LEGAL ISSUES SURROUNDING TRANSFERS, ASSIGNMENTS, AND RESALE PROGRAMS

Brian Balconi, Esq.
General Counsel, Vice President
Little Caesar Enterprises, Inc.

Kevin M. Shelley, Esq.
Partner
Kaufmann Gildin Robbins & Oppenheim LLP

October 14-16, 2009
The Westin Harbour Castle
Toronto, Canada

©2009 American Bar Association
TABLE OF CONTENTS

I. INTRODUCTION .................................................................................................................. 1
   A. Definitions ....................................................................................................................... 1

II. DUTIES OF THE FRANCHISOR: STATUTORY DUTIES .............................................. 3
   A. Statutory Duties: Regulation Of The Franchisor’s Right To Withhold Consent To Transfer .......................................................... 3
      1. Franchise Relationship Laws ..................................................................................... 3
      2. Franchise Disclosure Statutes ................................................................................. 6
      3. Industry Specific Statutes ....................................................................................... 7
   B. Contractual and Other Common Law Duties of the Franchisor ................................................. 8
      1. A Typical Transfer Provision ..................................................................................... 8
      2. Contractual Duties: What Standard Applies to a Franchisor’s Consideration of a Request to Consent to a Transfer? .................... 8
      3. Tortious Interference with Contract or Prospective Economic Relations ........................................................................... 12

III. DUTIES OF THE FRANCHISEE: CONDITIONS TO TRANSFER ................................. 13
   A. Non-Controversial Conditions .................................................................................... 14
      1. Pay money owed ...................................................................................................... 14
      2. Pay transfer fee ....................................................................................................... 14
      3. Transferor not in default ......................................................................................... 14
      4. Transferee to undergo training ............................................................................... 15
      5. Other reasonable requirements .............................................................................. 15
   B. Transferor signs a general release .............................................................................. 16
   C. Transferee must sign a then-current franchise agreement ........................................... 17
   D. Requirement that transferee remodel or refurbish unit, make other capital improvements or meet updated system standards .......... 19
   E. Transferee must meet franchisor’s financial, operational and other standards ................... 19
      1. The Franchisor’s consideration of sales price ............................................................. 19
      2. Evaluation of buyer: background, education, experience, financial backing .......... 20
      3. May franchisor require proposed transferee to undergo training? ........................... 21
      4. May franchisor require proposed franchisee to pass an English language proficiency exam? ......................................................... 21
      5. Must franchisor provide an explanation to transferor for its decision to consent or not consent to a proposed transferee? ............ 22
      6. May franchisor decline to consent for non-objective reasons? .................................. 22
   F. Proposed Sale to Public Company or Private Equity Fund ............................................ 23
   G. Minimum Period of Ownership .................................................................................... 24

IV. OTHER ISSUES ARISING FROM THE TRANSFER PROCESS ........................................ 24
   A. Intra-family Transfers .................................................................................................. 24
   B. Divorce .......................................................................................................................... 25
   C. Death or Disability of Franchisee .................................................................................. 25
   D. Right of First Refusal ................................................................................................... 27
      1. Typical Right of First Refusal Provisions .................................................................. 27
      2. Why is this an issue? ............................................................................................... 28
3. Disputes.................................................................................................................. 29

E. Extensive Franchisor Involvement in the Transfer Process...................................... 30
   1. Disclosure Issues................................................................................................. 30
   2. Other Statutory Considerations......................................................................... 33
   3. Franchisor’s communications with proposed transferee
      regarding financial information........................................................................... 33
   4. May franchisor review and insist upon changes to Purchase
      Agreement between franchisor and proposed transferee?.............................. 34

F. Resale Assistance Program...................................................................................... 35
   1. Advantages of a Franchise Resale Assistance Program...................................... 35
   2. Disadvantages of a Franchise Resale Assistance Program................................. 36
   3. Conclusion: Franchise Resale Assistance Program............................................ 36

V. CONCLUSION........................................................................................................... 36

EXHIBIT A: A Typical Transfer Provision.....................................................................A-1

This paper represents a collective work by its authors. Given the nature of the topic and its treatment,
as well as the desire to analyze the topic in a unified paper, the opinions and views expressed herein do
not necessarily represent the individual work, opinions or views of any individual author or his
employer or law firm
I. INTRODUCTION

If asked, every franchisor and franchisee would admit to the possibility, even the probability, that the franchisee will want to transfer its franchise at some point during the term of the franchise agreement. Whether an individual franchisee desires to transfer the franchise to his heirs, or whether an individual or entity franchisee wishes to "cash out" and liquidate its investment by sale to a third party, transfer is often the culmination of a successful franchise relationship. Like death and taxes, transfer is inevitable and the parties should plan for it. Yet while foreseeable, this event is still a common source of friction and dispute.

Franchise Agreements often provide that the agreement may be terminated by the franchisor if a change in ownership occurs without the franchisor’s consent or without satisfying other contractual conditions. It is therefore crucial that franchisees satisfy the conditions set forth in the franchise agreement prior to changing ownership.

Despite such serious ramifications, it’s not unheard of for a franchise field representative to visit a franchised store and have a stranger greet him or her with: “Hi, I’m the new business owner.” Franchisees have also been known to sell an interest in the franchised business with the intent of concealing this interest from the franchisor.

For a franchisor, the ability to screen, and thereafter build a relationship with, its franchisees is critical. Accordingly, franchisors may very well choose to terminate a franchise agreement if it is discovered that the franchisee has transferred ownership without consent, since the franchisee has irreparably broken the trust of the franchisor and the franchisor has not had the opportunity to evaluate the transferee.

On the other hand, franchisees may be frustrated in their efforts to achieve their own financial or estate planning goals by franchisors who see opportunity in transition.

This paper will consider business and legal dynamics from the franchisor and franchisee perspectives, including standards of consent, typical and not so typical transfer conditions, renovation and upgrade requirements, a franchisor’s internal transfer procedures and involvement in the process, franchisor resale programs, rights of first refusal and their use in the real world, involuntary transfers arising from death and disability, as well as increasingly difficult issues relating to franchisor and franchise assessment of candidates, value and price.

A. Definitions

A change in ownership could be the result of any number of circumstances such as a full sale of the business to a third party pursuant to an arms-length negotiation; a sale resulting from death, disability, or divorce; a public offering of stock in the franchisee entity; a franchisee taking some “chips off the table” by selling a portion of the business to a private equity company; or an ownership transfer to a family member for estate planning purposes.

Before discussing the substantive issues of transfers, assignments and resale programs, it is helpful to review the definitions of these terms within the franchise context along with the
closely related terms “change in control” and “right of first refusal.” These definitions are as follows:

**Transfer**

Literally, the term “transfer” refers to any direct or indirect change of ownership. In practice, however, the term “transfer” often refers to a change in ownership that is above a certain threshold, typically a change of control (another threshold used is a change of 25% interest or greater). In this paper, “transfer” will be used simply to refer to a change in ownership.

**Change in Control**

Franchise Agreements define change of control differently. However, this paper will refer to “control” as either: (1) 50% or more ownership interest in the franchise; or (2) the power to direct the conduct or management of the business affairs, with or without majority ownership.

**Assignment**

Literally, “assignment” is synonymous with “transfer.” In fact, the definition of “assignment” is “the act of transferring....”1 In practice, however, some franchise systems may use “assignment” to refer to a change of ownership below a certain threshold and, therefore, the franchisee assigns a minority interest in the existing franchise agreement rather than entering into the then-current franchise agreement. Other franchisors may simply use “transfer” and “assignment” interchangeably. The term “assignment” will not be used in this paper to avoid confusion.

**Resale Program**

The term “Resale Program” is short for “Franchisor-Sponsored Resale Assistance Program,” which refers to a program in which franchisors provide assistance in the transfer process, such as lead generation, general assistance and overall guidance, many times for a fee.2

**Right of First Refusal**

A Right of First Refusal is the right to meet the terms of a proposed contract.3 This is a standard provision in the transfer section of franchise agreements. It provides the franchisor with the opportunity to purchase the franchised unit on the same or substantially similar terms to those of the proposed transfer.

---

II. DUTIES OF THE FRANCHISOR: STATUTORY DUTIES

A. Statutory Duties: Regulation Of The Franchisor’s Right To Withhold Consent To Transfer

1. Franchise Relationship Laws

Twenty-three states or territories have enacted so-called “franchise relationship” statutes which govern various aspects of the franchisor-franchisee relationship. Nine of these twenty-three franchise relationship statutes specifically address the issue of transfer, with some portions of each of these statutes offering franchisors and franchisees some guidance and protection as they navigate the tricky waters of balancing the competing interests involved in a franchise transfer.

a. Statutory “Good Cause” Requirements

From a franchisor’s perspective, the most restrictive statutes may be those in Hawaii and Michigan. The Hawaii and Michigan statutes both deem it an unfair or deceptive act to refuse to permit a transfer of a franchise without good cause. Both of these statutes identify four instances in which a franchisor may withhold consent for good cause by defining good cause to include situations where the proposed transferee fails to meet the franchisor’s then-current reasonable standards and qualifications; the proposed transferee is a competitor of the franchisor; the proposed transferee is unwilling to comply with all lawful obligations; and, the franchisee, the proposed transferee, or both fail to pay all sums due to the franchisor or fail to cure any default under the franchise agreement existing at the time of the proposed transfer. While these specified instances of good cause address the most common reasons to deny transfer, the list is non-exclusive, and the franchisor can otherwise prove that its reasons for refusal are based upon good cause. Note that Hawaii incorporates the concept of good faith into its statute, and as a result, requires that the franchisor act in good faith when considering a request by a franchisee to transfer its franchise.

One common contractual condition to the franchisor’s consent to transfer is the tender of a general release in favor of the franchisor by the franchisee. That contractual condition was challenged under a statutory “good cause” requirement in Michigan by a franchisee in Franchise Management Unlimited v. America’s Favorite Chicken. In that case, a franchisee sought to transfer its franchise agreement, but refused to comply with the contractual condition of proffering a release in favor of its franchisor. Without the release, the franchisor declined to consent to the transfer, and the franchisee sued, alleging that the refusal to consent to the transfer was a violation of the Michigan Franchise Investment Law (“MFIL”). In pertinent part, the MFIL dictates that a provision which permits a franchisor to refuse to permit a transfer of ownership of a franchise is void and unenforceable unless the franchisor has good cause. The court disagreed with the franchisee, finding that its refusal to execute the release constituted a

---

default under the franchise agreement, providing the franchisor with sufficient good cause, as it is defined in the MFIL, to deny the proposed transfer under the statute. The court went further to say that even if the failure to provide a release in favor of the franchisor did not fall within one of the enumerated situations in which good cause existed under the MFIL, that failure still provided the franchisor with adequate “good cause” as that term is commonly understood. Finding that the meaning of good cause centers on commercial reasonability, the court concluded that a franchisor acts in a commercially reasonable manner where it requires a franchisee to resolve disputes before approving a proposed transfer. 7

b. Burden Shifting and Explanation of Denial

Each of the Arkansas, Nebraska and New Jersey franchise relationship statutes has created transfer procedures that both franchisor and franchisee must follow. Initially, the franchisee has the burden of notifying the franchisor of any proposed transfer, sale or assignment, and must provide the franchisor with pertinent information about the transfer. Failure to provide notice of intent to transfer is a violation of these statutes. 8 Once the franchisor has received notice of the proposed transfer, the burden shifts from the franchisee to the franchisor, who then must approve the transfer or provide the franchisee with a material reason for the unacceptability of the proposed transferee based upon the character, financial ability, or business experience of the proposed transferee. 9 Franchisors and franchisees in Arkansas, Nebraska and New Jersey may not avoid these statutory transfer procedures by providing different procedures in their franchise agreement. 10

Franchisors who do not respond in a timely manner to transfer notices do so at their own peril, as courts have held that when the franchisor does not provide the “material reason” for its failure to consent to the transfer as required by their statutes, consent is manifested by operation of law. For instance, in V.W. Credit, Inc. v. Coast Automotive Group, Ltd., 11 the franchisor refused to consent to a proposed transfer without providing material reasons for the unacceptability of the proposed transferee. Finding no material reason was proffered, the court granted the franchisee’s request for specific performance and enjoined the franchisor from

---

7 Id. at 246-47.
8 Arkansas Franchise Practices Act, Ark. Code Ann. §4-72-205; Nebraska Franchise Practices Act, Neb. Rev. Stat. §87-405; and New Jersey Franchise Practices Act, N.J. Stat. N. §56:10-6. See also, Southeastern Distributing Co. v. Miller Brewing Co., 366 Ark. 560, 571 (2006) (sugesting a franchisor has notice of a franchisee’s proposed transfer where, despite the franchisee’s failure to provide written notice, the franchisor has interfered with the franchisee’s efforts to contact and negotiate with prospective transferees).
9 See Maple Shade Motor Corporation v. Kia Motors America, Inc., 260 Fed.Appx. 517 (3d Cir. 2008) (holding that franchisor’s rejection of a proposed transfer was not prohibited by the New Jersey Franchise Practices Act when the proposed transferee of a Kia car franchise could not provide franchisor with any assurances that it could build a Kia showroom that was separate from its existing Cadillac showroom, in contravention to the terms of the existing franchise agreement).
10 See, e.g. The Department of Motor Vehicles of the State of Florida v. Mercedes-Benz of North America, Inc., 408 So.2d 627 (Fla. Dist. Ct. App. 1981) (stating that the transfer clause in franchise agreement had to be severed since it violated the New Jersey Franchise Practices Act).
preventing the transfer, noting that where “a franchisor unreasonably withholds consent to a transfer, the franchise transfers to the proposed transferee by operation of law.”

The court in Simmons v. General Motors Corporation, Oldsmobile Division, however, noted that a franchisor does not have an obligation to provide “material reasons” for its failure to consent to a proposed transfer until it has received proper notice from its franchisee under the New Jersey Franchise Practices Act. In that case, the franchisee, less than two weeks after providing the franchisor with what the court determined was an insufficient notice of its intention to sell its car dealership, consummated the sale without the franchisor’s knowledge. Although the transferee had previously submitted a franchise application to the franchisor, the sale took place before the franchisor received proper notice and before it had an opportunity to review the transferee’s application and either approve or reject it. The franchisor later rejected the transferee’s application on the basis that the transferee’s other car dealerships were considered some of the worst in the area, having received an “inordinately high” number of consumer complaints, fines from the State of New Jersey and other negative feedback when it came to its business practices. The court stressed that the franchisor’s right to approve a new owner is paramount for a manufacturer, and that both the franchisee and transferee were in violation of the New Jersey Franchise Practices Act for making the transfer and accepting the transfer without prior notice to the franchisor.

**c. Transfer to or by Surviving Spouse, Heirs or Estate**

The California Franchise Relations Act and the Indiana Deceptive Franchise Practices Act prohibit franchisors from preventing a surviving spouse, heir, or estate of the franchisee (or a major shareholder of the franchisee) from participating in the ownership of the franchise for a reasonable period after the death of the franchisee (or a major shareholder of the franchisee), provided that the surviving spouse, heir or estate satisfies all of the franchisor’s then-current standards and qualifications. The California statute further prohibits franchisors from preventing the surviving spouse, heirs or estate from selling, transferring or assigning the franchise to a person who satisfies the franchisor’s then-current standards and qualifications. While these statutes are intended to provide extra protection to a franchisee’s family in the event of the death of the franchisee or its principal shareholder, they do not appear to add any additional protections not otherwise available and we have found no cases in which these statutes have been tested through litigation.

---

12 Id. See also Mercedes-Benz of North America, Inc. v. The Department of Motor Vehicles of the State of Florida, 455 So.2d 404, 408–09 ( Fla. Dist. Ct. App. 1984) (affirming the trial court’s holding that, because franchisor had received proper notice of franchisee’s intent to transfer and had not advised franchisee within 60 days of receipt of that notice of the unacceptability of the transferee, consent to the transfer was deemed granted as a matter of law).


14 Id. at 540.


d. Arbitrary or Capricious Denial

The Iowa Franchise Act\textsuperscript{17} and the Minnesota Franchise Act\textsuperscript{18} provide that if a proposed transferee satisfies the franchisor’s then-current standards and qualifications for new franchisees, the franchisee may transfer the franchise. The Iowa statute defines a reasonable current qualification for a new franchisee to mean qualifications that are based on a legitimate business reason. That statute further provides that a franchisor may decline to permit a transfer if the transferee does not meet such qualifications, provided that the refusal to consent is not arbitrary or capricious. Further, the Iowa statute expressly permits a franchisor to condition its consent to transfer upon any of: (i) the proposed transferee’s completion of the franchisor’s training program; (ii) the payment of a transfer fee to the franchisor for reimbursement of the franchisor’s reasonable and actual expenses attributable to the transfer; (iii) a requirement that the franchisee pay or make provisions to pay the franchisor or any of its affiliates in the amount due to the franchisor or any of its affiliates at the time of the transfer; or, (iv) the compliance of the terms of the transfer with the franchisor’s then-current financial requirements for its franchisees.\textsuperscript{19}

Again, these statutory protections seem largely redundant with common franchise agreement provisions covering transfer, and we have not found any cases holding that these statutes provide protections different than those commonly afforded to the franchisor under its franchise agreement.

2. Franchise Disclosure Statutes

In addition to franchise relationship laws, the franchisor may be subject to the disclosure requirements of various franchise registration and disclosure statutes in connection with its consent to a transfer. Generally, franchise registration/disclosure statutes require the seller of a franchise to file with the appropriate state agent and disclose to a prospective franchisee, in advance of a sale, a compliant franchise disclosure document. In addition, the statutes generally prohibit fraud or other misconduct in connection with the sale of a franchise.

A federal district court in Minnesota recently held that a franchisor’s consent to transfer constituted the “sale or establishment” of a franchise for purposes of the Florida Franchise Act, thereby entitling the transferee to the protections of that statute. In Randall v. Lady of America Franchise Corp.,\textsuperscript{20} the court held that a transferee who had purchased a franchise from a third party had a claim against the franchisor under the Florida Franchise Act, which prohibits misrepresentations by the franchisor in connection with “selling or establishing” a franchise. Noting that the transferee had paid the franchisor a franchise fee and a transfer fee, executed a new franchise agreement, and communicated with the franchisor’s representatives extensively before purchasing the franchise, the court found that the transferee had standing to assert a claim against the franchisor as a result of its consent to transfer.\textsuperscript{21}

\begin{footnotesize}
\textsuperscript{17} Iowa Franchise Act, Iowa Code Ann. §537A.
\textsuperscript{18} Minnesota Franchise Act, Minn. Stat. Ann. §80C.14(5).
\textsuperscript{19} Iowa Franchise Act, Iowa Code Ann. §537A.5.c.
\textsuperscript{20} 2007 WL 2128180 (D. Minn. 2007).
\textsuperscript{21} Id. at *20.
\end{footnotesize}
The holding in *Lady of America* appears to be of limited precedential value. First, the standing issue was resolved without substantial analysis, and in the context of a long opinion dealing with many other issues. Second, although the court found that the transferee had standing to assert a claim under the statute, the court thereafter, in the same opinion, granted the franchisor summary judgment on all transferees' claims under that statute based upon a contractual disclaimer.\(^{22}\) Finally, the majority (if not all) of other courts have declined to hold that a transferee has standing to assert claims against a franchisor as a result of the franchisor's consent to transfer.\(^{23}\)

3. **Industry Specific Statutes**

Aside from the general franchise relationship, registration and disclosure statutes discussed above, nearly every state has enacted industry-specific statutes that govern franchisor and distributorship relationships within specified industries, and many of these industry specific statutes contain provisions governing the transfer of the franchise or distributorship. For example, nearly every state has enacted statutory procedures that limit the restrictions a franchisor may impose on the sale, transfer, or assignment of a franchise in the motor vehicle industry and at least thirty states regulate franchise transfers in the beer, wine, or liquor industries. A non-comprehensive list of industries which are affected by statutes governing transfer includes heavy equipment, petroleum or motor fuels franchises, service stations, agricultural equipment, insurance, watercraft and outboard motors, and trailers.

While varying greatly from state to state and industry to industry, these statutes generally prohibit franchisors from unreasonably withholding consent to the transfer of a franchise in the specific industry regulated, and some require that the franchisor communicate the material reasons for its refusal to consent to the transfer.\(^{24}\) In addition, a number of these statutes specify reasons why consent to a transfer may be withheld.\(^{25}\) And at least one motor vehicle franchise statute outright prohibits the use of a right of first refusal provision.\(^{26}\)

\(^22\) Id. at *22.

\(^23\) See, e.g., *Schubot v. McDonald's Corp.*, 757 F.Supp. 1351 (S.D.Fla. 1990) (holding that a franchisee could not assert a claim under the Florida Franchise Act against a franchisor who consented to the transfer of the franchise from a predecessor franchisee to the plaintiff franchisee); *Shahbazi v. Equilon Enterprises*, 2006 WL 3020938 (Cal. App. 6. Dist. 2006) (assignment does not equal a sale for purposes of claims asserted by the California Franchise Investment Law); *Western Convenience Stores, Inc. v. Burger King Corp.*, 2007 WL 26822445 (D. Neb. 2007) (franchisor granted summary judgment on franchisee's claim that franchisor's refusal to approve or renew franchise rights violated the Nebraska Franchise Practices Act).

\(^24\) See *Bowser Cadillac, LLC v. General Motors Corp.*, 2008 WL 189557 (W.D.Pa. 2008) (alleging that the manufacturer failed to exercise its contractual right of first refusal in a timely manner, in violation of the Pennsylvania Board of Vehicles Act, 63 P.S. §818.2 et seq., finding it unlawful for a manufacturer to fail to respond in writing to a request for consent to the sale of a franchise within sixty (60) days of a receipt of a written request).

\(^25\) See, e.g., *Stonecrest Square Auto Center LLC v. Equilon Enterprises, LLC*, 2008 WL 4906424 (Cal. App. 4th Dist. 2008) (affirming that gasoline franchisor may utilize subjective criteria to evaluate potential transfers under Cal. Bus. & Prof. Code §21148(a), which establishes five permissible reasons to withhold consent to transfer of petroleum franchise); *Fladeboe v. American Isuzu Motors, Inc.*, 150 Cal. App. 4th 42, 58 Cal. Rptr. 3d 225 (4th Dist. 2007) (claim under California Vehicle Code Section 11713.3, alleging
While detailed analysis of these industry specific statutes is beyond the scope of this paper, counsel should be aware of the existence of these industry specific regulations when representing clients in the regulated industries.

B. Contractual and Other Common Law Duties of the Franchisor

Aside from the statutorily-imposed duties discussed above, the franchisor’s duties with respect to a proposed transfer are, obviously, governed by the parties’ franchise agreement and other related common law principles. While these duties may overlap with the statutory duties, any particular franchise agreement may, and often will, contain its own unique standards and requirements.

1. A Typical Transfer Provision

What, exactly, does a comprehensive transfer provision look like? Exhibit A to this paper contains a sample provision, which provides that the franchisee must obtain prior written consent from the franchisor before transferring the franchise agreement, which consent will not be unreasonably withheld. The provision also establishes conditions to the transfer, and gives the franchisor a right of first refusal.

2. Contractual Duties: What Standard Applies to a Franchisor’s Consideration of a Request to Consent to a Transfer?

To the extent the transfer process is not subject to statutory duties, the parties’ respective duties and obligations in connection with a proposed transfer of a franchise are governed by the parties’ franchise agreement. Generally, franchise agreements set forth, in detail, the parties’ respective obligations concerning a proposed transfer. In nearly all franchise agreements, the franchisor is free to transfer the franchise agreement without the consent of the franchisee (although many franchise agreements require the franchisor to provide a franchisee with advance notice of the proposed transfer). Conversely, most franchise agreements require the franchisee to obtain the advanced written consent of the franchisor to a proposed transfer by the franchisee, which consent is typically conditioned upon the franchisee and proposed transferee’s satisfaction of various conditions.

unreasonable denial of consent to transfer dealership, barred by plaintiff’s unclean hands); Abraham & Sons Enterprises v. Equilon Enterprises, LLC, 292 F.3d 958 (9th Cir. 2002) (reversing summary judgment for defendants on franchisee’s claim under California Business and Professional Code §20999.25(a), which prohibits a franchisor from selling, transferring, or assigning to another person the franchisor’s interest in the premises, unless the franchisor has first made a bona fide offer to sell, transfer or assign a franchisor’s interest in the premises to the franchisee); Chrysler Corp. v. Bowshier, 2002 WL 465118 (Ohio App. 10th Dist. 2002) (applying Ohio statute requiring franchisor to evaluate transfer request on basis of “reasonable and objective criteria fairly and objectively applied”); Mierson, Inc. v. Exxon Company, USA, Bus. Fran. Guide (CCH) ¶12,546 (D.Md. 2003) (granting summary judgment to defendant on claims that it unreasonably refused to approve transfers by franchisee under Maryland statute).

Moreover, many franchise agreements establish, with a greater or lesser degree of certainty, the standard by which the franchisor is required to evaluate the franchisee’s request for its consent to a proposed transfer. The most common contractual standards governing a franchisor’s response to a franchisee’s request for consent to a transfer are: (i) provisions that the franchisor’s consent will not be unreasonably withheld,\(^{27}\) (ii) provisions prohibiting the franchisor from acting arbitrarily,\(^{28}\) and (iii) provisions granting the franchisor discretion, “sole discretion,” or even authorizing arbitrary determinations.\(^{29}\)

The vast majority of cases in which a disappointed franchisee has challenged a franchisor’s denial of a request to transfer a franchise have upheld the franchisor’s denial as a proper exercise of contractual rights. Typically, if the franchisor has followed the procedural steps required of it by the parties’ franchise agreement, and has proffered evidence that the franchisee or putative transferee do not meet the contractual conditions to transfer or satisfy the franchisor’s then current standards and qualifications, the franchisor’s exercise of its contractual rights will be upheld.\(^{30}\)

In addition to express duties imposed upon a franchisor by the parties’ franchise agreement with respect to a request to consent to a transfer, many franchisees have argued, and some courts have held, that the law implies a duty to act reasonably in response to such a request. Of course, nearly every state implies into a contract a covenant of good faith and fair dealing, which essentially precludes a party from acting in a manner that deprives the other party of the anticipated benefits under the contract.\(^{31}\) Although many franchisee advocates have argued that

\(^{27}\) See, e.g., Dunkin’ Donuts Inc. v. Sharif, Inc., 2004 WL 3419578 (D.N.M. 2004), aff’d, 177 Fed. App. 809 (10th Cir. 2006) (franchisee must obtain prior written consent of franchisor for any transfer or assignment, which consent shall not be unreasonably withheld).

\(^{28}\) See, e.g., Perez v. McDonald’s Corp., 60 F.Supp. 2d 1030 (E.D. Cal. 1998).

\(^{29}\) See, e.g., Burger King Corp. v. H&H Restaurants, LLC, 2001 WL 1850888 (S.D. Fla. 2001) (satisfaction of contractual conditions to transfer to be determined by franchisor in its “sole judgment” under franchise agreement); Keating v. Baskin-Robbins USA, Co., 2001 WL 407017 (E.D.N.C. 2001) (franchise agreement permitted franchisor to withhold consent to a transfer “arbitrarily and for any reason whatsoever or may condition any consent in [franchisor’s] sole discretion”).

\(^{30}\) See, e.g., Miramar Truck and Auto Center, Inc. v. General Motors Corp., 2007 WL 757827 (Cal. App. 4th Dist. 2007) (manufacturer disapproved of transfer because proposed purchaser had been previously terminated as a GM dealer for inadequate sales performance and low customer satisfaction results, and had plead guilty to perjury, upheld in arbitration and subsequent court action); Maple Shade Motor Corp. v. Kia Motors America, Inc., 2006 WL 2320705 (D.N.J. 2006), aff’d, 260 Fed.Appx. 517 (3d Cir. 2008) (manufacturer justified in refusing to approve request to transfer, because dealership was in default, and proposed purchaser would not or could not promise to remedy those defaults); Dunkin’ Donuts, Inc. v. Sharif, Inc., 177 Fed. App. 809 (10th Cir. 2006) (franchisor did not unreasonably withhold its consent to a transfer when both the transferring franchisee and the prospective franchisee, already a franchisee at another location, were in default of their respective franchise agreements); Escape Enterprises, Ltd. v. Gosh Enterprises, Inc., 2005 WL 1252504 (Ohio App. 10th Dist. 2005) (upholding franchisor’s right to reject the proposed transfer to a competitor of the franchisor); Transamerica Services Technical, Supply, Inc. v. General Motors Corp., 2004 WL 234684 (Ohio App. 7th Dist. 2004) (dismissing claims that manufacturer violated statutory and contractual duties by refusing to consent to transfer of automobile dealership franchise).

the implied covenant applies both in the case where the franchise agreement is silent and when a franchise agreement imposes specified standards, courts have been slow to use the implied covenant to create or modify duties that are expressly defined in the franchise agreement.

In many states, the implied covenant limits a party’s ability to act in a discretionary manner, even when the contract specifically provides for that discretion; in those jurisdictions, the courts generally provide that the parties’ exercise of that discretion is subject to a reasonableness review under the implied covenant. In the franchise context, franchisees have often argued that this limitation on a party’s discretion, based upon the implied covenant, should be used to prevent a franchisor from exercising its discretion to deny consent to transfer when, for example, the contractual conditions to such transfer are not met or when the proposed transferee does not meet the franchisor’s standards and qualifications. However, the majority of courts have denied claims for breach of the implied covenant under those circumstances, as long as the franchisor met the obligations established by the parties’ franchise agreement. In other words, courts have been reluctant to impose duties for a franchisor that have not been expressly established in the parties’ franchise agreement.

This reluctance is particularly strong when the franchise agreement vests the franchisor with sole, absolute or unconditioned discretion. In those cases, although the exercise of discretion is subject to the implied covenant, some courts have held that the parties’ express agreement to provide the franchisor with uncontrolled discretion precludes review of franchisor’s exercise of that discretion under the implied covenant, on the ground that the court may not imply terms that are inconsistent with the express terms of the written agreement.

One interesting application of the implied covenant doctrine in connection with transfers is an argument made by a disappointed franchisee that a franchisor that declined to consent to a transfer fails to mitigate its damages in failing to approve a new franchisee, and thus breaches the

32 See, e.g., Dalton, supra (“Where the contract contemplates the exercise of discretion, this pledge [that neither party will do anything that has the effect of destroying the other party’s right to received the benefits of the contract] includes a promise not to act arbitrarily or irrationally in exercising that discretion”); Carma Dev. (California) Inc. v. Marathon Dev. California, Inc., 2 Cal. 4th 342, 826 P.2d 710 (1992) (the implied covenant of good faith and fair dealing “finds particular application in situation where one party is invested with a discretionary power affecting the rights of another.”)

33 See, e.g., Burger King Corp. v. H & H Restaurants, LLC, 2001 WL 1850888 (S.D.Fla. 2001) (because franchisor is entitled to disapprove of the proposed transfer under the terms of the franchise agreement, the franchisees’ claim for breach of the implied covenant of good faith and fair dealing based on the franchisor’s refusal to consent dismissed on summary judgment); Ernie Haire Ford, Inc. v. Ford Motor Co., 260 F.3d 1285 (11th Cir. 2001) (manufacturer’s rejection of proposed transfer and relocation of dealership, in compliance with dealership agreement, was neither capricious nor in contravention of the parties’ reasonable expectation, and therefore did not breach the implied covenant of good faith and fair dealing under Florida law).

34 See, e.g., Keating v. Baskin-Robbins USA, Co., 201 WL 407017 (E.D.N.C. 2001) (when franchise agreement expressly allowed franchisor to withhold consent to a transfer of the franchisee’s interest in a franchise agreement “arbitrarily and for any reason whatsoever;” the court dismissed the implied covenant of good faith and fair dealing claim because the implied covenant cannot override the express terms of a written agreement granting franchisor uncontrolled discretion to refuse consent).
implied covenant. For example, in *Dunkin' Donuts, Inc. v. Sharif, Inc.*, a Dunkin’ Donuts franchisee defaulted under its franchise agreement and related agreements by failing to pay money owed to its franchisor. Ultimately, the franchisor terminated the franchise agreement and commenced an action for an injunction and monetary damages. In opposing the motion for preliminary injunction, the franchisee argued that the franchisor breached its duty to mitigate damages, breached its duty of good faith and fair dealing, and breached the contract in bad faith by failing to approve a transfer of the franchise to a third party. In issuing the injunction in favor of the franchisor, the court found that the franchisor had no duty to consider the transfer of the franchise because, *inter alia*, the franchisee owed money to the franchisor and the franchise agreement had been properly terminated. Implicit in this holding is a finding that when a franchisor acts in accordance with an express contractual provision permitting the franchisor to terminate for non-payment and requiring franchisor consent prior to transfer of the franchise, the failure to permit a transfer does not violate a duty to mitigate and, indeed, no such duty exists.

On the other hand, claims for breach of contract and breach of the implied covenant have survived summary judgment when the franchisee has created a triable issue of fact concerning whether the franchisor followed the procedures set forth in the parties’ contract, or whether the reasons proffered for the refusal to consent were pretextual.

For example, in *Dunkin' Donuts v. Shreedev Donut, LLC,* the franchisor filed an action seeking to enjoin the franchisee from continuing to operate a donut shop franchise, alleging violation of the franchise agreement, and the franchisee counterclaimed alleging, *inter alia*, that the franchisor terminated the franchise agreement for pretextual reasons. The franchisee alleged that the proffered reason for its refusal to consent to the transfer -- the franchisee’s alleged bribe of a franchisor employee in connection with the requested transfer -- was not the actual reason for the denial. Instead, the franchisee alleged that the franchisor denied the request to transfer because it wanted to acquire its two locations itself, and then resell those locations for a profit. The court denied the franchisor’s motion for summary judgment, reasoning that if the approval was withheld for the reasons alleged by the franchisee, a reasonable jury could conclude that the approval was unreasonably withheld for an improper reason, in violation of the parties’ franchise agreement, and resulted in interference with the franchisee’s contractual and prospective contractual relations with the proposed transferee.

Similarly, in *Gabe Staino Motors, Inc. v. Volkswagen of America, Inc.*, a Volkswagen franchisee attempted to sell its franchise to another franchisee. Two deals were proposed and both were rejected by the franchisor. The franchisee and proposed transferee commenced an action against the franchisor alleging, *inter alia*, that defendant unreasonably rejected plaintiffs’

---

36 Id. at *3.
38 See also, *Puthussery v. Shell Oil Co.*, Bus. Fran. Guide (CCH) ¶12,710 (N.D. Ill. 2003) (court declined to dismiss claim for breach of the implied covenant of good faith and fair dealing; former gasoline station franchisee asserted that franchisor’s refusal to approve prospective buyers violated the express and implied terms of the parties’ agreement requiring the franchisor to act reasonably to determine whether to consent to an assignment).
proposals to sell the franchise, in violation of the Pennsylvania Board of Vehicles Act and the parties’ contract. The franchisor asserted several reasons in support of its motion for summary judgment, including that a proposed dual facility was inadequate; plaintiff’s customer service ratings were unsatisfactory; plaintiffs were undercapitalized; and, a proposed location of the transfer dealership encroached upon the market area of another dealership. Plaintiffs responded that the franchisor applied its standards inconsistently to different dealers and that the specific reasons identified by the franchisor were nothing more than pretext. Denying the parties’ motions for summary judgment, the court held that plaintiffs alleged sufficient evidence to create a question of material fact, and that the ultimate decision must be left to a jury to determine the reasonableness of the franchisor’s actions.\footnote{See also, \textit{Big Apple BMW, Inc. v. BMW of North America, Inc.}, 974 F.2d 1358 (3rd Cir. 1992), cert. den., 507 U.S. 912 (1993) (holding that a jury could infer that the purported reason for rejection of a dealership transfer was pretextual where a manufacturer treats the proposed dealers differently).}

Taken together, the implied covenant cases indicate that the courts are reluctant to substitute their own judgment for that of the parties when they have agreed, in advance, to their respective duties in connection with the proposed transfer. Summary judgment is routinely granted in favor of the franchisor if it can establish that it followed the procedural steps required by the franchise agreement, and where the proposed transferee failed to meet contractual conditions or the franchisor’s standards and qualifications.

3. **Tortious Interference with Contract or Prospective Economic Relations**

Aside from contractual claims, the most common claim arising from a franchisor’s refusal to consent to a transfer is a claim for interference with contract or prospective business relationships. Typically, a disappointed franchisee alleges that the franchisor’s refusal to consent to a requested transfer constitutes tortious interference with the proposed purchase and sale agreement between the franchisee and proposed transferee. However, there is a fundamental problem with these claims, which often results in their dismissal. In most states, in order to prevail on a tortious interference claim, a plaintiff must show: (i) the existence of a business relationship, (ii) that defendant had knowledge of the relationship, (iii) that defendant nevertheless intentionally and unjustifiably interfered with the relationship, and (iv) that plaintiff suffered damage as a result.\footnote{See, e.g., \textit{Printing Mart-Morrisstown v. Sharp Electronics Corp.}, 116 N.J. 739, 563 A.2d 31 (1989).} In addition, most states provide that a party to a contract cannot be held liable for interference with that contract and that a party to a contract is justified or privileged to act in its own self-interest.

In the context of a failed transfer, these claims are often denied because: (i) the franchisor is deemed a “party” to the contract between the franchisee and the proposed transferee, based upon the franchisor’s required consent to such transfer;\footnote{See, e.g., \textit{Cook v. Little Caesar Enterprises, Inc.}, 210 F.3d 653 (6th Cir. 2000) (summary judgment for franchisor affirmed, since franchisor was not third party, as required to support a claim for tortious interference with contractual and advantageous relationships under Michigan law); \textit{Ernie Haire Ford, Inc. v. Ford Motor Co.}, 260 F.3d 1285 (11th Cir. 2001) (because plaintiffs’ proposed transaction with transferee was conditioned upon manufacturer’s approval, under Florida law, manufacturer could not be}
the franchisor acted solely with malice, and did not have a non-malicious business reason for its refusal to consent; \textsuperscript{43} and, (iii) the franchisor’s refusal was in compliance with the parties’ franchise agreement. \textsuperscript{44} However, interference claims asserted by franchisees have survived motions to dismiss the complaint at the beginning of the litigation when the plaintiffs have alleged the requisite elements of these claims. \textsuperscript{45}

III. DUTIES OF THE FRANCHISEE: CONDITIONS TO TRANSFER

As noted in the definition section above, franchisors often make a distinction between changes of ownership that are above or below a certain threshold, with the transfer of a 50% or more ownership interest generally constituting a change of control of the franchise. Some franchisors, whether in their franchise agreement or in practice, do not mandate all of the transfer conditions if the change of ownership is below the set threshold.

Described below are typical transfer conditions set forth in franchise agreements, which generally \textit{will} be required in the event of a change of control and \textit{may} be required in lesser changes in ownership.

\textsuperscript{43} See, e.g., 
\textit{Burger King Corp. v. H&H Restaurants, LLC}, 2001 WL 1850888 (S.D. Fla. 2001) (holding that franchisor entitled to summary judgment on franchisee’s tortious interference claim where franchisee did not show that franchisor’s sole basis for disapproving the sale to prospective purchaser was malicious); 
\textit{Burger King v. Ashland Equities, Inc.}, 217 F.Supp. 1266 (S.D.Fla. 2002) (granting franchisor summary judgment since franchisees failed to make a showing that the franchisor’s sole reason for disapproving the sale at issue was malicious).

\textsuperscript{44} See, e.g., 
\textit{Barkan v. Dunkin Donuts, Inc.}, 520 F.Supp.2d 333 (D.R.I. 2007) (franchisee’s claim for tortious interference arising from franchisor’s refusal to consent to transfer dismissed; defendant’s contractual right to impose conditions to transfer justified alleged interference); 
\textit{Glod v. Baker, 899 So. 2d} 642 (La. App. 3d Cir. 2005) (plaintiff’s contention that franchisor’s failure to timely object to the transfer rendered the transfer effectively denied, and franchisor’s post transfer termination upheld; the court noted that the franchisee breached the franchise agreement by transferring without consent, and any actions thereafter by the franchisor were excused by the franchisee’s breach); 
\textit{Brock v. Baskin Robbins, USA, Inc.}, 2003 WL 21309428 (E.D. Tex. 2003) (granting franchisor summary judgment on tortious interference claim arising from franchisor’s refusal to consent to transfer, the court noted that interference claim does not lie when the interference occurs as a result of the exercise of the contractual right; because the franchisor has an absolute right not to allow plaintiff’s transfer, its denial could not give rise to a tortious interference claim).

\textsuperscript{45} See, e.g., 
\textit{Kardell v. Century 21 Real Estate Corp.}, 2004 WL 2550591 (W.D. Tex. 2004) (denying motion to dismiss tortious interference claim, the court held that plaintiff alleged facts supporting the elements of tortious interference and that the sufficiency of the claim would be resolved by the trier of fact); 
\textit{Dixie Gas & Food, Inc. v. Shell Oil Co.}, 2005 WL 1273273 (N.D. Ill. 2005) (a franchisee’s allegation that gasoline franchisor used delaying tactics and interfered with a proposed franchise transfer stated a claim for interference with respect to economic advantage).
A. Non-Controversial Conditions

1. Pay money owed

Most notably, franchisees are required to pay the franchisor all money owed prior to and as a condition of a transfer. This is typically a very simple and straightforward provision, such as the condition to “pay in full all money you owe us....”

2. Pay transfer fee

Transfers impose internal and occasionally external costs on franchisors. Accordingly, franchise agreements generally include a transfer fee. These fees typically range from $1,000 to $7,500. \(^{46}\) Some franchisors have a lower fee if the transfer is to an existing franchisee due to a lower level of review and training. Some franchisors do not charge a fee or charge a lesser fee (e.g., $500) for an ownership change that does not involve a change in control.

Some franchise agreements are silent as to the reason the franchisee is paying the fee. Others give reasons, such as for “review and approval” or for “legal, accounting, training, and other expenses we incur.” At least one franchise agreement refers to the fee as “partial reimbursement” for costs incurred.

A franchisor’s time and expense of processing a transfer may vary considerably depending on the individual circumstances of the deal. A transfer fee may be adequate in a “cookie cutter” situation but woefully inadequate for individually negotiated deals. To deal with this disparity, the following transfer fee provision may solve this problem:

“The greater of $X or our actual costs and expenses incurred in approving and effecting the transfer, including, without limitation, all “in-house” and outside personnel and professional costs.”

One unusual transfer fee is as follows: In a system with a $25,000 initial franchise fee and a 10 year initial term, the transfer fee is: “$25,000 less $2,500 times the number of full years remaining on the initial term of this Agreement.” Accordingly, the transfer fee is very low early in the term and increases through the term.

3. Transferor not in default

A condition of transfer in some franchise agreements is that the transferor is not “in default” of the Franchise Agreement. Some go further by stating that in order to transfer the franchise, the franchisee must have “substantially and timely complied with all terms and conditions” of the franchise agreement. Despite this wording, franchisors are typically forward-looking when it comes to defaults; compliance at the time the transferee takes over the location is

really the concern. Accordingly, other franchise agreements state that, prior to the transfer, the
unit must be in full compliance with its current standards.

Franchisees should be counseled to comply in all respects with their franchise
agreements, even if the relationship has broken down or they have decided to sell or transfer the
franchise for any reason. To the extent a franchisee is in default, and the franchisor issues a
notice of default or a notice of termination based on that default, the franchisee can be effectively
precluded from selling or transferring the franchise, since the existence of an unsecured default
will provide the franchisor with sufficient reason to decline to consent to the transfer. More
obviously, to the extent the franchise is actually terminated as a result of the default, the
franchisee can no longer transfer the franchise agreement, and challenges to a franchisor’s
refusal to consent to a transfer subsequent to the termination of the franchise have, not
surprisingly, met with little success.47

It is important to note, however, that from a practical perspective, transfer issues often
arise in the context of a franchisee that is in default, that is having business difficulties, and that
is looking for a way to exit the system while obtaining some return on its investment. Transfer is
often a “win-win” for a struggling franchisee and its franchisor, and a franchisor that refuses to
consent to a transfer based upon an unsecured default is likely missing an opportunity to improve
the system (and is also likely to generate litigation in the process).

4. Transferee to undergo training

The training requirement of the transferee is typically a straightforward obligation with
only a short reference in the franchise agreement. For example, a typical franchise agreement
states that the transferee must “satisfactorily complete Franchisor’s required training program.”
The training is typically done before the transfer takes place because franchisors do not want an
untrained person impacting the goodwill of the brand. But due to the time involved in
scheduling and performing training, some franchisors may allow training to take place after the
transfer occurs.48

5. Other reasonable requirements

Typically, franchise agreements provide a list of conditions, but also state that the
franchisor may impose other requirements as well. Some franchise agreements state “and other
reasonable requirements.” Such reasonable requirements may include not transferring the
franchise to a competitor of the franchisee.49

47 See, e.g., Dunkin Donuts Inc. v. Taseski, 47 F.Supp.2d 867 (E.D.Mich. 1999) (franchisee’s claims for
breach of contract and breach of the implied covenant as a result of franchisor’s refusal to consent to
transfer subsequent to termination of franchise dismissed on summary judgment); Chic Miller’s
Chevrolet, Inc. v. General Motors Corp., 352 F.Supp.2d 251 (D.Conn. 2005) (manufacturer did not
breach dealer agreement by failing to approve a transfer of the franchise because by the time the dealer
sought the approval, manufacturer had already terminated dealer agreement for cause).

48 See Frith, supra note 46, p. 2.

2005); In re Nedwick Steel Co., Inc., 289 B.R. 95 (N.D. Ill. 2003).
B. Transferor signs a general release

Franchisors typically require transferors to sign a general release at the time of transfer. While franchisors consider this to be a standard routine and clear contractual obligation, franchisees see it differently.

Throughout the year and across the country, the following conversation is continuously repeated:

Franchisee: “I don’t want to sign a General Release.”

Franchisor: “You have to if you want us to consent to the transfer.”

Typically, that is the extent of the conversation. But the conversation may continue as follows:

Franchisor: “If you have legal issues with your franchise, let’s discuss and resolve prior to the transfer.”

Franchisee (or his lawyer): “It will take awhile to resolve this and may involve extended litigation. So, allow me to sell the business to mitigate my damages against you.”

Mitigation of damages may be a valid point. Due to circumstances, the franchisee may not be able to continue to operate the store while attempting to resolve the dispute or may need to sell at a lower price if required to sell later. Therefore, in some circumstances, it may be in the best interest of the franchisee to negotiate a carve-out of the particular issue that concerns the franchisee. But, waiving the general release entirely is not advised. And, absent a statutory prohibition, courts have generally enforced a contractual release requirement upon transfer.\(^{50}\)

However, franchisors should be aware that a number of franchise relationship statutes contain “anti-waiver” provisions which generally render void any waiver or release by a franchisee of a right created under the particular statute.\(^{51}\) Thus, even if the franchisor obtains a

\(^{50}\) See *Stradling v. Southland Corp.*, 924 F. Supp. 38 (M.D.Pa. 1996) (holding that requirement of franchise agreement covering convenience store in Pennsylvania that franchisee execute release as condition to franchisor’s consent to transfer of franchise did not violate provisions of New Jersey Franchise Practices Act where franchisee was willing to relocate to New Jersey but release applied only to claims existing at time of execution of release and not to future activities in New Jersey); *America’s Favorite Chicken Co. v. Suryoutomo*, 889 F. Supp. 916 (E.D.La. 1995) (holding that a franchisor’s consent to a franchise transfer is adequate consideration for a franchisee’s signing a release of all claims).

\(^{51}\) See, e.g., Ark. Code Ann. §4-72-206 (“It shall be a violation of this subchapter for any franchisor . . . [t]o require a franchisee at the time of entering into a franchise arrangement to assent to a release . . . [or] waiver . . . which would relieve any person from liability imposed by this subchapter.”); Haw. Rev. Stat. §482E-6(2)(F) (mirroring language of Arkansas statute); Ind. Code § 23-2-2.7-1(5) (stating it is unlawful for franchise agreement to require franchisee to assent to a release or waiver which relieves person from liability under the statute); Iowa Code Ann. § 523H.4 (stating although parties may freely settle claims
release from the outgoing franchisee, the release may not necessarily extinguish claims that the
former franchisee may have under an otherwise applicable franchise relationship statute.

The Franchise Management Unlimited case bifurcated the franchisee’s claims into those
arising under the Michigan Franchise Investment Law and those unrelated to the Michigan
statute. There, as described above, the franchisor refused to consent to the franchisee’s
proposed transfer until it agreed to sign a release of all claims against the franchisor. Although
the court sided with the franchisor in deciding that the franchisor did have good cause to
withhold consent until a release was signed, it excepted out any claims falling under the
Michigan Franchise Investment Law. Since the release would not encompass any claims under
the Michigan statute, the court held that the release was not void because the franchisee was not
deprived of any rights or protections provided for in the Michigan Franchise Investment Law.

C. Transferee must sign a then-current franchise agreement

Franchise agreements may require: 1) the buyer to assume the existing franchise
agreement of the transferor; 2) sign the then-current franchise agreement; or 3) either #1 or #2 at
the option of the franchisor. If the then-current franchise agreement is executed at the time of
transfer, the term is often the remaining term on the seller’s franchise agreement, rather than the
term then being offered to franchisees opening new units. However, if the franchise agreement
requires execution of the then-current agreement, the franchisor is not obligated to offer a lesser
term, and such contractual provisions are generally enforced.

The provisions of the then-current franchise agreement may be very different than the
provisions of the franchise agreement that the seller signed, especially in evolving systems.
Some franchisors attempt to emphasize this by pointing out that the terms may “differ”
(“including financial terms”) or using similar words. At least one franchisor takes the opposite
position in its franchise agreement by specifically stating that royalties will not increase to the
buyer at the time of the transfer. The franchisee and the proposed transferee may complain that
the then-current franchise agreement would change the nature of the business to be transferred.
However, absent statutory prohibition, the franchisor is on firm ground to insist upon execution

arising under the Iowa statute, any condition or provision requiring franchisee to waive a right arising
under the statute is void); Mich. Comp. Laws Ann. §445.1527(b) (stating a provision contained in a
franchise document is void and unenforceable if it requires franchisee to assent to a release or waiver
which deprives it of its rights and protections under the Michigan Franchise Investment Law, although
franchisee is able to settle any and all claims after entering onto franchise agreement); Neb. Rev. Stat. §
87-406 (mirroring language of Arkansas statute); N.J. Stat. Ann. §56:10-7 (mirroring language of
purporting to bind any person to waive compliance with any provision of this law is contrary to public
policy and void.”); Minn. Stat. Ann. §80C.21 (mirroring language of California Franchise Relations Act);
Wishart Act, infra, note 85, S.11.

52 Franchise Management Unlimited, supra, note 6 and accompanying text.
53 Id. at 127-28.
54 See, e.g., Iowa Franchise Act, Iowa Code Ann. § 523H.5(4)(“A franchisee may transfer the franchisee’s
interest in the franchise, for the unexpired term of the franchise agreement, and a franchisor shall not
require the franchisee or the transferee to enter into a new or different franchise agreement as a condition
of the transfer.”).
of the then-current agreement as a condition of the transfer, and we are aware of only one case in which a court has determined that the enforcement of such a condition would violate the law or would otherwise be improper.\textsuperscript{55}

In addition to financial terms, other issues that may change in the then-current franchise agreement are granting additional rights to the franchisor for alternative channels of distribution or reducing the franchisee’s exclusive territory. Territories described as being within a certain radius are more easily reduced at the time of transfer than territories that are uniquely drawn for that particular location.

The “then-current franchise agreement” refers to the franchise agreement then being offered to franchisees opening new units, and this is often specifically stated in the transfer section. Since transferees are entering the franchise system with the same rights and responsibilities of these new unit franchisees, it may be difficult for a franchisee in a transfer situation to argue that the terms are unreasonable. Sometimes, though, a franchisor may not be selling new franchise units and, therefore, does not have a current franchise agreement. In that case, what is the then-current franchise agreement? Does the franchisor have carte blanche to write a franchise agreement specifically for transferees that strips away virtually all rights enjoyed by the transferor franchisee, and proclaim it to be the then-current franchise agreement? Probably not, at least when it involves transferors with “not unreasonably withheld” language in the transfer provision of its franchise agreement or within states that have laws governing franchise transfers. But without a yardstick of reasonableness or case law for guidance, it is fair to say that lawyers representing franchisors and franchisees will have widely differing views on what a transferee may lawfully be required to sign when a franchisor does not have a form franchise agreement that is being offered to new unit franchisees.

From a more fundamental viewpoint, one can argue that the requirement that the transferee sign a then-current agreement vitiates the franchisee’s right, sometimes statutory, to transfer the business (or more specifically, the franchise agreement). If the franchisor requires the transferee to sign a new agreement, then the franchisee is not transferring or assigning the existing franchise agreement (or the business) at all. And the transferee is not acquiring what the franchisee had immediately before the transfer (the right to operate the business under the terms of the prior agreement, until the end of the term of that agreement). It is instead obtaining the right to enter into a new agreement, and presumably buying assets which will enable it to perform under that new agreement. This is not exactly the same as a transfer, and we wonder whether any court would construe the new agreement requirement to violate a statutory or contractual right to transfer. We have found no judicial decisions on this issue.

\textsuperscript{55} See, e.g., Kardell v. Century 21 Real Estate Corp., 2004 WL 2550591 (W.D. Tex. 2004) (claim of interference based upon franchisor’s requirement that transferee execute then-current franchise agreement for full term dismissed); but, see, Culligan Soft Water Service of Inglewood, Inc. v. Culligan Int’l Co., 288 N.W.2d 213 (Minn. 1979)(franchisor could not require transferee to sign a then current franchise agreement where existing franchise agreement provided that franchisor could not withhold consent if certain conditions were satisfied, and signing a then current agreement was not one of the specified conditions).
D. Requirement that transferee remodel or refurbish unit, make other capital improvements or meet updated system standards

As discussed above, franchise agreements typically require the franchisee to be in compliance with the franchise agreement at the time of the transfer. This applies to the condition of the unit. Franchisors may review the store prior to a transfer and require the franchisee to fix deficiencies, such as fixing broken tiles, etc. Some franchise agreements may require a remodel and upgrade to the current image, or a more limited refurbishment at the time of a transfer. However, in most systems, a significant remodel is unlikely at the time of transfer because there is not sufficient time to plan for and complete such an extensive makeover. Rather, franchisors sometimes use transfers as an opportunity to require franchisees to purchase or install certain items that the franchisor could have contractually required but were reluctant to make mandatory for the system. Examples include new exterior signs, new interior signs (e.g., menu board for QSRs), and installation of new equipment needed to sell an “optional” item (now mandatory for the buyer).

E. Transferee must meet franchisor’s financial, operational and other standards

1. The Franchisor’s consideration of sales price

   a. Should a franchisor reject a proposed transferee based upon its determination that the sales price is too high?

   Franchisors typically review the deal points between the seller and the buyer. The franchisor does not want a buyer to overpay for the business. If the buyer overpays, the buyer may not receive a fair return on his investment, which would result in an unhappy franchisee. Even more significantly, the buyer may not be able to keep current with his financial obligations, which would result in damage to the goodwill of the brand and the franchisor not being timely paid. As described further below, in certain situations, a franchisor should reject a transfer if the sales price is too high.

   Courts have generally looked with favor upon a franchisor’s denial of consent to transfer when the franchisor determines, in good faith, that an excessive sales price will cause the franchisee to be unable to meet its commitments under a proposed franchise agreement. For example, in *Burger King Co. v. H&H Restaurants, LLC*, a franchisee asserted claims for breach of contract, breach of the covenant of good faith and fair dealing, and tortious interference as a result of the franchisor’s refusal to consent to a transfer of the sale of 29 restaurants. The franchisor had declined to consent based upon its determination, among other things, that the agreed upon price was too high in light of necessary repairs to be made at the restaurants, and

---

56 2001 WL 1850888 (S.D. Fla. 2001). See, also, *Burger King Corp. v. Ashland Equities, Inc.*, 217 F.Supp.2d 1266 (S.D. Fla. 2002) (granting franchisor’s motion for summary judgment on franchisee’s claims arising from refusal to consent to transfer; reasons articulated for denial included the highly leveraged nature of the transaction and the unrealistic sales projections used by the proposed transferee); *Walner v. Baskin Robbins Ice Cream Co.*, 514 F.Supp. 1028 (1981) (rejecting challenge to franchisor’s refusal to consent to transfer based upon excessive purchase price under the Sherman Act; rejection of transfer was consistent with franchisor’s obligations to protect its trademark and system).
would place both the purchaser and the franchisor at unreasonable risk. The franchisee claimed that the franchisor’s disapproval of the sale was based on arbitrary and pretextual reasons, and the franchisor’s true motivation in disapproving the sale was to force a sale at a drastically reduced price to certain preapproved buyers. The court granted the franchisor summary judgment on the breach of contract claim, since the decision to disapprove the sale was based upon the grounds specifically left to the franchisor’s sole judgment in the franchise agreement. In addition, the court found that because the decision was not capricious nor in contravention of the parties’ reasonable expectations, it did not constitute a breach of the implied covenant of good faith and fair dealing under Florida law. Finally, the court held that because the franchisor had a non-malicious business reason for its refusal of the sale - - that the financial resources of the proposed franchisee were unable to sustain operation of the restaurants given the sale price - - the plaintiff could not show that the franchisor’s sole basis for disproving the sale was malicious. As a result, the tortious interference claim was also dismissed on summary judgment.

b. The review of sales price and financial transaction; break-even analysis

Some franchise systems engage in a break-even analysis of the transfer to ensure that the buyer will be above break-even after the sale is closed. If the store does not break-even, the franchisor rejects the transfer. As a practical matter, the buyer could resubmit the deal with less debt or with financing extended over a longer period of time so that the unit will be above break-even. As noted above, courts have upheld a franchisor’s rejection of a deal that does not break-even. Often, the franchisor relies upon its general right under the franchise agreement to impose reasonable conditions on a transfer. Nevertheless, a provision found in some franchise agreements makes this right clear by stating that the sales prices must not be “so high that the transferee will be unlikely to properly maintain, operate and promote the unit and meet the transferee’s financial and other obligations.”

c. Reasons for higher than market sales price

It’s instructive here to look at the possible reasons for a sales price being higher than the franchisor would expect. There are at least three possibilities: 1) the buyer is valuing the business using a different metric (e.g., larger value based on upward trend in sales); 2) the buyer lacks sophistication and is being taken advantage of; or 3) the seller has two sets of books – one he reports to the franchisor and the IRS and a second one (the actual figures) that he provides to a buyer. If a franchisor suspects the third reason, the franchisor may want to perform an audit on the business to determine if it was paid the correct amount of royalties.

57 Id. at *6.
58 Id. at *7.
59 Id. at *8.
2. Evaluation of buyer: background, education, experience, financial backing

Franchisors often have minimum financial requirements to become a franchisee, typically expressed as a minimum net worth and a minimum amount in liquid assets. Additionally, franchisors often perform a credit and background check on the franchisee candidate. Experience in the particular industry is often not necessary. In fact, franchise systems are typically built on the premise that it can take someone without experience in a particular field and provide that person with the necessary training and support to become proficient in that industry. Education is typically not a prerequisite. A business background is helpful, but again is often not required. Beyond the financial requirements and screening those with criminal records, the requirements become a bit more subjective.

As Confucius taught more than 2500 years ago, “it is the attitude that matters.”\(^{60}\) Today, attitude along with motivation and the commitment to follow the franchisor’s system are important factors in franchisee selection. But, how do you define “attitude,” “motivation” and a “commitment to follow the franchisor’s system?” And are the lack of these qualities legally acceptable reasons for rejecting a transfer when an existing franchisee has a ready, willing and able buyer with a check in his hand?

Due to their importance to franchisee selection, these criteria seem to be proper considerations for a franchisor to rely upon when rejecting a prospective transferee. Depending on the jurisdiction and contract language, however, a franchisor that is unable to articulate clear business reasons for denial may face franchisees’ claims that the stated reason for denial was in bad faith or otherwise invalid.

3. May franchisor require proposed transferee to undergo training?

Either pursuant to an express condition in the parties’ franchise agreement or pursuant to a general or “catch all” condition, a franchisor most certainly can require the proposed transferee to undertake training as a condition of the transfer. In addition, most franchise agreements require the new franchisee (here, the transferee) to undertake training as part of the franchisee’s obligations at the commencement of the franchise term. As a result, training should be viewed as a non-controversial condition to transfer, and we are unaware of any cases in which a franchisor was precluded from requiring the transferee to undertake appropriate training as a condition for transfer.

4. May franchisor require proposed franchisee to pass an English language proficiency exam?

Following a recent trend, a federal court in California recently held that a franchisor’s requirement that a proposed transferee pass an English language test was not unreasonable. In *DeWalshe v. Togo’s Eateries, Inc.*,\(^{61}\) a Togo’s franchisee had found buyers for its business and sought the franchisor’s consent to the transfer. After the prospective buyers failed an English

\(^{60}\) Confucius, *The Analects of Confucius* 7 (Simon Leys trans., 1997).

proficiency test required by the franchisor, the franchisor refused to approve the transfer. The franchisee closed its business and sued, claiming the franchisor breached the parties’ contract and the covenant of good faith and fair dealing by imposing unreasonable conditions on the transfer. The court granted defendant’s summary judgment on the breach of contract claim, noting that the franchisor had proffered substantial evidence that its requirement of English proficiency was a reasonable business requirement in the operation of a Togo’s restaurant. The court noted that the franchise agreement also expressly permitted the franchisor to impose reasonable conditions on the transfer, including passing an English proficiency test. As a result, those breach of contract and implied covenant claims were dismissed.\(^{62}\)

5. **Must franchisor provide an explanation to transferor for its decision to consent or not consent to a proposed transferee?**

If a prospective buyer is rejected, both the seller and the buyer will demand to know the reasons for the rejection.\(^{63}\) The simpler situation is when the franchisee prospect is rejected for an objective reason, such as lack of liquid assets. This can be easily communicated. When the franchisee prospect lacks some of the more subjective requirements, communicating this becomes more challenging, although it may suffice to state that it’s not the right “fit,” unless it is within Arkansas, Nebraska or New Jersey. Often, there are a number of reasons that a franchisee prospect is rejected. When this is the case, any communication should include a reference to all of the reasons so that the franchisor doesn’t get “locked in” to only one justification for the franchisee rejection in subsequent litigation.

6. **May franchisor decline to consent for non-objective reasons?**

A franchisor’s right to withhold consent based on purely subjective reasons turns largely on the state law that governs the franchise agreement and the language of the transfer provision itself in the franchise agreement.

As discussed above, there are a number of states with franchise relationship laws that set forth a statutory standard with which a franchisor must comply when it rejects a proposed transfer. In sum, those states generally require a franchisor to exercise good faith in rejecting a transfer, to not act arbitrarily or capriciously in denying a transfer and/or to provide material reasons for the unacceptability of a transfer. A franchisor that rejects a proposed transfer simply because it does not like the prospective transferee, based on seemingly unsubstantiated reasons, could subject itself to scrutiny by a court and worse, the consummation of the transfer by operation of law.

---


\(^{63}\) As noted earlier, the Arkansas, Nebraska and New Jersey franchise relationship statutes require the franchisor to communicate a material reason for its refusal to consent to a transfer. See *supra* notes 8-14 and accompanying text.
In *VW Credit, Inc. v. Coast Automotive Group, Ltd.*, the court interpreted New Jersey’s Franchise Practices Act to place the burden on the franchisor to present credible reasons supported by substantial evidence to support a denial of consent to a transfer. A transferee’s character, financial ability and business experience were all identified by the court to be relevant for the purpose of determining whether a franchisor’s withholding consent to transfer is reasonable under the New Jersey Franchise Practices Act. It is clear that, under New Jersey law, consent cannot be withheld based on personal animus alone.

On the other hand, in *Brock v. Baskin Robbins, USA, Co.*, the plaintiff brought a claim for tortious interference with contract when Baskin Robbins, its franchisor, declined to consent to a proposed transfer of its franchise. In that case, the franchise agreement entered into between the parties stated as follows: “BASKIN ROBBINS may withhold its consent to transfer of an interest referred to in Section 18.1 arbitrarily and for any reason whatsoever or may condition any consent in their sole discretion.” The court held that the franchisor had an absolute right to reject a proposed transfer and as such, the plaintiff could not succeed on a claim for tortious interference with contract. The case suggests that where there is an express provision allowing wholesale rejection of a proposed transfer, a franchisor may lawfully withhold consent for any reason it chooses or no particular reason at all.

In those situations where there is neither a governing state statute nor an express contractual provision regarding the franchisor’s basis to consent or deny a proposed transfer, a franchisor should be prepared to face a court’s scrutiny if its sole basis for rejection of a transferee is for personal reasons. There is little case law concerning challenges to a franchisor’s subjective decision to decline to consent, such as those based upon personal animus against the transferee or other criteria unrelated to legitimate business criteria. Depending upon your level of cynicism, this could be explained by either the absence of such subjective motivations, or the ability of the franchisor to mask such motivations through the expression of pretextual objective reasons for the decision.

**F. Proposed Sale to Public Company or Private Equity Fund**

In recent years, increasing numbers of public companies and private equity firms have entered the franchise arena, seeking to acquire both franchisors and (primarily multi-unit) franchisees.

Some franchise agreements specifically prohibit any direct or indirect public ownership of its franchised business. Private equity, on the other hand, is more difficult to define. A private

---

56 Id. at *7.
57 But see *KMS Restaurant Corp.*, infra note 89 (suggesting even where franchisor retains a contractual right to disapprove of a transfer, liability can arise out of complicating the business relationship rather than simply denying the right to transfer in the first place).
58 See *Burger King Corporation v. Ashland Equities, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,356 (S.D. Fla. 2002) (holding that, under Florida law, an action for tortious interference will arise where franchisor’s sole basis for rejecting a proposed purchaser is based on spite, bad motive or malice).
equity fund essentially involves ownership by a large number of passive investors. Accordingly, a private equity fund may not qualify to become a franchise in a system that requires its franchisees to be hands-on owners and requires all direct and indirect owners to sign a guarantee and covenant not to compete.

After a number of years in which major franchisors have been acquired by public or private equity firms, these buyers are increasingly turning toward the acquisition of large multi-unit franchisee entities. The acquisition by a private equity firm of a large multi-unit franchise entity presents unique challenges to the franchisor in connection with the transfer process. The private equity firm may have a less strategic focus on the franchises it purchases, instead seeking to revamp management, increase efficiencies, and resell the business in the short term for a large gain. Such nonstrategic owners may focus on aggressive returns on investment, at the expense of continuing to make required investment in the franchised business for the long-term health of that business and the system in general.\(^6\) In addition, the franchisor may have concerns that a private equity owner may use competitive information relative to the franchise system for the benefit of other businesses owned by that owner, including competitive franchise systems. Finally, the franchisor may have difficulty communicating with decision makers at the private equity firm in connection with the continued operation of the franchised businesses after the transfer.

These considerations, and others unique to a particular proposed transaction, require a franchisor to examine a proposed transfer to a private equity firm with increased care and attention. Understanding that any refusal to consent will be met with heightened scrutiny, the franchisor must implement policies and procedures to review private equity transactions, with a view toward making a good faith determination of whether the proposed transfer is in the best interests of the franchisor and the franchise system.

G. Minimum Period of Ownership

Some franchise agreements require that the transferor must operate the unit for at least six months prior to selling (the franchisor wants operators, not developers). This is not a typical provision.

IV. OTHER ISSUES ARISING FROM THE TRANSFER PROCESS

A. Intra-family Transfers

Franchised businesses are often family businesses, employing other family members with the intention that one or more of these family members will take over the business at some point. At the time of transfer to one of these family members (typically an adult son or daughter of the

\(^6\) Private equity firms have contributed greatly to franchising by investing capital to finance growth of both franchisors and franchisees. Private equity firms' involvement in franchising, though, has its pros and cons, a full discussion of which is beyond the scope of this paper. Just as an example, we understand that certain commentators believe that the above discussed potential downsides of private equity investment in franchisees apply to investment in franchisors as well.
franchisee), the family member often has extensive operational experience and training in the franchised system. Also, the franchisor has had an extensive period of time to evaluate their abilities as a potential franchisee. Provided that the family member is qualified, a franchisor has an incentive to facilitate a transfer from the parent who may no longer be involved in the day-to-day operation of the business to a family member who is fully-trained and is operating the franchised unit full-time. Accordingly, this “transfer” is the seamless conclusion of an extended transition to the next generation.

Special considerations may be given to transfers to immediate family members, which may be defined as “the spouse of a person, the natural and adoptive parents, natural and adopted siblings, and natural and adopted children of such person and their spouses.” For example, franchise agreements may sometimes waive or lower transfer fees to transfers within a family. But, mostly, intra-family transfers follow the standard transfer provisions.

B. Divorce

In theory, a divorce is not different than other transfer scenarios. But, in practice, there are unique issues to resolve.

Divorce is typically not dealt with specifically in transfer provisions. It’s left to the standard transfer provisions and the policies of the franchisor. Here’s a typical scenario. A franchised business is owned 50/50 by a husband and wife. They divorce. One spouse mails to the franchisor a copy of the divorce decree that purports to award the franchise to one spouse or the other – without any reference that the “award” is subject to the approval of the franchisor. Then, the franchisor explains its position that this divorce decree is implicitly subject to the review and approval of the franchisor and compliance with any applicable franchise agreement provision. The franchisor then will evaluate the remaining spouse and whether he or she is financially and operationally capable to remain as the sole franchisee. The standard franchise agreements will then apply.

C. Death or Disability of Franchisee

The death or disability of “franchisee” may refer to “any member, partner or shareholder of franchisee” or “a person with any interest” in the franchisee or it may be limited to the death or disability of a “controlling person.”

The death or disability of the franchisee presents unique challenges to a franchisor. Franchise systems are based on the premise that the brand goodwill is protected by the vested interest of an owner-operator who is a skilled manager, trained in the ways of the franchise system and able to oversee the day-to-day operations. If this person is not available, the result may be what franchisor executives most fear: a wayward, mismanaged franchised business that is not following the franchisor’s system. This could translate to dirty locations, poor customer service, etc. Yet, as this is a difficult time for the person’s family, franchisors must be sensitive to the situation and handle it appropriately. This issue is particularly acute for small to medium sized franchisees that do not have the infrastructure of larger franchisees and may not have succession planning in place.
As noted earlier, the California Franchise Relations Act and the Indiana Deceptive Franchise Practices Act prohibit franchisors from preventing a surviving spouse, heir or estate of the franchisee (or a major shareholder of the franchisee) from participating in the ownership of the franchise for a reasonable period after the death of the franchisee (or a major shareholder of the franchisee), provided that the surviving spouse, heir or estate satisfies all of the franchisor’s then-current standards and qualifications. These statutory protections may complicate a franchisor’s ability to ensure that the franchise businesses continue to be operated in compliance with applicable system standards after the death of the principal operator.

Many franchise agreements do not define “disability,” leaving it open to interpretation to what constitutes disability and how long it must continue before the franchise agreement transfer section is triggered. At least one franchisor defines “permanent disability” as “any physical, emotional or mental injury, illness or incapacity which would prevent a person from performing the obligations set forth in this Agreement ... for at least ninety (90) consecutive days.” This franchise agreement further states that this disability will be determined by a physician selected by the franchisor.

Upon death or disability, the executor, administrator, or other representative of the franchisee has a period of time to sell the business, some examples of which are 120 days, 6 months, a reasonable period not to exceed 9 months, 12 months, or a timeframe established by the franchisor. The typical franchise transfer fee may apply, but some franchisors waive the transfer fee for this situation.

Based on the above, the interim period between the triggering event of death/disability and the actual transfer to an approved and trained franchisee may be a very long period of time. Furthermore, if the deadline to transfer is not met, the franchisor may feel compelled to extend the time period. So, what happens during this interim period? And how can the franchisor protect the goodwill of the business? Many franchise agreements are silent on handling this interim period and, accordingly, the units are in franchise “no man’s land” pending the sometimes long process of settling the estate and an eventual sale of the business. In an effort to tighten this up, there are two additional provisions that may be used to deal with this interim period: appoint interim management and an option to purchase.

One way some franchisors provide for this interim period is to plan for the possibility of appointing interim management. Some franchise agreements require the franchisee to appoint a qualified interim manager that is approved by the franchisor (provisions include: reasonable period of time not to exceed 7 days or 90 days). Other franchisors reserve the right in the franchise agreement to assume the management of the business (sometimes with a fee payable to the franchisor) or appoint a manager. Another way to provide for this interim period is to provide the franchisor with an option to purchase the unit upon the franchisee’s death or disability; although this is not a typical provision.

70 See notes 15 & 16, supra., and accompanying text.
D. Right of First Refusal

Many franchise agreements grant the franchisor a right of first refusal in connection with the proposed transfer of the franchise. Specifically, these provisions typically require that the franchisee present every offer to purchase the franchise to the franchisor, together with information on the specific terms and conditions of the offer, and that franchisor has a specified period of time in which to acquire the franchise at the price and under the terms offered by the third party. Depending on the sophistication or complexity of the right of first refusal provision, the franchisor may have the right to negotiate different terms than those presented by the third party offer. In the event the franchisor declines to exercise its right of first refusal, the franchise agreement typically requires that the proposed transfer is subject to the same standard approval process for all transfers, including, without limitation, that the transfer must be approved in advance by the franchisor.

1. Typical Right of First Refusal Provisions

One franchise agreement for a major franchisor simply states as a condition of transfer that the franchisee “first offer, in writing, to sell the [unit] to us on the same terms and conditions offered by a bona fide third party purchaser ....” Other Rights of First Refusals continue for more than a page. Right of First Refusal provisions may include the following:

a. Timing: Thirty, forty-five and sixty days are typical deadlines for the franchisor to exercise the Right of First Refusal.

b. Documents for Review: In addition to a copy of the “offer,” the provision may provide for additional documents that the franchisor may need to analyze the offer – usually expressed in very general terms such as “additional information concerning the proposed transaction that we may reasonably request.” This may include documents and information such as a copy of the lease, financial information, tax returns and any other documents provided to the proposed buyer. The franchise agreement may state that the time does not begin running until the franchisor has all of the requested documentation, in addition to the “offer.”

c. Consideration: Some franchise agreements provide that the franchisor may “substitute cash for any other form of consideration.”

d. Assignable: Some franchise agreements provide that the Right of First Refusal may be assignable by the franchisor. This may be used by the franchisor to assign the sale to another franchisee, who is better suited to operate the store (e.g., is an excellent operator who has units in close proximity).

e. Documentation Needed for Transfer to Franchisor: One issue that arises is that the “offer” may be, to only somewhat exaggerate to make the point, a few scribbles on a napkin and it purports to be the full and final agreement. The price looks good, but it’s missing certain provisions common in a Purchase and Sales agreement such as indemnification and warranty of title. This may cause some concern to the franchisor who is required to take the deal “as is.”
Franchisors would likely take the position that it implies warranty of title, etc. To remove any doubt, some provisions include the following statement:

“If we or our designee accept the assignment, we will be entitled to all of the customary representations and warranties given by the seller of assets of a business, including (without limitation) representations and warranties as to ownership, condition of and title to assets, liens and encumbrances on the assets, validity of contracts and agreements, and your contingent and other liabilities affecting the assets.”

2. Why is this an issue?

At first glance, it would appear that a dispute would never arise based on the Right of First Refusal. After all, a franchisee should not care whether the franchise agreement has a Right of First Refusal (many franchise agreements have this provision) nor care whether a franchisor exercises the Right of First Refusal. At the end of the day, the franchisee always gets the full market value for his business, right? Well, it’s not that simple.

a. Effect of Right of First Refusal on Price

Proposed buyers of franchised businesses may be reluctant to expend considerable time and effort into due diligence and negotiating a deal with a franchisee knowing that a franchisor may snatch it away from them by its exercise of the right of first refusal. Consequently, some believe that a franchised business may be more difficult to sell to a third party and/or command a lower sales price if the franchise agreement contains a Right of First Refusal provision.

b. Seller's Initial Price May be Below Market Price

When negotiating a sale with a prospective buyer, the franchisor’s Right of First Refusal may not always be “top of mind” to the existing franchisee. Thus, a franchisee may put together a deal without considering the implications of this right of the franchisor. This proves to be particularly problematic if the sales price is below “market price.” This leads to the question: why would the sales price be below its market value?

Well, there are a number of possible reasons for this, with both altruistic and sinister motives. Examples of the altruistic motive are that a franchisee may be selling the business to a family member, a friend, or a long-term employee who they would like to reward with the opportunity to take over the business at a lower than market price. Examples of the sinister motive, on the other hand, are that a franchisee may understate the true purchase price (and pay part of the consideration in cash or otherwise outside of the “official transaction”), in order to pay a lower transfer fee to the franchisor (for systems whose transfer fee is based on the sales price), pay lower commissions to a business broker, or pay lower taxes or other payments to governmental authorities.

Whatever the motive, the franchisee will get a rude awakening when the franchisor exercises the Right of First Refusal. Thus, in the case of a sales price below market value, the
existing franchisee will have an incentive to dispute the franchisor’s exercise of the Right of First Refusal.

3. Disputes

As noted above, a seller may have an incentive to contest the franchisor’s exercise of a Right of First Refusal. One possible area of contention is whether the franchisor timely exercised the Right of First Refusal. Sending the “offer” to the franchisor is perhaps the only time when the Notice section in the franchise agreement to the franchisor comes into play. Sometimes the offer can sit in the trunk of the field representative’s car or bounce around the franchisor’s home office until it finds its way to the appropriate person. To tighten this up, one franchisor specifies that Notice must be sent to the attention of the legal department and that: “Notices to Franchisor will not be effective unless sent to the attention of the Legal Department.”

Clear communication between franchisor and franchisee is critical to avoiding disputes concerning transfer, and more specifically, the exercise of a right of first refusal. The interplay of a request to transfer and an exercise of a right of first refusal may give rise to disputes between the parties. For example, in *Mason County Drugs, Inc. v. Medicap Pharmacies, Inc.* 71, a franchisee sought to transfer certain tangible assets of its business, as well as intangible assets such as phone numbers, goodwill and customer lists to a third party. The franchisor refused to consent to the transfer pursuant to the parties’ franchise agreement, which stated that the franchise business could not be assigned without the prior written consent of the franchisor, which permission would not be unreasonably withheld upon satisfaction of contractual conditions. In the inevitable lawsuit that followed, the franchisee did not allege that its franchisor unreasonably withheld its consent to transfer. Instead, it alleged that once the franchisor affirmatively chose not to exercise its right of first refusal, it essentially waived its right to withhold consent to the proposed transfer. The court disagreed, however, stating that the agreement specifically provided that the franchisor’s rights were cumulative, and that it was clear from the agreement that all the conditions and requirements had to be satisfied under the agreement before the transaction could occur. As a result, the court denied plaintiff’s motion for summary judgment, and further held that the franchisor did not act outside of its rights in connection with the proposed transfer, and that the franchisee was not free to consummate the proposed transfer without the franchisor’s consent.

In *Victory Lane Quick Oil Change, Inc. v. Hoss,* 72 a franchisee’s premature sale of the assets of its franchised business, notwithstanding the franchisor’s expressed intent to exercise its right to purchase the assets of the business, resulted in litigation between the parties. In *Hoss,* the franchisee notified his franchisor that he had decided to retire from the business and would not be renewing his franchise agreement. In response, the franchisor notified the franchisee that under the terms of the franchise agreement, it intended to exercise its option to purchase the assets of the franchisee’s business. However, the franchisee had already disposed of or transferred a substantial amount of the assets of the franchised business to members of his family. Because the franchisee did not extend the franchisor’s right of first refusal to purchase the assets of the franchise on the same terms and conditions as he had offered to his family, the

---

71 2006 WL 328255 (N.D. Ill. 2006).
franchisor filed suit, alleging trademark infringement, dilution, unfair competition, and breach of the franchise agreement. The franchisee moved for partial summary judgment on the franchisor’s specific performance claim, contending that the right of first refusal in the franchise agreement was void and unenforceable under the Michigan Franchise Investment Law, and was contrary to public policy. Rejecting the motion, the court noted that the Michigan Franchise Investment Law does not render unenforceable a right of first refusal in a franchise agreement. Further, the court noted that where the franchisee transferred ownership of his business, he failed the requirement of dealing in good faith with the franchisor that held the right of first refusal. Therefore, not only was the franchisee’s motion denied, but the court made a preliminary determination that the franchisee may have violated his obligation of good faith and fair dealing under the franchise agreement.  

Failure to communicate its intent to exercise its right under a right of first refusal can also lead to difficulties for the franchisor. For example, in Bowser Cadillac, LLC v. General Motors Corp., the franchisee and a transferee, Bowser, agreed on terms in connection with the purchase of a dealership from a franchisee and sought the manufacturer’s approval. The manufacturer requested additional information and ultimately denied the transfer and stated that it intended to exercise its right of first refusal to acquire the dealership. Bowser responded that the manufacturer did not exercise its right of first refusal on a timely basis, and sued for tortious interference. On a motion to dismiss, the manufacturer argued that it had a privilege to interfere because its contractually provided for right of first refusal was a legally protected interest that was exercised in good faith. The court ruled that the issue was not whether the manufacturer had a contractual right of first refusal, but rather whether it effectively exercised its right of first refusal, which depended on whether its notification was timely. Because the issue could not be determined solely based on the pleadings, the court denied the manufacturer’s motion to dismiss the complaint.

E. Extensive Franchisor Involvement in the Transfer Process

1. Disclosure Issues

Does the approval of a franchise transfer implicate federal or state disclosure requirements? The answer to that question largely depends upon the extent of the involvement of the franchisor in the transfer process.

United States federal and state law, and Canadian provincial franchise laws, requires a franchisor to comply with franchise disclosure rules in connection with the “offer” or “sale” of a franchise.

---

73 Id. at *10.
74 Id.
76 But, see, Daneshgih v. Texaco Refining and Marketing Inc., 3 Cal.App.4th 1262, 6 Cal.Rptr. 515 (Cal. App. 4th Dist. 1992)(gasoline franchisor did not waive its statutory right to repurchase one of its franchisees after withholding consent to the franchisee’s proposed sale to a third party by either passage of time or by franchisor’s approval of the proposed purchaser’s credit application and training of the proposed purchaser’s brother; franchisor’s actions did not constitute the express approval of the purchaser as a franchisee, and therefore could not act as a waiver of its right to purchase the franchise.).
franchise (unless the transaction is otherwise exempt). A franchisor’s consent to a transfer of a franchised business may, in fact, constitute an offer or sale of a franchise, thereby triggering franchise disclosure obligations. Franchisors must, as a result, carefully consider the extent of their involvement in the transfer process, and enact systemic guidelines that trigger compliance with applicable disclosure rules in the event that the franchisor’s involvement rises to the level of an offer or sale of a franchise.

The Amended Federal Trade Commission Franchise Rule (the “Amended FTC Rule”) requires franchisors to comply with franchise disclosure rules in connection with the “offer” or “sale” of a franchise unless the transaction is otherwise exempt. The Amended FTC Rule’s definition of the sale of a franchise specifically addresses the issue of whether a franchisor’s role in the transfer process constitutes a sale of a franchise, as follows:

The sale of franchise includes an agreement whereby a person obtains a franchise from a franchise seller for value by purchase, license, or otherwise.... It ... does not include the transfer of a franchise by an existing franchisee where the franchisor has had no significant involvement with the prospective transferee. A franchisor’s approval or disapproval of a transfer alone is not deemed to be significant involvement.

Thus, absent a separate exemption, a franchisor must comply with applicable franchise disclosure obligations unless the franchisor has had “no significant involvement with the prospective transferee.” What “significant involvement” means is obviously a fact-intensive inquiry, and the cases do not provide any significant guidance. The cases confirm that the applicability of these disclosure statutes turns upon the extent to which the franchisor controls the transfer process. The definition does expressly provide that, by itself, a franchisor’s consent or withholding of consent to a transfer does not represent “significant involvement.”

The Amended FTC Rule, also, exempts from the scope of its disclosure requirements “existing franchisees who sell only their own outlet and who are otherwise not engaged in franchise sales on behalf of the franchisor.” Four states – Hawaii, Illinois, Indiana and Michigan – have also created both disclosure and registration exemptions for franchisee sales of

---

77 Amended FTC Rule, 16 CFR §436.2 (2007).
79 See, e.g., Drake v. Maid-Rite Co., 681 N.E.2d 734 (Ind. Ct. App. 1997) (master franchisee’s sale of existing restaurant was exempted from disclosure under the Indiana Franchise Act because the sale was made “for his own account” and was “not effected by or through the franchisor”); Interstate Automatic Transmission Co. v. Harvey, 350 N.W.2d 907 (Mich. Ct. App. 1984) (holding that the franchisor controlled the assignment of the franchise agreement from an existing franchisee to transferee, thereby requiring it to provide the transferee with a franchise prospectus as required by the Michigan Franchise Investment Law).
80 Note that there is no similar provision under the original (1979) version of the FTC Rule in the definition of a sale of a franchise. However, it would seem apparent that a franchisor need not comply with applicable franchise disclosure rules in the absence of significant involvement in the transfer process. See, generally, Interpretive Guides, 44 FR at 49969, Bus. Fran. Guide (CCH) ¶6220.
81 16 CFR §436.1(j).
existing units. Ten other registration states specifically exempt only the registration component of the statutory scheme.

Most state disclosure statutes that address the transfer of a franchise follow the lead of the Amended FTC Rule. Note that while these statutes generally exempt transfers that are not "effected by or through the franchisor" from registration and disclosure obligations on the part of the franchisor, the statutes often impose conditions upon the transferee and/or the franchisee in connection with such transfers. Such conditions may, for example, limit the franchisor's role in the process; limit the franchisee's ability to effect or broker numerous transfers; or require the franchisee to provide access to its books and records or provide the prospective transferee with a copy of the franchisor's current disclosure document.

Moving north of the border, Ontario's Arthur Wishart Act exempts a franchisor from the otherwise applicable disclosure requirements in connection with a transfer by a franchisee provided that "the grant of the franchise is not effected by or through the franchisor." The Wishart Act, similar to the Amended FTC Rule, carves out an exemption for a franchisor that merely approves or disapproves of the transfer or receives a transfer fee.

Counsel should be aware that the Canadian courts have construed the Wishart Act exemptions to disclosure in the context of a transfer narrowly. For example, in 1518628 Ontario, Inc. v. Tutor Time Learning Centres, LLC, the Ontario Superior Court of Justice held that a franchisor's imposition of a condition that the spouse of the transferee's principal shareholder sign a personal guarantee meant that the grant of the franchise was "effected by or through the franchisor" for purposes of the Wishart Act. Critically for the court, that condition was not contained in the parties' franchise agreement, and the court held that the franchisor's imposition of any condition not expressly set forth in the parties' franchise agreement constitutes sufficient involvement in the process to trigger the disclosure obligations under the Wishart Act. As a result, franchisors subject to the Wishart Act should take care to make sure that the franchise agreement specifically enumerates all conditions and other elements of the approval process that must be satisfied as part of the transfer. The Tutor Time case teaches that if a condition not expressly provided for in the franchise agreement is imposed by the franchisor, the franchisor must provide a disclosure document and otherwise comply with the disclosure provisions of the Wishart Act.

---

86 Wishart Act, S.5(a).
In sum, whether a franchisor’s involvement in the transfer process rises to the level requiring disclosure is more of an art than a science, and franchisors are cautioned that compliance, as a matter of course, may be the safer practice in applicable jurisdictions. Certainly, to the extent that a franchisor’s involvement in the transfer process is more than a simple approval or denial of consent to the transfer, and instead involves more significant participation in the process, franchise counsel should consider the franchisor’s potential disclosure obligations. Further, franchisors may consider whether disclosure, as a matter of course, in a transfer situation is beneficial to the franchisor, on the theory that providing the prospective transferee with more information will better enable that proposed transferee to make an informed decision and understand its potential obligations under the franchise agreement. While providing such disclosure may elevate the franchisor’s involvement in the transfer (perhaps to the chagrin of the franchisee), such involvement may enable the franchisor to better evaluate the proposed transferee.

2. Other Statutory Considerations

In addition to franchise disclosure statutes, a franchisor’s involvement in the transfer process may have other statutory implications. For example, state licensing requirements may be triggered by a franchisor’s involvement in the transfer process.

Many states have enacted real estate and business broker licensing schemes pursuant to which such brokers must be licensed by the state in order to participate in real estate and business sales (and enforce contractual rights derived therefrom, including compensation). A franchisor may inadvertently be considered a real estate broker or business broker in connection with his involvement in the transfer process. Making this determination, courts often look to the facts of the sales process itself and the transaction at issue to determine whether the sale of the real estate or business was central to, or incidental to, the entire transaction. Further, a number of such statutes specifically exempt franchise sales from the definition of a real estate broker or business broker.  

3. Franchisor’s communications with proposed transferee regarding financial information

Prospective buyers sometimes request that the franchisor verify the accuracy of information received by the selling franchisee. Should the franchisor choose to provide this information to the prospective buyer, this is not an unlawful Financial Performance Representation (“FPR”), formerly called “Earnings Claims.”

At first glance, financial information provided to prospective buyers meets the definition of FPRs, which cannot be provided to prospective franchisees outside of Item 19 in the FDD:

[A]ny representation, including any oral, written, or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits, or net

---

88 See, Schnell & Yatchak, supra, note 2.
profits. The term includes a chart, table, or mathematical calculation that shows possible results based on a combination of variables. 16 C.F.R. Section 436.1(e).

Note, however, that this financial information falls within the following exception:

If a franchisor wishes to disclose only the actual operating results for a specific outlet being offered for sale, it need not comply with this section, provided the information is given only to potential purchasers of that outlet. 16 C.F.R. Section 436.5(s)(4).

The above exception is typically used when a franchisor is selling a company-owned unit, but the statutory language broadly refers to “outlet being offered for sale” and, therefore, is not limited to a company-owned unit.

Franchisors providing this information may want to consider the following three practices:

1) The selling franchisee should acknowledge in writing that the franchisor may release the information to the prospective buyer.

2) The prospective buyer should acknowledge in writing that he or she is receiving this information solely for the purpose of the potential purchase of that specific unit.

3) When disclosing the information to the prospective buyer note that the franchisor is simply passing along information reported to it and that the franchisor has not audited the information or otherwise verified its accuracy.

4. May franchisor review and insist upon changes to Purchase Agreement between franchisor and proposed transferee?

A number of interesting cases demonstrate the danger of a franchisor becoming too involved in the transfer process. When a transfer is ultimately not successful, the disappointed franchisee and proposed transferee often will assert claims against the franchisor not only based upon its refusal to consent to the transfer, but upon its active role in the transfer process.

For example, in KMS Restaurant Corp. v. Wendy's International, Inc., the plaintiff attempted to purchase twenty-seven Wendy’s restaurants in Florida from Citicorp. Citicorp had agreed to the sale, subject to the franchisor’s approval. An employee of the franchisor allegedly told the plaintiff that the sale would definitely be approved with the condition that the plaintiff associate with a specified member of the franchisor’s Board of Directors. This representation led to a series of events in which the Director was sold an interest in the venture, which he then relinquished. Ultimately, the franchisor declined to approve the sale because of concerns about the plaintiff’s corporate structure. Predictably, plaintiff sued, and at trial, the jury awarded $5.1 million dollars to the franchisee on its claims against the franchisor. On appeal, the 11th Circuit affirmed that use of improper methods by the franchisor may support a tortious interference claim even when the defendant did not act solely out of malice, and remanded for further

89 361 F.3d 1321 (11th Cir. 2004).
proceedings. While the appeal addressed additional issues unrelated to the transfer claims, the jury verdict highlights the dangers of becoming overly involved in the transfer process.

F. Resale Assistance Programs

Much of the transfer process is similar to the process a franchisor uses to sell and open new franchised units. For example, in both the transfer and new sales processes, the franchisor: 1) qualifies the prospect; 2) collects fees; 3) trains; and 4) prepares and executes the franchise documents. As described in the definition section, the term “Franchise Resale Program” refers to a program in which franchisors provide assistance in the process, such as lead generation, general assistance and overall guidance, many times for a fee.\textsuperscript{90}

Franchisors have differing levels of participation in the transfer process. Should they simply be involved or should they be committed to the resale? Motivational speakers sometimes describe the difference between involved and committed as this: in a bacon and egg breakfast, the chicken was involved, the pig was committed. So, should franchisors be like the chicken and simply provide the opportunity, or be more committed to the resale?

To illustrate the varying levels of participation, picture the left side of the continuum being the franchisor’s minimal involvement in the process: verify financial qualification, credit and background check and perform a short personal interview. On the right side of the continuum, the franchisee tells the franchisor that he or she is interested in selling the franchised business and the franchisor pretty much takes it from there. A “Franchise Resale Assistance Program” is a formal resale assistance program that is in the middle or to the right of the above described continuum.

1. Advantages of a Franchise Resale Assistance Program

Franchisors are in the business of selling and supporting franchised businesses. Accordingly, franchisors are experts in identifying and qualifying prospects to purchase new franchised businesses – and closing deals! Franchisors, therefore, have skill sets that would be helpful in assisting with a resale.

One challenge in dealing with transfers is that an existing franchisee may present only one franchise candidate for a transfer, who qualifies financially, has a clean background and has some relevant experience, but in the interview has a bad attitude. The franchisor may find it difficult, legally and otherwise, to reject the franchise candidate because the franchise sales manager got a “bad vibe” or didn’t like the “cut of his jib.” If the franchisor has an active resale assistance program, the franchisor can recruit and prequalify other franchise candidates that more closely fit the needs of the franchisor. This would allow the franchisor to raise the bar of the franchise system.

The skill set necessary to operate an existing franchised business is typically distinct from the skill set necessary to open a new unit. Opening a new unit involves site selection, construction oversight and other related skills while operating a franchised business requires

\textsuperscript{90} See, \textit{Schnell \& Yatchak, supra}, note 2.
managerial, financial and customer service skills. Thus, some franchise prospects may be better suited to purchasing an existing unit rather than developing and opening a new one. Franchisors that have a resale assistance program can pre-screen prospects and classify them as more suited to opening a new unit or an existing unit.

Lastly, another potential benefit of a resale assistance program is to facilitate the exit of non-compliant franchisees. Assisting non-compliant franchisees to sell their franchised businesses raises the bar of the franchise system and also lessens the likelihood of disputes and eventual litigation with that non-compliant franchisee.

2. Disadvantages of a Franchise Resale Assistance Program

As discussed in Point IV.E., supra, federal and state franchise disclosure laws may be applicable to the franchise transfer process in the event that the franchisor has substantial involvement in, or controls, the transfer process. The concerns in connection with an individual transfer apply, with greater force, to any franchise resell program. Almost by definition, a formalized resale program substantially involves the franchisor in the transfer process, thereby triggering the applicability of federal and state franchise disclosure statutes.

Additionally, selling an existing business is quite different than selling a new franchise. Therefore, the franchisor would need to train its people and establish an infrastructure to properly implement this. There would be competition between new franchises and resales and, thus, the financial incentive for the resale program would need to compensate for transfer fees being lower than initial franchise fees, and much time would be needed to participate in this resale assistance transfer.

Another disadvantage is the potential interplay between the franchisor and the purchase price of the unit. The franchisor does not want to be in the business of setting the purchase price for units in its system. Yet, sellers (particularly those who the franchisor is encouraging to sell) may have unrealistically high asking prices.

3. Conclusion: Franchise Resale Assistance Program

Overall, a franchise resale assistance program may well serve a particular need of a franchise system, such as facilitating the exit of non-compliant franchisees or raising the bar of franchisees entering the system through transfers. If a franchisor has one of these needs, it should consider an active franchise resale program. Otherwise, the franchisor may want to limit its involvement to a more traditional approval process.

V. CONCLUSION

Transferring an interest in a franchised business often implicates a large number of legal and business issues. In order to properly advise the client, a lawyer facing this situation must not only consider the traditional sources of franchise law such as franchise relationship statutes, case law, franchise agreement interpretation and disclosure laws, but must also understand the business aspects of franchising. And if it is not handled properly by a franchisee or its lawyer
(e.g., a transfer without the franchisor’s consent), the franchisor could terminate the franchise agreement!

The triangular relationship between the seller, buyer and franchisor typically involves: 1) a seller who is either being forced out by the franchisor, voluntarily cutting his losses and looking for someone to rid him of the headache, or simply cashing out after a successful run as a franchisee; 2) a wide-eyed buyer who is enthusiastic about embarking upon a new venture; and 3) a franchisor who, depending on your vantage point or level of cynicism, is either acting diligently in good faith in the best interest of the franchise system or acting arbitrarily to the detriment of a good, hard-working franchisee. Often, a franchise system’s fundamental issues (both legal and business) bubble to the surface at the time of a proposed transfer by a franchisee. This cast of characters and storyline can lead to the sort of drama that makes franchise legal disputes and transactions interesting.
EXHIBIT A
A TYPICAL TRANSFER PROVISION

1. ASSIGNMENT

1.01 Assignment By Us

We will have the right to assign this Agreement, and all of our rights and privileges under this Agreement, to any person or business entity, provided that: (i) the assignee must, at the time of assignment, be financially responsible and economically capable of performing Franchisor's obligations under this Agreement, and (ii) the assignee must expressly assume and agree to perform these obligations.

You agree and affirm that we may sell our company, our assets, our Proprietary Marks and/or System to third party; may go public; may engage in a private placement of some or all of our securities; may merge, acquire other business entities or be acquired by another business entity; and/or, may undertake a refinancing, recapitalization, securitization, leveraged buyout or other economic or financial restructuring. With regard to any such sale, assignment, merger, acquisition or financial activities, you expressly and specifically waive any claims, demands or damages arising from our related to the substitution of our name, Proprietary Marks (or any variation thereof) and System; the loss of association with us or identification of us as the "Franchisor" under this Agreement; and, any and all other claims, demands or damages arising from or related to such activities.

If we assign this Agreement, as provided herein, you expressly agree that immediately upon and following such assignment, we will no longer have any obligation – directly, indirectly or contingently – to perform or fulfill the duties and obligations imposed upon "Franchisor" hereunder. Instead, all such duties and obligations will be performed solely by our assignee, and you will never assert, contend or complain otherwise.

1.02 Assignment By You – General

You understand and acknowledge that we have entered into this Agreement in reliance on and in consideration of your singular personal skill and qualifications (or, if you are a business entity, the personal skill and qualifications of your owners and managers), and the trust and confidence that we repose in you (or your owners and managers, if you are a business entity), and that this Franchise Agreement and the franchise conveyed hereunder is therefore personal to you and is your personal obligation. Accordingly, except as provided below, neither all nor any part of your interest in this Agreement; the franchise conveyed hereby; your rights, privileges or obligations under this Agreement; the franchised Business; your franchised [franchise] [Shop/[name for base or center]/Restaurant/School]; the ownership of your franchised Business; or, your rights to use the [franchise] System, Proprietary Marks, Confidential Information and Manual may in whole or in part be assigned, sold, transferred, shared, sublicense or divided, voluntarily or involuntarily, directly or indirectly, by operation of law or otherwise, in any
fashion without first obtaining our written consent in accordance with this Article 0 and without first complying with our right of first refusal pursuant to Section 1.06 below.

Any actual or attempted assignment, transfer or sale of this Agreement, the franchise conveyed hereunder, the franchised Business, your franchised [franchise] [Shop/[name for base or center]/Restaurant/School], any ownership interest in you (if you are a business entity), any of the other interests, rights or privileges identified in the preceding paragraph, or any interest in any of these, in violation of the terms of this Article 0, will be null, void and of no effect, and will be a material and incurable breach of this Agreement which, unless we waive to the breach, will entitle us to terminate this Agreement immediately upon notice to you, with no opportunity to cure.

If you are a business entity, then for the purposes of this Agreement “assignment” includes (without limitation) the transfer, issuance or redemption in the aggregate of more than 25% of the voting power or (as applicable) the capital stock, partnership interest, membership interest or any other species of ownership interest in you (or any lesser percentage sufficient to control your business entity or the franchised Business, as the term “control” is most broadly defined by any United States or state securities and/or corporate and/or partnership law) to any person or entity who is not (i) already a (as applicable) shareholder, member, partner or other category of owner of your franchised Business; (ii) the spouse of such individual; (iii) a trust controlled by such individual; or, (iv) a business entity owned, controlled and composed solely of such individuals in the same proportionate ownership interest as each such individual had in you before the assignment, as provided below. You agree to immediately report to us all such transfers or assignments of ownership in your business entity, even if less than 25%, in accordance with the procedure set forth in our Manual or otherwise.

1.03 Assignment By You – To A Business Entity You Form

If you are an individual and would like to transfer your interest in this Agreement to a business entity you form solely for the convenience of business entity ownership, you must obtain our prior written consent. We will not unreasonably withhold consent if all of the following conditions are met:

A. The business entity must be newly organized and duly formed, and its activities must be confined exclusively to serving as “Franchisee” under this Agreement.

B. You must be the sole owner of all ownership interests in the business entity and its principal officer or manager (as applicable) (or the sole owner of 75% or more of all ownership interests in the business entity, with the remaining owners being your spouse and/or adult children).

C. If more than two individuals serve as “Franchisee” hereunder, each individual must have the same proportionate ownership interest in the business entity as he or she had in the franchised Business before the transfer.

D. You and the business entity must execute an agreement with us under which you and the business entity agreed to be jointly and severally liable for all duties, responsibilities and
obligations to us under this Agreement and expressly agree to be bound by all of the terms, conditions and covenants of this Agreement. Each then-current and future owner of any interest in the business entity must agree in writing to personally guarantee the performance by the business entity of your obligations under this Agreement, and to be individually bound by all of the terms and conditions of this Agreement and any other agreements between you and us, in the form of Exhibit A to this Agreement.

E. Each present and future owner of any interest in the business entity must execute our Confidentiality/Non-Competition Agreement in the form of Exhibit B to this Agreement.

F. The name of the business entity formed by you may not include the Proprietary Mark “[franchise]”, any variant thereof or any word confusingly similar thereto.

G. All of your business entity’s organizational documents and evidences of ownership interests (such as stock certificates) must state that the issuance and transfer of any interest in the business entity are restricted by the terms of this Agreement and subject to our prior written consent.

Any transfer pursuant to this Section 1.03 will not be subject to our right of first refusal below and will not require you to pay to us any transfer fee.

1.04 Assignment By You – Sale To Third Party

You may not sell or otherwise assign or transfer all or any interest in you (if you are a business entity), the franchise conferred by this Agreement, your franchised Business, your [franchise] [Shop/[name for base or center]/Restaurant/School], your right to use the [franchise] System, Proprietary Marks, Confidential Information and/or Manual, or any interest in any of these, to a third party without our prior written consent. If we do not elect to exercise our right of first refusal (as provided in Section 1.06 below), then we will not unreasonably withhold consent to the assignment and sale. You agree that it will not be unreasonable for us to impose, among other requirements, the following conditions to granting consent to the proposed assignment and sale:

A. That the proposed assignee applies to us for acceptance as a franchisee, and furnishes to us the information and references that we request to determine the proposed assignee's skills, qualifications, financial condition, background and history, reputation, economic resources and ability to assume your duties and obligations under this Agreement and any related agreement. You must pay the costs of any such investigation conducted by us.

B. That the proposed assignee (or, if an entity, the principals of the proposed assignee) presents itself for a personal interview at our corporate office, or any other location we designate, at the date and time we reasonably request, without expense to us. We may determine to meet with your proposed assignee at his, her or its principal place of business or residence and, if we do, you will reimburse us for all travel, lodging, meal and personal expenses related to such activity.

A-3
C. That the assignee (or, if an entity, the principals of the proposed assignee) demonstrates that it has the skills, qualifications, ethics, moral values and economic resources necessary, in our reasonable judgment, to conduct the Business contemplated by this Agreement.

D. That the proposed assignee and his, her or its proposed [Business/Store/Shop/Restaurant/General] Manager attend and successfully complete our Initial Training Program before the assignment, and any other training that we reasonably require, at the assignee's expense (which will include our then-current training fee and the cost of the trainee's transportation, lodging, food and other living expenses).

E. That the lessor or sublessor of your [franchise] [name for base or center] Location consents in writing to the assignment of your lease to the proposed assignee.

F. That, as of the date of the assignment, you have cured any existing defaults under any provisions of this Agreement or any other agreement or arrangement with us or our affiliates, and have fully satisfied in all respects all of your accrued and/or then-current monetary and other obligations to us and our affiliates (under this Agreement or otherwise), all sources of financing of your franchised Business and all material sources of supply of your franchised Business.

G. That the assignee executes a new [franchise] Franchise Agreement, and all other agreements required of new franchisees, in the form and on the terms and conditions we then offer to prospective franchisees, which terms and conditions may vary significantly from this Agreement. The assignee will not be obligated to pay another Initial Franchise Fee under the new Agreement but will be required to pay our then-current fees for furnishing our Initial Training Program and any other services we are required to furnish under the new Agreement. The term of the new Franchise Agreement will be equal to the balance of the term of this Agreement. The execution of the new Franchise Agreement will terminate this Agreement, except for your guarantees; any of your obligations to us or our affiliates which remain outstanding and/or unsatisfied; and, the post-termination and post-expiration provisions of this Agreement which, by their nature, will survive.

H. That the assignee has acquired, or will be able to immediately acquire following the execution of the new Franchise Agreement, all permits, licenses and other authorizations required by any federal, state or local, rule or regulation to operate the franchised Business. If applicable law enables you to transfer or assign any of the aforementioned permits, licenses and/or authorizations which you possess to the assignee, then you agree to do so immediately following our execution of the assignee's new Franchise Agreement.

I. That the Total Sales Price is not so excessive, in our sole determination, that it jeopardizes the continued economic viability and future operations of the franchised Business and/or the assignee. "Total Sales Price" means all consideration of every kind paid or payable to you or any other person in connection with, arising out of or relating to the assignment or transfer of the franchise, the Franchise Agreement or the franchised Business, whether money, property or other thing or service of value including consideration received for your Business; your rights under this Agreement; contracts; goodwill; restrictive covenants; your furniture, fixtures, equipment and trade dress elements; accounts receivable; any consulting salary; or, any
other fees or arrangements or other form of consideration, whether the consideration is received in the present or promised to be given to the assignor or any other person in the future (including the highest possible value of any contingent future consideration).

J. That if the assignee is a business entity, then the owners of that business entity must execute a Confidentiality/Non-Competition Agreement in the form of Exhibit B to this Agreement and a Guarantee in the form of Exhibit C to this Agreement.

K. That you, if you are a business entity; all of your owners; and, the assignee (and, if it is a business entity, all of its owners) execute a General Release in the form of Exhibit D of any and claims, demands and causes of action which you, such owners or the assignee may or might have against us and/or our affiliates.

L. That if the assignee is a business entity, all of the requirements of its new Franchise Agreement concerning business entities must be complied with before we will execute the new Franchise Agreement and, as applicable, will continue to be complied with thereafter.

M. That you furnish us with a copy of any proposed contract of assignment (and any related agreements) and, promptly following execution, furnish to us a copy of the executed contract of assignment (and any related agreements).

N. That the assignee, at its expense, upgrade the [franchise] [name for base or center] to conform with our then-current standards and specifications and completes this upgrading within the time reasonably specified by us.

O. That you pay us a transfer fee of ____________.

If we consent to the assignment of this Agreement and/or your franchised Business, we will also consent to the assignment of your lease for your [franchise] [name for base or center] and all other agreements between you and us or our affiliates, and you agree to assign your lease and such other agreements to the same assignee. After the assignment, you will remain liable under all the assigned agreements to the extent they require.

You expressly agree that your obligations to indemnify and hold harmless us and the other Indemnitees under this Agreement extends to and embraces liabilities arising from or relating to, directly or indirectly, any statements, representations or warranties that you may give to or receive from any proposed assignee and/or any claim that you (and, if you are a business entity, your owners, [Business/Store/Shop/Restaurant/General] Manager, management or employees) or your assignee engaged in fraud, deceit, violation of franchise laws or other illegality in connection with the negotiation or consummation of the assignment. As with all other indemnification obligations set forth in this Agreement, this specific indemnification obligation will survive the termination or expiration of this Agreement.

You further understand and agree that our approval of any assignment transaction will not constitute our waiver of any claims against you by us or our affiliates, under this Agreement or otherwise.
1.05 Assignment By You – Transfer Upon Death or Disability

Upon your death or disability (as defined below) (if you are an individual), or the death or disability of your last surviving owner (if you are a business entity), that person’s rights will pass to his or her estate, as heirs, legates, guardians or representatives, as appropriate (collectively, the “Estate”).

The Estate may continue the operation of your franchised Business if: (i) the Estate provides a competent and qualified individual acceptable to us to serve as [Business/Store/Shop/Restaurant/General] Manager and operate your franchised Business on a full-time basis; (ii) this individual attends and successfully completes our next offered Initial Training Program at the Estate's expense; and, (iii) this individual assumes full-time operation of your Business as [Business/Store/Shop/Restaurant/General] Manager within one month of the date you or your last surviving owner (as applicable) dies or becomes disabled. In the alternative, the Estate may sell the Business within six months of the death or long-term disability in accordance with the provisions of Section 1.04 and subject to our right of first refusal under Section 1.06. Failure to comply with one of these alternatives will be a material breach of this Agreement which, unless cured by the Estate as provided in this Agreement, will result in this Agreement being terminated immediately.

“Disability” means any physical, emotional or mental injury, illness or incapacity which prevents or will prevent a person from performing the obligations set forth in this Agreement for at least ninety consecutive days. Disability will be determined either after this ninety day period or, if we elect, at an earlier time following an examination of the person by a licensed practicing physician selected and paid for by us. If the person refuses to submit to an examination, then the person will automatically be considered permanently disabled as of the date of the refusal.

From the date of death or disability until a fully trained and qualified [Business/Store/Shop/Restaurant/General] Manager assumes full-time operational control of the franchised Business, we may assume full control of and operate the franchised Business, but will have no obligation to do so. If we do so, then during this period, we will deduct our expenses for travel, lodging, meals, and all other expenses and fees from the Business's Gross Revenues and pay ourselves a management fee equal to the greater of (i) two times the salary paid to the individual(s) assigned by us to operate the Business, or (ii) 10% of the Business's weekly Gross Revenues. This management fee will be in addition to the Continuing Royalties due us under this Agreement. We will then remit any remaining funds to the Estate. The Estate must pay us any deficiency in sums due to us under this Agreement within ten days of our notifying the Estate of the deficiency. We will not be obligated to operate your Business. If we do so, we will not be responsible for any operational losses of the Business, nor will we be obligated to continue operating the Business.

1.06 Right of First Refusal

Your rights to assign, transfer, redeem or sell any interest in this Agreement or the franchised Business, voluntarily or by operation of law (as provided above), will be subject to our right of first refusal (except in those instances specified above where no such right will
pertain), which right of first refusal we may freely assign to any individual or entity. We will exercise our right of first refusal in the following manner.

A. You must deliver to us a true and complete copy of the proposed assignee’s offer (the "notice") including all its material terms and furnish to us any additional information concerning the proposed transaction and the proposed assignee that we reasonably request.

B. Within 60 days after our receipt of the notice (or, if we request additional information, within 60 days after receipt of the additional information), we may either consent or withhold its consent to the assignment or redemption, in accordance with this Article, or at our option accept the assignment to ourselves or to our designee, on the terms and conditions specified in the notice. If we or our designee accept the assignment, we will be entitled to all of the customary representations and warranties given by the seller of assets of a business, including (without limitation) representations and warranties as to ownership, condition of and title to assets, liens and encumbrances on the assets, validity of contracts and agreements, and your contingent and other liabilities affecting the assets. Any dispute regarding the value of all or any part of the assets or rights proposed to be assigned and/or the consideration proposed to be paid or payable to you or any third party in connection with the proposed assignment shall be determined by a reputable independent appraiser we select, and you and we equally share the expense of, whose determination will be final and binding on us.

C. If you are a business entity and a partial transfer is proposed through the assignment or redemption of more than 25% of your entity’s ownership interests other than to any of your entity’s co-owners, then we or our designee will have the option to purchase not only the interests being transferred but also all remaining interests, so that our resulting ownership will be 100% of your business entity. The price of these remaining interests will be proportionate to the price of the interests initially being offered.

D. Our credit will be considered at least equal to the credit of any proposed purchaser. We may substitute cash for the fair market value of any other form of payment proposed in the offer.

E. If we give notice of exercise of our right of first refusal, we will be given at least sixty days after our notice to prepare for closing. You agree to take all action necessary to assign your lease agreement with the lessor of your [franchise] [name of base or center] Location to us.

F. If we elect not to exercise our right of first refusal and we consent to the proposed assignment or redemption, then you will, subject to the provisions of this Article, be free to assign this Agreement or the franchised Business to your proposed assignee on the terms and conditions specified in the notice if you satisfy the conditions of Section 1.04 for our approval of an assignment and if you close the transaction within sixty days (or such further time as may be stipulated by law, rule or regulation). If, however, the terms specified in your notice are changed, the changed terms will be considered a new offer, and we will have an identical right of first refusal with respect to this new offer. Further, if you fail to close the assignment transaction within sixty days (or such further period of time as may be stipulated by applicable law, rule or
regulation), then our right of first refusal hereunder shall be restored and we may elect to exercise same within thirty days thereafter.

G. Our election not to exercise our right of first refusal with regard to any offer will not affect our right of first refusal with regard to any later or modified offer. If we do not exercise our right of first refusal, this will not constitute approval of the proposed transferee, assignee, redemption or the transaction itself. You and any proposed assignee must comply with all the criteria and procedures for assignment of the franchise, the Franchise Agreement and/or the franchised Business specified in this Article 0.

1.07 No Encumbrance

You will have no right to pledge, encumber, mortgage, hypothecate or otherwise give any third party a security interest in this Agreement, the franchised Business or your [franchise] [name for base or center] in any manner without our prior written permission, which we may withhold for any reason.
BIOGRAPHICAL SKETCH
KEVIN M. SHELLEY

E-Mail: kshelley@kaufmanngildin.com

Kevin M. Shelley is a partner at Kaufmann Gildin Robbins & Oppenheim LLP.

Mr. Shelley represents the firm’s franchise and commercial clients in all phases of litigation, from pre-action investigation through trial and appeal. Mr. Shelley has broad experience litigating and arbitrating commercial cases, including recent cases involving franchise termination; franchise fraud; enforcement of in-term and post-term contractual restrictions in the franchise and employment settings; unfair competition; securities fraud; employment law; and breach of contract. Mr. Shelley has also filed numerous amicus curiae appellate briefs on behalf of the International Franchise Association, in cases involving vicarious liability, franchise fraud and other issues of critical importance to the franchising industry nationwide. Mr. Shelley also regularly represents the firm’s clients before various federal, state, and local administrative agencies.

In addition to litigation, Mr. Shelley is also active in the firm’s transactional practice, especially in connection with merger/acquisition and franchise-related securitization transactions.

Mr. Shelley is a member of the New York State Bar Association’s Franchise Law Committee, the International Franchise Association, and the American Bar Association’s Forum on Franchising. He is the co-author of “Preliminary Agreements: How to Avoid Unintended Contractual Obligations,” 25 Franchise Law Journal 15 (2005); “The Uncharted Boundary Between Fair Competition and Tortious Conduct,” 22 Franchise Law Journal 184 (2003); and “‘Control’ in Franchising and the Common Law,” 19 Franchise Law Journal 119 (2000). Mr. Shelley served as a contributor and panelist at the International Franchise Association’s 2009 Legal Symposium; the American Bar Association’s 2006 Forum on Franchising; and, the Ontario Bar Association’s Second Annual Franchise Law Conference in 2002. Mr. Shelley also served as a contributor to the Practising Law Institute’s “Understanding Franchising Business and Legal Issues” Symposium in June, 2001, and to the American Bar Association’s Franchise Desk Book (2001, and revised in 2007).

A graduate of the Villanova University School of Law (where he served as an editor of the Villanova Law Review), Mr. Shelley also holds two undergraduate degrees from the University of Notre Dame. He has been engaged in private practice since 1992, and has been with Kaufmann Gildin since 1996.

Mr. Shelley is admitted to practice in the state and federal courts in New York and Connecticut.
BIOGRAPHICAL SKETCH
BRIAN BALCONI

Brian Balconi is Vice President and General Counsel of Little Caesar Enterprises, Inc., Blue Line Foodservice Distribution, and other affiliated companies. He previously served as in-house counsel for Dunkin’ Brands and Mail Boxes Etc. Prior to making the move in-house, Mr. Balconi represented franchisees and their trade association in private practice. Mr. Balconi received his Bachelor of Business Administration from the University of Notre Dame and his J.D. from the University of San Diego School of Law. Mr. Balconi currently serves on the ABA Forum on Franchising Corporate Counsel Division Steering Committee and is co-chair of the Forum’s 2009 Community Service Event.