TERRITORY, EXCLUSIVITY AND ENCROACHMENT:
THINKING AHEAD OF THE CURVE AND
DEALING WITH THE FALLOUT

Erika L. Amarante
Wiggin and Dana LLP

Andraya C. Frith
Osler, Hoskin & Harcourt LLP

Karen B. Satterlee
Hilton International, Inc.

October 14 – 16, 2009
Westin Harbour Castle
Toronto, Ontario

© 2009 American Bar Association
TABLE OF CONTENTS

I. Introduction ............................................................................................................1

II. Drafting and Contract Issues Related to Territory and Exclusivity ...................1

   A. Different Types of Territorial Rights ...............................................................1

       1. No Exclusivity ..............................................................................................1

       2. Exclusivity – Radius Protection/Territorial Maps/Other Descriptors.....2

       3. Conditional Grants of Exclusivity ..............................................................4

       4. Right of First Refusal ..................................................................................4

   B. Importance of Reserved Rights and Other Limitations on Exclusivity........5

III. DISCLOSURE REQUIREMENTS FOR EXCLUSIVE OR PROTECTED TERRITORIES .........................................................................................................8

   A. Overview of the New Requirements under Item 12 Of the Amended Rule ..8

   B. Required Disclosures Under Item 12 ..............................................................8

       1. Disclosures Relating to Territories, Locations and Rights of First Refusal .................................................................................................................8

       2. Disclosures Required for Non-Exclusive Territories ...............................9

       3. Disclosures Required for Exclusive Territories .....................................10

       4. Disclosures Required Concerning other Channels of Distribution and Competing Affiliated Businesses of the Franchisor.............10

   C. Canadian Disclosure Requirements .............................................................12

IV. CREATING A PROGRAM TO AVOID ENCROACHMENT CLAIMS ....................13

   A. The Purpose of Impact Policies ....................................................................13

   B. What Factors Should Franchisors Consider in Determining Impact? ......14

   C. Utilizing Impact Studies to Assess Cannibalization ...................................14
D. Commissioning a Third Party Impact Study ..............................................................16

E. Alternative Dispute Resolution ........................................................................16

V. LITIGATING AN ENCROACHMENT / EXCLUSIVITY CLAIM ...............................17

A. Breach of Contract ..........................................................................................17

1. Cases Where the Contract Does Not Provide for any Exclusive Territory .........................................................17

2. Cases Where the Contract Provides for Territorial Protection ..........19

3. When Do Internet Sales Encroach? .........................................................22

B. Implied Covenant of Good Faith and Fair Dealing.........................................24

C. Tort Claims .....................................................................................................28

1. Misrepresentation / Fraud .............................................................................28

2. Tortious Interference ......................................................................................29

3. Breach of Fiduciary Duty .............................................................................30

D. Statutory Causes of Action ..............................................................................31

1. Franchise Relationship Laws .......................................................................31

2. Motor Vehicle Dealership Laws .....................................................................32

3. Unfair Trade Practice Laws ..........................................................................34

4. Antitrust Laws ..................................................................................................35

E. The Canadian Litigation Experience ...............................................................37

VI. Conclusion ......................................................................................................40

Appendix A - Sample Questionnaire ..................................................................42
I. Introduction

Whether to provide a protected, exclusive territory – and how much – is a crucial decision for many franchise systems. Franchisees often look for protected rights, and value them tremendously. Franchisors may be reluctant to provide for a protected territory, especially given the length of most franchise agreements (10-20 years). Any protected territory in a franchise agreement must be clearly stated and fully disclosed to prospective franchisees. Franchisors and their counsel also should think ahead to all possible applications of the chosen language – i.e., what happens if the franchisor decides to distribute its products directly to consumers through a local supermarket, telephone orders, or on the Internet? Similarly, what happens if the franchisor merges with a competitor in the franchisee's protected territory? Whether and when these activities are problematic will depend largely on the language in the franchise agreement.

Because of the quick pace at which technology changes, it is more important than ever for franchise counsel to stay ahead of the curve on these issues. The growth of the Internet as a distribution and sales channel in recent years illustrates this point: many franchise agreements that were drafted 7-8 years ago are already out-of-date with respect to the Internet, eBay, Twitter and other new forms of sales and distribution in cyberspace.

This paper is intended to highlight the issues that franchise counsel should consider when contemplating exclusivity and territorial protections. We begin in Part II of the paper with a brief review of the language that franchise agreements typically use to describe an exclusive relationship (or lack thereof). Part III turns to the disclosure requirements applicable to exclusive relationships in both the United States and Canada. In Part IV, we discuss the considerations involved in creating a program to avoid encroachment claims by measuring impact internally or through a third-party study. Such impact policies must be carefully structured and implemented. Part V ends with a review of recent caselaw on encroachment and exclusivity issues in the United States and Canada.

II. Drafting and Contract Issues Related to Territory and Exclusivity

Set out below are samples of typical clauses found in franchise agreements to address the nature of the franchisee’s rights, the scope of any protection offered by the franchisor and those rights which the franchisor expressly reserves to itself and its affiliates to allow for growth and market expansion, as well as new and alternative methods of distribution.

A. Different Types of Territorial Rights

1. No Exclusivity

In certain industries (for example, lodging and real estate) and in some cases in mature franchise systems regardless of the industry (for example, quick service restaurants), it is common for the franchise agreement to provide the franchisee with no territorial protection. In these situations, the franchisor grants the franchisee a non-exclusive and limited right to engage in the franchised business at a specific site, offering the franchisee no protection from
competition from the franchisor, its affiliates or other franchisees. Sample clauses which provide that the franchisee has no exclusivity and no protection from competition are as follows:

**No Exclusivity - Quick Service Restaurant**

This Agreement does not grant you any territorial rights and you acknowledge and agree that Franchisor and its Affiliates have unlimited rights to compete with you and to license other third parties to compete with you. You understand and acknowledge that this Agreement does not grant you any territorial rights and that there are no radius restrictions or minimum population requirements which limit where we can license or operate another ABC restaurant. You further acknowledge and agree that you do not have any right to exclude, control, or impose conditions on the location or development of any ABC restaurant, other restaurant, store or other method of distribution, under the ABC trademark or any other trademark.

**No Exclusivity - Hotel**

Franchisor hereby grants to Franchisee a non-exclusive and limited license to use the System only at the Hotel. The franchise granted hereunder applies to the location specified in this Agreement and to no other location.

**No Exclusivity – Real Estate**

Franchisor hereby grants to Franchisee a non-exclusive license and franchise (the “Franchise”) to participate in and use the System by conducting the Franchised Business using the trademarks solely in the Territory at the Locations, Subdivision Sales Offices and Satellite Offices described in Exhibit “A.” The Franchise applies only to Franchisee’s Locations, Subdivision Sales Offices, Satellite Offices and purely administrative offices duly approved by Franchisor in accordance with this Agreement and no other places of business, offices, or types of business. For greater certainty, nothing contained in this Agreement shall be deemed to grant Franchisee an exclusive territory. The Franchise applies to Franchisee's Locations, Subdivision Sales Offices and Satellite Offices and no other places of business or offices.

2. **Exclusivity – Radius Protection/Territorial Maps/Other Descriptors**

As discussed above, while some franchise systems do not offer the franchisee territorial protection, many other franchisors do offer franchisees certain exclusive rights. It is important that these exclusivity rights (as well as any rights which the franchisor intends to carve out of the grant and reserve unto itself and/or its affiliates), be clearly identified and specifically defined in the franchise agreement.
Territorial protection can be defined in several ways. Typically, a territory is defined by reference to specific metes and bounds of a geographic area identified in a schedule attached to the franchise agreement or to a mileage radius from the franchisee’s premises. In addition, a protected territory is sometimes defined by reference to particular zip codes or postal codes, county lines, or census data.¹

Set out below is a sample exclusivity clause in a car rental franchise agreement that defines the protected area by reference to a specified radius from the franchisee’s location. Alternatively, franchisors may describe a particular geographic area in a schedule to the franchise agreement. Franchisees must be absolutely clear when describing the physical coordinates or drawing the geographic boundaries of the protected territory (which may include attaching a map of the territory), as uncertainties or inaccuracies in the description of the protected territory can often lead to disputes between the parties.

**Protected Area**

During the Term of this Agreement, Franchisor will not establish or operate or license others to use the System or the Trademarks to establish and operate a car rental business at a facility located within 5 miles from the front door of your Authorized Location.

Although it is generally best to have identified the precise location and size of the protected territory prior to entering into the franchise agreement, where the exact size and boundaries of the protected territory are not known at the time the franchise agreement is entered into, the franchisor may include language similar to the following:

Franchisee has applied for a franchise to own and operate an ABC outlet within a geographic area mutually agreed upon by the parties (the "Territory"). The approximate size of the Territory will be a three (3) mile radius around Franchisee’s Site; however the actual size and dimensions of the Territory may be less than a three (3) mile radius and will depend upon the specific market variables of Franchisee’s Site, including demographics, density, market and development trends, traffic flow and natural and man-made boundaries. Unless the geographic area comprising the Territory is identified on Exhibit A attached to this Agreement at the time you sign this Agreement, the Territory shall be negotiated after you sign this Agreement. Once agreed upon, Schedule “A” shall be modified to identify the exact geographic area comprising the Territory.

While the above sample clause is found in many franchise agreements, if the ultimate protected territory is less than the approximated size provided for in the franchise agreement, this could give rise to disclosure issues under the new requirements under Item 12 of the Amended Rule (see Part III below).

3. **Conditional Grants of Exclusivity**

Where a franchisee is granted exclusive rights, many franchisors will specify that this grant is conditional upon the franchisee remaining in compliance with its obligations under the franchise agreement. Although less common, some franchise agreements will also specify that the franchisor reserves the right during the term of the franchise agreement to reduce the scope of the protected territory in the event there are certain developments or changes in circumstances that cause the franchisor to determine that the protected territory could support an additional franchisee. These developments or changes include changes in the population, demographics, usage of or demand for the franchisee’s products and/or services, or other market or economic conditions in the geographic area. Some franchise agreements will also specify that at the time of renewal or even on a transfer, the franchisor reserves the right to amend the protected area.

Where the exclusivity is conditional and provides the franchisor with some flexibility to offer an additional franchise in the protected territory where there has been such a change in circumstances, the franchise agreement may also provide the franchisee with a right of first refusal in respect of this additional franchise. A sample clause is provided in Section II.A(4) below.

4. **Right of First Refusal**

A franchisee may be granted a right of first refusal in the event the franchisor exercises its reserved right to reduce the size of the protected territory where there has been a change in circumstances which the franchisor believes justifies an additional franchise. Typically such a change is based on specific demographic criteria, such as population or number of households, however, in some limited cases the franchisor reserves a more general right to reduce the territory where there is a change in consumer demand for the system’s products or services or a change in market or economic conditions. In addition, the franchisee may be granted a right of first refusal in respect of a new franchise in the geographic area adjacent to the franchisee’s protected area. We have set out below a sample right of first refusal clause where the franchisor has reserved a general right to reduce the scope of the protected territory based on changes in circumstances:

**Right to Reduce Territory and Right of First Refusal**

Notwithstanding the exclusivity granted to the Franchisee in Section X above, if Franchisor determines based on changes in circumstances which include, but are not limited to, changes in the population, demographics, usage of the Services, drive times, or other market or economic conditions in the geographic area that includes all or part of the Territory, that the Territory could support an additional ABC outlet, then Franchisor will offer Franchisee a thirty (30) day right of first refusal to acquire and operate the additional ABC outlet. The right of first refusal may not be exercised by Franchisee, and Franchisor may operate or grant
rights to another person to operate an ABC outlet within Franchisee’s Territory, if any one of the following conditions is satisfied:

(a) Franchisee is not then in compliance with any material term of this Agreement and cannot cure the non-compliance within thirty (30) days of written notice;

(b) Franchisor determines, in its sole judgment, that Franchisee does not meet Franchisor’s then current standards for new franchisees of ABC outlets;

(c) Franchisor determines, in its sole judgment, that Franchisee lacks the financial resources to develop and operate an additional ABC outlet;

(d) Franchisee fails to sign a franchise agreement (containing our then-current terms and conditions) for the additional ABC outlet within thirty (30) days of the date Franchisor delivers a franchise agreement for signature; or

(e) Franchisee notifies Franchisor that it does not wish to develop and operate an additional ABC outlet within Franchisee’s Territory.

B. Importance of Reserved Rights and Other Limitations on Exclusivity

Where the franchisee has been provided with some level of protection in the form of an exclusive territory, it has become increasingly important, in part due to the court’s findings in Scheck v. Burger King Corp., for the franchise agreement to reserve explicitly certain rights to the franchisor and its affiliates which are not intended to be impacted by the franchisee’s exclusive rights. Set out below are the categories of reserved rights clauses that are typically included in a franchise agreement where the franchisee has been granted exclusivity, as well as a brief discussion of the business and/or legal rationale for including these clauses. Ideally, these reserved rights will be drafted for the benefit of both the Franchisor and its affiliates.

(i) the right to establish and operate, or license any other person the right to establish and operate, a Franchised Business anywhere outside the Exclusive Territory, including under any terms and conditions the Franchisor deems appropriate and regardless of their proximity to the Premises or the Exclusive Territory or their actual or threatened impact on sales within the Exclusive Territory

While the above statement may seem relatively obvious, it serves to reinforce that the franchisee’s exclusive rights are limited to the franchisee’s specifically defined protected territory. Perhaps less obviously, this statement also serves to protect the franchisor from a claim by Franchisee A that Franchisee B, albeit a franchisee located outside of Franchisee A’s protected area, is encroaching on Franchisee A’s territory by drawing customer sales away from Franchisee A’s sales. This statement puts Franchisee A on notice that a “competitor”

---

Franchisee B may be granted the right to operate the Franchised Business in an area adjacent to Franchisee A’s protected territory, regardless of the impact this has or may have on Franchisee A’s sales, and that Franchisee A’s rights are limited to the Exclusive Territory only.

(ii) the right to develop, use and license the use of, at any location inside or outside the Exclusive Territory, proprietary trademarks other than the Trademarks, in connection with the operation of a program or system which offers products or services which are the same as or similar to and which may compete with the Franchised Business

This type of clause allows the Franchisor to engage in any activity – even a competing activity – whether inside or outside of the Franchisee’s Exclusive Territory, as long as the Franchisor is using different trademarks. As a result, the Franchisor can operate one or more competing brands in the same market area. This type of reserved right is often objectionable to franchisees because it allows direct competition by the Franchisors or other franchisees of the Franchisor, albeit using different trademarks.

(iii) the right to develop, market, own, operate or participate in any business other than a Franchised Business under the ABC Trademarks or any other trademarks

This clause serves to clarify that the Franchisee’s exclusive rights are limited to the right to use the particular trademarks in association with the Franchised Business, but that nothing in the franchise agreement or otherwise is intended to limit the Franchisor’s rights to use or license others to use the same trademarks in a non-competing business – even if that business is carried on in the Franchisee’s Exclusive Territory. In the event the Franchisor exercises this right, a debate may arise between the parties as to the exact scope of the Franchised Business and, more particularly, as to what products and/or services may compete with those offered by the Franchisee as part of the Franchised Business.

(iv) the right to distribute or sell, by itself or through its Affiliates or license other persons, including without limitation other ABC Franchisees, to distribute or sell products, including the Products, and offer services, including the Services, through other channels of distribution (including, without limitation, electronic, computerized or other remote-entry ordering systems (such as the Internet), direct mail, mail order catalogues, infomercials, grocery stores, retail stores and department stores), whether inside or outside the Exclusive Territory

Although similar to the specific trademark rights reserved under paragraph (iii) above, this clause is much greater in scope. This clause requires the franchisor and its legal advisor to discuss the franchisor’s possible expansion plans and whether the franchisor envisions growing its business by selling the products and services through alternative channels of distribution. It typically requires the greatest degree of customization when preparing the franchise agreement.

(v) the right to establish and operate, or license any other person the right to establish and operate, an ABC Restaurant at any mall, shopping center, business center, food commissary in industrial or commercial facilities, sporting stadium or similar venue, hospital or other health care facility, high school, college, university or other educational facility, airport, or
public transportation facility, at any location inside or outside the Exclusive Territory

Like the clause in paragraph (iv) above which addresses different channels of distribution, this clause reserves to the Franchisor the right to establish the franchised business in alternative venues, such as hospitals and airports, even if such locations are within the franchisee’s protected territory. Typically these venues enjoy a “captive market” and, on this basis, are not expected to cannibalize the franchisee’s sales.

(vi) the right to establish a website or websites to promote the Franchisor and/or the Franchised Business and/or from which to sell, offer for sale, distribute and/or promote the Products and/or the Services, which website(s) may, in the Franchisor's discretion, include a page specific to each ABC franchisee

While this right is arguably already reserved by the broad provision in paragraph (iv) above, due to the sometimes controversial practice of franchisors selling products and/or services via the Internet to consumers located within the franchisee’s exclusive territory, it is common for franchise agreements to specifically deal with Internet sales in a separate provision. See discussion at Section V.A(3), infra.

(vii) the right to acquire the assets or ownership interests of one or more businesses providing products and services similar to those provided by the Franchised Business in association with trademarks other than the Trademarks, and franchising, licensing or creating similar arrangements with respect these businesses once acquired, wherever these businesses (or the franchisees or licensees of these businesses) are located or operating (including inside the Exclusive Territory)

This right expands upon the right reserved in paragraph (ii) above and clarifies that the franchisor may acquire a competing system that may offer similar products and/or services to the franchisee (which system may include corporate or franchised outlets located within the franchisee’s protected area), provided such products and/or services are associated with the acquired brand and trade-marks.

(viii) the right to be acquired (in whole or in part and regardless of the form of transaction), by a business providing products and services similar to those provided by the Franchised Business in association with trademarks other than the Trademarks, or by another business, even if such business operates, franchises and/or licenses a business involved in the offer or sale of products or services which are the same as or similar to and which may compete with the Franchised Business within the Exclusive Territory

This right complements the right reserved in paragraph (vi) above and addresses the situation where the franchisor may be sold to a competitor who operates or licenses businesses located within the franchisee’s protected area.
III. DISCLOSURE REQUIREMENTS FOR EXCLUSIVE OR PROTECTED TERRITORIES

A. Overview of the New Requirements under Item 12 of the Amended Rule

While the Amended Rule is closely modeled on the old UFOC Guidelines, 16 CFR Part 436.5(l) et seq. has expanded the disclosure requirements in Item 12 regarding the granting of exclusive and non-exclusive territories. Under the Amended Rule, franchisors are now required to disclose: (1) the conditions under which a franchisor will approve the relocation of the franchisee’s business and the franchisee’s establishment of additional outlets; (2) any present plans on the part of the franchisor to operate a competing franchise system offering similar goods or services; and (3) in instances when a franchisor does not offer an exclusive territory, a prescribed warning about the consequences of purchasing a non-exclusive territory.3 The Amended Rule also addresses disclosure requirements for new technologies and market developments, such as the Internet and alternative channels for distributing a franchisor’s goods.4 This section of the paper sets forth the specific disclosure requirements of Item 12 in detail.

B. Required Disclosures Under Item 12

1. Disclosures Relating to Territories, Locations and Rights of First Refusal

Item 12 contains a broad array of requirements meant to ensure that prospective franchisees understand the scope of competition they will face both from their own franchisor and from their fellow franchisees. These requirements are set forth in six subsections. Subsections one through four (16 CFR Part 436.5(l)(1)-(4)) require the franchisor to state basic information concerning the exclusivity that is (or is not) granted including:

(1) Whether the franchise is for a specific location or a location to be approved by the franchisor;

(2) Any minimum territory granted to the franchisee (for example, a specific radius, a distance sufficient to encompass a specified population, or another specific designation);

(3) The conditions under which the franchisor will approve the relocation of the franchised business or the franchisee’s establishment of additional franchised outlets; and

(4) Franchisee options, rights of first refusal, or similar rights to acquire additional franchises.

---

4 Id.
2. Disclosures Required for Non-Exclusive Territories

Subsection five requires the Franchisor to state affirmatively whether it grants exclusive or nonexclusive territories. If the franchisor does not grant an exclusive territory, it is required to include the following warning in Item 12, which must be set forth verbatim:

You will not receive an exclusive territory. You may face competition from other franchisees, from outlets that we own, or from other channels of distribution or competitive brands that we control.

While franchise agreements almost always contain an express grant indicating whether the franchise granted was exclusive or non-exclusive, the FTC stated that the potential financial risks associated with a non-exclusive territory were so significant that franchisors that do not offer an exclusive territory should warn prospective franchisees about such possible risks. Further, the FTC acknowledged that it “generally disfavors the use of warnings that merely repeat what is already expressly stated in the franchise agreement, but believes that a specific warning regarding exclusive territories is warranted in light of the volume and persuasiveness of franchisee complaints regarding territory issues. As noted previously, the FTC is convinced that additional disclosures are warranted where they will likely prevent deception about the nature of the franchise relationship.”

While the delineation between an exclusive and non-exclusive territory may seem relatively unambiguous, many franchisors would prefer to make this “negative disclosure” because they typically reserve the right to engage in other channels of distribution. In its recently released FAQs, the FTC was asked to clarify what constitutes an exclusive territory that would permit a franchisor to omit this disclaimer? The FTC defined “exclusive territory” to mean a geographic area granted to a franchisee within which the franchisor promises not to establish either a company-owned or franchised outlet selling the same or similar goods or services under the same or similar trademarks or service marks.” If the franchise agreement omits “either” commitment, the disclaimer is required.

If, however, the franchisor simply reserves the right to make sales into a franchisee’s territory through alternative channels of distribution (such as through supermarkets) or through other competitive brands, the disclaimer is not required, the rationale is that the disclosures required in 436.5(l)(6)(i) and (iii), (set forth below) adequately cover this information and that further warnings would be “redundant and confusing”. However, the FTC went on to note that “non-traditional franchises that cannot make any such commitment because they do not grant a geographic territory (e.g., Internet-based franchises) are required to include the disclaimer.”

5 16 C.F.R. Part 436.5(l)(5)(i).
6 SBP at page 15493, note 511.
7 Id. at note 512
8 Amended Franchise Rule FAQ's at Question 25, http://www.ftc.gov/bcp/franchise/amended-rule-faqs.shtml#25. Note that the FAQ’s are opinions expressed by the FTC staff and are not binding on the FTC.
3. Disclosures Required for Exclusive Territories

In the event the franchisor does grant exclusive territories, Section 436.5(l)(5)(ii) requires the franchisor to disclose:

(A) Whether continuation of territorial exclusivity depends on achieving a certain sales volume, market penetration, or other contingency, and the circumstances when the franchisee's territory may be altered. Describe any sales or other conditions. State the franchisor's rights if the franchisee fails to meet the requirements.

(B) Any other circumstances that permit the franchisor to modify the franchisee's territorial rights (for example, a population increase in the territory giving the franchisor the right to grant an additional franchise in the area) and the effect of such modifications on the franchisee's rights.

While this sort of information will clearly be set forth in the franchise agreement with a particular franchisee, requiring this information to be set forth in the Franchise Disclosure Document (“FDD”) requires a franchisor to develop a framework for the consistent application of altering or terminating exclusive territories and lessens the chance that a franchisee will be the victim of the inconsistent application of the modification of territorial rights within the franchise system.

4. Disclosures Required Concerning other Channels of Distribution and Competing Affiliated Businesses of the Franchisor

Subsection 6 of the Amended Rule\(^\text{11}\) sets forth the disclosure requirements relating to the franchisor's ability to make sales within the franchisee's territory, whether the territory granted is exclusive or non-exclusive. Franchisors must disclose:

(i) Any restrictions on the franchisor from soliciting or accepting orders from consumers inside the franchisee's territory, including:

(A) Whether the franchisor or an affiliate has used or reserves the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing sales, to make sales within the franchisee's territory using the franchisor's principal trademarks;

(B) Whether the franchisor or an affiliate has used or reserves the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing, to make sales within the franchisee's territory of products or services under trademarks different from the ones the franchisee will use under the franchise agreement; and

(C) Any compensation that the franchisor must pay for soliciting or accepting orders from inside the franchisee's territory.

Likewise, 16 CFR 436.5(l)(6)(ii) requires the franchisor to disclose restrictions on the franchisee's ability to

\(\text {\textsuperscript{11}}\) 16 C.F.R. Part 436.5(l)(6) \textit{et seq.}
(ii) [solicit[] or accept[] orders from consumers outside of his or her territory, including whether the franchisee has the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing, to make sales outside of his or her territory.

Given the increasing importance of the Internet in consumer sales, a careful drafting of the franchisee’s rights to use the Internet and other electronic media or marketing is critical.

Finally, to the extent the franchisor operates or licenses competing franchise systems under a trademark other than that being licensed to the franchisee, the franchisor must disclose:

(iii) If the franchisor or an affiliate operates, franchises, or has plans to operate or franchise a business under a different trademark and that business sells or will sell goods or services similar to those the franchisee will offer, describe:

(A) The similar goods and services;

(B) The different trademark;

(C) Whether outlets will be franchisor owned or operated;

(D) Whether the franchisor or its franchisees who use the different trademark will solicit or accept orders within the franchisee's territory;

(E) The timetable for the plan;

(F) How the franchisor will resolve conflicts between the franchisor and franchisees and between the franchisees of each system regarding territory, customers, and franchisor support; and

(G) The principal business address of the franchisor's similar operating business. If it is the same as the franchisor's principal business address stated in § 436.5(a) of this part, disclose whether the franchisor maintains (or plans to maintain) physically separate offices and training facilities for the similar competing business.

Section 436.5(l)(6)(iii) should be of particular interest to franchisors who manage multiple and arguably competing brands, e.g., a franchisor of multiple hotel brands or various QSR concepts. The Amended Rule now requires the franchisor to disclose the existence of future development plans in non-exclusive territories if they, in fact, have “present plans to operate or franchise a business under a different trademark and that business sells goods or services similar to those to be offered by the franchisee.”12 This should not be confused with simply failing to grant exclusive territories. The FTC felt that further disclosures about future intrabrand expansion were unwarranted because “any prospective franchisee who buys a franchise without any protected territory is essentially taking the risk that the franchisor will further develop the market area.”13

12 SBP at page 15492, note 500.
13 SBP at page 15492.
C. Canadian Disclosure Requirements

While Canadian disclosure requirements are not as detailed as those contained in the Amended Rule, provincial franchise legislation requires franchisors to disclose certain prescribed information regarding the granting of exclusive territories and proximity policies. At present, only three (soon to be four) provinces have a franchise law at all. The specific disclosure requirements relating to territory and proximity are very similar under each of the provincial franchise statutes. In Ontario, for example, every disclosure document must include the following prescribed information:

1. A description of any exclusive territory granted to the franchisee.

2. If the franchise agreement grants the franchisee rights to exclusive territory, a description of the franchisor’s policy, if any, as to whether the continuation of the franchisee’s rights to exclusive territory depends on the franchisee achieving a specific level of sales, market penetration, or other condition, and under what circumstances these rights may be altered.

3. A description of the franchisor’s policy, if any, on the proximity between an existing franchise and,

   i. another franchise,

   ii. any other distributor using the franchisor’s trade-mark, service mark, trade name or logo or advertising or other commercial symbol,

   iii. a franchise owned or operated by the franchisor that distributes similar products or services under a different trade-mark, service mark, trade name or logo, and

   iv. a franchise granted by the franchisor that distributes similar products or services under a different trade-mark, service mark, trade name or logo.

In addition, Canadian disclosure documents must contain all “material facts.” In Ontario, for example, a “material fact” is defined broadly and on a non-exhaustive basis as including "any information about the business, operations, capital or control of the franchisor or franchisor’s associate, or about the franchise system, that would reasonably be expected to have a

---


15 Ontario Regulation, Sections 12 – 14.

16 Alberta Act, Section 1(1)(o); Ontario Act, Section 1(1); PEI Act, Section 1(1)(l).
significant effect on the value or price of the franchise to be granted or the decision to acquire
the franchise.

As a result, while the specific Canadian disclosure requirements around exclusivity and
proximity are not as detailed as those contained in the Amended Rule, due to the general
requirement to include all material facts, Canadian franchisors should consider whether there
are any other facts related to the franchisee’s protected territory (or lack thereof) and the scope
of competition that they may face both from the franchisor and other franchisees that would
have a significant impact on the value of the franchise or the prospective franchisee’s decision
to enter into the franchise agreement.

Finally, many of the same drafting tips and suggestions regarding internal policies and
procedures discussed above in respect of the Amended Rule apply equally when preparing a
Canadian disclosure document. Indeed, Canadian franchisors and their legal advisors can
benefit from the additional details found in the Amended Rule and the guidance offered by the
FTC when preparing a disclosure document.

IV. CREATING A PROGRAM TO AVOID ENCROACHMENT CLAIMS

A. The Purpose of Impact Policies

While one objective of a franchisor choosing to adopt an impact policy is to avoid liability
for encroachment claims, the primary objective of the franchisor should be to ensure that the
franchise system is growing in a strategic manner that enables the system to grow without
having a substantial adverse impact on the business of a franchisor’s existing franchisee base.
A healthy, profitable franchise system enhances brand strength and value by pursuing
development that balances the needs of existing franchisees and the franchisor. As part of
preparing this paper, the authors reviewed several impact policies of major US based
franchisors. While individual impact policies are confidential within the system they serve, the
following section will address typical industry practices for creating and utilizing impact policies.

Impact policies are typically used by franchisors that do not grant protected territories. The
franchisor grants the franchisee the right to operate a franchised unit at one-site specific
location. The franchisor retains the right to grant additional franchises in the immediate area
through additional company operated or franchised units or through alternate, and possibly
competing, brands. Further, franchisors should take care to include a reservation of rights in
their franchise agreements and follow the disclosure requirements relating to the granting (or
not) of protected territories as set forth in Section III supra. Such reservation of rights should
also be restated in the applicable impact policy.

In the event that a franchisor does grant protected territories to some, but not all,
franchisees, the impact policy should expressly state that it is only applicable to franchisees that
have not agreed to a protected territory in their franchise agreement. (If there is a protected
territory in the contract, then the contract language would trump the results of any impact study,
in any event). Further, such policies are meant to serve their existing franchisees only, not
benefit prospective franchise candidates. Whatever the impact policy is, the franchisor will want
to ensure that it retains sole decision making authority over the granting of new franchised units
while being sensitive to the existing franchisee’s viewpoint on the addition of new franchised
units in areas adjacent to the existing franchisee.
B. What Factors Should Franchisors Consider in Determining Impact?

One of the first determinations a franchisor needs to make is how the franchisor will define “impact” in relation to its particular franchise system. Typically impact is defined as the potential for an additional franchised unit to have an adverse impact on an existing franchised unit’s gross revenues. There is typically a threshold amount for impact. This varies by industry but is generally around three to five percent, but may be as much as ten percent. Most franchisors do not consider replacement units for closed franchised outlets in a market eligible for an impact analysis, although if the new unit is larger or otherwise differentiated from the former unit there may be some consideration of these facts in a given impact policy.

As a general rule, when considering development, a franchisor will consider the desirability of the market at issue, the level of saturation with company operated or franchised units and the corresponding effect on existing franchisees. When thinking about impact a franchisor should consider:

- the existence and number of other retail businesses within a certain radius of the proposed site which indicates (or not) separate markets exist that are distinct from one another;
- the physical distance between the new site and existing units;
- population and demographic characteristics of the market;
- the extent of the investment to be made by the new franchisee and the investment already made by the existing franchisee;
- whether existing units are providing adequate market penetration in the market;
- quality of service and management of the existing units in the market;
- the potential positive impact for the brand through increased public exposure to the product; and
- the benefit to the franchised system of increased local marketing dollars for the market.

C. Utilizing Impact Studies to Assess Cannibalization

The key to a well developed impact policy is creating a clear and concise process for franchisees to utilize the policy and prevent cannibalization of the market. The first step in this process is determining which franchisees will be eligible to object formally to new development. Typically the franchisor will begin the process by notifying all franchisees that own and operate a unit within a defined area that an application for a new franchised unit is being considered. Some franchisors with significant company operated components will also notify managers of company operated units within the defined area. Typically the range is within a two to ten mile

---

17 Cannibalization refers to a negative financial outcome on an existing business as the result of a subsequent business decision.
radius of the proposed site. In markets with a large number of franchisees, notice may be restricted to the four to five closest franchisees in the area. In less dense markets, the notice area may be expanded. A franchisor should take care to be clear, to both prospective and existing franchisees, that simply sending a notification letter does not indicate approval of any given site.

The second step of the process is receiving and assessing responses from existing franchisees. Such responses must be received within a defined time period. Failing to follow the process, including the deadline for responses, will generally serve as a waiver by the franchisee of the benefit of the policy, even if the franchisee can show impact at a later date.

If a franchisee is going to object to a new unit, the franchisor will generally require the franchisee to submit that objection and supporting data in a certain format. Information requested may include:

- a review of the existing property including sales history or other relevant data like occupancy rates or other demand generators;
- the driving distance and travel times between the units at various times of the day;
- the current demographic and geographic area from which the existing unit is drawing including specific street names and traffic generators;
- the current demographic and geographic area from which the proposed unit will draw, including specific street names and traffic generators which demographic or geographical areas the franchisee thinks the proposed units will encroach upon;
- any man-made or natural barriers between the existing and proposed units;
- the physical appearance of the existing unit compared to a new store;
- the last remodel of the existing unit and any plans to remodel the existing store;
- what percent of sales the franchisee anticipates the new unit will cannibalize;
- the franchisee’s immediate development plans;
- information regarding marketing activities conducted by the franchisee at a local level in the past year; and
- whether existing locations are providing adequate market penetration and representation for the brand.

A sample questionnaire suggested by the franchisor may be found at Appendix A.
Once the franchisee has submitted the requested materials, the information is reviewed by an individual or committee tasked with reviewing the merits of the objection. This activity is nearly always handled in-house, but in a few systems, the committee may consist of regional councils that include franchisee representatives. While franchisees may be informed of pending applications, it is important that a franchisor not permit franchisees to have veto power on the granting of new franchises. Permitting franchisees to exercise such power has been held to be a horizontal market allocation and an illegal restraint on territories and markets in violation of Section 1 of the Sherman Act. Based upon this review, the committee responds in writing to the franchisee, approving, denying or tabling the application. If the site is approved over the franchisee’s objection, an impact study may be commissioned by the franchisee.

D. Commissioning a Third Party Impact Study

If a franchisee objects to a new franchised unit, and the franchisor is inclined to proceed with the new franchised unit, the franchisor typically has a set process for commissioning an impact study. This process is started by the franchisee requesting the franchisor to engage a consultant from an approved list of suppliers qualified to assess impact for the franchised industry at issue. As a condition to the market study, the franchisor will usually require the franchisee to pay for the study on the front end, reimbursing the franchisee if material impact is found by the consultant. While the list is supplied by the franchisor, the franchisee is generally permitted to select the particular consultant who will perform the actual impact study. The consultant will be asked to review supporting information supplied to him or her by the franchisee and franchisor, as well as any other information that may be relevant to determining impact.

Generally, the franchisor will not move forward with the application during the assessment period, which may be several months in duration. Some franchisors will move forward if such a delay will result in the loss of the location. A finding of impact does not necessarily mean that the franchisor will decline the proposed unit. Rather, some franchisors will negotiate a monetary settlement with the franchisee. Such settlements may include royalty relief, lump sum payments, company purchase of the impacted unit or transfer of the impacted unit to a third party. It is important that the impact policy is clear on the potential outcomes of the process so the franchisee is not left with the impression that the results of the impact study are definitive on the acceptance of the proposed application.

E. Alternative Dispute Resolution

A franchisor may also want to consider having an Alternative Dispute Resolution process in place in the event that the results of the impact study are disputed by either party. Many franchisors include voluntary mediation clauses in their franchise agreements and incorporate mediation or arbitration into their impact policies. If the dispute arises after the new site has been opened, a franchisor may consider a royalty deferral or some other economic relief while the dispute is pending. While the franchisor may want to mediate the economic effect of the new unit on an existing store, it should be cautioned not to mediate the decision to grant the additional unit. The decision to grant franchises should be solely within the purview of the franchisor. A carefully drafted franchise agreement should avoid a colorable claim against the franchisor.

See, e.g., American Motor Inns, Inc. v. Holiday Inns, Inc., 521 F.2d 1230 (3d Cir. 1975). See also discussion at Section V.D(4), infra.
V. LITIGATING AN ENCROACHMENT / EXCLUSIVITY CLAIM

The preceding sections have outlined the contract language that many franchise systems employ when establishing and disclosing territorial protections, if any, in a franchise agreement, as well as the internal processes that may lead to the development of a new (and allegedly encroaching) franchise. Even under the best of circumstances (with full disclosure and extensive impact policies), disputes may arise regarding the scope and enforcement of an alleged or actual exclusive territory. Franchisees often bring claims against a franchisor that sound in contract, typically breach of contract or breach of the implied covenant of good faith and fair dealing. Franchisees have also brought tort claims based on misrepresentation, tortious interference and breach of fiduciary duty, as well as a variety of statutory claims.

For the most part, franchise encroachment claims meet with little success. There are exceptions, however, and the analysis of contract, tort and statutory claims will often hinge on the contract and disclosure language itself. Thus, it is important for the transactional lawyers who draft the franchise agreements and FDDs to understand the various ways in which courts might interpret that language. The following summary of recent caselaw aims to highlight the lessons that can be learned from franchise litigation regarding an encroachment or exclusivity claim.

A. Breach of Contract

The most common claim for franchisees to bring in an encroachment case is for breach of contract. Plaintiffs will ask the court to interpret allegedly ambiguous language in the franchise agreement or the FDD. Some plaintiffs will allege that oral statements have altered the written contract, or that the impact policy itself constituted a contract – a claim that rarely succeeds when a contract is fully integrated.

Courts employ general principles of contract interpretation when resolving whether a franchisee has a valid claim to an exclusive territory. Unambiguous contract language will be given its natural and unequivocal meaning. Ambiguous language is subject to interpretation using the usual interpretative aids.

1. Cases Where the Contract Does Not Provide for any Exclusive Territory

Where a franchise agreement does not provide for any exclusive territory or rights beyond a particular location, courts will often grant summary judgment for a franchisor or dismiss encroachment claims based on breach of contract. For example, in *Domed Stadium Hotel, Inc. v. Holiday Inns, Inc.* the court affirmed the grant of summary judgment to the franchisor, rejecting an encroachment claim because:

The franchise agreement grants the [plaintiff] Superdome Hotel the right to operate a Holiday Inn hotel at a specific site. It specifically states that the license

19 Ms. Amarante would like to acknowledge Wiggin and Dana LLP associate Richard Ramsay for his assistance in the preparation of this paper.

20 For this paper, we have tried to focus on recent cases, i.e., within the last 10 years, where possible. For a review of older cases, see Ronald R. Fieldstone, *Franchise Encroachment Law*, 17 FRANCHISE L. J. 75 (Winter 1998).

21 732 F.2d 480 (5th Cir. 1984).
is not exclusive, and that Holiday Inns may ‘construct and operate one or more
Holiday Inns at any place other than on the site licensed.’ Nothing could be
clearer than the fact that Holiday Inns did not grant the Superdome Hotel a
territorial license, and that consequently Holiday Inns did not breach the express
terms of the franchise agreement . . . .”

Similarly, in *Eichman v. Fotomat Corp.*, the court affirmed a grant of summary judgment to the
franchisor, rejecting a breach of contract claim asserting encroachment because “[n]o exclusive
market area or territory is set forth in the contract,” and “we have stated previously that as a
general rule where there is no express grant of an exclusive territory in a contract or franchise
agreement, none will be impliedly read into the contract.” More recently, in *C.K.H. LLC v. The
Quizno’s Master, LLC*, the district court rejected breach of contract and other claims where
“[e]ach of the Franchise Agreements grants each franchisee the right to operate a Franchised
Location at a specific address . . . and expressly disclaims any intention to create an exclusive
territory.” The court also rejected plaintiffs’ argument that post-contract verbal promises had
modified the written contract.

In several cases, franchisees without an exclusive territory in the contract have asserted
that a franchisor’s internal site review or impact policies amended the contract to somehow limit
a franchisor’s ability to open new locations. Courts have routinely rejected these claims. In
*Payne v. McDonald’s Corp.*, for example, the franchise agreement expressly provided that
“this License establishes a Restaurant at the location specified . . . only and that no ‘exclusive,’
‘protected,’ or other territorial rights in the contiguous market area of such Restaurant is hereby
granted or inferred.” In the face of that unambiguous language of non-exclusivity, plaintiffs
asserted that McDonald’s “internal policies and practices” of observing a non-encroachment
policy were incorporated into the contract. The court disagreed, largely because “the integration
clause contained in the License Agreement does not permit plaintiffs to rely on documents not
expressly incorporated therein.”

In *Harford Donuts, Inc. v. Dunkin’ Donuts, Inc.* the court also rejected a claimed
breach of the franchisor’s impact policy. Recognizing that the franchise agreement did not
create any express territorial rights, plaintiff argued that the parties were contractually bound to
adhere to the defendant’s Encroachment Impact Policy, and that defendant had breached the
terms of that Policy. The court concluded that the Policy was not an enforceable part of the
franchise agreement, both because of the franchise agreement’s integration clause, and also
because there was no consideration for any purported amendment of the franchise
agreement. Further, the court held that, even if the parties were bound to follow the Policy, “it
does not confer any ultimate rights on [the plaintiff] or any ultimate obligations on [the

---

22 Id. at 484.
23 880 F.2d 149 (9th Cir. 1989).
24 Id. at 164.
27 Id. at 754.
28 Id. at 756; *See also Nibeel v. McDonald’s Corp.*, No. 97 C 7203, 1998 WL 547286, at *8 (N.D. Ill. 1998) (same).
30 Id. at *5.
defendant]. Rather, the Policy sets out an analytical process through which Dunkin’ can assess the adverse impact of new franchises on existing stores and develop an appropriate remedy if Dunkin’ concludes that remediation is necessary. In no set of circumstances does the Policy require Dunkin’ to take any specific action.”

2. Cases Where the Contract Provides for Territorial Protection

If the contract provides for some protected territory, then a franchisee might have a legitimate breach of contract claim if the franchisor fails to respect the franchisee’s territory. For example, in *BJM Assocs., Inc. v. Norrell Servs.*, a franchisee of temporary personnel services succeeded on breach of contract claims against a franchisor that tried to carve-out “management services” from the exclusive provision. Paragraph 8 of the Agreement provided:

8. *Protected Area.* Norrell agrees that during the term of this Agreement it will not itself operate or license another person or persons to operate . . . any similar type business to that which is to be conducted by the Licensee within the Protected Area. . . .

When Norrell’s affiliate started offering “management services” in plaintiffs’ protected territory, plaintiff sued. After a bench trial, the district court concluded: “Norrell has attempted to sell its newly defined Management Services and outsourcing business, which is a ‘similar type business’ to that which BJM had also been offering for many years, in BJM’s protected area, in violation of paragraph 8 of the Agreement.” The court therefore concluded that the franchisor had breached the contract.

Applying the general rules of contract interpretation, courts often interpret territorial language in franchise agreements literally. Thus, in *Interim Health Care of Northern Illinois, Inc. v. Interim Health Care, Inc.*, the franchise agreement provided for a protected area, and further stated that “neither [the franchisor] nor any person or firm authorized or licensed by it shall establish an office for the purposes heretofore described, within the foregoing area.” When the home health care franchisor allegedly started soliciting customers in plaintiff’s protected area from a location outside the protected territory, plaintiff sued, asserting that the franchisor encroached on her territory. The district court for the Northern District of Illinois disagreed, granting summary judgment to the franchisor on plaintiff’s breach of contract claim. The Seventh Circuit affirmed. Reading the language in the franchise agreement literally, the appellate court held that, while the agreement prevented the franchisor from “establish[ing] an office” in the franchisee’s territory, it was silent as to the right of the franchisor to solicit or service clients from an office located outside the territory’s boundaries. According to the Seventh Circuit:

---

31 *Id.*
33 *Id.* at 1485.
34 *Id.* at 1492.
35 *Id.*
36 225 F.3d 876 (7th Cir. 2000).
37 *Id.* (emphasis added).
38 *Id.* at 881.
The language bars the establishment of an office for certain purposes in the Evanston territory. It does not bar the establishment of an office for those same purposes outside the Evanston territory, which means that the provision of health services in the Evanston area from an extraterritorial office is permissible.39

The court thus concluded that the contract gave the franchisor “the right to provide (on its own, or by licensing a franchisee) health services in the [franchisee’s] area, so long as it does not establish an office in that area.”40 In reaching this conclusion, the court made two observations: (1) the parties could have chosen to “wholly restrict the provision of health care in the [franchisee’s] territory” and that (2) the franchisee did not “try to negotiate stronger exclusivity language when she purchased the franchise.”41

Similarly, in *Cook v. Little Caesar Enters., Inc.*,42 the court refused to consider parol evidence to expand on the terms of a franchise agreement that contained an integration clause. The agreement provided that the franchisor would not locate other restaurants within one mile of Cook’s locations. Cook claimed, however, that he had been promised both orally and in written map outlines that a specific territory would be set aside exclusively for him. The district court granted summary judgment for Little Caesar on breach of contract and other claims, and the appellate court affirmed. According to the Sixth Circuit, the “record supports the conclusion that the franchise agreements were intended to be complete expressions of the parties’ agreements and they are not ambiguous.”43

A franchisor’s acquisition of a competitor within a franchisee’s protected territory often leads to encroachment claims. Whether such an acquisition violates the contract depends upon the language in the franchise agreement. In *Auto-Chor System of Minnesota, Inc. v. JohnsonDiversey*,44 the contracts provided plaintiffs with “the exclusive right to use the Registered Trademarks and Trade Names and the Company’s products” within a specified territory. When the defendant manufacturer acquired a competitor and began selling the competitor’s products in the plaintiffs’ territory, plaintiffs sued, arguing that defendant manufacturer was restricted from selling any competitive products in the protected territories. The district court for the District of Minnesota disagreed:

>Americlean’s competition does not breach the Dealer Contracts . . . ACS did not promise that no affiliate or parent would compete with Plaintiff in the sense of using non-Auto-Chlor trademarks and products in Plaintiffs’ territory. There is a difference between a non-compete provision, which Plaintiffs’ contracts do not contain, and a product specific exclusive territory provision, which the contracts do contain.45

39 *Id.*
40 *Id.* at 883.
41 *Id.* at 881, 883.
42 210 F.3d 653 (6th Cir. 2000).
43 *Id.* at 656.
45 *Id.*
The court also declined to find a breach where the manufacturer sold Auto-Chlor products to an entity located outside one dealer’s territory, even where that entity had the potential to resell those same products in the dealer’s territory. The court was unconvinced that the manufacturer’s sale of products to an entity with a speculative potential, at best, to resell Auto-Chlor products encroached upon the dealer’s exclusive territory to undermine the value of that dealership. Since the exclusive territory delineated by the complaining dealer’s contract did not extend to the geographic area where the non-Auto-Chlor entity was located, the court found no reason to hold the manufacturer accountable for encroaching upon the dealer’s territory.46

Similarly, in Gossard v. Adia Servs., Inc.,47 the court considered whether a franchisee could assert a claim for tortious interference against its franchisor’s parent corporation, which acquired a competitor and thereby caused the franchisor to infringe on the franchisee’s protected territory. The franchise agreement provided that neither the franchisor (Nursefinders) “nor any person or firm authorized or licensed by it shall establish an office for the purposes” of providing competing services within the franchise territory. During negotiations over the franchise, the parties also agreed that neither Nursefinders nor its parent or affiliates would provide similar services within the franchise territory. Defendant Adia purchased Nursefinders, and then also purchased StarMed, a direct competitor of plaintiff franchisee located in the protected territory. Plaintiff sued Adia for tortious interference with its contract with Nursefinders, and the district court entered judgment as a matter of law for Adia. On appeal to the Eleventh Circuit, the court certified a question of law to the Florida Supreme Court, namely, whether Florida law recognized a claim for tortious interference on these facts. The Florida Supreme Court answered in the affirmative, noting that, “by purchasing Star-Med, Adia knowingly caused Nursefinders to be in breach of its ‘promise’ to Gossard that neither a parent nor affiliate of Nursefinders would provide similar health care services within Gossard’s territory. Stated another way, because of Adia’s purchase of Star-Med, Nursefinders had ‘no choice’ but to be in violation of its franchise agreement with Gossard.”48

Sometimes the preliminary question is not whether an exclusive territory provision exists, but whether such a provision is in effect when the contract breach allegedly occurred. The court in Hotel Assoc., Inc. v. Howard Johnson Franchise Systems, Inc.,49 faced this very question. The court held that the franchise agreement’s territorial protection provision was not in effect at the time of the alleged breach because the events required to trigger commencement of the term of the agreement had not taken place when Howard Johnson Franchise Systems (“Howard Johnson”) licensed a competing Howard Johnson hotel in the same geographic area as the plaintiff’s franchise. The franchisee alleged, and the court observed, that the franchise agreement expressly carved out a specific area within which Howard Johnson could not license another Howard Johnson lodging facility. The agreement provided, however, that its terms would become effective when the franchisee’s property was integrated into the Howard Johnson Reservation System. Since the franchisee’s hotel had not been integrated into the Reservation System at the time of the alleged breach of contract, the court granted summary judgment for the franchisor.

46 Id.
47 723 So.2d 182 (Fla. 1998).
48 Id. at 184.
49 Bus. Franchise Guide (CCH) ¶ 13,400 (1st Cir. Aug. 1, 2006).
In cases with a contractually-protected territory, there may be litigation over what kinds of establishments, products, activities or transactions might constitute encroachment. In *G.I. McDougal, Inc. v. Mail Boxes Etc., Inc.*[^50] the California state court considered whether establishing unstaffed, self-serve drop boxes and shipping outlets, among other things, breached a contractual exclusive territory for a retail packaging and shipping franchise. The contract prohibited the franchisor and its affiliates from operating “a business selling or leasing similar products or services” in the protected territory. The defendant franchisor argued that the unstaffed drop-off locations did not sell or lease anything; instead, customers could print shipping labels themselves from the Internet and then drop the packages off for shipping. The court denied the franchisor’s motion for summary judgment, finding that plaintiff franchisees “provided evidence that setting up drop boxes or licensing [authorized shipping outlets] within a franchisee’s territory was direct competition with that franchisee, and took away business that could have come to a franchisee’s business.”[^51] Further, the fact that the defendant’s drop boxes used the UPS trademark, instead of Mail Boxes Etc. like the franchised locations, did not change the analysis. Plaintiffs successfully argued that “UPS was an affiliate of MBE, that the franchise agreement provision prevented ‘MBE or its affiliates’ from establishing company-owned outlets selling similar products or services within an individual franchise area, and that MBE allowed its affiliate UPS to license, establish, and operate drop boxes and [authorized shipping outlets] in plaintiffs’ exclusive territories.”[^52]

Similarly, franchisees have alleged that franchisor sales in a supermarket violate an exclusive territory. That claim failed in *Silverman v. Carvel Corp.*,[^53] where the contract prohibited the “opening of another Carvel store on Ridge Road within a quarter mile of the plaintiff’s store,” but was silent with respect to distribution of Carvel products in supermarkets or convenience stores. In contrast, a jury returned a verdict for franchisees with similar contract language in *Carvel Corp. v. Noonan*,[^54] finding that Carvel breached the agreements and the implied covenant of good faith and fair dealing when it began selling products directly to supermarkets.

### 3. When Do Internet Sales Encroach?

A franchisee with an exclusive territory may argue that franchisor sales over the internet encroach on the protected area. These arguments have met with mixed results, as explained below. The cases highlight the need for franchise agreements and FDDs to address the Internet and other forms of new and changing technology at the outset.

The first case that discussed the possibility of encroachment-by-internet was in *Emporium Drug Mart v. Drug Emporium, Inc.*,[^55] where an arbitration panel enjoined the franchisor from operating its Internet drug store in competition with its franchisees. There were

[^51]: *Id.* at *12.
[^52]: *Id*.
two different versions of franchise agreement at issue in Drug Emporium: certain franchisees had agreements with an “exclusive license,” while other franchisees had agreements that limited the franchisor’s right to “operate competing drug stores” in a specified territory. The arbitrators rejected respondent’s claim that it was not operating a competing drug store in the territory, using language from the respondent’s own website that advertised it as a “full-service online drugstore.” Accordingly, the panel granted the injunction and ordered the franchisor to stop selling goods and products over the Internet into claimants’ territories.

In contrast, in In re Arbitration Between Franklin 1989 Revocable Family Trust v. H&R Block, Inc., an arbitration panel held that the franchisor’s sale of tax preparation services over the Internet did not encroach a franchisee’s exclusive territory. The agreement barred the franchisor from “operating from a location” within the franchisee’s exclusive territory. Though the Internet servers used by the franchisor were located outside the relevant territory, the franchisee argued that the Internet enabled the franchisor to interact with customers in the franchisee’s territory. The panel found that the parties did not consider the role of the Internet in their relationship when they entered the contract. Accordingly, the franchisor’s Internet service offerings rendered the meaning of “operating from a location” ambiguous. The panel ultimately held that the franchisor’s Internet presence targeted a different market than the brick-and-mortar presence of the franchisee and, as such, the Internet services did not unreasonably intrude on the franchisee’s operations.

Discussing alternative channels of distribution, including the Internet, in the franchise agreement at the outset will alleviate the uncertainty of whether a protected territory is violated by the Internet (or the next new technology, e.g., Twitter). In Lee v. General Nutrition Co., Inc., the franchise agreement provided a protected territory, but also expressly reserved for the franchisor the right to sell and distribute goods by “direct mail, mail order, catalog sales, or any other similar method,” to businesses and individual customers located in or outside a franchisee’s limited protected territory. Although the contract did not specifically name the “Internet”, the court held that the language was clear enough to prevent a franchisee’s claim that Internet sales into the protected territory violated the covenant of good faith and fair dealing.

Similarly, In the Matter of Hales v. Conroy’s, Inc., involved a flower shop franchisee with an exclusive territory. In an amendment to the franchise agreement, however, the franchisor specifically reserved to itself the right to develop and use other systems and technology. Based on that contract language, an arbitration panel rejected the franchisee’s claim that the franchisor’s toll-free telephone and Internet sales infringed on the protected territory.

These cases illustrate that it is important for franchise counsel to consider future distribution channels, like the Internet, and address them expressly in the franchise agreement.

---

58 Id.
60 For suggested language and issues to consider, see generally Andre R. Jaglom, Distribution Contracts, SN019 ALI-ABA 745, Part VIII (Mar. 6-8, 2008); Thomas J. Collin & Marie A. Bris-Bois, Product Distribution and the Internet—The Antitrust Issues, 17 CORP. Couns. Q. (2001); Gaylen I. Knack and Ann K. Bloodhart, Do Franchisors Need to Rechart the Course to Internet Success? 20(3) FRANCHISE L.J. 101 (2001).
B. Implied Covenant of Good Faith and Fair Dealing

Many franchisee plaintiffs have asserted that a franchisor breached the implied covenant of good faith and fair dealing when opening new locations near an existing franchise. These claims arise most frequently when the franchise agreement does not provide for any exclusive territory. Although franchisees have succeeded on these claims in a small number of cases, the majority of courts reject any attempt to alter the written contract terms through an implied covenant.

The seminal case that breathed wind into the sails of franchisee implied covenant claims is *Scheck v. Burger King Corp.* There, defendant Burger King Corporation (“Burger King”) placed a new restaurant two miles from plaintiff’s existing Burger King franchise. The franchise agreement at issue expressly denied the plaintiff franchisee any exclusive territorial interest whatsoever. It provided: “This license is for the described location only and does not in any way grant or imply any area, market or territorial rights proprietary to FRANCHISEE.” Based on this language, the district court granted summary judgment on plaintiff’s claims of an implied contract term, but denied summary judgment on the alleged breach of the implied covenant of good faith and fair dealing. Interpreting the contract language very narrowly, the district court concluded: “The express denial of an exclusive territorial interest to Scheck does not necessarily imply a wholly different right to Burger King – the right to open other proximate franchises at will regardless of their effect on the Plaintiff’s operations.” In so holding, the court noted that Burger King had developed its own internal policies and procedures to minimize the impact of new development on existing franchises, and that plaintiff’s claim was based in large part on Burger King’s alleged failure to follow its own policies. On Burger King’s motion for reconsideration, the district court refused to budge:

It is evident that although the language of the Franchise Agreement states that the *franchisee* cannot expect an exclusive territory, such language does not even mention the franchisor, let alone does the language provide that Burger King retains the unlimited right to establish Burger King franchises at any location desired.

The district court repeatedly asserted that it was not stating a new principle of law, and that its ruling adhered to the basic premise that the implied covenant cannot override an express contract term. In the court’s view, however, there was no express contract term that addressed Burger King’s right to develop additional franchises. The court explained that franchisors can explicitly reserve the right to develop additional locations in the franchise agreement.

---


63 *Scheck*, 798 F. Supp. at 695.

64 *Scheck*, 756 F. Supp. at 549.

65 Id.

66 Id.

67 *Scheck*, 798 F. Supp. at 696 (emphasis in original).
Undoubtedly, it is Burger King’s failure to make explicit in the Franchise Agreement the rights Burger King claims it carved out for itself which has created the very situation Burger King now confronts. Had the Defendant entered into a Franchise Agreement with the Plaintiff in which the Agreement explicitly stated that Burger King maintained the sole and unlimited right to establish other Burger King restaurants at any location desired, both the Court’s analysis, and the ultimate conclusion reached today, would have likely differed.68

Commentators and courts criticized Scheck and its rationale heavily.69 In 1999, the Eleventh Circuit officially rejected Scheck in Burger King Corp. v. Weaver.70 There, the Court considered the identical franchise language and reached the opposite conclusion, affirming a grant of summary judgment to the franchisor. According to the Eleventh Circuit:

The reasoning of Scheck I and Scheck II is also unconvincing logically. The Scheck court held that the franchisee had a cause of action, even though the franchise agreement provided no right to exclusive territory, because BKC [Burger King Corporation] had not expressly reserved the right to license additional Burger King® restaurants nearby. The flaw in this reasoning is that right and duty are different sides of the same coin; if one party to contract has no right to exclusive territory, the other party has no duty to limit licensing of new restaurants.71

The Weaver court went on to hold that “no independent cause of action exists under Florida law for breach of the implied covenant of good faith and fair dealing . . . More specifically, a cause of action for breach of the implied covenant cannot be maintained (a) in derogation of the express terms of the underlying contract, or (b) in the absence of a breach of an express term of the underlying contract.”72 Weaver thus sounded the death knell for Scheck and its progeny.

Franchisees continue to assert violations of the implied covenant of good faith and fair dealing based on allegedly encroaching locations. These claims are seldom successful, however, especially when an express term of the franchise agreement addresses the territorial claims. For example, Payne v. McDonald’s Corp.,73 the district court granted summary judgment for the franchisor on a claimed breach of the implied covenant of good faith and fair dealing. Dispositive to the franchisee’s claim was the fact that “[t]here is no provision in the agreements which imposes a limitation on McDonald’s right to open new restaurants near

68 Id. at 697.
69 See, e.g., Payne v. McDonald’s Corp., 957 F. Supp. 749, 759-60 (D. Md. 1997) (refusing to follow Scheck, noting the criticism of the decision and the differences between Florida and Illinois law); Barnes v. Burger King Corp., 932 F. Supp. 1420 (S.D. Fla. 1996) (declining to follow Scheck and rejecting franchisee’s claim that Burger King had breached an implied covenant by licensing a new restaurant in the vicinity of plaintiff’s location). A small handful of cases have followed Scheck and its rationale. See, e.g., Camp Creek Hospitality Inc. Inc, v. Sheraton Franchise Corp., 139 F.3d 1396 (11th Cir. 1998); In re Vylene Enters., Inc., 90 F.3d 1472 (9th Cir. 1996).
70 169 F.2d 1310 (11th Cir. 1999).
71 Id. at 1317 (emphasis added).
72 Id. at 1317-18.
73 957 F. Supp. 749, discussed supra Part V.A(1).
existing franchises.74 Likewise, in *Interim Health Care of Northern Illinois, Inc. v. Interim Health Care, Inc.*,75 the court found that the health care service franchisor had not violated the duty of good faith and fair dealing when it serviced patients within the franchisee’s territory from an office outside the territory because the express terms of the contract did not bar cross-border servicing.76

Claims under the implied covenant of good faith and fair dealing may be successful where there is no applicable contract provision. Thus, in *Lakeworth Lodging Partners, Ltd. v. Best Western Int'l, Inc.*,77 the franchisor approved two new franchise applications, for two locations within five miles of each other, on the same day. Neither new franchisee had a contractual right to notice of the proposed new location, and the court therefore dismissed the breach of contract claim. However, the court refused to dismiss a claim brought under the covenant of good faith and fair dealing on these facts, noting that “[b]y approving both applications simultaneously Best Western has circumvented the contract’s notice requirement.”

Franchisees may claim that a franchisor has breached the covenant of good faith and fair dealing by failing to protect the franchisees’ exclusive territory against infringement by another franchisee or third party. For example, in *Servpro Indus., Inc. v. Pizzillo,*78 the court granted the franchisor’s motion for summary judgment where the franchisee plaintiff complained that the franchisor breached the covenant of good faith and fair dealing by failing to punish an adjoining franchisee for violating the franchisor’s territorial policy. The franchise agreement and territorial policy together assigned franchisees to a particular territory and prohibited them from soliciting or performing work outside their territory. An adjoining franchisee allegedly solicited business from insurance agency customers within the plaintiff’s territory and engaged in a course of conduct to slander the plaintiff’s franchise to those customers, thus resulting in a loss of revenue and profits. The plaintiff sued the franchisor for failure to enforce its territorial policy against the adjoining, and allegedly breaching, franchisee. The trial court granted summary judgment for the franchisor, and the appellate court affirmed. According to the appellate court: “It is undisputed that by its own terms, the territorial policy gives Servpro the power, but not the obligation, to take steps against franchisees who encroach upon the territory of other franchisees.”79 Thus, unless the plaintiff could show that the franchisor bore malice against him, wished to damage or destroy his franchise, or colluded with the encroaching franchisee to advance his franchise at the expense of the plaintiff’s franchise, the court was unwilling to find that the franchisor had breached the covenant of good faith and fair dealing when it took no action to punish the offending franchisee.80

---

74 Id. at 758. See also Nibeel v. McDonald’s Corp., No. 97C7203, 1998 WL 547286, at *9 (N.D. Ill. Aug. 27, 1998) (“the language of the License Agreement is so clear, Nibeel’s argument that the implied covenant of good faith somehow modifies the rights and obligations of the parties is without merit.”)

75 225 F.3d 876 (7th Cir. 2000), discussed supra Part V.A(2).

76 See id. at 881, 884. See also, e.g., Cook v. Little Caesar Enters., Inc., 210 F.3d 653, 657 (6th Cir. 2000) (“Cook could not employ the implied covenant of good faith and fair dealing to override the express terms of the franchise agreements which allowed Little Caesar Enterprises to license franchises outside of Cook’s one-mile exclusive territories.”); Hobin v. Coldwell Banker Residential Affiliates, Inc., 144 N.H. 626, 630 (N.H. 2000) (as a general rule, implied terms should never be read to vary express terms).


79 Id. at *4 (emphasis added).

80 See id.
In contrast, the court in *Pepsi-Cola Bottling Co. of Pittsburg, Inc. v. PepsiCo, Inc.*, held that there was sufficient evidence to establish that defendant PepsiCo had breached its agreement with the plaintiff, an exclusive bottler, and violated the covenant of good faith and fair dealing when it failed to adhere to its transshipment enforcement policy (TEP), designed to prevent competing bottlers from selling into an exclusive territory. Under the TEP, PepsiCo would investigate complaints that another bottler was selling into an exclusive territory and impose a fee if it deemed the charges to be true. An Exclusive Bottling Appointment (EBA) designated plaintiff as the exclusive bottler of Pepsi products in a designated territory in Kansas and Missouri. Plaintiff made several complaints to PepsiCo’s Transshipment Department, without any result, and ultimately sued PepsiCo on a variety of claims. The district court granted PepsiCo’s motion for summary judgment, but the Tenth Circuit reversed in part. On the claims related to PepsiCo’s alleged failure to enforce the TEP, the Court concluded “based both on the original EBA’s text, [the] parties’ subsequent actions, and the implied covenant of good faith and fair dealing – that PepsiCo had a duty to take reasonable steps to prevent competing bottlers from encroaching on Pittsburgh Pepsi’s exclusive territory.” The Court then concluded that there was sufficient evidence from which a jury could conclude that “PepsiCo knew transshipment was occurring and, despite promising to make Pittsburgh Pepsi the exclusive PepsiCo dealer, chose to permit the transshipment with the hope of weakening the franchise of a dysfunctional bottler.”

Following an impact policy caused problems of a different variety for the franchisor in *Stetzer v. Dunkin’ Donuts, Inc.*, where the plaintiff claimed that the defendant breached the implied covenant of good faith and fair dealing when it failed to grant an extension of time for the plaintiff to open a store at a specified location. In support of its claim of “bad faith,” plaintiff offered letters from neighboring franchisees protesting plaintiff’s proposed unit as encroaching on their trade areas. As discussed in Section IV, *supra*, letters like this are common in any franchise system that has a development impact policy. Nonetheless, the district court concluded that the letters from neighboring franchisees precluded summary judgment for Dunkin’ because they provided evidence that Dunkin’s “true purpose in refusing to renew the site approval was anti-competitive and prompted by a dishonest purpose.” This holding demonstrates the court’s fundamental misunderstanding of the franchisor’s impact policy and the import (or lack thereof) of the letters from neighboring franchisees.

Last, in *RHC, LLC v. Quizno’s Franchising, LLC*, plaintiffs claimed that the franchisor should not have let them open the location they requested because it was too close to an existing location and caused their store to fail. After a bench trial, the Colorado state court disagreed, noting that the franchise agreements at issue “provide that the franchisee has no territorial protection,” and also that site selection is ultimately up to the franchisee, not the

---

81 431 F.3d 1241 (10th Cir. 2005).
82 Id. at 1259.
83 Id. at 1260.
84 87 F. Supp. 2d 104 (D. Conn. 2000).
85 Id. at 115. As discussed in Part V.D(4) *infra*, franchisees should not play a role in the decision-making process regarding a proposed new franchise location. See, e.g., *American Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230 (3d Cir. 1975). However, it is perfectly legitimate for franchisees to be notified of a proposed new location, and even to voice their protest in written letters to the franchisor. This is a common element of many franchisor’s impact policies.
The court also noted that there was insufficient evidence to establish the cause of plaintiff’s failure: “Plaintiffs’ only evidence relating to their theory that the proximity of other Quizno’s franchise stores caused the lower sales volume is the historical sales experienced at each location before and after opening the alleged competing restaurant. Plaintiffs have absolutely no evidence addressing the myriad of other potential causal factors associated with the sales performance of their respective restaurants.” This case is instructive with respect to the difficulties inherent in proving damages in an encroachment case.

C. Tort Claims

1. Misrepresentation / Fraud

Encroachment plaintiffs sometimes assert that oral representations outside the contract support a claim of misrepresentation, fraud or promissory estoppel. These claims often fail, especially where the franchise agreement contains an integration clause.

For example, in General Electric Co. v. Latin American Imports and Hobin v. Coldwell Banker Residential Affiliates, Inc., the claimants alleged that, in choosing to enter an agreement with the defendants, they relied on the franchisors’ oral pre-contractual promises concerning each claimant’s right to do business in an exclusive geographical area. In General Electric Co., the court found that General Electric Company’s (“GE”) representations, if true, never made it into the contract. The franchise agreement not only provided that the counterclaimant would serve as the nonexclusive distributor of GE products in Peru, but it also contained an integration clause. On these facts, the Sixth Circuit affirmed the district court’s grant of summary judgment for GE.

Similarly, in Hobin, the franchisee’s allegations that the franchisor made representations about exclusivity were found to be in direct conflict with the non-exclusivity provision in the franchise agreement. The plaintiff franchisee claimed to rely on statements regarding the franchisor’s internal approval process for the placement of new franchises in proximity to existing franchises (and an alleged oral promise that there would be a five-mile radius between locations). Carefully reviewing the applicable timeline, the court discovered that the alleged representations had been made after the franchisee signed the contract; therefore, the franchisee could not have relied on those statements in executing the franchise agreement. On these facts, the court upheld the lower court’s decision to dismiss the claim of misrepresentation.

87 Id.
88 Id.
89 Bus. Franchise Guide (CCH) ¶ 13,021 (6th Cir. Feb. 8, 2005).
90 744 A.2d 1134 (N.H. 2000).
92 Hobin, 744 A.2d at 1140. The plaintiff also alleged that the franchisor implied that the market area where he would be situated could not support an additional franchise much less several additional franchises. However, California’s parol evidence rule did not permit the court to admit evidence of such promises so the court disregarded the allegations. Id. at 1139.
93 Id. at 1140. See also Cook v. Little Caesar Enters., Inc., 210 F.3d 653, 658 (6th Cir. 2000) (“[r]eliance upon oral representations or prior documents, even if false, is unreasonable if the party enters into a subsequent agreement.”)
Finally, in *Barnes v. Burger King*, the district court rejected a franchisee’s promissory estoppel claim based on Burger King’s alleged oral promise that it had an encroachment policy pursuant to which it would not permit any additional Burger King franchises to be built within a specified radius of plaintiff’s franchise. The court determined that, in the face of express contract language to the contrary, any reliance of the alleged oral representations was “unreasonable and unjustifiable as a matter of law.”

2. **Tortious Interference**

On occasion plaintiffs have asserted claims, albeit with limited success, that a franchisor’s allegedly encroaching behavior tortiously interfered with an actual or expected business relationship. Generally, a claim of tortious interference requires proof that the plaintiff had a valid business relationship with a third party, that the defendant knew about the relationship with that party and intentionally interfered with it, and the plaintiff suffered actual loss as a result of the interference. In *Interim Health Care*, the plaintiff alleged that, by servicing clients located within the plaintiff’s exclusive territory, the defendant tortiously interfered with the business relationship she was entitled to have with all potential clients in her territory. The court found that the plaintiff’s territorial rights were limited, however. Though the contract provided for an exclusive territory, it did not grant the plaintiff the right to service every client in her exclusive territory. The franchisor was free to service clients in the plaintiff’s territory so long as it did so from an office located outside the plaintiff’s territory. Absent a showing that the plaintiff had a reasonable expectancy of a valid business relationship with every client within her territory, the plaintiff’s tortious interference claim could not and did not survive summary judgment.

*Gossard v. Adia Services, Inc.*, also arose as a tortious interference claim, in which a franchisee alleged that the franchisor’s parent corporation tortiously interfered with the franchise contract. The Florida Supreme Court held that there was sufficient evidence to support a tortious interference claim on the facts of the case.

In *Pepsi-Cola Bottling Co.*, a Pepsi bottler brought a tortious interference claim against PepsiCo, and its wholly owned subsidiary, Bottling Group, alleging that both defendants had tortiously interfered with the plaintiff’s business relationships with current and prospective customers located in its exclusive territory. The court found that the facts called for a different result for each defendant. First, the court found that the franchisee provided no evidence to support its claim that PepsiCo’s long-term business plan, administrative structure and failure to enforce a Transshipment Enforcement Policy (TEP) amounted to tortious interference. The franchisee merely asked the court to “infer that, because PepsiCo created a climate which made it possible for [the franchisee’s] customers to purchase products from another bottler, PepsiCo...”

---

95 Id. at 1441. See also *Lakeworth Lodging Partners, Ltd. v. Best Western Int’l, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,580 (D. Ariz. Jul. 3, 2003) (“[e]ven assuming the facts alleged by the Plaintiff are true, it was not reasonable for the Plaintiff to rely on any such oral representations,” because of the contract’s non-exclusivity and integration clauses).
96 225 F.3d 876 (7th Cir. 2000), discussed supra at Part V.A(2).
97 Id. at 887.
98 723 So.2d 182 (Fla. 1998), discussed supra at Part V.A(2).
99 431 F.3d 1241 (10th Cir. 2005).
should be held liable for *intentionally causing* [the franchisee’s] customers to purchase from others."³⁰¹ Unwilling to make this inference without more, the court upheld summary judgment for PepsiCo.

Second, the court determined that there was sufficient evidence to reverse the summary judgment grant against Bottling Group. The evidence suggested that Bottling Group’s actions encouraged a third-party vendor to purchase Pepsi products in the plaintiff’s territory from an entity other than the plaintiff. Whether the franchisee would have obtained the vendor’s business but for Bottling Group’s conduct was a question to be answered at trial.³⁰² In addition, the court found that a jury could interpret the same evidence as proof that Bottling Group possessed the requisite malicious intent needed to sustain a tortious interference claim.³⁰³

In *Carvel v. Noonan*,³⁰⁴ the New York Court of Appeals considered a question on certification from the Second Circuit, namely, whether the franchisor’s conduct selling products in supermarkets in apparent breach of its franchise agreements also stated a claim under New York law for tortious interference with prospective economic relations. The franchisees did not claim that their ice cream customers had binding contracts with the franchisees that Carvel induced them to breach; instead, they alleged only that, by implementing the supermarket program, Carvel induced the customers not to buy Carvel products from the franchisees. The Court held that these allegations were insufficient to sustain a claim for tortious interference with prospective economic relations. To succeed on that claim, plaintiffs would also need to allege and prove that Carvel’s conduct was criminal or independently tortious, or undertaken “for the sole purpose of inflicting intentional harm on plaintiffs.”³⁰⁵

### 3. Breach of Fiduciary Duty

Courts have dismissed claims that seek to frame encroachment as a breach of fiduciary duty.³⁰⁶ For the most part, “courts have not imposed general fiduciary obligations upon franchisors.”³⁰⁷ In *RHC, LLC v. Quizno’s Franchising, LLC*,³⁰⁸ two franchisees contended that a sandwich shop franchisor breached its fiduciary duty to them by engaging in self-dealing when it assigned the leases to two company-owned stores to the plaintiffs. The company-owned stores were located in the same area as the new restaurants that the plaintiffs were in the process of constructing. The Colorado state court found that the plaintiffs’ claim failed because Colorado law, like many other jurisdictions, did not recognize a fiduciary relationship between franchisor and franchisee.³⁰⁹ Plaintiffs’ relationship with the franchisor was described as a “normal arms-length business arrangement” arising out of the franchise agreements at issue. Moreover, the franchise agreements provided that, in exercising its right to approve sites for new franchises,  

---

³⁰¹ Id. at 1265 (emphasis in original).
³⁰² Id. at 1264.
³⁰³ Id.
³⁰⁵ Id. at 189-90 (internal quotation marks omitted).
³⁰⁷ *Domed Stadium Hotel, Inc. v. Holiday Inns, Inc.*, 732 F.2d 480, 485 (5th Cir. 1984).
³⁰⁹ Id.
the franchisor was acting to promote its own interests and secure its own benefit, not to endorse or guaranty that the approved site was a suitable location for the franchisee. The court found that the agreements made clear that the franchisor assumed no duty to act on behalf and in the best interests of the plaintiffs.\textsuperscript{110} 

Likewise, the distributorship arrangement in \textit{Pepsi-Cola Bottling Co.} was held not to have created an implied fiduciary relationship between the plaintiff and its distributor, PepsiCo.\textsuperscript{111} There, the plaintiff claimed that PepsiCo breached certain fiduciary duties by failing to enforce PepsiCo’s policy to protect the exclusive territories of its franchisees, among other reasons. The Tenth Circuit affirmed summary judgment on this claim, finding that Kansas law did not recognize a fiduciary relationship between franchisor and franchisee “absent proof that the parties assumed fiduciary duties apart from their standard relationship.”\textsuperscript{112} The relationship between the parties was deemed to be the typical arms-length, commercial relationship regulated by the terms of a written franchise agreement.\textsuperscript{113} 

\section*{D. Statutory Causes of Action}

There are several types of statutory claims that appear with some frequency in encroachment litigation. Depending on your state, there may be applicable provisions in a franchise relationship law, or motor vehicle dealership law. Encroachment plaintiffs also may raise claims under unfair trade practices or antitrust statutes. These statutory claims will be discussed below.

\subsection*{1. Franchise Relationship Laws}

At least three states have enacted franchise relationship laws that specifically address exclusivity.\textsuperscript{114} For example, it is unlawful in Indiana for any franchise agreement to contain a provision that “[a]llows the franchisor to establish a franchisor-owned outlet engaged in a substantially identical business to that of the franchisee within the exclusive territory granted the franchise by the franchise agreement; or, if no exclusive territory is designated, permitting the franchisor to compete unfairly with the franchisee within a reasonable area.”\textsuperscript{115} Washington State’s Franchise Investment Protection Act provides that it is unfair, deceptive and therefore unlawful for any “franchisor or subfranchisor to compete with a franchisee in an exclusive territory or to grant competitive franchises in the exclusive territory area previously granted to another franchisee.”\textsuperscript{116}

\begin{itemize}
  \item \textsuperscript{110} \textit{Id.}
  \item \textsuperscript{111} \textit{Pepsi-Cola Co.}, 431 F.3d at 1266-67, discussed \textit{supra} at Part V.C(2).
  \item \textsuperscript{112} \textit{Id.} at 1267.
  \item \textsuperscript{113} \textit{See id.}
  \item \textsuperscript{115} IND. CODE § 23-2-2.7-1(2) (2009). The language is not limited to the franchisor’s trademarks or trade names, and broadly covers the operation of “any similar business.”
  \item \textsuperscript{116} WASH. REV. CODE § 19.100.180(2)(f) (2009). This provision applies only “[i]f the franchise provides that the franchisee has an exclusive territory, which exclusive territory shall be specified in the franchise agreement.” \textit{Id.}
Iowa has the most extensive provisions on encroachment, by far. The Iowa statute creates a cause of action for damages if a franchisor “develops, or grants to a franchisee the right to develop, a new outlet or location which sells essentially the same goods or services under the same trademark . . . as an existing franchisee and the new outlet or location has an adverse effect on the gross sales of the existing franchisee’s outlet or location . . . .” 117 The statute contains various exceptions, and the franchisor can avoid liability by, among other actions, first offering the new location to the existing franchisee on the same basic terms and conditions, or establishing and employing a formal procedure for hearing the existing franchisee’s claims in advance of opening the new location and providing compensation for any lost profits caused by the establishment of the new location.

Other franchise relationship laws may also apply, even if they do not expressly address encroachment. For example, the Wisconsin Fair Dealership Law prohibits a franchisor from implementing a “substantial change in competitive circumstances” in a franchise relationship absent good cause and substantial notice.118 In The Wisconsin Compressed Air Corp. v. Gardner Denver, Inc.,119 the district court held that defendant’s appointment of an additional approved dealer in plaintiff’s non-exclusive area of primary responsibility effected a “substantial change in competitive circumstances” that required “90 days prior written notice.”

2. Motor Vehicle Dealership Laws

Several states have statutes specific to motor vehicle dealerships that govern the placement of a new dealership in an existing dealer’s “Relevant Market Area.” The RMA is often defined with reference to census data, distance by air or a combination of both. Thus, for example, the Virginia Motor Vehicle Dealer Franchise Act defines the RMA as “a circular area around an existing franchised dealer with a population of 250,000, not to exceed a radius of 10 miles, but in no case less than seven miles.”120 Applying that statute, the court in Leesburg Imports, L.L.C. v. D.B. Smit, Comm’r,121 upheld the commissioner’s decision, based on census data, that the applicable RMA was 10 miles. The court thus rejected the existing dealer’s protest of a proposed new location 14 miles away, and therefore outside the RMA.

Applying the West Virginia Motor Vehicle Dealer Law, the court in Moses Auto., Inc. v. Am. Honda Motor Co.,122 applied the statute’s 15-mile radius and rejected a dealer’s protest to a proposed new location that was 16.3 miles away. The dealer argued that he wanted to move his location three miles closer to the proposed new dealership, and that the 15 miles should be measured from the existing dealer’s proposed new location. The court rejected that argument, noting that “American Honda did not grant permission for Moses to relocate,” and therefore the


118 See WIS. CODE §§ 135.03 & 135.04.


120 VA. CODE § 46.2-1500.


only applicable measurement is from Moses’ current location which is over fifteen miles from the
new dealership.”

The Missouri Motor Vehicle Dealer Law § 407.817 provides that, in a county with a
population greater than 100,000, dealers within a six-mile radius of a proposed new location are
entitled to notice and a hearing to establish the manufacturer’s good cause for opening the
proposed new dealership. In Parkstown Imports, Inc. v. Audi of Am., the court held that an
existing dealer located 10 miles from the proposed location “has no authority to contest the
establishment of a [new] dealership under § 407.817.”

When a dealer does have standing to challenge a proposed new location, the
determination of whether the automobile manufacturer has “good cause” to proceed is subject
to a multi-factored test. In Diskin Enters., Inc. v. State Bd. of Vehicle Mfrs., the proposed new
location was 9.85 miles from an existing dealer. Pennsylvania’s statute provided for a 10 mile
RMA. Pursuant to statute, the Board of Vehicle Manufacturers, Dealers and Salespersons
(Board) considered whether Mitsubishi had “good cause” to establish the proposed new
dealership. The statute required consideration of the following nonexclusive list of factors:

(1) Permanency of the investment of both the existing and proposed new vehicle
dealers.

(2) Growth or decline in population and new vehicle registrations in the relevant
market.

(3) Effect on the consuming public in the relevant market area.

(4) Whether it is injurious or beneficial to the public welfare for an additional new
vehicle dealer to be established.

(5) Whether the new vehicle dealers of the same line-make in that relevant
market area are providing adequate competition and convenient customer
care . . .

(6) Whether the establishment of an additional new vehicle dealer would increase
competition and whether such increased competition would be in the public
interest.

(CCH) ¶ 14,090 (W. Va. Jan. 30, 2009), held that the protesting dealer lacked standing to protest a possible new location “in the South Charleston area.” Because the manufacturer had not yet identified an address for the new
dealership, “it is not apparent whether the new dealer will be situated within [plaintiff’s] relevant market area of fifteen
air-miles or outside of this perimeter.”


125 Id. See also Bloomington Chrysler Jeep Eagle v. DaimlerChrysler Motor Co., LLC, 2005 U.S. Dist. LEXIS 37172
(D. Minn. Dec. 29, 2005) (dismissing claim under Minnesota statute that provides for a radius of five miles around any
existing dealer, where plaintiff’s dealership was 5.9 miles away from proposed new location).


127 Id. (citing 63 P.S. 818.27(c)).
Applying these factors, the Board concluded that there was reason to prohibit the establishment of a new Mitsubishi dealership at the proposed location, and the court affirmed.\textsuperscript{128}

3. Unfair Trade Practice Laws

Franchisee plaintiffs have also alleged that a franchisor’s encroaching behavior violates a state’s unfair trade practice statute. The first question in these cases is often what state’s law applies to the claim, especially if the franchise agreement contains a choice-of-law provision.\textsuperscript{129}

On the merits, these claims often fail because, generally, a breach of contract does not amount to a deceptive trade practice. Thus, in \textit{Rhino Linings USA v. Rocky Mountain Rhino Lining},\textsuperscript{130} the Supreme Court of Colorado held that the plaintiff failed to bring an actionable claim under Colorado Consumer Protection Act (CCPA). According to the Court, the defendant’s failure to honor its promise of exclusivity constituted a valid breach of contract claim, not a deceptive trade practice.\textsuperscript{131}

Similarly, in \textit{Hobin v. Coldwell Banker Residential Affiliates, Inc.},\textsuperscript{132} the Supreme Court of New Hampshire affirmed dismissal of an unfair trade practice claim where the plaintiff “has alleged no actions on the part of Coldwell Banker that could be construed as conflicting with the express or implied terms of the agreement.” The court rejected plaintiff’s claim that his allegations of breach of contract, breach of the implied covenant of good faith and fair dealing, and misrepresentation—all of which failed in their own right—supported a valid claim under New Hampshire’s Consumer Protection Act, finding that the plaintiff’s allegations did not “rise to the level of rascality” contemplated by the statute.\textsuperscript{133}

\textsuperscript{128} \textit{Id}. Some manufacturers have challenged the constitutionality of state motor vehicle laws, with mixed results depending upon the breadth of the statute’s provisions. \textit{Compare Parkstown Imports, Inc. v. Audi of Am.}, Bus. Franchise Guide (CCH) ¶ 13,946 (Mo. Ct. App. Jul. 8, 2008) (upholding a Missouri motor vehicle dealer statute that was narrowly-tailored and confined standing only on those dealerships that could show they were directly damaged by franchisor conduct designated as unlawful under the statute), with \textit{Yamaha Motor Corp. v. Jim’s Motorcycle, Inc.}, 401 F.3d 560 (4th Cir. 2005) (invalidating Virginia’s motorcycle dealer law as overbroad and an undue burden on interstate commerce because it granted protest rights to all existing dealers whenever a franchisor sought to establish a dealership anywhere in the state even where the site of the proposed dealership was located outside the relevant market area of the protesting dealer).

\textsuperscript{129} See, e.g., \textit{Lakeworth Lodging Partners, Ltd. v. Best Western Int’l, Inc.}, Bus. Franchise Guide (CCH) ¶ 12,580 (D. Ariz. Jul. 3, 2003) (choice of Arizona law did not preclude claim under Texas Deceptive Trade Practices Act because the “choice of law provision is inapplicable to the alleged violation of a Texas statute”); \textit{Burger King Corp. v. Weaver}, 169 F.3d 1310, 1318 (11th Cir. 1999) (affirming dismissal of claim under Montana Trade Practices Act (MUTPA) because franchise agreement chose Florida law, and “the MUTPA is inapplicable to a lawsuit construed in accordance with the laws of Florida”) (internal quotation marks omitted).

\textsuperscript{130} 62 P.3d 142 (Colo. 2003).

\textsuperscript{131} \textit{Id}. at 149. \textit{See also RHC, LLC v. Quizno’s Franchising, LLC}, Bus. Franchise Guide (CCH) ¶ 13,119 (Col. Dist. Ct., Denver, Jul., 19, 2005) (rejecting CCPA claim where plaintiff’s evidence related only to “contractual rights and obligations,” and did not constitute an “actionable deceptive trade practice”); \textit{C.K.H. LLC v. The Quizno’s Master, LLC}, Bus Franchise Guide (CCH) ¶ 13,027 (D. Col. Mar. 25, 2005) (dismissing CCPA claim because plaintiffs’ “remedy lies in contract, not tort,” and they “cannot supplement or supplant the terms of those contracts by reformulating their claims under the CCPA”).

\textsuperscript{132} 744 A.2d 1134, 1141 (N.H. 2000).

\textsuperscript{133} \textit{Id}. at 1141.
4. Antitrust Laws

Federal and state antitrust laws may also come into play when litigating encroachment and exclusivity claims. While granting exclusive territories and limiting competition among franchisees was at one time viewed as anticompetitive and illegal under Section 1 of the Sherman Act, the Supreme Court’s seminal decision in *Continental T.V., Inc. v. GTE Sylvania Inc.*[^134] changed those presumptions. Reasoning that the primary concern of the antitrust laws is promoting interbrand competition, not intrabrand competition, the *GTE Sylvania* Court held that territorial, location and other non-price vertical restrictions are not manifestly anticompetitive, and instead should be subject to the rule of reason.[^135]

Market power is the critical first inquiry under the rule of reason.[^136] “If the franchisor lacks market power, territorial restraints are conclusively reasonable. If, on the other hand, it has market power, the restraints must be evaluated for their effect on interbrand competition.”[^137] Thus, while most franchise agreements providing for exclusive territories will pass muster, a franchisor with a significant percentage of the relevant market must tread carefully. For example, in *Graphic Prods. Dist. v. Itek Corp.*,[^138] a manufacturer with 70% of the relevant market imposed exclusive territories on its distributors and precluded them from selling products outside their assigned territories. Under these circumstances, a jury found that the manufacturer’s vertical territory restrictions were anticompetitive in violation of Section 1 of the Sherman Act. The Eleventh Circuit affirmed, concluding that “there was sufficient evidence for the jury to find that intrabrand competition, in this context, was an important source of competitive pressure on price, and that Itek’s system of territorial restraints – which totally foreclosed intrabrand competition – had substantially adverse effects on price competition and consumer welfare.”[^139]

Claims under Section 2 of the Sherman Act, which prohibits monopolies or attempted monopolies, also hinge on whether the franchisor has market power. Thus, in *Domed Stadium Hotel, Inc. v. Holiday Inns, Inc.*,[^140] the franchisee plaintiff claimed that the defendant franchisor monopolized the market for “Holiday Inn hotel rooms” in downtown New Orleans.[^141] Under plaintiff’s definition of the relevant market, Holiday Inns had 100% of the market. The district court granted summary judgment for Holiday Inns, however, and the Fifth Circuit affirmed. The Court disagreed with the franchisee’s market definition: “Hotel rooms, then, and not Holiday Inn hotel rooms, must be the relevant market.”[^142] The evidence revealed that Holiday Inns had, at

[^135]: 433 U.S. at 54, 58. The Court has since extended this reasoning to vertical price restraints as well. See *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).
[^136]: Defining the applicable relevant market can be tricky in franchise cases. Although franchisees will almost always invoke *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451 (1992), in an attempt to define a single-brand market, those attempts rarely, if ever, succeed. See, e.g., *Queen City Pizza, Inc. v. Domino’s Pizza, Inc.*, 124 F.3d 430, 434 (3d Cir. 1997).
[^137]: ABA SECTION OF ANTITRUST LAW, ANTITRUST HANDBOOK FOR FRANCHISE AND DISTRIBUTION PRACTITIONERS 107 (2008).
[^138]: 717 F.2d 1560 (11th Cir.1983).
[^139]: *Id.* at 1575.
[^140]: 732 F.2d 480 (5th Cir. 1984).
[^141]: *Id.* at 488.
[^142]: *Id.* at 489.
best, 4% of the market for hotel rooms generally in downtown New Orleans, and it therefore could not be liable under Section 2.143

Market definition was also critical in Photovest Corp. v. Fotomat Corp.,144 where the court concluded that defendant franchisor was liable for attempted monopolization under Section 2 of the Sherman Act. The plaintiff defined the relevant market as “the drive-thru retail photo processing submarket in the Indianapolis metropolitan area,” and the court agreed that this was a valid market (as opposed to the larger retail market for photo processing generally). The court then concluded that there was ample evidence to support the district court’s conclusion that “when Fotomat determined that owning the kiosks was more profitable than franchising them, Fotomat, among other things, saturated the market with company-owned kiosks to reduce severely the profitability of Photovest’s kiosks and thereby attempt to reduce substantially the value of Photovest’s kiosks so that Fotomat could buy them at a low price.”145 The facts in this unusual case therefore supported a finding of attempted monopolization, among other claims.

Horizontal agreements to divide territories and agreement not to compete remain per se illegal, even after GTE Sylvania. Thus, if franchisees are involved in the decision-making process for opening new locations (or have veto power as part of a franchisor’s impact policy), courts may hold the arrangement automatically illegal under the antitrust laws. In American Motor Inns v. Holiday Inns,146 for example, the franchisor solicited comments from nearby franchisees regarding any proposed new location, and treated an objection from an existing franchisee as a veto. The district court entered judgment for the plaintiff, issuing an injunction and awarding treble damages of $4 million. The Third Circuit affirmed:

By thus permitting its existing franchisees to determine whether a potential competitor would be allowed to enter the Elizabeth-Newark market, HI enabled its franchisees already in the Elizabeth-Newark area to divide that market between themselves, thus precluding further intrabrand competition. Such conduct constitutes a horizontal market allocation that is a violation of the Sherman Act.147

This line of cases makes clear that franchisors must make independent judgments about locations and territories.

143 Id. (noting that, “absent special circumstances, a defendant must have a market share of at least fifty percent before he can be guilty of monopolization”).

144 606 F.2d 704 (7th Cir. 1979).

145 Id. at 715.

146 521 F.3d 1230 (3d Cir. 1975).

147 Id. at 1242. See also ES Dev't, Inc. v. RWM Enters., Inc., 939 F.2d 547, 555 (8th Cir. 1991) (affirming injunction against group of automobile dealers who agreed to protest collectively the entry of a proposed competitor in the area; while their franchise agreements allowed them to send protest letters to their manufacturers individually, “[a]cts which may be legal and innocent in themselves, standing alone, lose that character when incorporated into a conspiracy to restrain trade”) (internal quotation marks omitted).
E. The Canadian Litigation Experience

To date, there have been very few reported decisions in Canada involving encroachment or exclusivity claims. Like the US experience, franchise encroachment claims in Canada are typically founded in breach of contract, breach of the implied covenant of good faith and fair dealing and breach of the statutory and common law duty of fair dealing.

Supermarché A.R.G. Inc. v. Provigo Distribution Inc.\(^{148}\) a decision of the Québec Superior Court is the first reported franchise case in Canada to deal with the issue of encroachment.\(^{149}\) While the common law and statutory duty of good faith and fair dealing remains to be considered in a Canadian encroachment case, this case addresses the issue of encroachment under the Québec Civil Code.

During the 1970s and 1980s, the defendant Provigo had acted merely as a wholesaler supplying merchandise to independent stores operating under its banner. These stores signed “affiliation agreements,” similar to franchise agreements, obliging them to purchase 90% of their merchandise from Provigo, to respect Provigo’s advertising and marketing standards, to submit all proposed advertising for Provigo’s approval and not to compete with Provigo. The agreements did not specify that Provigo was not to compete with the affiliates. During the early 1990s, Provigo’s business strategy changed to focus on discount retailing. A corporate owned chain, known by the name “Heritage”, instituted a policy of “every day low prices,” while the plaintiff affiliates were prevented by Provigo from implementing a similar pricing policy.

As it changed its strategy, Provigo marketed products through its discount stores much more vigorously. The Court found that Provigo preferred to maintain a price difference between its Heritage stores and the conventional supermarkets owned by its franchisees. The difference was such that the price at which the franchises bought their inventory from Provigo exceeded the price at which Provigo sold the goods through its corporate discount stores to consumers. There was also evidence that Provigo had used the knowledge gained through its right to approve advertising to allow its discount stores to specifically counter promotional campaigns put on by the franchisee.

The plaintiffs claimed that Provigo had abused its rights under the affiliation agreements, alleged that Provigo was guilty of bad faith, unfair competition and breach of fiduciary duty and sought damages and injunctive relief. The plaintiffs also sought an order preventing Provigo from carrying on any activities having a negative effect on the plaintiffs’ businesses, requiring Provigo to reduce its prices on merchandise so as to enable the plaintiffs to match Heritage’s prices or alternatively to close a nearby Heritage store located only 1,000 feet from one of the plaintiff’s supermarkets.

Provigo was found guilty of acting in bad faith and abusing contractual rights. The Court held that the principle of good faith must govern the parties in the execution of their contract and that this principle includes the obligation to act honestly and not to abuse the other party’s weaknesses. The decision held that since good faith in contractual relations is an overriding obligation under Québec’s civil law, Provigo could not use the terms of the affiliation agreements to undermine the plaintiffs by depriving them of the marketing tools and pricing strategy which


they needed to compete and which were being successfully employed by the nearby corporate-owned Heritage store. Provigo, however, was entitled to compete with its affiliates. The Court stated that Provigo did not owe a fiduciary duty to its affiliates and was not guilty of unfair competition as it had not intentionally or recklessly inflicted harm on the plaintiffs. The Court stated that the common law principle of fiduciary obligations cannot be extended to commercial relationships when parties are trading at arm’s length, except in cases where one party is justified in believing that the other party must act for its benefit.

On appeal, while noting that there were no explicit provisions in the contract requiring Provigo not to compete directly or indirectly with its franchisees, the Québec Court of Appeal stated that the obligations under a contract are not limited to those expressed or foreseen by the parties. In particular, based on certain provisions of the Québec Civil Code, all contracts must be carried out in good faith. The Court stated that it is difficult to hold as a general rule that a franchisor can never, in any manner, undertake any activities having the effect of competing with its franchisee, in a market in perpetual evolution or where the constant adaptation of commercial practices to changes in the market and consumer taste are a question of corporate survival. The Court held, however, that, in effect, when a franchisor enters into a franchise agreement with the franchisee it enters into a sort of partnership which limits its rights to compete freely in this respect.

By reason of its duty of good faith, the franchisor must also provide the benefit of new marketing methods and techniques to its franchisees. Provigo was found to have breached this duty of good faith towards the franchisee.

In the case of Flair Franchise Systems (1996) Ltd. v. Millebrook Investments Ltd.150 the franchisor applied for injunctive relief seeking to restrain what it asserted to be breaches of a franchise agreement, including breach of a non-competition clause.

The franchise agreement was originally entered into between U-Frame-It Limited and the defendant. The franchisee was granted an exclusive license to operate a U-Frame-It franchise on Vancouver Island, British Columbia, defined as the “dealership area.” The original franchisor sold its assets, including all rights under the agreement, and as a result of further sales and corporate name changes, the plaintiff held the rights of the franchisor.

The franchisee began withholding royalty fees on the basis of the franchisor’s alleged failure to support and promote the U-Frame-It business. In addition, the franchisee received a memo from a company identified as “Canadian Framing and Art Group” stating that the company had acquired all the trademarks of Flair/U-Frame-It, and explaining that Canadian Framing and Art Group was also the owner and franchisor of two competitor organizations, Framing and Art Centre and Framing Experience.

The court reviewed a number of relevant clauses in the franchise agreement, including a covenant whereby the franchisor agreed that it would not itself sell the products or compete in any way with the dealer within the dealership area, nor would it directly or indirectly own or have any interest in any business competing with the dealer and located within the dealership area.

The court was faced with an analysis as to whether the franchisor competed with the franchisee “in any way” in the dealership area, by reason of the fact that there was a Framing

and Art Centre store located in Victoria. The head office of the franchisor therefore provided services to both the defendant franchisee and its competitor.

The court considered that it was reasonable to infer that the franchisor either participated in setting up the Canadian Framing and Art Group or chose to become a member of the Group. The franchisor could therefore be assumed to exercise some control over this entity. This entity provided services to the franchisor, and also provided services to the franchisee's competitor. Furthermore, the entity was encouraging U-Frame-It stores to move to the competitor. As a result, the court considered that the franchisor was indirectly competing with the franchisee, and could be considered to be competing within the dealership area. The court stated that whether one describes the competition as if the franchisor was not coming before the court with clean hands or whether it related to the fundamental question of whether it was just and equitable in all of the circumstances to grant the relief sought by the franchisor, in the view of the court the end result was the same and that the relief sought by the franchisor should be denied.

The Flair Franchise Systems case illustrates concerns which franchisors must address where they acquire competing chains and intend to convert such chains to their prime franchise systems. In this particular case, the negative covenant of the original franchisor, which could be interpreted as an exclusive territorial grant, was considered to have been breached by reason of the fact that the original franchisor successor had competing stores within the same dealership area under the succeeding franchisor's own franchise system. The case illustrates the necessity for franchisors to carefully draft their franchise agreements so as to properly reserve rights to acquire competing systems, and to convert such competing systems to the franchisor's system, failing which vaguely worded or inconclusively worded or exclusivity rights may be breached to the detriment of the franchisor.

In the case of Simpson v. First Choice Haircutters Ltd. and Regis Corp.\(^1\), First Choice Haircutters had entered into a development agreement with a franchisee which granted the developer/franchisee the right to operate "Shops" in an assigned "Territory," under separate franchise agreements. The defendant, Regis Corporation, had acquired ownership and control of First Choice. Regis itself was the franchisor of a number of other competing franchise units, in the same territory carrying on similar businesses under different trademarks.

The franchisee brought an action against First Choice and Regis, seeking a permanent injunction against Regis operating and franchising hair cutting salons under competing brands within the assigned territory, in addition to damages.

The decision turned on the interpretation of the term "Shops" contained within the franchise agreement. The franchisee argued that "Shops" encompassed any generic full service hair cutting shop, while the defendants asserted that "Shops" pertained only to First Choice Haircutters brand shops.

After reviewing the Development and Franchise Agreement, the judge stated that:

> When looked objectively and giving business efficacy while avoiding commercial absurdity, one can only come to the conclusion that the development agreement’s definition of “Shops” includes the concept of their being under the brand First Choice.

Accordingly, the exclusivity granted to the franchisee was limited to the First Choice brand of hair cutting shops.

The plaintiff also asserted that Regis had contravened the duty of fair dealing contained within Section 3 of the *Arthur Wishart Act (Franchise Disclosure)*, 2000 on the basis that Regis constituted a “franchisor’s associate” as defined in that legislation. The Court held that Regis did not fall within this definition as it was not directly involved in the grant of the franchise nor did it exercise significant operational control over the franchisee. As such, Regis was not bound by any duty of fair dealing. The judge stated as follows:

To date there does not appear to be any incident, let alone a cause of action, of bad faith dealing between [First Choice] to [Developer] particularly in light of the contractual exclusivity being restricted to [First Choice] brand salons.

As a result, the franchisee was unable to make out a case for an injunction or for any damages pursuant to the *Arthur Wishart Act (Franchise Disclosure)*, 2000.

On appeal, the Ontario Court of Appeal unanimously agreed with the trial judge’s interpretation of the contracts. In relation to the franchisee’s territory, the franchisor agreed only to not grant anyone else a franchise to operate a First Choice Haircutters Shop, and the contractual language could not be taken any further to provide the franchisee with wider protection against competition. Assuming that a “franchisor’s associate” could be subject to the duty of fair dealing in the *Arthur Wishart Act (Franchise Disclosure)*, 2000, the Ontario Court of Appeal also agreed with the trial judge’s interpretation of the term “franchisor’s associate” and his conclusion that the Act did not apply to the present case. In dismissing the appeal, the Ontario Court of Appeal agreed that on the basis of the record, the trial judge properly refused to grant any relief in response to the franchisee’s allegation of bad faith and to the franchisee’s claim that the corporate veil should be pierced.

VI. Conclusion

This paper has highlighted the importance of clear drafting and full disclosure in the context of exclusivity and territorial protection. When drafting and updating franchise agreements, franchisors and their counsel must be proactive and forward thinking. In particular, thought must be given to anticipating possible alternative and emerging distribution channels for the franchise system’s products and services, as well as the possibility that the franchisor could merge with a competitor operating corporate or franchised locations in the franchisee’s protected territory.

As evidenced by the recent U.S. and Canadian case law summarized in this paper, the territory and reserved rights provisions are among the most important in any franchise agreement, as ambiguity and uncertainty in these provisions can often lead to disputes regarding the scope and enforcement of an alleged or actual exclusive territory. Typical franchisee claims in this area sound in breach of contract or breach of the implied covenant of good faith and fair dealing, as well as tort claims based on misrepresentation, tortious interference and breach of fiduciary duty. The strengths or weaknesses of these claims will often turn on the language contained in the franchise agreement and the disclosure document itself. It is, therefore, critical that the commercial lawyers who draft these documents keep abreast of judicial developments in this area so that their drafting stays ahead of the curve and their franchisor clients have the benefit of a franchise agreement that will stand the test of time and enable the franchisor to
grow a healthy franchise system. This growth should balance the needs of existing franchisees and the franchisor and we have seen how franchisors can use an impact policy to achieve this objective of balanced development.
APPENDIX A

SAMPLE QUESTIONNAIRE

The following questionnaire has been developed to assist franchisees with expressing concerns about the development of additional locations within the franchise system. If you wish to object to the proposed development of a new location, you must submit this questionnaire prior to the deadline set forth in the attached letter. Please ensure all of your answers are as specific as possible and not general or conclusory in nature. It is important that you provide all of the information requested. Please attach additional pages to complete your responses, if necessary.

1. Franchisee Name and Address:

2. Existing Location Address [Insert space for unit number or store identifier]

3. Proposed Site Location:

4. What is the driving distance between the existing location and the proposed location?

5. What is the average travel time between the existing location and the proposed location by day part?

6. Please attach a map of the routes used to determine the answers to questions 4 and 5 above.

7. Please describe the geographical area from which your location draws customers. Please use street names, distances and traffic generators (such as malls or airports).

8. In your view, what is the trade area of the proposed site? Please use street names, distances and traffic generators (such as malls or airports).

9. Which areas set forth above do you believe will impact your location?

10. Which streets provide the main flow of traffic to your location? Please include street names and directional flow.

11. Which streets provide the main flow of traffic to the proposed location? Please include street names and directional flow.
12. Are there any natural or man made barriers (such as interstate highways, rivers, etc.) that separate your location from the proposed location?

13. How would you rate the appearance of your location with that of the new location? Please give reasons for your opinion.

14. What is the date of your last remodel and what was the scope of work?

15. Are you currently planning for an upgrade at your location? What is the scope of the renovation and target renovation date?

16. What is the current value of the land, building and equipment at your location? What is the current debt on the land, building and equipment at your location?

17. Please describe local marketing programs that you have run for your location in the past six months.

18. What percentage of sales do you think you may lose if the location is built at the proposed site?

19. Which day parts would be most affected and why?

20. Please set forth any further factors that you believe we should set consider in determining whether or not to develop this location.
ERIKA L. AMARANTE

Erika Amarante is a partner in Wiggin and Dana’s Litigation Department. Her practice includes both trial and appellate litigation in federal and state courts, focusing on franchise and distribution law, antitrust litigation and counseling, and complex civil and commercial litigation. Erika is a member of the firm’s Antitrust and Trade Regulation Practice Group, Franchise and Distribution Practice Group, and Appellate Practice Group.

Erika has litigated a number of franchise encroachment cases and territorial disputes. She also regularly counsels the firm’s franchise and distribution clients on the requirements of federal and state antitrust law. Erika is actively involved in the ABA Section of Antitrust, and serves as a Vice-Chair to the Section’s Distribution and Franchising Committee.

Erika is a graduate of Cornell University, and received her J.D. cum laude from New York University School of Law. After law school Erika served as law clerk to Justice Richard N. Palmer and Justice Francis M. McDonald on the Connecticut Supreme Court, and later served as Executive Assistant to Chief Justice Francis M. McDonald on the Connecticut Supreme Court.
ANDRAYA FRITH

Andraya Frith is a partner in Osler, Hoskin & Harcourt LLP's Business Law Department and is Co-Chair of the firm's National Franchise & Distribution Law Group. She practises business law with an emphasis on franchising, distribution, intellectual property, privacy, e-commerce, marketing and trade practice matters.

Andraya's practice focuses on advising Canadian and International franchisors on all aspects of Canadian franchise legal matters. Andraya also regularly provides advice to franchisors, retailers and on-line businesses on Canadian distribution and trade practice law, including consumer protection legislation, Internet sales, advertising, promotions, packaging and labelling, telemarketing and privacy law. Andraya practices extensively in advising foreign franchisors and retailers expanding their operations to Canada. She helps them manoeuvre through significant judicial, statutory and cultural differences between their home states and Canada to help ensure a smooth and successful entry into Canada. She also provides franchising, intellectual property and privacy support on business transactions, including domestic and cross-border transactions.

Andraya is a member of the Canadian Franchise Association’s Ontario Regional Advisory Council. She is also Co-Founder and Co-Chair of the Toronto Chapter of the International Franchise Association and Canadian Franchise Association's Women’s Franchise Network.

Andraya is recognized as a leading franchise practitioner in the Canadian Legal Lexpert Directory and in The Best Lawyers in Canada.
Karen Boring Satterlee

Karen Satterlee is Vice President, Global Franchise for Hilton Hotels Corporation. She is responsible for all legal issues relating to negotiating, drafting, interpreting and enforcing hotel management and franchise agreements supporting the Company’s global development efforts. Prior to that she was Director, Franchise Licensing for Starbucks Coffee Company and Seattle’s Best Coffee, LLC. Her practice concentrates on advising clients on business issues related to franchising and licensing including sales, administration and organizational matters.

Karen is a member of the American Bar Association Forum on Franchising’s Governing Committee, the Steering Committee for the CPR Institute, National Franchise Mediation Program and the International Franchise Association’s Women’s Franchise Committee. She also serves on the Board of Governors for the Institute of Certified Franchise Executives and received her CFE in 2005.

In addition, Karen a frequent speaker at legal seminars regarding franchise law issues and has published a variety of articles and papers on franchise topics. Most recently, for the Spring 2009 Franchise Law Journal, Karen co-authored Exemption Based Franchising: Are You Playing in a Minefield?

Ms. Satterlee received her Bachelor’s degree and JD from the University of Tennessee where she was a member of the Tennessee Law Review.