ENFORCING SYSTEM STANDARDS —
A FRANCHISOR’S PREROGATIVE?

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October 10-12, 2018
Nashville, Tennessee

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TABLE OF CONTENTS

I. INTRODUCTION .......................................................................................................................... 1

II. EFFORTS BY FRANCHISEES TO ENFORCE SYSTEM STANDARDS .......... 1

III. THE PERILS OF INCONSISTENT ENFORCEMENT: COMMON LAW DEFENSES TO ENFORCEMENT .............................................................. 5

   A. Waiver .................................................................................................................................. 6

      1. General Principles .............................................................................................................. 6

      2. Revocation of Waiver ...................................................................................................... 8

   B. Modification .......................................................................................................................... 8

   C. Estoppel .............................................................................................................................. 10

   D. Duty of Good Faith and Fair Dealing .................................................................................. 10

   E. Limits of Selective Enforcement Defenses to Termination ............................................ 11

   F. Particular Perils Regarding Post-Termination Non-Competition Covenants .......... 12

      1. Inconsistent Enforcement May Undermine Claimed Justification for
         Covenant Not to Compete ............................................................................................. 12

      2. Inconsistent Enforcement May Undercut Claim of Irreparable Harm .......... 14

      3. Inconsistent Enforcement May Give Rise to Waiver or Estoppel Defenses .......... 15

IV. POTENTIALLY APPLICABLE STATE RELATIONSHIP LAWS ............ 16

   A. Post-Termination Obligations ............................................................................................ 17

   B. Transfers .............................................................................................................................. 18

   C. Payment Issues .................................................................................................................. 20

   D. State Antidiscrimination Provisions ................................................................................. 21

V. BEST PRACTICES .................................................................................................................... 22

   A. Franchise Agreement Provisions ....................................................................................... 22

      1. Anti-Waiver and Modification-in-Writing Clauses ....................................................... 23

      2. Third-Party Beneficiary Clauses .................................................................................... 24


      4. Other Considerations ....................................................................................................... 25

   B. The Operations Manual ...................................................................................................... 26
ENFORCING SYSTEM STANDARDS – A FRANCHISOR’S PREROGATIVE?

I. INTRODUCTION

Uniform system standards are critical for any successful franchise system. Such standards regulate everything from the products and services sold by franchisees, to the look-and-feel of outlets, to methods of operation, including how products must be stored, prepared, and delivered to customers. Several articles have been written and sessions have been presented regarding a franchisor’s ability to implement, modify, and enforce system standards.\(^1\) It is well established that a franchisor should consistently enforce its system standards. But what if a franchisor doesn’t, either due to neglect, lack of resources, business strategy (such as a desire not to jeopardize a relationship with a high-performing but partially non-compliant franchisee), or otherwise?

This paper explores the legal and business problems that may arise when a franchisor does not consistently and uniformly enforce its standards. Section II addresses whether franchisees can compel the franchisor to enforce system standards at company-owned outlets or against other, non-compliant franchisees. Section III discusses how a franchisor’s history of selective or non-enforcement of system standards regarding some non-compliant franchisees may jeopardize efforts to enforce system standards against other non-compliant franchisees by giving rise to waiver, modification, estoppel, or violation of duty of good faith and fair dealing defenses. Section IIII also addresses the related issue of how a franchisor’s history of selective or non-enforcement may affect a franchisor’s efforts to enforce post-term covenants not to compete. Section IV analyzes the effect of state franchise relationship laws and anti-discrimination statutes on a franchisor’s differential enforcement of system standards. Finally, Section V proposes some best practices for franchisors regarding enforcement (or renewed enforcement) of system standards.

II. EFFORTS BY FRANCHISEES TO ENFORCE SYSTEM STANDARDS

Generally speaking, unless the franchise agreement explicitly imposes an affirmative obligation on a franchisor to take certain steps to protect the system, franchisees typically lack the ability to force the franchisor to take action to enforce system standards.

In *Shoney’s Inc., v. Morris*,\(^2\) a former franchisee claimed the franchisor breached its franchise agreements by “causing or permitting the decline of the value, reputation, and sales of Shoney’s,” thus resulting in a reduction in sales at both company-owned and franchisee-operated stores” that forced the franchisee to prematurely close all of his restaurants.\(^3\) The decline in sales allegedly was due to “a decline in operational execution, food quality and service standards” that Shoney’s either committed or allowed to occur.\(^4\) The franchisee argued that the franchisor had a specific contractual obligation to enforce its brand standards—“to

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\(^2\) 100 F. Supp. 2d 769 (M.D. Tenn. 1999).

\(^3\) *Id.* at 771, 775 (internal quotations and citation omitted).

\(^4\) *Id.* at 774 n.10.
maintain high standards for food quality, operational execution, service and cleanliness”—at its own company-owned restaurants. The U.S. District Court for the Middle District of Tennessee disagreed, finding that the franchisor had no obligation to enforce brand standards or otherwise maintain a “high level of reputation” among its company-owned stores. The court specifically noted that the language of the franchise agreement required the franchisees to maintain system standards without creating a concomitant right to enforce those standards against the franchisor.

While Shoney’s Inc. v. Morris was seemingly limited to the franchisor’s lack of an obligation to maintain high standards at its own company stores, the same court later clarified that Shoney’s similarly had no obligation to require the franchisees to maintain brand standards. In Kinnard v. Shoney’s, Inc., the plaintiff franchisees claimed the franchisor breached the parties’ agreements by failing to maintain its company-owned stores according to the standards set forth in the franchise agreements and failing to require all franchisees to maintain such standards, thereby causing harm to Shoney’s reputation. In granting summary judgment to Shoney’s, the court focused on the specific language of the franchise agreement to hold that Shoney’s did not have a contractual obligation to take action to maintain brand standards at company-owned and franchised restaurants. According to the court, neither the contractual requirement that the franchisees follow the system nor the franchisor’s contractual right to inspect the franchisee’s restaurants “create an obligation on the part of Shoney’s to maintain its restaurants according to certain standards or to ensure that the other franchisees are maintained according to such standards.” That is, the franchisees had a contractual obligation to Shoney’s to maintain system standards at their franchised restaurants, but Shoney’s had no contractual obligation to specific franchisees to maintain system standards at company-owned restaurants. Similarly, while Shoney’s had a right to inspect franchised restaurants, it did not have an obligation to do so.

A similar result was reached by the court in Creel Enterprises, Ltd. v. Mr. Gatti’s, Inc. The case dealt with a plaintiff-franchisee who owned two Mr. Gatti’s pizza restaurants in Birmingham, Alabama. Another franchisee, B.S.D., owned five Mr. Gatti’s restaurants. After all of B.S.D’s restaurants were shuttered, the plaintiff argued that the franchisor had failed to enforce its quality standards, and that the loss of units in the market had damaged the plaintiff’s locations. The U.S. District Court for the Northern District of Alabama rejected the franchisee’s claim, finding that “Plaintiffs have failed to point to any provision in their franchise agreements which obligates Mr. Gatti’s to enforce the quality standards provisions in the contracts signed by another franchisee.”

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9 Id. at 775.
6 Id.
7 Id.
8 100 F. Supp. 2d 781 (M.D. Tenn. 2000).
9 Id. at 794.
10 Bus. Franchise Guide (CCH) ¶ 9825 (N.D. Ala. 1990), aff’d, 933 F.2d 1022 (11th Cir. 1991).
11 Id. The court further noted that “Creel was not a party to the contracts complained about and thus has standing to enforce it only if it is a third-party beneficiary, not indirectly by suing on its own contract with Mr. Gatti’s.” Id. See also Kilday v. Econo-Travel Motor Hotel Corp., 516 F. Supp. 162, 163 (E.D. Tenn. 1981) (granting franchisor’s motion to dismiss because franchise agreement provision empowering franchisor to require franchisee to conform to quality standards did not “obligate the [franchisor] to require all its franchisee to conform to the standards required of the [plaintiffs].”).
While the above decisions suggest courts will not impose on franchisors an implied duty to enforce system standards or otherwise "protect" the system, courts are willing to enforce such a duty where expressly imposed by the parties' contract. In The Jade Group, Inc. v. Cottman Transmission Centers, LLC, each of the relevant license agreements imposed on the franchisor—Cottman—a contractual obligation to "continue to develop, promote and protect the good will and reputation associated with the Cottman name and marks and other distinguishing aspects of the SYSTEM."\footnote{No. 16-01237, 2016 WL 3763024, at *3 (E.D. Pa. July 13, 2016).} Certain franchisees claimed Cottman had breached this obligation when it acquired another related brand, AAMCO, and then shifted resources from Cottman to AAMCO.\footnote{Id.} According to the plaintiffs, this resulted in a substantial reduction in the total number of Cottman units, in addition to a loss of critical infrastructure and support.\footnote{Id. at *7.}

Cottman moved to dismiss, arguing the plaintiffs had no legitimate basis to expect that the number of Cottman units would increase in perpetuity.\footnote{Id. at *7.} Although agreeing with Cottman that goodwill was not necessarily tied to the number of units, the U.S. District Court for the Eastern District of Pennsylvania nevertheless denied the motion to dismiss, finding the plaintiff stated a claim under the specific language of the contract.\footnote{Id.} In the court's view, the franchisee sufficiently alleged that the franchisor failed to "develop, grow and protect the brand" as required by the license agreement.\footnote{Id. (citing Newark Morning Ledger Co. v. United States, 507 U.S. 546, 555-56 (1993) (describing "goodwill" as "the expectancy of continued patronage").} The case subsequently settled without any dispositive order on whether or not Cottman's alleged failure to invest in the brand breached the licensed agreement.

In Yankee Enterprises, Inc. v. Dunkin' Donuts, Inc.,\footnote{121 F.3d 703 (5th Cir. 1997).} Dunkin' Donuts promised in its franchise agreement to "continue its efforts to maintain high and uniform standards of quality, cleanliness and service at all its stores."\footnote{Id. at *1.} Based on this contractual obligation, an alleged injured franchise could bring a breach of contract claim based on allegations that Dunkin' diverted attention, resources, and personnel away from the plaintiff's region and failed to properly supervise other franchisees in the area.\footnote{Id.} More specifically, the plaintiff alleged that reduced standards of cleanliness in other nearby stores—resulting from the franchisor's failure to supervise—caused the plaintiff to lose sales, even though the plaintiff's store met or exceeded system standards.\footnote{Id. at *2.} The jury agreed, rendering a verdict in favor of the franchisee. On appeal, the Fifth Circuit did not dispute that the wording of the franchise agreement could require a franchisor to enforce its system standards as a matter of contract. Nevertheless, the court reversed the jury's verdict, finding there was no credible evidence to support the jury's finding that Dunkin's alleged breach caused the plaintiff's purported damages.\footnote{Id. at *3.}
Similarly, in *Bishop v. GNC Franchising LLC*, the Western District of Pennsylvania denied a franchisor’s motion to dismiss under the pre-*Twombly/Iqbal* standard after finding the plaintiffs may be able to state a set of facts to support their claim that GNC breached its contractual obligation under franchise agreement to “seek to maintain high standards of quality, appearance, and service of the System.”

Cases like *The Jade Group*, *Yankee Enterprises*, and *Bishop* are unusual in that the relevant agreements included language that explicitly and affirmatively required the franchisor to take action to maintain high standards or otherwise protect the system. While the provisions quoted above may seem vague and aspirational, these cases illustrate that the wording of the franchise agreement can obligate a franchisor to enforce its system standards and otherwise “protect” the system.

Finally, although involving attempted enforcement of trade secrets and non-compete obligations as opposed to system standards, *Canha v. LaRoche* is instructive as to the challenges and opportunities faced by a franchisee who wishes to force its franchisor or other franchisees to protect the brand.

In *Canha*, the plaintiff franchisee owned a Gymboree franchise, which was in the business of providing programs and equipment for child development. The plaintiff claimed the value of her franchise had been diminished when the franchisor and another franchisee, Jane LaRoche, failed to take action to prevent Maureen LaRoche, Jane’s former employee and sister-in-law, from unfairly operating a competing business using Gymboree’s trade secrets and confidential materials. The plaintiff further alleged that Jane LaRoche had an interest in the competing business. The plaintiff sued Gymboree for breaching: (1) the plaintiff’s franchise agreement; (2) the franchise agreement between Gymboree and Jane LaRoche; and (3) a non-disclosure/non-competition agreement signed by Maureen LaRoche, and she sued Jane LaRoche for breaching LaRoche’s own franchise agreement. The plaintiff also asserted claims against all defendants—Gymboree, Jane LaRoche, and Maureen LaRoche—for breach of the implied covenant of good faith and fair dealing, and violations of Massachusetts’ Consumer Protection Act.

The Massachusetts Superior Court granted the franchisor and other franchisee’s motions to dismiss the plaintiff’s breach of contract claims. The plaintiff claimed Gymboree had a contractual obligation to protect her from unfair competition because her franchise agreement grants her the right to an exclusive territory. The court disagreed, finding “Gymboree is under no obligation to [the] plaintiff to bring an action against another franchisee, or anyone else.” While Gymboree agreed not to place another Gymboree Program within the plaintiff’s exclusive territory, Maureen LaRoche’s competing business was not a Gymboree and therefore did not violate the plaintiff’s franchise agreement. The court further found “Gymboree had no contractual duty to protect plaintiff from the competition which Maureen’s business poses, nor is Gymboree under any obligation to plaintiff to regulate the conduct of any person or entity not a party to the [franchise agreement between plaintiff and Gymboree].”

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25 *Id.* at *3.
26 *Id.*
27 *Id.* at *4.
The court also rejected the plaintiff’s efforts to enforce the contractual obligations between Gymboree, Jane LaRoche, and/or Maureen LaRoche on a third-party beneficiary theory.28 The court found there was no contractual relationship between the plaintiff and either Jane LaRoche or Maureen LaRoche and the plaintiff was not a third-party beneficiary of their agreements. For example, the franchise agreement specifically provided that “Franchisee shall have no right to enforce the obligations of any other franchisees of Gymboree. Franchisee shall not be deemed a third-party beneficiary with respect to any other franchise agreement or other agreement or have any rights to enforce any obligations thereunder.”29 Relying on that language, the court dismissed the plaintiff’s contract claims, noting the franchisor “did not intend for plaintiff to have a stake in the action on the part of Gymboree against any other party.”30

The plaintiff had more success with her implied covenant of good faith and fair dealing claim—at least as to the franchisor. Under Massachusetts law, the implied covenant requires that “[n]either party shall do anything that will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.”31 Despite dismissing the breach of contract claims because there was “no breach of the express terms of the [plaintiff’s Franchise] Agreement,” the court refused to dismiss the implied covenant claim “because the implied covenant cannot be contracted away. Ultimately, plaintiff may be able to prove her case for breach of this covenant by showing that Gymboree sought to deny her the fruits of the [plaintiff’s Franchise] Agreement by allowing Maureen to infringe on plaintiff’s exclusive territory.”32 On the other hand, the plaintiff could not state a contract-based implied covenant claim against Jane LaRoche or Maureen LaRoche because, as noted above, the plaintiff was not a party to or third-party beneficiary of their contracts.33

Finally, the plaintiff claimed that Maureen LaRoche’s unfair competition using the system’s trade secrets and Gymboree and Jane LaRoche’s failure to stop such unfair competition constitute unfair or deceptive business practices in violation of Massachusetts’ broad Consumer Protection Law.34 Finding this is a fact-specific, case-by-case inquiry and the plaintiff had sufficiently alleged unfair and deceptive acts, the court denied the defendants’ motions to dismiss and allowed these claims to proceed.35

III. THE PERILS OF INCONSISTENT ENFORCEMENT: COMMON LAW DEFENSES TO ENFORCEMENT

As noted above, real or perceived inconsistent enforcement of system standards can hand a franchisee tools in a dispute with a franchisor. Faced with a franchisor’s lawsuit to enforce system standards or other contractual obligations (such as a covenant not to compete), the non-compliant franchisee may argue that historical non-enforcement or inconsistent enforcement by the franchisor should bar the franchisor’s current efforts. In this section, we

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28 id.
29 id. at *4.
30 id.
31 id. at *5 (quoting Anthony’s Pier Four, Inc. v. HBC Assoc., 411 Mass. 451, 471 (1991)).
32 id.
33 id. at *5.
34 MASS. GEN. LAWS. CH. 93A.
discuss common-law defenses to franchisor enforcement when a franchisee claims that
enforcement has been inconsistent.\footnote{Defenses arising from state relationship laws are discussed in Section IV, infra.}

A. Waiver

1. General Principles

Waiver is "[t]he voluntary relinquishment—express or implied—of a legal right or
advantage...."\footnote{BLACK'S LAW DICTIONARY (10th ed. 2014).} A party must be aware of the rights that it is waiving for waiver to effectuate. A
waiver must be a clear expression made with full knowledge of the facts and an intent to waive
the right.\footnote{Traumann v. Southland Corp., 842 F. Supp. 388 (N.D. Cal. 1993) (holding a letter congratulating prospective franchisees upon being accepted as franchisees was not a waiver of a contractual provision stating that they were subject to further approval). But see Physicians Weight Loss Centers of Am. v. Creighton, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 8000, 1992 WL 176992 (N.D. Ohio 1992) (franchisee waived rights where it answered a questionnaire stating that it was satisfied with the franchisor and that the franchisor was not in default of its obligations).

A number of courts have found waiver where affirmative conduct demonstrates an
intention to waive enforcement of a contractual provision.\footnote{Robinson v. Charter Practices Int'l LLC, No. 3:14-CV-1736-PK, 2015 WL 1799833 (D. Or. Apr. 16, 2015), aff'd, 2017 WL 2684122 (9th Cir. 2017); see also Ramada Franchise Sys., Inc. v. Capitol View II Ltd. P'ship Venture, 132 F. Supp. 2d 358 (D. Md. 2001) (finding waiver where franchisee knowingly and willingly paid higher fees to the franchisor knowing that the fees were overcharges); JMF, Inc. v. Medicine Shoppe Int'l, Inc., No. 3:09-cv-73, 2011 WL 4369475 (D.N.D. Sept. 19, 2011) (where franchisees complained that a franchisor had failed to provide promised accounting services but then retained their own accountants and failed to enforce an alleged breach, the franchisor was entitled to summary judgment because the franchisees had waived their rights). But see Blinn Wholesale Drug v. Eli Lilly & Co., 648 F. Supp. 1433 (E.D. N.Y. 1986) (where a manufacturer guaranteed certain prices for time periods beyond the expiration date of a distributorship agreement, the court found that the manufacturer had not waived the expiration date of the contract because that provision was not inconsistent with the right to terminate at expiration).}

The most obvious cases for waiver occur where a party explicitly waives a particular
right in writing. But waiver can also be implied from action or failure to act.

The parties originally signed multiple franchise agreements, all but one of which expired or terminated over time. The original franchise agreement at issue contained provisions expressly prohibiting the franchisee from
owning, operating or being employed by any competing veterinary hospital at any time during
the term of the agreement or for two years thereafter within five miles of the franchise location.
The original franchise agreement contained a provision allowing the franchisee to renew the
agreement for an additional five year term provided certain terms and conditions were met.
When the franchisee originally applied to be a franchisee in the system, he advised the
franchisor that he owned and operated a veterinary hospital that he intended to continue to own
and operate if he became a franchisee. With this knowledge, the franchisor nevertheless signed
multiple franchise agreements with the franchisee. Problems arose when, ten years later, the
franchisee sought to renew a franchise agreement and continue to operate one location as a
franchised location while maintaining other, non-franchised locations. The franchisor informed
the franchisee that it would not permit renewal of the franchise agreement while the franchisee operated other non-franchised locations, which would violate the covenant not to compete contained in the then-current form of agreement. The franchisee filed suit.\textsuperscript{41}

Several of the franchisee’s theories were premised on the proposition that the franchisor had waived enforcement of the noncompetition provisions in the original franchise agreements in connection with his ownership of the non-franchised veterinary hospital. The court agreed, holding that the franchisor had waived enforcement of the covenant not to compete through its course of conduct because it had accepted the franchisee’s application to be a franchisee with clear advance notice that the franchisee intended to continue to operate the non-franchised hospital and then permitted him to operate it for the ensuing decade.\textsuperscript{42}

Some courts have found waiver when a party knowingly fails to enforce provisions of an agreement.\textsuperscript{43} \textit{Elder Care Providers of Ind., Inc. v. Home Instead, Inc.}, provides an example of a case where the franchisor’s non-enforcement of termination provisions led to a holding that it could not terminate without notice and an opportunity to cure.\textsuperscript{44} The franchisor, Home Instead, offered franchises that provided non-medical care to senior citizens. The franchisee’s owners formed “Home Again Senior Care” to provide skilled nursing and home health aide services, not provided by the franchised business. When the franchisor first learned of Home Again, it was concerned about potential confusion of Home Again’s name with Home Instead, and concerned that Home Again would provide services in competition with the franchised business, but took no steps to enforce various provisions in the franchise agreement that might be implicated by Home Again’s existence for twenty months. The franchisor also made statements to the franchisee that the court described as “casual and acquiescing” and nonthreatening over a twenty-month period.

At the end of twenty months, during which time Home Instead contended it was “investigating” whether the franchisee was competing through Home Again, Home Instead terminated the franchise agreement for, among other things, violating the in-term covenant not to compete. The franchisee ultimately sued, alleging that the termination was a breach of the franchise agreement and violation of Indiana’s franchise statute. On cross motions for summary judgment, the court held that the franchisor’s “out of the blue” termination after only mentioning in passing concerns about the Home Again name was wrongful. The court further held that Home Instead’s “failure to take immediate steps to terminate the Franchise Agreement upon discovery” and “instead allowing twenty months to pass” led the franchisee to believe that the franchisor would not terminate without notice and an opportunity to cure. Thus, the court found that Home Instead had waived the ability to immediately terminate the franchise agreement.

Because waiver cases are fact intensive, cases that seem to have similar facts can have opposite results. For example, two courts applying Florida law arrived at opposite conclusions when faced with similar facts on whether the franchisor waived the right to terminate a

\textsuperscript{41} Id.

\textsuperscript{42} Id. at *9.


\textsuperscript{44} \textit{Elder Care Providers of Ind.}, 2017 WL 1106093, at *8.
franchisee for failure to make timely payments. A bankruptcy court applying Florida law held that the franchisor did not waive the right to terminate.\textsuperscript{45} However, another Florida case reached the opposite result on similar facts.\textsuperscript{46}

2. Revocation of Waiver

A waiver of a known right can be revoked by a party with reasonable notice.\textsuperscript{47} For example, in the Robinson case, the court held that the franchisor had effectively revoked its prior waiver of the non-competition provisions by providing 18 months' notice of its intention to require strict compliance with corresponding provisions in a renewal franchise agreement.\textsuperscript{48} The court went on to hold that franchisor was not required to offer the franchisee a renewal agreement permitting continued competition by the franchisee. Because the renewal provisions of the franchise agreement that the renewal would be conditioned upon execution of the then-current form of agreement and because the terms of that agreement could differ in both specified and unspecified ways from the original agreement, the franchisor's "insistence that [the franchisee] execute a form of agreement that contained unwaived non-competition provisions notwithstanding its partial waiver of the analogous provisions of the original agreement was not in violation of the express terms of the parties contract."\textsuperscript{49}

A notice reinstating the previously waived right must be sufficiently tailored to the waived right. For example, a franchise agreement required an area developer to open 27 stores within six years. The franchisor did not enforce the provision in the face of the franchisee's failure to develop the territory and then attempted to retract the waiver by giving general notice to all franchisees that it would, henceforth, enforce such provisions. The court found that the notice was ineffective because it was too vague. To successfully retract the waiver, it was necessary to give notice that the franchisees would be expected to meet specific goals within specific, reasonable periods of time.\textsuperscript{50}

B. Modification

Franchisees faced with enforcement after a period of non- or inconsistent enforcement sometimes argue that the parties have modified the franchise agreement by conduct. While waiver is the relinquishment of a right which results in a surrender of past claims, modification "alters the entire contract, embracing both performed acts as well as unperformed acts."\textsuperscript{51} The parties to a franchise agreement may modify the agreement by express consent or implied conduct. Modification occurs where elements in a contract are added or removed, but the effect

\textsuperscript{45} In re M & E Enters., Inc., 23 B.R. 820 (Bankr. S.D. Fla. 1982). But see Sheldon v. Munford, Inc., 950 F.2d 403 (7th Cir. 1991) (where franchisee had paid royalties late for the entire 12 years of the franchise agreement, and there was evidence that the franchisor had expressly agreed to permit franchisee a period of time in which to bring payments current, franchisor waived its right to terminate for late payment of such royalties).

\textsuperscript{46} CJ Restaurant Enters., Inc. v. FMS Mgmt. Sys., Inc., 699 So. 2d 252 (Fla. 3d DCA 1997). See also Sheldon, 950 F.2d 403.

\textsuperscript{47} Robinson, 2015 WL 1799833, at *10.

\textsuperscript{48} Id.

\textsuperscript{49} Id. (citations omitted).


\textsuperscript{51} Kerry L. Bundy & Scott K. Ikeda, How Waiver, Modification, and Estoppel May Alter Franchise Relationships, 30 Franchise L. J. 3 (Summer 2010).
and purpose of the contract are unaffected.\textsuperscript{52} There must be an intent to modify an agreement for a modification to occur. Courts generally look to whether the parties have mutually assented to a particular change when considering modification. Modification by mutual assent may be proven by either explicit agreement to modify or by conduct, if the intent is mutual and clear.\textsuperscript{53} Thus, unilateral statements will generally not be found to constitute a modification.\textsuperscript{54}

Many franchise agreements contain provisions that prohibit a finding of modification absent a writing signed by both parties. Generally, courts will not enforce oral modifications where agreements specifically require modifications in writing.\textsuperscript{55} However, oral modification may be enforceable where the parties’ conduct reflected the modification.\textsuperscript{56} Further discussion of anti-waiver and anti-modification provisions is set forth in Part V.A., below.

\textit{G.L.M. Security & Sounds, Inc. v. LoJack Corp., Inc.} is instructive. In that case, distributor GLM agreed to purchase stolen vehicle recovery units (SVRUs) from LoJack for resale and installation. The agreement provided that payments would be considered late sixty days after invoice and that late payments would bear 1.5\% interest per month until paid. The agreement contained integration and anti-waiver clauses, and a clause providing that the contract could not be modified without a writing. After GLM fell behind on payment, LoJack terminated. GLM sued, and LoJack counterclaimed for payment. In the first reported opinion on the case, the court granted LoJack’s motion for summary judgment on its counterclaim against GLM.\textsuperscript{57} In a subsequent opinion on LoJack’s motion for damages, GLM argued that LoJack had modified the sixty day payment deadline but not the interest provisions of the agreement.

On the payment deadline, the court held that LoJack had modified the payment deadline from sixty to ninety days via an email from the president of the company stating that the parties needed to “stick with the payment terms LoJack has already extended to GLM which are 90 days.” The court held that this email evidenced an oral modification of the agreement. The court held that “memorialization of the agreement, action in conformity with the agreement, written communications, such as an email, recognizing the terms of the agreement, among other things,” sufficed to support GLM’s contention that LoJack had orally modified the agreement.\textsuperscript{58} The court held that there must be “evidence of sufficient force to overcome the presumption that the parties did not intend to waive the written modification requirement in the fully integrated and complete Distribution Agreement” for an oral modification to prevail against a non-modification agreement.\textsuperscript{59} On the other hand, in a subsequent opinion, the court held that LoJack had not modified the interest provisions by failing to charge interest on invoices and through its course of conduct. The court held that GLM could not overcome the provisions of the distribution

\textsuperscript{52} § 8:19. Modification, 2 Franch & Distrib. Law & Prac. § 8:19.

\textsuperscript{53} Elliott & Frantz, Inc. v. Ingersoll-Rand Co., 457 F.3d 312 (3d Cir. 2006) (a franchisor’s statement of policy that was expressly nonbinding did not modify the franchise agreements).


\textsuperscript{56} See Robinson, 2015 WL 1799833, at *9 (“Even where an agreement contains a provision expressly requiring any waiver or modification of any other provision of the agreement to be in writing, any party thereto may waive any provision thereof either orally or through course of conduct.”).


\textsuperscript{58} Id.

\textsuperscript{59} Id. at *8.
agreement because LoJack’s conduct with respect to interest did not "clearly and convincingly support the complete elimination of the Agreement's interest provision." 60

Similarly, a court applying Wisconsin law found that oral statements referring to past experience and made in casual contexts are not sufficient enough to manifest an intent to change the contract. 61 Under Wisconsin law, a contract may be modified by conduct but only when the acts are unequivocal in their character and inconsistent with enforcing the written agreement. 62 The court held that the manufacturer's pattern of terminating franchises with cause was not unequivocally inconsistent with retention of the power to terminate without cause, and therefore manufacturer did not modify franchise agreement by enforcing a termination at-will provision. 63

C. Estoppel

Estoppel is another commonly invoked counterclaim or defense where a franchisee argues inconsistent enforcement of the franchise agreement as a defense to current enforcement. The elements of estoppel are: "(1) action or inaction, (2) on the part of one against whom estoppel is asserted, (3) which induces reasonable reliance thereon by the other, either in action or inaction, and (4) which is to his or her detriment." 64 The party seeking to rely on estoppel has the burden of showing that it relied detrimentally on the action or inaction and that the reliance was reasonable. 65 Estoppel is a close relative of waiver. Estoppel requires a change in position in reliance on the actions of the party to be estopped, where waiver does not.

Estoppel is an equitable doctrine. "[O]nce the elements of equitable estoppel have been established as a matter of law, the decision to actually apply the doctrine to provide relief is a matter of discretion." 66 In other words, even if the elements are established, a court might not necessarily apply the doctrine. For example, a court declined to hold that a franchisor was estopped from collecting certain amounts from the franchisee where, even though the franchisor's statements of account erroneously showed that the franchisee did not owe the money, the franchisee knew that the statements were in error. 67 Similarly, the court in the Haynes Trane case held that the franchisee's unclean hands and "failure to play straight" with the franchisor were an appropriate basis on which a district court declined to apply the doctrine, even though the franchisee had established the elements of equitable estoppel. 68

D. Duty of Good Faith and Fair Dealing

Franchisees may also claim that a franchisor violated the covenant of good faith and fair dealing by enforcing the franchise agreement inconsistently, either as a defense or a

63 Id. at 956.
64 Bundy & Ikeda, supra note 51, at 4 (citation omitted).
65 Id.
66 Haynes Trane Serv. Agency, 573 F.3d at 957 (applying Wisconsin law) (internal quotation omitted).
68 See Haynes Trane Serv. Agency, 573 F.3d at 957.
counterclaim.\textsuperscript{69} Nearly all states recognize that there is a covenant of good faith and fair dealing implied in every contract, requiring honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.\textsuperscript{70} The covenant means that "neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the full fruits of the contract."\textsuperscript{71} However, if the contract addresses the issue in express, clear terms, the implied covenant does not apply to override the contractual language.\textsuperscript{72}

The \textit{7 Eleven Inc. v. Sodhi} case is illustrative of the principle that the covenant cannot override the express language of an agreement.\textsuperscript{73} There, the franchisee was the operator of six locations in New Jersey. The franchise agreement contained a provision requiring the franchisee to pay all taxes, including sales, payroll, income and property taxes. 7-Eleven conducted an audit and found that the franchisee had intentionally failed to report hundreds of thousands of dollars of merchandise sales, siphoned cash from the stores to pay workers off the books, failed to comply with wage and hour laws and failed to pay sales and payroll taxes. 7-Eleven then issued the franchisee a notice of incurable breach and termination. 7-Eleven sued the franchisee seeking a declaration that it had properly terminated for breach, and the franchisee counterclaimed on a number of theories, including good faith and fair dealing. The district granted summary judgment on the good faith and fair dealing claims, which the franchisee appealed. The franchisee claimed his stores were targeted for enforcement where other franchisees were not because he was a critic of the franchisor, but he did not dispute that he breached the franchise agreement. The Third Circuit affirmed, holding that the admitted failure to pay taxes breached the agreement and gave 7-Eleven good cause to terminate the agreement, "whatever its motivation in doing so."\textsuperscript{74}

E. Limits of Selective Enforcement Defenses to Termination

One notable case that doesn't mention waiver, estoppel, good faith and fair dealing, or the other concepts discussed above is \textit{Original Great American Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.}\textsuperscript{75} In that case, a former franchisee who was terminated for underreporting gross sales, among other defaults, challenged its termination by arguing that the franchisor had not terminated other franchisees for similar breaches. The Seventh Circuit rejected the defense, holding that a franchisor's treatment of its other franchisees was irrelevant to the propriety of the termination.\textsuperscript{76} Judge Posner explained, "[t]he fact that the [franchisor] may, as the [franchisees] argue, have treated other franchisees more leniently is no more a defense to a breach of contract than laxity in enforcing the speed limit is a defense to a

\textsuperscript{69} As discussed in Section IV below, non-uniform treatment of franchisees may trigger causes of action or defenses under state relationship laws.

\textsuperscript{70} Restatement (Second) of Contracts § 205. See also Uniform Commercial Code.


\textsuperscript{72} \textit{Id.} at 780 (holding "the implied covenant of good faith and fair dealing cannot override an express term in a contract").

\textsuperscript{73} \textit{Id.}

\textsuperscript{74} \textit{Id.} See also \textit{Bull Intl', Inc. v. MTD Consumer Grp., Inc.}, 654 F. App'x 80 (3d Cir. 2016) (holding that manufacturer did not act improperly in terminating agreement according to its terms, despite allegations that termination was motivated by allegedly improper reasons).

\textsuperscript{75} 970 F.2d 273 (7th Cir. 1992).

\textsuperscript{76} \textit{Id.} at 279. After concluding that the termination was proper, the Seventh Circuit held that the district court should have granted the franchisor's motion for preliminary injunction to enjoin the former franchisee's continued operation under the marks. \textit{Id.} at 282.
speeding ticket." The Seventh Circuit’s decision contained no discussion of issues like waiver, estoppel, or discrimination, instead simply noting that “[i]liability for breach of contract is strict.”

Under *Original Great American Chocolate Chip Cookie*, a franchisor’s failure to enforce the franchise agreement’s contractual provisions (including the requirement to comply with brand standards) against another franchisee does not render the provision unenforceable against the defendant or excuse the defendant’s contractual breach. Without more, the fact that a franchisor waived certain obligations as to *some* current or former franchisees does not mean it waived the obligations as to *all* franchisees.

**F. Particular Perils Regarding Post-Termination Non-Competition Covenants**

Just as a franchisor may seek to protect the reputation and goodwill of the system through implementation and enforcement of system-wide brand standards, a franchisor may also attempt to protect the system through enforcement of covenants not to compete. Of course, for any number of reasons, franchisors may not choose to sue to enforce its restrictive covenants in all cases. However, selective or inconsistent enforcement could jeopardize future enforcement efforts for reasons particular to covenants not to compete.

While courts may be resistant to selective enforcement defenses in traditional breach of contract cases, the unique nature of restrictive covenants—including statutory and common law restrictions on their enforceability, and the facts that they are primarily enforced through equitable actions and restrict future conduct—may make courts more receptive to such arguments in post-term non-compete cases. Faced with a franchisor’s lawsuit to enforce a post-termination restrictive covenant, the competing former franchisee may argue that past inconsistent enforcement by the franchisor against other franchisees: (1) undermines the franchisor’s claimed justification for the non-compete; (2) shows an injunction is not necessary because the franchisor is not being irreparably harmed by the ongoing competition; or (3) shows the franchisor waived or is equitably estopped from enforcing the restrictive covenant. As discussed below, a franchisor seeking to enforce its post-term covenant not to compete must be prepared to explain any prior selective enforcement of the restrictive covenant.

**1. Inconsistent Enforcement May Undermine Claimed Justification for Covenant Not to Compete**

Inconsistent enforcement of a non-compete may jeopardize a franchisor’s ability to establish that the non-compete is reasonable and necessary, and thus valid and enforceable.

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77 Id. at 279. See also Zeidler v. A&W Rest., Inc., No. 99 C 2591, 2001 WL 62671, at *4 (N.D. Ill. Jan. 25, 2001) (“A & W’s treatment of its other franchisees is irrelevant to its treatment of plaintiffs” in plaintiffs’ wrongful termination suit against the franchisor alleging lack of support); Bonanza Int’l, Inc. v. Restaurant Mgmt. Consultants, 625 F. Supp. 1431, 1447 (E.D. La. 1986) (“Whether or not [the franchisor] treated defendants differently than other area distributors has no bearing on whether [the franchisor] acted fairly and in good faith in their treatment of defendants under the Area Distributor’s Agreement”).

78 970 F.2d at 279.

79 See Mr. Steak, Inc. v. Bellevue Steak, Inc., 555 P.2d 179, 182 (Colo. App. 1976) (holding that the franchisor’s “actions with regard to other franchises cannot sustain a finding that it waived its rights under the specific terms of its agreement with these defendants”).


81 Id. at 257-60.
In assessing the enforceability of a non-compete, courts generally ask whether the restriction is reasonably necessary to protect the company’s legitimate business interests, and whether the restriction is narrowly tailored.82 A former franchisee could argue that a franchisor’s inconsistent enforcement against other former franchisees shows that the franchisor either does not have a protectable interest to justify the non-compete or that the non-compete is broader than necessary to protect such interest.83

For example, several courts have held that protection of a franchisor’s trade secrets and confidential information is a legitimate interest that can support enforcement of a post-termination covenant not to compete.84 However, the argument for protecting a franchisor’s purported trade secrets appears much less compelling where a franchisor knowingly allows other former franchisees who possessed the franchisor’s trade secrets to compete against the franchisor without action. Indeed, failure to maintain its secrecy jeopardizes trade secret status.85 In such a case, the former franchisee could argue that if a post-term non-compete was really necessary to protect the franchisor’s trade secrets, the franchisor would have enforced the non-compete against all former franchisees who launched competing businesses.

In addition, franchisors frequently argue that their interest in refranchising the relevant marks supports enforcement of a particular post-term covenant not to compete. Evidence of the franchisor’s growth strategy is critical when the franchisor raises this justification. For example, in Petland, Inc. v. Hendrix,88 a franchisor moved to enjoin its former franchisee from operating a competing pet store in Stafford, Texas. After Petland argued that its interest in refranchising justified the non-compete, the defendant argued that Petland had in fact permitted three other former franchisees to remain in the pet store business following the termination of their franchise agreements. The court was receptive to the franchisee’s argument, noting “this fact might even prove dispositive if the circumstances of the instant case were not inescapably distinguishable.”87 Specifically, the court found that “the company had no intention of refranchising those select markets,” while “Petland claims an interest in re-franchising the Stafford market.”88 The court went on to conclude that “[a]ny selective enforcement of the clause here is ground in credible business reasons and does not serve to render the non-competition clause invalid against [Hendrix].”89

82 Peter J. Klarfeld & Mark S. VanderBroek, Law on Covenants Against Competition Shifts Toward Greater Enforceability by Franchisors, 31 FRANCHISE L.J. 76, 76 & 78 (Fall 2011).
83 See Dance & Sentell, supra note 80, at 257.
84 See, e.g., Sylvan Learning, Inc. v. Gulf Coast Educ., Inc., No. 1:10-CV-450-WKW [WOL], 2010 WL 3943643, at *6 (M.D. Ala. Oct. 6, 2010) (enforcing a covenant not to compete where the franchisee had “continued to use [the franchisor’s] goodwill, method of operation, and client list to operate his own independent learning center after the termination”).
87 Id. at *7.
88 Id.
89 Id.
The court in *Petland* concluded that the franchisor’s ability to offer credible business reasons for its selective enforcement distinguished it from cases like *Patel v. Baskin-Robbins, USA Co.*,\(^{90}\) where the court denied an injunction because the franchisor failed to present persuasive evidence for its inconsistent enforcement of its non-compete clause. Quite simply, courts will scrutinize a franchisor’s claimed rationale for past selective enforcement in assessing whether the franchisor has shown the non-compete is enforceable.

2. **Inconsistent Enforcement May Undercut Claim of Irreparable Harm**

Allowing other former franchisees to compete may undercut a franchisor’s argument that it will suffer prospective or ongoing “irreparable harm” absent an injunction. For example, in *Baskin-Robbins Inc. v. Patel*, the U.S. District Court for the Northern District of Illinois declined to issue a preliminary injunction due to the franchisor’s selective enforcement of its non-compete.\(^{91}\) After Baskin-Robbins made the business decision to move away from “standalone” ice cream shops in favor of stores offering ice cream, doughnuts, and sandwiches, many former Baskin-Robbins stores converted to a competing brand, KaleidoScoops.\(^{92}\) Although Baskin-Robbins objected to some of the conversions and sought to enforce its non-compete, in many instances it chose not to enforce the covenants.\(^{93}\) In light of evidence that Baskin-Robbins had allowed other former franchisees to convert to a competing brand, the court denied the requested injunction for failure to establish irreparable harm.\(^{94}\)

On the other hand, other courts have concluded that past selective enforcement will not preclude a finding of irreparable harm as long as the franchisor can offer a rational business explanation for why it sought to enforce its post-term non-compete against some former franchisees but not others. For example, in *Bad Ass Coffee Co. of Hawaii v. JH Enterprises, L.L.C.*, the franchisor sought an injunction after the defendants declined to renew their franchise agreement and converted to a competing business in the same location.\(^{95}\) The former franchisees argued that the franchisor could not show irreparable harm because it allowed other former franchisees to open competing businesses and because it lacked a “formalized system to monitor whether former franchisees comply with the non-compete agreements.”\(^{96}\) Although agreeing that “each of these considerations cuts against a finding of irreparable injury,” the court nevertheless concluded the franchisor was free to forego enforcement of its non-compete agreements in specific instances based on its own business judgment.\(^{97}\) Courts will consider whether or not a franchisor can rationally explain any history of non-enforcement in evaluating whether a former franchisee’s non-compete violation will cause irreparable harm.

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\(^{90}\) 264 F. Supp. 2d 607, 612 (N.D. Ill. 2003) (denying the franchisor’s motion for a preliminary injunction).

\(^{91}\) Id.

\(^{92}\) Id. at 609.

\(^{93}\) Id.

\(^{94}\) Id. at 610-11. Though the court denied the requested injunction on the papers, it indicated that it would allow additional evidence at any future injunction hearings. In addition, the court acknowledged that the franchisor may have been “influenced by a conclusion that they no longer wished to operate a stand-alone store in that location and had no plans to develop a multiple products store there.” Id. at 609.

\(^{95}\) 636 F. Supp. 2d 1237 (D. Utah 2009).

\(^{96}\) Id. at 1250.

\(^{97}\) Id. at 1251.
3. **Inconsistent Enforcement May Give Rise to Waiver or Estoppel Defenses**

Finally, a franchisor's history of non-enforcement or inconsistent enforcement of its post-term covenants not to compete may give rise to waiver or equitable estoppel arguments. Some courts have indicated at least a willingness to consider a franchisee's selective enforcement defenses in franchisee non-compete cases. For example, by expressly noting that the defendant-franchisees "have failed to offer sufficient documentation to support this [selective enforcement] defense," the U.S. District Court for the Middle District of Florida in Medi-Weightloss Franchising USA v. Las Colinas Media Weightloss Clinics LLC suggested that selective enforcement defenses to non-compete violations are available to franchisees, though the evidentiary burden is high.\(^{98}\) As discussed below, the viability of defense to a non-compete based on alleged inconsistent enforcement is fact specific, depending largely on the number of the past instances where the franchisor failed to enforce the post-termination covenant not to compete, how recent those instances were, and the similarities between those former franchisees (and their markets) and the franchisee at issue.

Discussions of waiver and estoppel defenses in non-compete cases appear more often in the employment context than in the franchise context. (As discussed above, the relevant franchise cases tend to focus on the enforceability of the non-compete or on the franchisor's ability to prove irreparable harm.\(^{99}\)) Accordingly, it is useful to examine non-franchise non-compete cases. In the employment context, several courts have rejected waiver or equitable estoppel arguments that a company's prior selective enforcement precludes current efforts to enforce a post-termination non-compete. For example, in *Minnesota Mining & Manufacturing Co. v. Kirkevold*,\(^{100}\) plaintiff 3M moved for a preliminary injunction to enforce a non-compete against its former employee. The former employee argued that 3M had waived its contractual rights and should be estopped for equitable reasons from enforcing the restrictive covenant based on 3M's failure to enforce such restrictive covenants against other former employees who possessed knowledge of 3M's confidential information. The U.S. District Court for the District of Minnesota rejected the employee's argument that 3M's failure to enforce the non-compete against others constituted an estoppel or waiver. The court found there were many differences between the defendant and the other employees, which factored into the employer's decision not to seek to enforce the other restrictive covenants. Prior non-enforcement against others, the court stated, was "not overly probative of any intent to relinquish its contractual rights or to knowingly mislead so as to estop" enforcement of the covenant.\(^{101}\) "[T]o hold otherwise would effectively place employers in the precarious position of being compelled to enforce all such restrictive covenants with respect to all its former employees, which might encourage attempts

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\(^{100}\) 87 F.R.D. 324 (D. Minn. 1980).

\(^{101}\) Id. at 336.
to restrain trade, and which might undermine labor relations."\textsuperscript{102} That is, businesses should be entitled to make case-by-case assessments of whether to enforce a particular non-compete.\textsuperscript{103}

On the other hand, some courts have credited waiver or equitable estoppel defenses in non-compete cases, at least when faced with a substantial history of non-enforcement. For example, in \textit{Surgidev Corp. v. Eye Technology, Inc.},\textsuperscript{104} the U.S. District Court for the District of Minnesota refused to enjoin four former officers who set up a competing company because the plaintiff company had permitted at least 28 other former employees, including high-ranking executives, to leave and join competitors. The court accepted the defendants’ waiver and equitable estoppel defenses, finding that “it would be inequitable to permit plaintiff to now rely on a non-compete agreement which it has so blithely ignored in the past.”\textsuperscript{105} Notably, the magnitude of the past non-enforcement was critical to the court’s holding. Employment cases like \textit{Surgidev} suggest that a former franchisee may be able to escape enforcement of a post-term covenant not to compete if the franchisor repeatedly failed or refused to enforce the non-compete against other former franchisees in the past.

\section*{IV. POTENTIALLY APPLICABLE STATE RELATIONSHIP LAWS}

State relationship laws and state anti-discrimination statutes may afford franchisees protection against a franchisor’s selective enforcement of franchise agreements. Eighteen states have laws of general applicability addressing the franchise relationship.\textsuperscript{106} While these state relationship laws should be analyzed by both franchisors and franchisees alike for potential applicability in any dispute, it is critical that a franchisor determine what would be the impact of the laws on a franchisor’s selective enforcement.

Some states have enacted relationship laws that contain “good cause” requirements or prohibit “unfair” treatment of franchisees, but do not contain express anti-discrimination provisions.\textsuperscript{107} However, some states have interpreted “good cause” requirements in a manner that includes discrimination within the scope of the relationship law.\textsuperscript{108} A franchisor’s failure to treat all franchisees or potential franchisees equally, when no reasonable basis appears for distinguishing between those favored and those disfavored, may well result in a violation of the “good cause” requirement.\textsuperscript{109} While these statutes do not specifically address selective

\textsuperscript{102} Id.

\textsuperscript{103} See, e.g., \textit{Laidlaw, Inc. v. Student Transp. of Am., Inc.}, 20 F. Supp. 2d 727, 751 (D.N.J. 1998) (“Whether a restrictive covenant may be enforced depends on its reasonable \textit{under the particular circumstances} and requiring an employer to enforce every non-compete, without regard to individual circumstances or cost, would be "impractical and unfair, not only to [the plaintiff company] but to other former employees.".

\textsuperscript{104} 648 F. Supp. 661 (D. Minn. 1988).

\textsuperscript{105} Id. at 698.


\textsuperscript{107} See \textit{CAL. BUS. & PROF. CODE} § 20037; \textit{CONN. GEN. STAT.} § 42-133(f)(a); \textit{MICH. COMP. LAWS} § 445.1501-1564.


\textsuperscript{109} See \textit{General Aviation v. Cessna Aircraft Co.}, 13 F.3d 178 (6th Cir. 1993). Under Michigan franchise law, whenever a franchisor renews some franchisees and not others, the disparate treatment must meet a good cause standard. Franchisor could have treated franchisee differently from other franchisees with expired contracts if it had provided legitimate reasons for the treatment, but the court found insufficient grounds for nonrenewal when franchisor simply asserted that it needed to cut back on the size of its operation by eliminating one franchisee without any changes in its policies regarding the other franchisees. \textit{Id.
enforcement, a franchisor’s inconsistent treatment of franchisees may play a significant role in the determination of good cause necessary to selectively enforce the franchise agreement.

The outcome of cases, based on the selective enforcement of a franchise agreement, may depend upon whether the jurisdiction has a statute that prohibits disparate treatment. In states with anti-discrimination laws, franchisees may have better success since the statutes generally prohibit disparate treatment. However, even in these states, there are many defenses available for a franchisor to justify disparate treatment. In this section, we discuss applicable state relationship law claims and defenses to a franchisor’s selective enforcement of a franchise agreement when a franchisee claims that enforcement has been inconsistent.

A. **Post-Termination Obligations**

A few states have statutes that prohibit or limit post-termination obligations in franchise agreements. Further, a few states have statutes that prevent franchisors from discriminating against franchisees in any business dealing, including post-termination covenants. For many reasons, franchisors may choose to not sue to enforce a post-termination covenant against a franchisee. However, in states with applicable franchise relationship laws, selective or inconsistent enforcement could jeopardize future enforcement efforts by the franchisor. A terminated franchisee in violation of a post-termination obligation may argue under an applicable state law that past inconsistent enforcement by the franchisor undermines the franchisor’s claimed justification for the post-termination obligation.

As a defense to disparate treatment claims by a franchisee, a franchisor may argue that the disparate treatment was reasonable based on justifiable distinctions amongst the franchisees that are not arbitrary. This argument often finds a receptive ear even when there is an applicable state relationship law against disparate treatment of franchisees. In *Armstrong v. Taco Time International, Inc.*, the franchise agreement contained a covenant not to compete with Taco Time for five years after the contract’s termination. The franchisee opened a competitive franchise within the fifty-mile non-compete radius and then sued to invalidate the non-compete covenant. The trial court found the covenant enforceable and upheld it, although it reduced the duration and geographical scope of the post-termination covenant. The court of appeals affirmed the trial courts’ decision.

In *Armstrong*, the franchisee asserted that enforcement of the non-compete covenant would violate the antidiscrimination provisions of the Washington Franchise Investment Protection Act ("WFIPA"), but the appellate court rejected that argument. The court held that the statute allows discrimination if the franchisor shows that the treatment is nonetheless (1)

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111 See IND. CODE ANN. § 23-2-2.7-1(9) (limits franchise agreement’s noncompetition clauses to the exclusive area granted by the franchise agreement and limits the clauses to three years after termination of the franchise); see also LA. REV. STAT. ANN. § 23:921(F)(1)(b)(i)(ii) (limits franchise agreement’s noncompetition clauses to two years after termination or expiration).

112 See WASH. REV. CODE ANN. § 19.100.180(2)(c).

113 See Dance & Sentell, *supra* note 80, at 253-63.


115 *Id.*

116 *Id.*
reasonable, (2) based on the franchises granted at materially different times and is reasonably related to that difference in time or based on other proper and justifiable distinctions considering the purposes of the WFIPA, and (3) not arbitrary. The record demonstrated that the covenants not to compete provided to other franchisees varied in relation to the time they were imposed and therefore were not arbitrary under the Washington Statute.

The U.S. District Court for the Western District of Washington followed Armstrong in Precision Enterprises, Inc. v. Precision Tune, Inc. holding that the selective enforcement was not a defense to enforcement of a covenant-not-to-compete: "The decision to sue a franchisee with multiple franchises while foregoing suit against a franchisee with a single franchise under the facts of this case is not arbitrary and does not amount to discrimination under R.C.W.A § 19.100.180(2)(c)." As long as a franchisor can offer reasonable explanations and distinctions for enforcing its non-compete against some former franchisees but not others, state anti-discrimination provisions in franchise relationship laws may not be an obstacle to enforcement.

B. Transfers

Nine states have statutory provisions that specifically address franchise transfers. There are similarities among certain states within this group, but there does not appear to be a developing national trend in terms of a uniform approach to the statutory regulation of franchise transfers.

A franchisor’s selective enforcement of the standards and qualifications of a proposed transferee may impact the franchisor’s ability to deny a transfer of a franchise in the future. The Iowa Franchise Act and the Minnesota Franchise Act provide that if the proposed transferee does not satisfy the franchisor's then current standards and qualifications, the franchisor may only withhold consent to the transfer if the franchisor's denial is not "arbitrary or capricious."

For example, Minnesota’s statute dictates that "it is unfair and inequitable for a person to unreasonably withhold consent to an assignment, transfer, or sale of the franchise whenever the franchisee to be substituted meets the present qualifications and standards required of the franchisees of the particular franchisor." In Basco, Inc. v. Buth-Na-Bodhaige, a franchisee sued the franchisor alleging violations of the Minnesota statute by discriminating between franchisees and by unreasonably withholding consent to transfer the franchise. Basco wanted to sell its franchise and when the franchisor refused to consent, Basco brought suit. At trial, Basco

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119 Id.
121 Iowa Code Ann. § 523H.5.
123 Id.
124 Basco, Inc. v. Buth-Na-Bodhaige, 198 F.2d 1053 (8th Cir. 1999).
presented the testimony of a certified public accountant who compared the franchise application of the proposed buyer for the franchise to the applications of fourteen franchisees that the franchisor had approved.126 According to the accountant, the prospective buyer was stronger financially than the majority of these accepted applicants.127 The record also revealed that Basco’s alleged lack of retail experience and inability to work in the store full time (items cited in support of the refusal to approve the transfer to the prospective buyer) had not prevented franchisor from approving other applicants.128 Based on the franchisor’s prior approval of applicants who were weaker financially and who had less retail experience than the prospective buyer, the court held that there was sufficient evidence for a jury to determine whether franchisor had unreasonably withheld its consent to transfer or had otherwise discriminated against Basco, and affirmed a verdict in favor of Basco.129

Further, when a franchisee alleges that a franchisor has selectively enforced its transfer standards, a court may order a transfer without the franchisor’s consent when the franchisor has no valid reason to deny the franchise transfer. Under the New Jersey Franchise Practices Act, specific performance is an available remedy. In *VW Credit, Inc. v. Coast Automotive Group, Ltd.*,130 Volkswagen and Audi refused to consent to a proposed transfer without providing material reasons for the unacceptability of the proposed transferee. In doing so, the manufacturers failed to meet their burden to present credible reasons for their denial of the transfer. The New Jersey court noted that the legislature’s intent is to allow a transfer in the absence of a valid reason for denial, so the court granted specific performance and enjoined the manufacturers from preventing the transfer. According to the court’s interpretation of the New Jersey Franchise Practices Act, where “a franchisor unreasonably withholds consent to a transfer, the franchise transfers to the proposed transferee by operation of law.”131

A franchisor’s consistent and uniform enforcement of its franchise agreements is one of the best defenses when a franchisee alleges that the franchisor has discriminated unfairly against it in considering a transfer. For example, in California, the plaintiff dealer in *Burke v. General Motors Corp.*132 proposed a purchaser for its dealership, but General Motors Corp. refused to approve the sale because it had a policy of recommending only one franchise candidate at a time and had already begun negotiation with a potential minority franchisee. Ultimately, the minority candidate did not purchase the dealership and Burke was forced out of business. Burke claimed that GM’s refusal to approve the proposed sale to a non-minority

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127 Id.

128 *Basco, Inc. v. Buth-Na-Bodhaige*, 198 F.2d at 1058.

129 Id.


131 Industry Specific Issue: Forty-six states have statutory procedures that limit the restrictions a franchisor may impose on the sale, transfer, or assignment of a franchise in the motor vehicle industry specifically. Thirty states regulate franchise transfers in the beer, wine, or liquor industries. Franchise transfers in other specific industries are regulated in certain states, including heavy equipment (Virginia), petroleum or motor fuels franchises (California, Maine, and New York), service stations (District of Columbia), agricultural equipment manufacturers (Georgia and Texas), insurance (Illinois), watercraft and outboard motor manufacturers (Michigan), and trailer dealers (Virginia). These regulations prohibit franchisors from unreasonably withholding consent to the transfer of a franchise in the specific industry regulated. Some states require that the franchisor set forth a material reason for denying consent to the transfer (Arkansas, Nebraska, New Jersey, South Dakota, and Texas). Some state statutes set out specific reasons why consent may be withheld (California, Florida, Hawaii, New Hampshire, and New York).

purchaser was discriminatory. The court disagreed and found that since GM’s policy of considering only one franchisee candidate at a time applied to all dealers, the policy was not discriminatory.\textsuperscript{133}

C. Payment Issues

Some state relationship laws require the franchisor and franchisee to deal with each other in good faith when payment issues arise.\textsuperscript{134} In states with laws requiring good cause for termination based on failure to pay, it may be relevant in assessing good cause if a franchisor does not uniformly enforce payment standards across the franchise system. In these states, the franchisor’s inconsistent treatment of franchisees may violate the good cause requirement in the state’s anti-discrimination statutes. If a franchisor terminates one franchise while allowing another franchise to continue, despite the same payment violation in each case, the terminated franchise can claim lack of good cause for termination. A franchisor’s failure to treat all franchisees equally, when no reasonable basis appears for distinguishing between those favored and those disfavored, may well result in a violation of the good cause requirement.\textsuperscript{135}

Under the Illinois Franchise Disclosure Act, franchisors may not “unreasonably and materially discriminate between franchisees operating a franchised business located in this State in the charges offered or made for franchise fees, royalties, goods, services, equipment, rentals, or advertising services.”\textsuperscript{136} In order to prevail on a claim of illegal discrimination under the Illinois Franchise Disclosure Act, a franchisee must establish that “such discrimination will cause competitive harm to a franchisee who competes with a franchisee that received the benefit of the discrimination.”\textsuperscript{137} However, the Illinois Act carves out five exceptions to this rule that a franchisor may use to defend itself against price discrimination claims amongst franchisees.\textsuperscript{138} A franchisor may use these exceptions for any classification of or discrimination between franchisees that is: (a) based on franchises granted at different times, and such discrimination is reasonably related to such differences in time; (b) related to one or more programs for making franchises available to person with insufficient capital, training, business experience or education, or lacking other qualifications; (c) related to local or regional experimentation with or variations in product or service lines or business formats or designs; (d) related to efforts by one or more franchisees to cure deficiencies in the operation of franchise businesses or defaults in franchise agreements; or (e) based on other reasonable distinctions considering the purposes of this Act and is not arbitrary.\textsuperscript{139}

Indiana’s Deceptive Franchise Practices Act broadly states that it is unlawful for franchisors to engage in the act of “discriminating unfairly among its franchisees or unreasonably failing or refusing to comply with any terms of a franchise agreement.”\textsuperscript{140} Unlike

\textsuperscript{133} Id. at 540.

\textsuperscript{134} See IND. CODE ANN. § 23-2-2-7-2(5); HAW. REV. STAT. ANN. § 482E-6(C); 815 ILL. COMP. STAT. § 705/18.

\textsuperscript{135} P&W Supply Co. v. E.I. DuPont de Nemours & Co., 747 F. Supp. 1262 (N.D. Ill. 1990) (The Illinois Franchise Disclosure Act prohibits the franchisor from discriminating between Illinois franchisees in the charges offered or made. For example, “a fast-food franchisor cannot sell hamburger meat to one franchisee at [thirty] cents a pound while selling the same meat to a competing franchisee at [sixty] cents a pound.”

\textsuperscript{136} 815 ILL. COMP. STAT. § 705/18.

\textsuperscript{137} Id.

\textsuperscript{138} 815 ILL. COMP. STAT. §§ 705/18(a)-(e).

\textsuperscript{139} Id.

\textsuperscript{140} IND. CODE ANN. § 23-2-2-7-2(5).
the Illinois Act, the Indiana Act does not list any defenses available to a franchisor to avoid fault when acting in a discriminatory fashion. Even with such a broad provision, courts still appear hesitant to rule in favor of a franchisee’s discrimination claim. Proof of “discrimination” requires a showing of arbitrary disparate treatment among similarly situated franchisees.\textsuperscript{141} Thus, a franchisor may successfully argue that it did not discriminate against the franchisee if the franchisee was not similarly situated to the other franchisees. In Carrel v. George Weston Bakeries Distrib., Inc., the Indiana court was unwilling to grant a franchisee’s motion for summary judgment when the franchisor provided different commission rates to various franchisees.\textsuperscript{142} The court stated that even if discrimination did occur, it must also be both arbitrary and unfair before it rises to the level of an actionable claim.\textsuperscript{143} This decision weakens the impact of a relatively pro-franchisee statute by allowing franchisors to pursue an extensive set of possible defenses to their allegedly actionable discrimination. Arguably, the franchisor need only present evidence that its actions were pondered or deliberated (not simply arbitrary) and were, in the overall context, based on a reasonable business decision.

D. State Antidiscrimination Provisions

Former franchisees located in certain states may also attempt to argue that a franchisor’s selective enforcement violates anti-discrimination provisions in applicable state relationship laws. Seven states have anti-discrimination provisions in their relationship laws or regulations: Arkansas, Hawaii, Illinois, Indiana, Minnesota, Washington, and Wisconsin. The particular provisions vary from state to state, but these statutes and regulations generally require franchisors to impose the same charges on their franchisees (e.g., franchise fees, royalties, and costs of goods) and to avoid discriminatory treatment of similarly situated franchisees.\textsuperscript{144} Even in these states, a franchisee’s discrimination claim may prove challenging for three main reasons: (1) some of the anti-discriminatory statutes only apply to the practice of termination or non-renewal instead of a broader range of general behavior; (2) some statutes provide express defenses for the franchisor; and (3) courts have often been reluctant to second guess a franchisor’s business decisions despite the existence of anti-discrimination statutes.

Statutes protecting automobile dealers in various states also often contain anti-discrimination elements. For example, the Wisconsin legislature specifically placed an “equality” element of “good cause” in its Fair Dealership Law.\textsuperscript{145} Section 135.02 of that law divides the definition of “good cause” to terminate into two elements: first, a dealer must fail to comply substantially with the manufacturer’s essential and reasonable requirements; second, such requirements must not be discriminatory when compared with the requirements imposed upon “similarly situated dealers.”\textsuperscript{146} A few other states have specific, anti-discrimination laws similar to

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\textsuperscript{141} See Canada Dry Corp. v. Nehi Beverage Co., Inc., 723 F.2d 512 (7th Cir. 1983).


\textsuperscript{143} Id.

\textsuperscript{144} There are also industry-specific statutes which expand franchisee and dealer protections to select trades. As an example of an industry specific prohibition against selective enforcement, the Petroleum Marketing Practices Act ("PMPA") was enacted to prevent "unfair and discriminatory termination of franchises by franchisors." Under the PMPA, “[a] franchisor will not be permitted to selectively enforce its franchise agreement, i.e., permit some franchisees to violate it while condemning other for doing so.” 15 U.S.C. § 2801 (2007).


\textsuperscript{146} Id. at § 135.04(a) (emphasis added).
Wisconsin's Fair Dealership Law.\textsuperscript{147} Even under Wisconsin law, a franchisor may protect itself from anti-discrimination claims if the franchisor has a clear and uniform policy of termination when a franchisee fails to comply with the minimum market share requirements under the franchise agreement.

A federal court highlighted this principle when it applied the Wisconsin definition of "good cause" in \textit{L-O Distributors, Inc. v. Speed Queen Co.}\textsuperscript{148} In \textit{L-O Distributors}, a terminated dealer accused its distributor of deciding to terminate on a discriminatory basis. Plaintiff L-O's argument that its termination was discriminatory centered on the fact that Speed Queen appointed another dealer in L-O's territory simultaneous to notifying L-O that it would be terminated unless L-O cured its breaches. The court held that the other dealer's appointment did not render discriminatory L-O's termination; the Speed Queen/L-O distributorship agreement expressly provided that the L-O distributorship was nonexclusive, and thus the other dealer's presence in the market did not make it contractually more difficult for L-O to effectuate a cure.

Denying L-O's claim, the court noted that Speed Queen had a clear policy of termination when a dealer failed to increase its market share. Thus, because all dealers were required to comply with the policy and the plaintiff had not done so, the court held the termination was based on "good cause" and was not discriminatory.\textsuperscript{149} By failing to comply substantially with Speed Queen's "essential and reasonable" sales goals, the court found the L-O Distributors' termination to be lawful.

\textbf{V. BEST PRACTICES}

A number of lessons and some best practices can be extracted from the discussion above. First, franchisors can manage some risk through careful drafting of franchise agreement provisions and being thoughtful about the operations manual. Second, franchisors should be thoughtful and intentional in the course of ongoing system communications and enforcement. Third, franchisee associations can play an important role in managing risks, and present franchisees with the opportunity to improve system communication.

\textbf{A. Franchise Agreement Provisions}

Franchise agreements are the foundation of the franchise relationship, defining the parties' rights and obligations over an extended period of time. Because of the often-extended duration of a franchise relationship, a franchise agreement must be able to stand the test of time and allow for the franchise system to evolve over the life of the agreement. Although no drafter can anticipate every situation and draft for it, franchisors should consider a number of contractual provisions to allow the franchisor to manage the system and the risk of claims or defenses arising from alleged inconsistent enforcement.

\textsuperscript{147} See McDonald's Corp. v. Robert A. Makin, Inc., 653 F. Supp. 401, 403 (W.D.N.Y. 1986) (discussing franchise discrimination as violating Illinois law); Corp v. Atlantic Richfield Co., 860 P.2d 1015, 1021 (Wash. 1993) (interpreting the Washington franchising law and noting that franchisor ARCO met the statutory requirement that it offer franchise terms to all franchisees "on a non-discriminatory basis"); ARK. CODE ANN. § 4-72-206(2) (Michie 1995); CAL. CIV. CODE §§ 51.8, 80-86 (West 1996).

\textsuperscript{148} L-O Distribts., Inc. v. Speed Queen Co., 611 F. Supp. 1569 (D. Minn. 1985) (interpreting the Wisconsin Fair Dealership Act).

\textsuperscript{149} Id. at 1581. This same reasoning can be found in Lee Beverages Co. v. I.S.C. Wines, 623 F. Supp. 867 (E.D. Wls. 1985) (withdrawal of a product from the market).
1. **Anti-Waiver and Modification-in-Writing Clauses**

Franchise agreements typically contain clauses that require that any waiver of a right or modification of terms be in writing and signed by both parties.\(^{150}\) Such clauses are a good start, but not always a fail-safe measure.\(^{151}\)

Many franchise agreements contain "no waiver" clauses, providing that failure to enforce any provision of the agreement will not constitute a waiver. Even though such provisions are common, courts take different approaches to such clauses. For example, a federal court applying Florida law relied on an anti-waiver provision in a franchise agreement to hold that, even though a franchisor had accepted late royalty payments from a franchisee, the franchisor had not waived the right to terminate on this ground.\(^{152}\) Similarly, a franchisee's late fee payment by electronic debit did not constitute a waiver by the franchisor of its right to terminate based on nonpayment of fees, particularly considering the non-waiver provision in the franchise agreement.\(^{153}\)

But some courts have declined to enforce no-waiver provisions. For example, a federal court applying Indiana law found that the franchisor waived its right to terminate based on the franchisee's failure to renew in writing where the franchisor allowed the franchisee to continue to operate in the two territories and even retroactively granted a limited extension of these territorial rights. The court noted that the franchisor should not "be permitted to interpose 'boilerplate' contract language to obtain a result which the jury could, based on the evidence presented, reasonably have found to be unduly harsh to [the franchisee]."\(^{154}\) Similarly, a court applied New Hampshire law in holding that a non-waiver clause was not enough to prevent the franchisee from proceeding with a cause of action for breach of contract and estoppel.\(^{155}\)

Nevertheless, anti-waiver clauses can be helpful in defeating a waiver defense and should be included in the franchise agreement. The following clause is adapted from a number of the cases cited herein and the authors' collective experience:

No waiver by Franchisor of any breach by you, nor any delay or failure by Franchisor to enforce any provisions of this Agreement, may be deemed to be a waiver of any other or subsequent breach or be deemed an estoppel to enforce our rights with respect to that or any other or subsequent breach. Subject to our rights to modify the Operations Manual and/or standards and as otherwise provided herein, this Agreement may not be waived, altered or rescinded, in whole or in part, except by writing signed by Franchisee and Franchisor.


\(^{151}\) *Robinson*, 2015 WL 1799833, at *5.

\(^{152}\) *Burger King Corp. v. Kellogg*, Bus Franchise Guide (CCH) ¶ 9730 (S.D. Fla. 1990).


\(^{154}\) *Canada Dry Corp. v. Nehi Beverage Co., Inc.*, 723 F.2d 512 (7th Cir. 1983).

To be effective, any modification, consent, approval, authorization or waiver granted under the franchise agreement must be in writing executed by you or, if on behalf of us, in writing executed by [an authorized officer or employee].

In addition to relying on these provisions, franchisors are well advised to communicate effectively when providing temporary relief from obligations or modifying the parties' obligations. A franchisor reduces the chance of a finding of waiver or modification if it implements a practice of putting such agreements in writing in an amendment to the franchise agreement or another writing signed by both parties. A franchisor reduces the risk of an oral modification or waiver claim or defense if it shows a sustained practice of documenting changes, such that the franchisor can argue that oral waiver or modification deviates from its standard practice.\(^\text{156}\)

For broader forbearance programs, a franchisor is well advised to communicate such programs in writing on a system-wide basis and make clear that the franchisor may revoke the program at some point in the future.\(^\text{157}\)

2. Third-Party Beneficiary Clauses

To avoid an affirmative claim by a franchisee that the franchisor is in breach of the franchise agreement as a result of non-enforcement against another franchisee, the franchisor should include a "no third party beneficiaries clause." Such clauses should be carefully drafted to make clear that only the parties to the agreement are entitled to enforce its provisions. One clause on which a franchisor relied to successfully defend against a claim by a franchisee based on another franchisee's alleged violations of the franchise agreement provided:

Franchisee shall have no right to enforce the obligations of any other franchisees. Franchisee shall not be deemed a third party beneficiary with respect to any other franchise agreement or other agreement or have any rights to enforce any obligations thereunder.\(^\text{158}\)

Another example of a clause that was successfully invoked to defeat nonparty claims:

[T]his Agreement is for the sole benefit of the parties hereto and nothing herein expressed or implied shall give or be construed to give any person or entity, other than the parties hereto, any legal or equitable rights hereunder.\(^\text{159}\)

3. Good Faith and Fair Dealing/Business Judgment Clauses

As discussed in Section III, contracts contain an implied obligation of good faith and fair dealing which cannot override the express terms of the agreement. The case law teaches that, to avoid claims or defenses based on the covenant of good faith and fair dealing, provisions that grant the franchisor discretion to act or refrain from acting in a certain manner should be as

\(^{156}\) See Bundy & Ikeda, \textit{supra} note 51, at 7.

\(^{157}\) See generally Robinson, 2015 WL 1799833, at *5 (discussing revocation of consent to franchisee operating a location providing veterinary services not under franchisor's brand).


detailed and comprehensive as possible with descriptions and examples of allowed discretion. 160 Express language permitting or prohibiting specific conduct can limit implied covenant claims. 161

It is also common (and wise) for franchise agreements to include provisions intended to prevent a finder of fact from substituting its own judgment for that of the franchisor. For example:

Whenever this Agreement or any related agreement, grants, confers or reserves to Franchisor the right to take action, refrain from taking action, grant or withhold Franchisor’s consent or grant or withhold Franchisor approval, unless the provision specifically states otherwise, Franchisor will have the right to engage in such activity at Franchisor’s option taking into consideration Franchisor’s assessment of the long term interests of the System overall. Franchisee and Franchisor recognize, and any court or judge is affirmatively advised, that if those activities and/or decisions are supported by Franchisor’s business judgment, neither said court, said judge nor any other person reviewing those activities or decisions will substitute his, her or its judgment for Franchisor’s judgment. When the terms of this Agreement specifically require that Franchisor not unreasonably withhold Franchisor’s approval or consent, if Franchisee is in default or breach under this Agreement, any withholding of Franchisor’s approval or consent will be considered reasonable. 162

4. Other Considerations

Although not directly relevant to the claims and defenses outlined above, a franchisor should include provisions in the franchise agreement permitting it to make system changes. Well-drafted provisions allow the franchisor to add, subtract, or change system standards and evolve the system in the franchisor’s sole judgment. Such provisions, in concert with the protective clauses discussed above, may improve a franchisor’s chance of success in an inconsistent-enforcement situation, because the clause underscores the franchisor’s role as the steward of the system as a whole. 163 For example:

System Modifications. Franchisee acknowledges and agrees that Franchisor has the right to modify, add to or rescind any requirement, standard or specification that we prescribe under this Agreement to adopt the System to changing conditions, competitive circumstances, business strategies, business practices and technological innovations and other changes as Franchisor deems appropriate. Franchisee must comply with these modifications, additions or rescissions at your expense, subject to any express limitations set forth in this Agreement.

160 See notes 71-74. See also Jamilia B. Granger, David W. Oppenheim, Brian B. Schnell, Fundamentals 201: Advanced Drafting of Franchise Agreements, ABA 36TH ANNUAL FORUM ON FRANCHISING W-2 (2013).
161 Id. See also Erica L. Calderas and Jason M. Murray, Good Faith and Fair Dealing – Alive and Well or is it a Matter of Business Judgment, ABA 39TH ANNUAL FORUM ON FRANCHISING W-12 (2016).
162 Granger et al., supra note 160, at 41-42.
163 See Beyer et al., supra note 1.
Adaptations and Variances. Complete and detailed uniformity under many varying conditions may not always be possible, practical or in the best interest of the System. Accordingly, franchisor has a right to vary the standards, specifications, and requirements for any franchised business or franchisee based upon the customs or circumstances of a particular franchise or operating agreement, site or location, population density, business potential, trade area population, existing business practice, competitive circumstance or any other condition that franchisor deems to be of importance to the operation of such business, franchisee's business or the System. We are not required to grant you a like or other variation as a result of any variation from standard specifications or requirements granted to any other franchisee. You acknowledge that you are aware that our other franchisees operate under a number of different forms of agreement that were executed at different times and that, consequently, the obligations and rights of the parties to other agreements may differ materially in certain instances from franchisees rights and obligations under this Agreement.164

The franchise agreement should provide that system-wide standards will be set forth in the operating manual, which should be defined broadly to include supplements and modifications to the manual, and should be incorporated into the franchise agreement.165 The franchise agreement should also require that the franchisee comply with all required standards set forth in the operating manual.

In addition, the franchisor should think carefully about the controls in the franchise agreement. Many franchisors draft franchise agreements that include many controls which a franchisor might never use. Not only does excessive right to control operations or the system as a whole expose a franchisor to vicarious liability and joint employment claims, it may also increase the risk of one of the inconsistent enforcement defenses discussed herein.166

B. The Operations Manual

The Operations Manual is another place that a franchisor can preserve flexibility in applying system standards. For example, a franchisor should reserve the ability to institute system-wide temporary forbearance programs, and to revoke those programs and require strict compliance with original terms in the future. Likewise, the Operations Manual is another place for the franchisor to state that forbearance from enforcing a standard shall not constitute a waiver of the standard, and that any waiver or modification of a standard must be in writing to be effective.

C. Ongoing Enforcement

Every franchisor should develop, implement, and enforce a standards compliance program. It should go without saying that the ultimate goal of such a compliance program is to

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164 These clauses are adapted from case law cited herein and language with which the authors have experience.

165 Incorporation of the operating manual into the franchise agreement is not a universally accepted practice, however.

166 The argument goes "because the franchisor controls or has the right to control x, y and z in the system, it must be waiving/modifying the franchise agreement if it isn't actually exercising its right to control." As of this writing, the authors were unable to locate a case adopting or rejecting such an argument.
ensure franchisees are following the system’s brand standards. For those franchisees unable or unwilling to comply with the system’s brand standards, the franchisor should be prepared to exercise its various enforcement options.

The best compliance programs can be described as “check, coach, check, and enforce (if necessary).” Franchisors can check franchisee compliance with system standards through a variety of methods, including in-house quality assurance inspections, customer surveys, mystery shoppers, audits, or private investigators. The franchisor should promptly communicate any brand standards noncompliance to the franchisee. In providing the franchisee with a copy of an inspection report or a formal notice of default, the franchisor should clearly identify the brand standards that the franchisee failed to comply with, “coach” the franchisee on what specific steps it must take to cure the default and come into compliance with the standard(s), and set forth the required time period for such cure. Following the required cure period, the franchisor should re-inspect to determine whether the franchisee has resolved the problems. If the franchisee has not come into compliance, the franchisor may then proceed with enforcement, which may involve a pre-termination lawsuit to enjoin continued noncompliance with system standards or, in the case of repeated or egregious noncompliance, termination.

Franchisors should develop a uniform inspection form for in-house site inspections. The form should be standardized and focus on the brand’s core components—for example, an inspection of a restaurant franchisee would focus on food preparation, menu appearance and presentation, food storage, sanitation, and cleanliness, among other core topics. The inspector should clearly and objectively document any defaults. Digital pictures of any defaults should be taken and incorporated into the inspection report, particularly those defaults involving product safety or public health risks. The report should identify any specific areas that must be immediately addressed. During or immediately following the inspection, the inspector should review the report, identified defaults, and necessary cures with the franchisee (or manager if the franchisee is unavailable). The inspection report form should contain a section for the franchisee (or manager) to sign stating that the inspector reviewed the inspection results with the franchisee (or manager). A copy of the report should be promptly provided to the franchisee. Any subsequent re-inspection and ongoing uncured defaults should be similarly documented.

A failed inspection report should be accompanied by (or expressly incorporated into) a written notice of default with a cure period. Any cure period must comply with the requirements of the franchise agreement and any applicable state franchise relationship law.

A franchisor that wishes to step up its standards compliance efforts after a period of non-enforcement or inconsistent enforcement should consider sending a “new day” letter to franchisees to alert them that, regardless of any past non-enforcement, failing scores on operations reviews may subject franchisees to standards enforcement actions, including potential defaults, enforcement lawsuits, or even termination.

D. Working with Franchisee Associations

Franchisee associations have become more prevalent. They often form when franchisees come to believe that the franchisor is acting in a manner contrary to the business and economic interests of franchisees. Franchisees believe that they can gain leverage with the franchisor by working collectively as a group and that is frequently the case. Many franchisors initially view the formation of a franchise association negatively and react adversely to such

167 Schumacher et al., supra note 1, at 12.
formation. However, such a reaction will alienate franchisees and further strain the business relationship. A progressive franchisor should view the franchisee association as a potential ally which may be used to enhance the business relationship, facilitate communication between the parties, plan and coordinate changes to the franchise system in a positive manner and generally align the interests of the franchisees and franchisor.

As it relates to the topic of this paper, a failure by a franchisor to treat franchisees uniformly, while legally permissible in many circumstances, will be perceived by franchisees to be arbitrary and unfair and will engender ill will in the franchise relationship. A franchisor may have sound business reasons for not acting uniformly in some circumstances. If the franchisor articulates these sound business reasons to the franchisee association, it may go a long way towards franchisees gaining an understanding and enhancing the business relationship.

In turn, franchisee associations must recognize that franchisors are not generally obligated to treat all franchisees equally and must understand that there are times when a franchisor must make exceptions to its policies or extend benefits to particular franchisees under extenuating circumstances in the best interests of the brand and system. Franchisee associations must recognize that the franchisor has the right to make such business decisions as the owner of brand.

Franchisee associations will be well served to retain experienced franchise counsel that can give them proper advice as to their contractual rights so that they can focus on what may be realistically accomplished in the franchise relationship. Franchisors should engage with and communicate positively with franchisee associations with the overall goal of working together towards improving the brand and enhancing the business interests of both parties.

VI. CONCLUSION

Numerous legitimate business reasons may justify a franchisor not consistently and uniformly enforcing every provision of a franchise agreement. However, as discussed throughout this paper, selective enforcement of system standards may complicate a franchisor's ability to enforce its standards.

The lesson for franchisees in any defense of an enforcement action brought by a franchisor is to attempt to determine whether the franchisor has consistently enforced similar violations or not. If not, the franchisees may be able to use various defenses discussed in this paper to successfully defend against an enforcement action.

The lesson for franchisors is that they should be vigilant in enforcing the most important provisions of their franchise agreements to avoid compromising their ability to enforce their agreements in the future. If valid reasons do exist for a franchisor not to enforce its standards in particular circumstances, it should document the basis for such non-enforcement decisions. As long as it can provide a rational explanation for its disparate treatment of particular franchisees, a franchisor should be able to enforce its agreements.
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Heather graduated with honors from the University of Colorado School of Law in 1998. She graduated with honors from the University Colorado School of Business with a Bachelor of Science degree with emphases in accounting and finance in 1993. Between college and law school, she practiced as a Certified Public Accountant in Colorado and Chicago. Immediately after graduating from law school, she served for two years as a law clerk to the Honorable Edward W. Nottingham, United States District Judge for the District of Colorado.