchise agreements are almost always trademark license agreements. Trademark licenses must allow for quality control if the licensor is to maintain his trademark rights. The threat of termination or nonrenewal is the primary method the franchisor has to police quality and protect the trademark. Continuation of substandard franchises reduces the value of the trademark to the franchisor and the other franchisees. Conversely, termination for reasons of quality control benefits other franchisees by preserving the goodwill of the system. Such termination also benefits consumers by ensuring that they receive products and services of the quality they expect. The relationship laws place the burden on the franchisor to prove that there was good cause.<sup>95</sup> This makes termination more difficult and costly, even where good cause exists.

93. See, e.g., *Corenswet, Inc. v. Amana Refrigeration, Inc.*, 594 F.2d 129, 138-39 (5th Cir. 1979); *S & R Corp. v. Jiffy Lube Int'l, Inc.*, 968 F.2d 371, Bus. Franchise Guide (CCH) ¶ 10,038 (3d Cir. 1992).

94. See, e.g., *Carl A. Haas Auto. Imports, Inc. v. Lola Cars, Ltd.*, Bus. Franchise Guide (CCH) ¶ 11,105 (N.D. Ill. 1996); *Karl Wendt Farm Equip. Co. v. Int'l Harvester Co.*, 931 F.2d 1112, Bus. Franchise Guide (CCH) ¶ 9801 (6th Cir. 1991).

95. *Hartford Elec. Supply Co. v. Allen-Bradley Co.*, Bus. Franchise Guide (CCH) ¶ 11,685 (Conn. Sup. Ct. 1999).

## D. Judicial Relief

One Oregon court drew an analogy between franchise agreements and commercial leases.<sup>96</sup> Commercial leases typically run for fixed terms. Some have a right to renew and some do not. Where there is no contractual right to renew, periodic renewals may give rise to expectations by the tenant that renewal is likely in the future. However, this does not create an obligation to renew. It makes no difference how much effort and money the tenant puts into the leased property. In addition, during the term of a fixed lease, the landlord cannot terminate except in accordance with the lease terms.

The Wisconsin Supreme Court declined to afford a dealer the protection of the Wisconsin Fair Dealership Law where the supplier failed to renew based on the dealer's rejection of the terms of the renewal agreement that were "essential, reasonable and nondiscriminatory."<sup>97</sup> The court said that while the Wisconsin Fair Dealership Law was intended to afford dealers substantial protection that had been unavailable at common law, ". . . the Wisconsin legislature could not have intended to impose an eternal and unqualified duty of self-sacrifice upon every grantor that enters into a distributor-dealership agreement."<sup>98</sup> The court also held that the Wisconsin Fair Dealership Law was not intended to insulate dealers from economic reality by requiring dealerships to be continued, without change, in perpetuity.

One court held that where the principal offers reasonable contract terms but nonetheless arrives at a bona fide impasse in negotiations with a dealer, there is just cause for termination under the Puerto Rico dealer relationship law.<sup>99</sup> Although the statute defines "just cause" as either the dealer's nonperformance of an essential obligation of the contract or an act by the dealer that adversely and substantially affects the interest of the principal, the court held that a principal's own circumstances may permit its unilateral termination, irrespective of the dealer's conduct.

Some courts have held that withdrawal from the market on a nondiscriminatory basis constitutes good cause for termination.<sup>100</sup> Courts sometimes follow the rule that an agreement of indefinite duration may not be terminated until the dealer has had sufficient time to recoup any investment made in facilities, equipment or

96. See *William C. Cornitius, Inc. v. Wheeler*, 276 Or. 747, 753, 556 P.2d 666, 671 (1976).

97. *Ziegler Co. v. Rexnord, Inc.*, 139 Wis. 2d 593, 407 N.W.2d 873, Bus. Franchise Guide (CCH) ¶ 8882 (Wis. 1987), *remanded*, 147 Wis. 2d 308, 433 N.W.2d 8, Bus. Franchise Guide (CCH) ¶ 9317 (Wis. 1988). See also cases cited *supra* at note 68.

98. *Id.* at 314, 433 N.W.2d at 11.

99. *R.W. Int'l Corp. v. Welch Foods, Inc.*, Bus. Franchise Guide (CCH) ¶ 10,967 (1st Cir. 1996).

100. See *supra* notes 63 and 64.

other capital goods necessary to operate the dealership.<sup>101</sup> Courts also have found that the state franchise law did not apply because the arrangement in question did not constitute a “franchise.”<sup>102</sup>

## E. Conclusion

To the extent that one can generalize a conclusion from the disparate body of case law, it appears that in most circumstances, absent extraordinary facts, courts are most likely to construe a statute that prohibits refusal to renew without good cause as applying only to an express contractual right (of some sort) to renew or extend a franchise relationship, but not to create a right to renew where none is provided by the agreement.

# VII. Remedies

## A. Types of Remedies

The franchise relationship laws give franchisees a number of specific remedies in the event of termination or nonrenewal. Remedies available under the statutes or case law may include:

1. Repurchase of inventory and other items;
2. Payment for goodwill;
3. Injunctive relief;
4. Damages, including lost profits, unrecouped expenses, and punitive damages; and
5. Attorneys’ fees.

Under some of these laws, state authorities also are empowered to seek civil remedies and criminal sanctions.

A court may require compensation of a terminated franchisee beyond that specifically referred to in the relevant statute. One franchisee was awarded lost profits, for example, under Wisconsin law.<sup>103</sup> Another franchisee was awarded damages in the amount of the reasonable value of the business under New Jersey

101. *Ag-Chem Equip. Co. v. Hahn, Inc.*, 480 F.2d 482 (8th Cir. 1973); *U.S. Surgical Corp. v. Or. Med. & Surgical Specialties, Inc.*, 497 F. Supp. 68, Bus. Franchise Guide (CCH) ¶ 7580 (S.D. N.Y. 1980). *But see Mech. Rubber & Supply Co. v. Am. Saw and Mfg. Co.*, 810 F. Supp. 986, Bus. Franchise Guide (CCH) ¶ 10,106 (C.D. Ill. 1990) (Illinois law recognizes recoupment doctrine only in agency relationships).

102. *See supra* note 17.

103. *Kealey Pharmacy & Home Care Servs., Inc. v. Walgreen Co.*, 761 F.2d 345, Bus. Franchise Guide (CCH) ¶ 8351 (7th Cir. 1985).

law.<sup>104</sup> Damages available under Puerto Rico law have been held to include not only five times the average annual profit, but possibly other “benefits,” including goodwill.<sup>105</sup> Punitive damages were awarded in one case under Missouri law for tortious interference by a manufacturer with the business relationship between a franchisee and its prospective customers.<sup>106</sup>

On the other hand, in one case under California law, the court held that the only remedy available was repurchase of the franchisee’s inventory.<sup>107</sup>

## **B. Repurchase**

While the relationship laws of Arkansas, California, Connecticut, Hawaii, Michigan, Rhode Island, Washington, and Wisconsin contain repurchase obligations, these laws differ from state to state on:

1. Whether repurchase is required only where there is no good cause for termination;
2. Whether repurchase is required in the case of both termination and nonrenewal;
3. What must be repurchased; and
4. The purchase price.

Must the franchisor repurchase if termination is with good cause? The franchise laws of Connecticut, Hawaii, Rhode Island, and Wisconsin require the franchisor to repurchase inventory from the franchisee upon termination, regardless of whether the termination was with good cause. Arkansas and California require the franchisor to repurchase inventory only if termination was without good cause.

Must the franchisor repurchase upon termination and nonrenewal, or only upon termination? Arkansas, Connecticut, Rhode Island, and Wisconsin require repurchase of inventory only in the case of termination. Michigan requires repurchase only in the case of nonrenewal. California, Hawaii, and Washington require repurchase in the cases of both termination and nonrenewal.

What must be repurchased? Arkansas, Connecticut, Hawaii, and Washington require repurchase of the franchisee’s inventory, supplies, equipment, and furnish-

104. *Westfield Centre Servs., Inc. v. Cities Servs. Oil Co.*, 86 N.J. 453, 432 A.2d 48, Bus. Franchise Guide (CCH) ¶ 7668 (1981).

105. *Ballester Hermanos, Inc. v. Campbell Soup Co.*, Bus. Franchise Guide (CCH) ¶ 10,346 (D. P.R. 1993).

106. *Am. Bus. Interiors, Inc. v. Haworth, Inc.*, 798 F.2d 1135, Bus. Franchise Guide (CCH) ¶ 8642 (8th Cir. 1986).

107. *Boat & Motor Mart v. Sea Ray Boats, Inc.*, 825 F.2d 1285, Bus. Franchise Guide (CCH) ¶ 8846 (9th Cir. 1987).

ings purchased from the franchisor or a supplier designated by the franchisor. No compensation is required for personalized items that have no value to the franchisor. California, Rhode Island, and Wisconsin require repurchase of inventory only.

What price must the franchisor pay? Arkansas law provides that the franchisor must “repurchase at the franchisee’s net cost, less a reasonable allowance for depreciation or obsolescence.” In California, the amount is “the lower of the fair wholesale market value or the price paid by the franchisee.” Connecticut requires “fair and reasonable compensation.” In Hawaii and Washington, the amount is the fair market value at the time of the termination or expiration. In Rhode Island, the amount is the “fair wholesale market value.”

In Michigan, the franchisor must compensate the franchisee by repurchase or by other means for the fair market value at the time of expiration “of the franchisee’s inventory, supplies, equipment, fixtures, and furnishings” where the term of the franchise is less than five years and either (a) the franchisee is not permitted to continue substantially the same business under a different name or mark in the same area, or (b) notice of the nonrenewal is not given at least six months prior to expiration.

In Iowa, the franchisor may not enforce a post-term noncompete obligation unless the competing business “relies on a substantially similar marketing plan as the terminated or nonrenewed franchise” or unless the franchisor offers, before expiration of the franchise, to purchase the assets of the franchised business for its fair market value as a going concern. This requirement does not apply to the assets of a franchised business which the franchisee did not purchase from the franchisor or its agent.

As a practical matter, repurchase requirements are not onerous for franchisors, provided that the franchisee has acquired reasonable quantities of inventory and other items in reasonable reliance that the franchise would continue. Franchisors might repurchase such items in the absence of relationship laws, because they might reasonably decide not to permit anyone other than franchisees or company-owned outlets to sell their goods or use their trademarks.

### **C. Goodwill**

While Delaware, Indiana, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, and Virginia do not require repurchase, the franchise laws of these states allow the franchisee to recover damages caused by a violation by the franchisor. Damages under the laws of these states may include compensation for the loss of goodwill. The Puerto Rico Dealers’ Act also permits recovery for goodwill.<sup>108</sup>

108. *Ballester Hermanos, Inc. v. Campbell Soup Co.*, Bus. Franchise Guide (CCH) ¶ 10,346 (D. P.R. 1993).

In Illinois, a franchisor that refuses to renew a franchise must compensate the franchisee “by repurchase or by other means for the diminution in the value of the franchised business caused by the expiration of the franchise” where the franchisee is not permitted to continue substantially the same business under a different name or mark in the same area, or where notice of the nonrenewal is not given at least six months prior to expiration.

A franchisee in Hawaii is entitled to the value of the goodwill of the business if the franchisor refuses to renew for the purpose of converting the franchise into a company-owned outlet. Goodwill must be paid to the franchisee in Washington upon the franchisor’s refusal to renew unless the franchisee has been given one year’s notice of nonrenewal and the franchisor agrees in writing not to enforce any covenant not to compete with the franchisor.

The requirement to pay goodwill raises the question: What does goodwill encompass, and who owns the goodwill? Is “goodwill” in a franchised business a unitary value? Or can it be broken out into component pieces? In a trademark license agreement governed by federal trademark law (the Lanham Act), the goodwill symbolized by the licensed trademarks is owned by the licensor, not the licensee. The licensor typically invests money, sometimes in large amounts, to develop the goodwill associated with a national or international brand name, and typically grants to the licensee a right to exploit the marks for a fixed period of time. To the extent that the franchisee is a licensee of the franchisor, the goodwill associated with the licensed trademarks is owned by the franchisor, at least in the absence of the relationship laws. These laws may presume just the opposite, or may be using “goodwill” in a different context. On the other hand, they may reflect the perception that a franchisee also develops a goodwill in the business, often called “sweat equity,” that reflects going-concern value of the business without reference to the brand and, therefore, is separate and distinct from the goodwill inherent in the licensed trademarks. These laws can be construed to relate to the goodwill that reflects the “going concern” value of the franchised business separate from the goodwill associated with the trademark.

Goodwill of a franchised business probably involves both trademark and non-trademark elements. One of the reasons many individuals buy franchises is to “be their own boss.” While franchising allows the franchisee a large degree of autonomy, buying a franchise is very different from starting a new business. The franchisee obtains a license to use known trademarks and service marks and a presumably proven system to enhance the probability of success. Such a system may entail less risk (or perhaps different risks) than starting up a new business. This increased likelihood of success is due in large part to the goodwill developed by the franchisor, as well as the special expertise of the franchisor and the training the franchisor provides. But the execution of the concept by the franchisee matters, too. Ultimately, franchisors may want to “be careful what they wish for.” If it were widely understood by the public that a franchise is only a self-financed job,

even for 10 or 20 years, with no residual equity to the investor, franchises might become quite difficult to sell.

### D. Injunctive Relief

At common law, preliminary (sometimes referred to as temporary) injunctive relief against termination or non-renewal of the franchise is available if the franchisee is able to prove likelihood of success on the merits of its case, the threat of irreparable injury if the injunction is not granted, and a balancing of hardships tipping in the franchisee's favor.<sup>109</sup>

In the absence of a statute prohibiting termination or non-renewal without cause, the franchisee would need to show that the proposed termination was a breach of the agreement between the parties or a violation of some other common law principle in order to fulfill the first requirement, likelihood of success on the merits. If the franchise is subject to a relationship law that requires notice and good cause for termination, a factual showing that the franchisor lacked good cause or failed to give the required notice, as defined by the statute, would provide a basis for this element.

Some state relationship statutes ease the burden upon a franchisee of obtaining a preliminary injunction by altering common law requirements. In Minnesota, for example, irreparable injury is presumed if there is a showing of a violation of the franchise act by a person required to register who fails to do so.<sup>110</sup> The statute also provides that a bond is not required for the granting of a preliminary injunction.<sup>111</sup> Delaware law provides that a "franchised distributor" shall be entitled to an order enjoining termination or non-renewal pending the issuance of a final determination of whether the franchisor has unjustly terminated or refused to renew the franchise.<sup>112</sup> The Wisconsin Fair Dealership Law provides that a dealer "shall" be entitled to injunctive relief,<sup>113</sup> and states that a violation of the chapter shall be deemed to constitute irreparable injury.<sup>114</sup> The courts have construed this provision as enabling the dealer to obtain an injunction without having to wait for actual injury to occur.<sup>115</sup> In Rhode Island, any violation of the Fair Dealership

109. See, e.g., *P. P. & K., Inc. v. McCumber*, 46 F.3d 1134 (7th Cir. 1995).

110. MINN. STAT. 80C.14.1. This provision is anomalous since an injunction on behalf of a franchisee will typically be one granted to enjoin termination. Whether the franchisor has registered with the state to sell franchises is immaterial to that issue.

111. *Id.*

112. DEL. CODE ANN. tit. 6, § 2553(a).

113. WIS. STAT. § 135.06.

114. WIS. STAT. § 135.065.

115. *Siegel v. Leer, Inc.*, 156 Wis. 2d 621, 627, 457 N.W.2d 533, 536, *Bus. Franchise Guide* (CCH) ¶ 9643 (Ct. App. 1990).

Law “is deemed an irreputable injury to the dealer in determining if temporary injunctions should issue.”

In contrast, the California Franchise Relations Act<sup>116</sup> has been construed as limiting a franchisee’s remedy for non-renewal to repurchase of inventory.<sup>117</sup> In contrast, the franchisee has available any common law remedy, including injunctive relief, if threatened with termination.<sup>118</sup> The statute does not specifically provide for injunctive relief for either termination or non-renewal.

In three states, Arkansas, Nebraska, and New Jersey, injunctive relief is available to a franchisee “where appropriate.”<sup>119</sup> In Mississippi and Missouri, “equitable relief” is authorized. These statutory authorizations would appear to refer to the requirements for the grant of injunctive relief at common law, as would be the case in other jurisdictions having relationship laws that do not specifically address injunctive relief.

## VIII. Transfers

### A. Grounds for Withholding Consent to Transfers

Iowa law contains the most extensive protection of franchisees’ rights to transfer. Although the Iowa statute permits a franchisor to disapprove a transfer if the proposed transferee does not meet the franchisor’s current financial requirements for franchisees, the refusal may not be “arbitrary or capricious when compared to the franchisor’s actions in other similar circumstances.” Certain changes in ownership are deemed not to be transfers requiring consent of the franchisor, and the franchisor may not “interfere” with such dispositions. Examples in the Iowa statute are transfers by a sole proprietor franchisee to a wholly owned corporation, transfers of equity within an existing ownership group, and transfers to a spouse, child, or partner upon the franchisee’s death or disability.

In Arkansas, Nebraska, and New Jersey, the franchisor can reject a proposed transfer of the franchise based on a material reason relating to the character, financial ability or business experience of the proposed transferee, failing which the franchisor’s approval is deemed granted. Where these grounds do not exist, the franchisor is nevertheless not required to do business with a transferee that does not agree to comply with all the requirements of the franchise.

116. CAL. BUS. & PROF. CODE § 20025.

117. *Motor-Mart v. Sea Ray Boats, Inc.*, 825 F.2d 1285 (9th Cir. 1987).

118. *JRS Products, Inc. v. Matsushita Electric Corp. of America*, 8 Cal. Rptr. 3d 840, 844-45, *Bus. Franchise Guide (CCH)* ¶ 12,726 (Cal. App. 2004).

119. ARK. CODE ANN. § 4-72-208; NEB. REV. STAT. § 87-409; N.J. STAT. 56:10-10.

In Hawaii and Michigan, the franchisor may not refuse to permit a transfer of a franchise except for good cause. Good cause includes any of the following:

1. The failure of the proposed transferee to meet the franchisor's reasonable qualifications;
2. The fact that the proposed transferee is a competitor of the franchisor;
3. The unwillingness of the proposed transferee to agree to comply with all franchise obligations; or
4. The failure of the franchisee or proposed transferee to pay any sums owing to the franchisor and to cure any default.

A Michigan court held that a franchisee's refusal to execute a release as required by the franchise agreement constituted good cause under Michigan law for the franchisor to withhold consent to the transfer.<sup>120</sup>

In Minnesota and Washington, the franchisor may not withhold consent to a proposed transfer where the proposed transferee meets the criteria for the purchase of a new franchise.

As a practical matter, transfers to qualified parties are not a problem for most franchisors, and many franchisors permit such transfers in the absence of the relationship laws. Where it is of concern, some franchisors reserve a right of first refusal to purchase the franchise themselves when the franchisee desires to sell it. Such rights of first refusal may be limited by Section 365(f) of the Bankruptcy Code, which prevents anti-alienation clauses in agreements from keeping a trustee from realizing the full value of the debtor's assets.<sup>121</sup>

## **B. Procedural Requirements for Transfer**

In Arkansas, Iowa, Nebraska, and New Jersey, the franchisee is specifically required to notify the franchisor of its intention to transfer or sell the franchise. The notice must include the prospective transferee's name, address, statement of financial qualification, and business experience during the previous five years. In these states, the franchisor has 60 days to reject the proposed transfer. In Iowa, only certain transfers are subject to franchisor notice and approval.

In Hawaii, the franchisor has 30 days after notice of a proposed transfer to approve or disapprove the proposed transfer, failing which the franchisor is deemed to have given its approval. In Iowa, the franchisor must have good cause to object to a public offering of securities as long as at least 50 percent of the voting power remains with the original franchisee.

120. *Franchise Mgmt. Unlimited Inc. v. America's Favorite Chicken*, Bus. Franchise Guide (CCH) ¶ 11,101 (Mich. Ct. App. 1997).

121. *See In re Headquarters Dodge, Inc.*, 13 F.3d 674, Bus. Franchise Guide (CCH) ¶ 10,487 (3d Cir. 1993).

### **C. Stock Transfers**

In Hawaii, the prohibition against withholding consent except for good cause also covers the transfer of the ownership of the franchisee.

In Arkansas, Nebraska, and New Jersey, the franchisor may not restrict the sale, transfer or issuance of any securities of the franchisee or prevent the sale, transfer or issuance of shares of stock or debentures to employees of the franchisee, as long as basic financial requirements of the franchisor are complied with and any such sale, transfer or issuance does not result in a sale of the franchise. The laws of these states also restrict the withholding of consent to a transfer of “an interest in a franchise.” In Iowa, a transfer within an existing ownership group is deemed not to be a transfer requiring consent of the franchisor, provided that more than 50 percent of the franchise is held by persons who meet the franchisor’s reasonable current qualifications.

In one New Jersey case, a franchisor was permitted to terminate the franchise where the shareholder of the franchisee sold stock to a new owner without the franchisor’s consent.<sup>122</sup> The new owner also owned competing franchises. In a District of Columbia case, a preliminary injunction against termination based on the former president’s sale of minority stock interest and withdrawal from management of the business was denied.<sup>123</sup>

### **D. Transfer upon the Death of a Franchisee**

In California, the surviving spouse, heirs, and estate of the deceased franchisee or majority shareholder of the franchisee must be given the opportunity to participate in the ownership of the franchise for a reasonable time after the death of the franchisee or majority shareholder of the franchisee. If the heirs do not satisfy all of the then-current qualifications for a purchaser of a franchise, they may transfer the franchise to a person who does satisfy the franchisor’s then-current standards for a new franchisee.

The franchisor’s use of a right of first refusal in the case of death of a franchisor is expressly permitted in California. In Indiana, the franchisor also must permit the surviving spouse, heirs, or estate of a deceased franchisee to participate in the ownership of the franchise for a reasonable time after the death of the franchisee. In Iowa, transfer to a spouse or child of the franchisee upon death or disability is not considered a transfer subject to the consent of the franchisor.

122. *Simmons v. Gen. Motors Corp.*, 180 N.J. Super. 522, 435 A.2d 1167, Bus. Franchise Guide (CCH) ¶ 7725 (1981).

123. *Beitzell & Co. v. Distillers Somerset Group, Inc.*, Bus. Franchise Guide (CCH) ¶ 8678 (D. D.C. 1986). The District of Columbia relationship law was subsequently repealed. Bus. Franchise Guide (CCH) ¶ 4510.

In Arkansas, Nebraska, and New Jersey, the franchisor may not restrict the sale, transfer, or issuance of any securities of the franchisee or prevent the sale, transfer, or issuance of shares of stock or debentures to heirs of the principal owner of the franchisee, as long as basic financial requirements of the franchisor are complied with and any such sale, transfer, or issuance does not result in a sale of the franchise.

In Washington, death of a franchisee does not constitute good cause for termination where the franchisor does not rely on the unique talents of the franchisee. In such a case, transfer upon death should be permitted.<sup>124</sup>

In one case, the death of a franchisee was held to be valid grounds for termination under New Jersey law.<sup>125</sup> Termination for substantial change in ownership or control following death of the principal of a distributor was upheld under Connecticut law where the franchise was run as a one-man operation.<sup>126</sup>

## **IX. Common Law Theories Affecting the Franchise Relationship**

### **A. Breach of Contract**

In the absence of franchise relationship laws, franchisees who suffer wrongful acts by franchisors can bring actions based on breach of contract, either of expressed terms of the contract or of covenants or duties implied by law.<sup>127</sup> There has been a strong tendency by the courts to uphold the sanctity of contracts. This tends to favor franchisors, since virtually all franchise agreements are drafted by the franchisor's counsel. For example, most agreements will devote pages to the obligations of the franchisee, while the franchisor's obligations will be set forth, at most, in a few paragraphs.

### **B. Promissory Estoppel and Recoupment**

Franchisees who spend sums in reliance on the franchisor's promises outside of

124. Bus. Franchise Guide (CCH) ¶ 4470.01. See Statement of Policy issued by the Dep't of Licensing, Securities Division (Mar. 14, 1983).

125. Estate of Garo Mamourian v. Exxon Co., Bus. Franchise Guide (CCH) ¶ 8093 (D. N.J. 1983).

126. McKeown Distribs., Inc. v. Gyp-Crete Corp., 618 F. Supp. 632, Bus. Franchise Guide (CCH) ¶ 8423 (D. Conn. 1985).

127. See generally Robert T. Joseph, *Do Franchisors Owe a Duty of Competence?*, 46 Bus. Law. 471 (1991); Lee A. Rau, *Implied Obligations in Franchising: Beyond Terminations*, 47 Bus. Law. 1053 (1992).

the contract can recover such sums on the basis of unjust enrichment, promissory estoppel,<sup>128</sup> or recoupment.<sup>129</sup>

### C. Noncompete Requirements

State common law limits the permissible scope of both in-term and post-term noncompete clauses imposed on the franchisee by the terms of the franchise agreement.<sup>130</sup>

### D. Consent to Transfer

Most franchise agreements accord the franchisor the right to approve or reject the franchisee's transfer of the franchise and provide a series of conditions to approval. These clauses are generally enforceable.<sup>131</sup>

Contractual clauses expressly prohibiting transfer without the consent of the franchisor or supplier, including clauses allowing the franchisor to withhold its consent "with or without cause," generally are upheld under the common law.<sup>132</sup> Such provisions would not be enforceable under some of the relationship laws.

Where such a clause does not include the phrase "with or without cause," the court may imply an obligation of reasonableness. In one case under Colorado law, the court held that withholding of consent to transfer must not be arbitrary or unreasonable unless the agreement expressly grants the franchisor an absolute right to refuse to consent.<sup>133</sup> On the other hand, in a case under California law, the

128. See, e.g., *Triology Variety Stores, Ltd. v. City Prods. Corp.*, 523 F. Supp. 691 (S.D. N.Y. 1981).

129. See, e.g., *Sofa Gallery, Inc. v. Stratford Co.*, 872 F.2d 259, Bus. Franchise Guide (CCH) ¶ 9366 (8th Cir. 1989); *Cambee's Furniture, Inc. v. Doughboy Recreational, Inc.*, 825 F.2d 167, Bus. Franchise Guide (CCH) ¶ 8888 (8th Cir. 1987); *Schultz v. Onan Corp.*, 737 F.2d 339, Bus. Franchise Guide (CCH) ¶ 8189 (3d Cir. 1984); *Allied Equip. Co. v. Weber Engineered Prods., Inc.*, 237 F.2d 879 (4th Cir. 1956).

130. For a state-by-state compendium of the law on noncompete covenants, see PETER J. KLARFELD, *COVENANTS AGAINST COMPETITION IN FRANCHISE AGREEMENTS*, Forum on Franchising, American Bar Association (2d ed. 2003).

131. See, e.g., *Zuckerman v. McDonald's Corp.*, 35 F. Supp. 2d 135, Bus. Franchise Guide (CCH) ¶ 11,584 (D. Mass. 1999); *Chu v. Dunkin' Donuts Inc.*, 27 F. Supp. 2d 171 (E.D. N.Y. 1998); *BASCO, Inc. v. Buth-Na-Bodhaige, Inc., d/b/a The Body Shop*, Bus. Franchise Guide (CCH) ¶ 11,477 (D. Minn. 1998).

132. See *C. Pappas Co. v. E & J Gallo Winery*, 610 F. Supp. 662, Bus. Franchise Guide (CCH) ¶ 8378 (E.D. Cal. 1985), *aff'd*, 801 F.2d 399, Bus. Franchise Guide (CCH) ¶ 8671 (9th Cir. 1986); *San Francisco Newspaper Printing Co. v. Super. Ct. of Santa Clara County*, 170 Cal. App. 3d 438, 216 Cal. Rptr. 462, Bus. Franchise Guide (CCH) ¶ 8422 (1985); *American Can Co. v. A.B. Dick Co.*, Bus. Franchise Guide (CCH) ¶ 8097 (S.D. N.Y. 1983).

133. *Larese v. Creamland Dairies, Inc.*, 767 F.2d 716, Bus. Franchise Guide (CCH) ¶ 8398 (10th Cir. 1985).

court held that the franchisor may withhold consent to a transfer on the basis that the prospective buyer had not taken the franchisor's applicant training program, as required by the franchise agreement, even where the franchisor arbitrarily restricts access to the training program.<sup>134</sup>

Where the contract is entirely silent on the question of assignability, some courts allow the franchisor or supplier to prevent transfer on the basis that the contract is one for personal services.<sup>135</sup>

Where the contract includes the grant of an exclusive territory, courts in states with no franchise relationship law have allowed the franchisor or supplier to refuse to consent to the proposed transfer to a competitor on the basis that the proposed franchisee would be unable to fulfill its implied best efforts obligation.<sup>136</sup>

A franchisor at common law also may withhold consent to a transfer on the basis that the price at which the franchisee is offering to sell the franchise is so high that it would jeopardize the financial stability of the business and hinder the transferee's ability to succeed.<sup>137</sup> The franchisor has an interest in ensuring that the purchaser will have a chance to realize a reasonable return on his investment and thereby be financially able to operate in accordance with system requirements.

## E. Encroachment

In Indiana, a franchise agreement may not permit the franchisor to compete "unfairly" with the franchisee "within a reasonable area." The franchise relationship

134. *Perez v. McDonald's Corp.*, Bus. Franchise Guide (CCH) ¶ 11,538 (E.D. Cal. 1998).

135. *See* *Berliner Foods Corp. v. Pillsbury Co.*, 633 F. Supp. 557, Bus. Franchise Guide (CCH) ¶ 8566 (D. Md. 1986); *Jennings v. Foremost Dairies, Inc.*, 37 Misc. 2d 328, 235 N.Y.S.2d 566 (N.Y. Sup. Ct. 1962); *Paige v. Faure*, 229 N.Y. 114, 127 N.E. 898 (1920); *Smith v. Craig*, 211 N.Y. 456, 105 N.E. 798 (1914); *Quinn v. Whitney*, 204 N.Y. 363, 97 N.E. 724 (1912). Where the franchisee or dealer is a corporation, there may be an issue of whether the parties contemplated such personal services. *See* *Sally Beauty Co. v. Nexxus Prods. Co.*, 801 F.2d 1001, Bus. Franchise Guide (CCH) ¶ 8677 (7th Cir. 1986) (Posner, J. dissenting).

136. *See, e.g., Sally Beauty, id.* at 1007 (best efforts obligation under Texas U.C.C. § 2-306(b)).

137. *See, e.g., In re Beverages Int'l, Ltd.*, Bus. Franchise Guide (CCH) ¶ 8636 (Bankr. D. Mass. 1986); *Walner v. Baskin-Robbins Ice Cream Co.*, 514 F. Supp. 1028, Bus. Franchise Guide (CCH) ¶ 7723 (N.D. Tex. 1981); *Hawkins v. Holiday Inns, Inc.*, 634 F.2d 342, Bus. Franchise Guide (CCH) ¶ 7568 (6th Cir. 1980); *Kestenbaum v. Falstaff Brewing Corp.*, 514 F.2d 690 (5th Cir. 1975); *Hanigan v. Wheeler*, 504 P.2d 972 (Ariz. Ct. App. 1972).

Courts generally have held that the proposed transferee does not have standing to sue where the franchisor has not consented to the transfer. *See, e.g., Jackson v. Freightliner Corp.*, Bus. Franchise Guide (CCH) ¶ 11,004 (10th Cir. 1996); *Superlease Rent-A-Car, Inc. v. Budget Rent-A-Car of Md., Inc.*, Bus. Franchise Guide (CCH) ¶ 9368 (D. D.C. 1989).

Franchisors also have the right to transfer franchise agreements. *See* *Marc's Big Boy Corp. v. Marriott Corp.*, Bus. Franchise Guide (CCH) ¶ 9100 (E.D. Wis. 1988); *O'Neal v. Burger Chef Sys., Inc.*, 860 F.2d 1341, Bus. Franchise Guide (CCH) ¶ 9251 (6th Cir. 1988).

law of Iowa specifically grants franchisees qualified territorial rights regardless of the contractual provisions between the parties to the contrary. In Iowa, the franchisor must compensate the franchisee for lost profits if the franchisee's annual gross sales are adversely affected by five percent or more by a new outlet, unless the franchisor has first offered the new outlet or location to the existing franchisee, or unless the franchisee does not meet then-current system standards for a new franchisee. The franchisor also can avoid this requirement if the franchisor establishes a formal procedure for hearing and acting upon encroachment claims by an existing franchisee and a procedure for awarding compensation to a franchisee to offset lost profits caused by encroachment.

The franchise relationship laws of other states purport to protect franchisees against encroachment on their exclusive territories by the franchisor.<sup>138</sup> Generally, this protection is no broader than that available at common law, since it applies only where the agreement provides for an exclusive territory.<sup>139</sup>

In all states except Iowa and Indiana, the issue in encroachment cases is what the parties have agreed to, regardless of whether relationship laws apply. Where the contract gives the franchisee an exclusive territory, the courts will enforce whatever the grant specifically provides. A franchisee may even prevent encroachment on the basis of another franchisee's contract if it can show that it is a third-party beneficiary of that contract.<sup>140</sup> Where the contract is for a single location and does not grant the franchisee an exclusive territory, most courts will not stop a franchisor from establishing another franchise or company-owned outlet near the location of the first franchise.<sup>141</sup> However, some courts have held that

138. See Appendix E.

139. See, e.g., *CCR Data Sys., Inc. v. Panasonic Communications & Sys. Co.*, Bus. Franchise Guide (CCH) ¶ 10,624 (D. N.H. 1995).

140. *Pepsi-Cola Bottling Co. of Pittsburgh, Inc. v. PepsiCo, Inc.*, 175 F. Supp. 2d 1288, Bus. Franchise Guide (CCH) ¶ 12,248 (D. Kan. 2001).

141. See *Lindquist & Craig Hotels & Resorts, Inc. v. Holiday Inns Franchising, Inc.*, Bus. Franchise Guide (CCH) ¶ 11,514 (C.D. Cal. 1998); *Hoffman v. Midas Int'l Corp.*, Bus. Franchise Guide (CCH) ¶ 11,555 (Ill. App. Ct. 1998); *Nibeel v. McDonald's Corp.*, Bus. Franchise Guide (CCH) ¶ 11,480 (N.D. Ill. 1998); *Chang v. McDonald's Corp.*, Bus. Franchise Guide (CCH) ¶ 11,078 (9th Cir. 1996); *Eichman v. Fotomat Corp.*, 880 F.2d 149, Bus. Franchise Guide (CCH) ¶ 9352 (9th Cir. 1989); *Super Valu Stores, Inc. v. D-Mart Food Stores, Inc.*, 146 Wis. 2d 568, 431 N.W.2d 721, Bus. Franchise Guide (CCH) ¶ 9255 (Wis. Ct. App. 1988); *KFC Corp. v. Vangeloff*, Bus. Franchise Guide (CCH) ¶ 9160 (W.D. Ky. 1988); *Spahn Enters. v. Badger Northland, Inc.*, Bus. Franchise Guide (CCH) ¶ 9009 (Wis. Cir. Ct. 1987) (Wisconsin law); *McLane v. Pizza King Franchises, Inc.*, Bus. Franchise Guide (CCH) ¶ 8963 (Ind. Super. Ct. 1987); *Patel v. Dunkin' Donuts of Am., Inc.*, 146 Ill. App. 3d 233, 496 N.E.2d 1159, Bus. Franchise Guide (CCH) ¶ 9258 (Ill. Ct. App. 1986) (Illinois law); *Wellcraft Marine, Inc. v.*

contractual language stating that the franchise was for a specific location did not necessarily give the franchisor the right to place additional outlets nearby.<sup>142</sup> A franchisor's sales over the Internet may constitute encroachment if the agreement can be construed to prevent such sales.<sup>143</sup> Physical proximity is not the issue in these cases. Rather, the issue is diversion of sales from an established outlet to a new outlet. If the diversion is severe, it can be characterized as depriving the impacted franchisee of the benefit of its contract—which is the right to establish and operate a business under its franchise agreement. Diversion of marginal sales can have a substantially disproportionate impact on profits (*e.g.*, losing the last 10 percent of *sales* can cost a franchisee 30 percent or more of its *profits*).

On the other hand, where the franchisor saturates the market in order to drive franchisees out of business, a rare case of subjective bad intent, a court may hold that the franchisor's acts are in bad faith and violate the antitrust laws.<sup>144</sup>

## F. Fraud

In the context of the franchise relationship (as distinguished from the franchise sales setting), fraud has not provided a viable means to prevent franchisor abuse. For one thing, fraud is difficult to prove. Once the franchise relationship has been established, it is unlikely that the franchisee will be able to show that the franchisor made *any* representations to the franchisee, much less one that the

Dauterive, 482 So. 2d 1002, Bus. Franchise Guide (CCH) ¶ 8565 (La. Ct. App. 1986) (Louisiana law); *Domed Stadium Hotel, Inc. v. Holiday Inns, Inc.*, 732 F.2d 480, Bus. Franchise Guide (CCH) ¶ 8176 (5th Cir. 1984); *Burger King Corp. v. Weaver*, 169 F.3d 1310 (11th Cir. 1999). *But see* *May v. Roundy's Inc.*, 188 Wis. 2d 78, 524 N.W.2d 647, Bus. Franchise Guide (CCH) ¶ 10,550 (Wis. Ct. App. 1994) (Wisconsin law).

142. *Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp.*, Bus. Franchise Guide (CCH) ¶ 11,393 (11th Cir. 1998); *Scheck v. Burger King Corp.*, 756 F. Supp. 543, Bus. Franchise Guide (CCH) ¶ 9760 (S.D. Fla. 1991), *reconsid. denied*, 798 F. Supp. 692, *criticized in* *Burger King Corp. v. Weaver*, 169 F.3d 1310 (11th Cir. 1999). *See also* *Burger King Corp. v. C.R. Weaver and M-W-M, Inc.*, 798 F. Supp. 684, Bus. Franchise Guide (CCH) ¶ 10,019 (S.D. Fla. 1992) (original ruling in favor of franchisee in substance withdrawn); *Burger King Corp. v. Weaver*, 33 F. Supp. 2d 1037 (1998) (favorable ruling for the franchisor was affirmed on appeal); *Burger King Corp. v. Weaver*, 169 F.3d 1310 (11th Cir. 1999); *May v. Roundy's, Inc.*, 188 Wis. 2d 78, 524 N.W.2d 647, Bus. Franchise Guide (CCH) ¶ 10,550 (Wis. Ct. App. 1994). *But see* *Chang v. McDonald's Corp.*, Bus. Franchise Guide (CCH) ¶ 10,677 (N.D. Cal. 1995); *Interim Health Care of N. Ill., Inc. v. Interim Health Care, Inc.*, 225 F.3d 876, Bus. Franchise Guide (CCH) ¶ 11,930 (7th Cir. 2000).

143. *Emporium Drug Mart, Inc. v. Drug Emporium, Inc.*, No. 71-1140012600 (Am. Arbitration Ass'n, Sept. 2, 2000), Bus. Franchise Guide (CCH) ¶ 11,966 (2000).

144. *See Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704 (7th Cir. 1979).

franchisor knew to be false at the time it was made. Usually, the representations made to the franchisee will have been made in connection with the sales process (and, therefore, outside the scope of this discussion).

In litigation involving the Burger Chef chain, however, certain franchisees asserted that the franchisor misrepresented its intentions by stating that it was committed to the franchisor's system, when in fact the franchisor was actively looking for a buyer. From that, the franchisees claimed that they had been damaged as a result of the franchisor's alleged fraud. There have been two reported cases litigated in this context. In both cases, the franchisees were victorious at the trial level, but the decisions were reversed on appeal.<sup>145</sup>

On the other hand, one court has held that a franchisor may rescind a franchise agreement based on the franchisee's fraud without giving the franchisee the contractually required notice and opportunity to cure.<sup>146</sup>

### **G. Fiduciary Relationship**

During the late 1970s and early 1980s, several franchisees alleged in litigation that their franchises created fiduciary relationships because the franchisees were highly dependent upon the franchisor and the franchisor had superior knowledge about its system and the marketplace.

One court accepted this reasoning, at least in terms of the language it used to express its decision.<sup>147</sup> However, a subsequent decision by the Eighth Circuit essentially limited the decision to its facts and may have even gone so far as to undercut the decision completely.<sup>148</sup>

Virtually all of the reported cases suggest that no fiduciary duty exists generally between franchisors and franchisees,<sup>149</sup> although there are sugges-

145. See *Vaughn v. Gen. Foods Corp.*, 797 F.2d 1403, Bus. Franchise Guide (CCH) ¶ 8630 (7th Cir. 1986); *O'Neal v. Burger Chef Sys., Inc.*, 860 F.2d 1341, Bus. Franchise Guide (CCH) ¶ 9251 (6th Cir. 1988).

146. *Southland Corp. v. Froelich*, 41 F. Supp. 2d 227, Bus. Franchise Guide (CCH) ¶ 11,629 (E.D.N.Y. 1999).

147. *Arnott v. American Oil Co.*, 609 F.2d 873 (8th Cir. 1979). The effect of the decision was no more than to apply the common law implied duty of good faith. The "fiduciary" language was superfluous. See Pt. I, below.

148. *Bain v. Champlin Petroleum Co.*, 692 F.2d 43, Bus. Franchise Guide (CCH) ¶ 7861 (8th Cir. 1982).

149. See, e.g., *Broussard v. Meineke Discount Mufflers Shops, Inc.*, 155 F.3d 331 (4th Cir. 1988); *O'Neal v. Burger Chef Sys., Inc.*, 860 F.2d 1341, Bus. Franchise Guide (CCH) ¶ 9251 (6th Cir. 1988) (and cases cited at 1349 n.4); *Premier Wine & Spirits v. E. & J. Gallo Winery*, 846 F.2d 537, Bus. Franchise Guide (CCH) ¶ 9106 (9th Cir. 1988); *Coca-Cola Bottling Co. of Elizabethtown, Inc. v. Coca-Cola Co.*, 696 F. Supp. 57 (D. Del. 1988), *aff'd*, 988 F.2d 386 (3d Cir.); *Seaward Yacht Sales, Ltd. v. Murray Chris-Craft Cruisers, Inc.*, 701 F. Supp. 766, Bus. Franchise Guide (CCH) ¶ 9287 (D. Or. 1988); *Cambee's Furniture, Inc. v. Doughboy Recre-*

tions in some of the decisions that the higher level of duty could exist in limited situations.

## H. Good Faith

Courts in most states consistently have held that the implied covenant of good faith and fair dealing that exists in any commercial contract also exists in franchise agreements.<sup>150</sup> Franchisees who feel that they have been aggrieved by their franchisors' post-sales conduct frequently cite this principle. The Iowa statute specifically provides that the covenant of good faith is part of every franchise relationship.

The covenant of good faith and fair dealing assists in interpreting the intention of the parties where the contract is silent. It will not override express contractual provisions.<sup>151</sup> To a large degree, it acts as a limitation on the reserved discretion of a party to a franchise agreement.

In essence, the "covenant" provides that the parties to a contract must act honestly and observe reasonable commercial standards of fair dealing in the trade. The covenant also has been interpreted to mean that neither party will act in such a manner as to deprive the other party of the benefit of the contract.<sup>152</sup> For example, if

ational, Inc., 825 F.2d 167, Bus. Franchise Guide (CCH) ¶ 8888 (8th Cir. 1987); Boat & Motor Mart v. Sea Ray Boats, Inc., 825 F.2d 1285, Bus. Franchise Guide (CCH) ¶ 8846 (9th Cir. 1987); Wallach Marine Corp. v. Donzi Marine Corp., 675 F. Supp. 838, Bus. Franchise Guide (CCH) ¶ 9014 (S.D. N.Y. 1987).

150. *Id.* See also U.C.C. §§ 1-203, 1-102(3); RESTATEMENT (SECOND) CONTRACTS § 205 (1979).

151. See, e.g., Zuckerman v. McDonald's Corp., 35 F. Supp. 2d 135, Bus. Franchise Guide (CCH) ¶ 11,584 (D. Mass. 1999); Burger King Corp. v. Weaver, 169 F.3d 1310, Bus. Franchise Guide (CCH) ¶ 11,592 (11th Cir. 1999); Hobin v. Coldwell Banker Residential Affiliates, Bus. Franchise Guide (CCH) ¶ 11,196 (N.H. Super. Ct. 1997); Davis v. McDonald's Corp., Bus. Franchise Guide (CCH) ¶ 11,387 (N.D. Fla. 1998); Ward's Equip., Inc., v. New Holland N. Am., Inc., Bus. Franchise Guide (CCH) ¶ 11,288 (Va. Sup. Ct. 1997); Consumers Int'l, Inc. v. SYSCO Corp., Bus. Franchise Guide (CCH) ¶ 11,309 (Ariz. Ct. App. 1997); Davis v. Sears, Roebuck & Co., 873 F.2d 888, Bus. Franchise Guide (CCH) ¶ 9384 (6th Cir. 1989); Tulsa Trailer & Body, Inc. v. Trailmobile, Inc., Bus. Franchise Guide (CCH) ¶ 8615 (N.D. Okla. 1986); Jack Walters & Sons Corp. v. Morton Bldg., Inc., 737 F.2d 698, Bus. Franchise Guide (CCH) ¶ 8192 (7th Cir. 1984); Corenswet, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129 (5th Cir. 1979). *But see* Overhead Door Co. of Reno, Inc. v. Overhead Door Corp., 103 Nev. 126, 734 P.2d 1233, Bus. Franchise Guide (CCH) ¶ 8812 (1987). See also Dayan v. McDonald's Corp., 126 Ill. App. 3d 11, 466 N.E.2d 945, Bus. Franchise Guide (CCH) ¶ 8185 (1984). See generally T.M. McLaughlin & C. Jacobs, *Termination of Franchises: Application of the Implied Covenant of Good Faith and Fair Dealing*, 7 FRANCHISE L.J. 1 (Summer 1987).

152. See Report to the House of Delegates of the ABA regarding the enactment by state legislatures of the "Franchise and Business Opportunities Act" of the National Conference of Commissioners on Uniform State Laws [presented in February 1988 and prepared by the Franchising Committee of the Section of Antitrust Law of the ABA], pp. 4-12 (Task Force Report).

the franchisor opens a unit immediately adjacent to a franchisee who has been granted a franchise only for a specified site and who has expressly acknowledged that he has no rights to territorial protection and the new unit causes harm to the established one, the franchisee will have a strong argument that the franchisor's action deprived him of the benefit of the contract.<sup>153</sup>

In some instances, the covenant was applied to prevent abusive conduct by a franchisor.<sup>154</sup> The covenant also has been applied in various situations to prevent unjust terminations.<sup>155</sup> One court held that a clause giving the franchisee a right of first refusal to extend the franchise "on terms and conditions to be negotiated" obligates the franchisor to negotiate an extension in good faith.<sup>156</sup> In another case, the court relied on the covenant of good faith to limit the franchisor's ability to sell through other distribution channels.<sup>157</sup> In another, the court held that a supplier's appointment of a new distributor in anticipation of the effective date of termination of the existing distributor's exclusive agreement and the refusal to fill the distributor's order before the date of termination can constitute the supplier's breach of the duty of good faith and fair dealing.<sup>158</sup>

Although the "covenant" of good faith and fair dealing probably is law in most jurisdictions,<sup>159</sup> there are very few cases where that principle, by itself, has led to a ruling favorable to a franchisee. Several courts have held that no cause of action exists for an alleged violation of the covenant in the absence of an allegation of violation in bad faith of an express term of the agreement.

## I. Antitrust

In the early 1970s, the federal antitrust laws, as then interpreted and applied by the courts, provided a powerful basis for claims against franchisors. The antitrust laws provide in many circumstances for treble damages as well as attorney's fee awards. At that time, the legality under federal antitrust principles of many vertical restrictions as practiced in business format franchise relationships was in doubt. In practice, many franchisors were engaging in tying practices. Many franchisees were

153. See note 142, *supra*.

154. The most notable might be *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704 (7th Cir. 1979), where there was abundant evidence suggesting that the franchisor was trying to drive the franchisee out of business.

155. See Task Force Report, *supra* note 134, notes 11-13.

156. *In re Vylene Enters., Inc.*, Bus. Franchise Guide (CCH) ¶ 10,981 (9th Cir. 1996).

157. *Carvel Corp. v. Baker*, Bus. Franchise Guide (CCH) ¶ 11,208 (D. Conn. 1997).

158. *Unidrug, S.A.R.L. v. E.T. Browne Drug Co.*, Bus. Franchise Guide (CCH) ¶ 11,415 (3d Cir. 1998). See also *Sons of Thunder v. Borden, Inc.*, 148 N.J. 396, 690 A.2d 575, Bus. Franchise Guide (CCH) ¶ 11,700 (1997).

159. See Task Force Report, *supra* note 152, at 4.

forced to buy equipment from the franchisor or its affiliates when perfectly acceptable alternative sources of supply of goods conforming to the franchisor's standards and specifications were available.

In the 1980s and 1990s, the pendulum of federal antitrust jurisprudence has swung to a much more narrow reading of the law. As a result of changes in practices in the industry and changes in the attitudes of regulatory and judicial officials toward antitrust laws, claims of antitrust violations dropped off significantly in the 1980s. Antitrust laws today are used by franchisees only in the more egregious cases.<sup>160</sup> See Chapter 6.

## X. Conclusion

Since 1979, after the California Franchise Relations Act and FTC Rule had both gone into effect, with the exception of Iowa in 1992 and Rhode Island in 2007, no general franchise relationship legislation has been enacted, although many bills were introduced. To a large extent, the disclosures required by the FTC Rule appeared to have lessened the abuses to which the relationship laws were aimed.

Counsel for franchisors, manufacturers, and suppliers will want to advise their clients of the risks under the franchise relationship laws of terminating franchise and dealership agreements and of withholding consent to their renewal or assignment. The advice should first come before any agreement is signed, so that the client can make an informed decision whether to sign the agreement, restructure the arrangement, or not sign. When the client desires to terminate or withhold consent to a renewal or assignment, he or she will need assistance in navigating through these laws to minimize the risk of litigation.

Counsel for dealers and franchisees should advise their clients of their rights under these laws. Wherever possible, counsel for dealers and franchisees will want to structure the arrangement (or frame the litigation) in a way that brings it within the coverage of the relationship laws, and to use contractual language that reinforces this coverage. When the franchisor, manufacturer, or supplier terminates or withholds consent to the renewal or assignment, the dealer or franchisee will need to know its rights and available remedies.

160. See *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704 (7th Cir. 1979).

