W-20: So You Want to Terminate for System Standards Violations

Leonard MacPhee
Polsinelli
Denver, Colorado

Scott McIntosh
Quarles and Brady, LLP
Washington, D.C.

Janaki Parmar
Marriott International, Inc.
Bethesda, Maryland

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SO YOU WANT TO TERMINATE FOR SYSTEM STANDARDS VIOLATIONS

I. INTRODUCTION

Standards are an integral component of any franchise system. Franchisors develop standards to communicate to franchisees requirements, know-how, and best practices for the establishment and operation of franchised outlets. Franchisees rely upon standards to guide them in the development and operation of their businesses. Importantly, comprehensive standards are necessary to ensure that each franchised outlet within a system consistently provides high-quality goods and/or services to customers. But what happens when franchisees fail to comply with system standards? This paper examines legal and practical issues associated with franchisees’ failure to comply with system standards, including the steps a franchisor may take to drive compliance, the default process, alternatives to termination, and the termination process.

II. ROLE OF SYSTEM STANDARDS

A. Importance of Standards to the Brand and System

One of the distinguishing characteristics of a franchise relationship is the franchisor’s right to exert a significant degree of control over the franchisee’s operation of the business and the franchisor’s promise to provide assistance to the franchisee. The premise is that such guidance will empower a franchisee to effectively operate a business under the franchisor’s trademark. Franchisors provide guidance in a variety of areas, including training, advertising, research and development, and the establishment of minimum operating requirements which franchisees are obligated to follow. The minimum operating requirements are referred to as “system standards” or simply “standards.”

Standards are generally established to promote efficiency in the operation of franchised outlets, as well as to ensure the quality and uniformity of goods and services provided by franchised outlets. Standards are intended to ensure that customers have a consistently positive experience at each franchised outlet within the system, promoting customer loyalty and repeat business. Indeed, franchisees pay a premium to associate with franchise systems that are recognized by consumers as consistently providing high quality goods and services at every location.

Standards have the added benefit of reducing potential liability for the franchisor and the franchisee. Clearly articulated standards surrounding items such as safety and cleanliness can help reduce risks to customers, associates, and promote public safety.

B. Development of Standards

Standards are a reflection of a franchisor’s knowledge and experience regarding the operation of system outlets (both company-owned and franchised) and a franchisor’s understanding of consumer preferences and market conditions. For franchisors who have experience operating corporate locations for a material amount of time prior to offering franchises, standards are often created by meticulously documenting best practices in the

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1 This is recognized in the definition of a franchise. See, e.g., 16 CFR 436.1(h)(2); see also CAL. CORP. CODE, §31005(a)(2) (a franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system substantially prescribed by the franchisor).
operation of company-owned outlets. In creating standards, a franchisor generally considers the basic procedures necessary to establish and operate a franchised outlet and the practices and procedures that differentiate the franchisor’s brand from competitors (i.e., the secret sauce). Franchisors should approach the standard development process as an opportunity to learn what procedures work well within their system, why they work well, and what procedures or practices require improvement. In addition to examining existing best practices, a franchisor may also consider new or different operating procedures to create the best customer experience.

For franchise systems that are designed to be operated by a wide range of franchisees, the standards should be communicated in such a manner as to be easily comprehended and implemented by even the most inexperienced business operator. Even in systems that are geared towards franchisees with some pre-existing business experience or background in a particular area, clear communication of standards is important to their successful implementation. Standards are often communicated in writing (in hard copy or electronic format) and via instructional videos and guides. Most franchisors compile their standards into an “operations manual,” which organizes standards into chapters or modules addressing subject matter categories such as design and construction standards, pre-opening standards, day-to-day operating standards, etc. Franchisors often retain consultants to assist them in documenting best practices and compiling operations manuals. The operations manual should be appropriately defined in the franchise agreement and listed among the franchisor’s confidential and proprietary information. Franchisors should take such actions as are necessary to ensure the confidentiality of the operations manual both during and after the term of the franchise relationship.²

Moreover, it is important to note that there are vicarious liability and joint employer³ issues associated with establishing standards. The greater the degree of control a franchisor exerts over certain aspects of the franchisee’s operation, such as employment matters or the management of customer data, the greater the possibility a franchisor may be found liable to third parties for franchisees’ actions in that regard. Franchisors must continually weigh the risk of vicarious liability (including vis-à-vis customers and franchisees’ employees) arising from prescribing and enforcing standards with the risk to the brand and direct liability for the franchisor and franchisees resulting from insufficient standards. One way to mitigate risk is to clearly define the parties’ obligations in the standards. For example, most franchisors have established social media and data protection standards. It may be advisable to include in such standards a provision stating that franchisees are solely responsible for their actions in using social media and customer data and that franchisees must establish policies for their businesses and employees with respect to such activities (which must be consistent with the franchisor’s policy).

C. Categories of Standards

Standards may address a variety of operating issues from the appearance of a system outlet, to the standard telephone greeting, to the scent of the outlet! As discussed above, the purpose of standards includes increasing the operating efficiency and providing consumers with the same signature customer experience at every system outlet.

² For guidance on franchise agreement provisions and actions that a franchisor can utilize to protect standards that rise to the level of trade secrets, see Scott McIntosh and Natalma McKnew, A New World for Trade Secrets in Franchising: New Options and Strategies Under the Federal Defend Trade Secrets Act, ABA 40th Annual Forum on Franchising W-4 (2017).
³ See Section IV(F), infra.
In addition to operating standards, franchisors often establish standards for the periodic renovation of the system outlets and upgrades to premises and technology. These standards ensure that all system outlets, regardless of age or location, are “on brand” and meet customer expectations. These standards also ensure that system outlets are operating on the most efficient technology platforms. It is very important to set franchisees’ expectations regarding periodic renovations and upgrades prior to entering into a franchise agreement. Periodic renovation requirements should be set forth in the franchise agreement, and franchisees should receive ample notice of periodic renovations as well as realistic deadlines for completing renovations. Some franchisors suggest or require franchisees to set aside a portion of gross sales in “reserves” to be applied towards periodic renovations, to ease the blow of large cash outlays. Technology upgrades are much more difficult to predict, but their value is often easier to justify – faster processing, improved functionality, better data protection, etc.

One additional category of standards merits discussion. Franchisors often require franchisees to provide operating reports and financial statements. These reports are critical to the efficient administration of a franchise system, as they apprise the franchisor of the health of the franchise system and assist the franchisor in identifying operating and financial performance issues on an outlet and system-wide basis. Franchisors often prescribe the format of such reports to make apples-to-apples comparisons of individual outlet performance. Some industries have established industry-wide reporting standards. A good example of this is the Uniform System of Accounts for the Lodging Industry promulgated by the Hospitality Financial and Technology Professionals association.

Franchisors are encouraged to research such industry-wide reporting standards (financial and otherwise) and to conform their reporting standards for franchisees with accepted industry standards, where available. This will enable franchisors to compare system outlet performance with industry performance and the performance of competitors. These reporting standards may be incorporated into the point-of-sale systems and other electronic systems prescribed by the franchisor. Franchisors should retain the right to independently access the franchisee’s electronic systems in order to retrieve or compile such reports. Franchisors should verify the accuracy of such reports by engaging in periodic brand standard audits and, where merited, financial statement audits. Verified reports and statements are invaluable tools when discussing system-wide performance and individual outlet performance with franchisees, investors, and third-party stakeholders.

D. Changes to Standards

As discussed above, standards reflect a franchisor’s knowledge and experience regarding the operation of system outlets and a franchisor’s understanding of consumer preferences and market conditions. However, a franchisor’s knowledge and understanding of the business will evolve over time, often as a result of experience or research and development. Consumer preferences and market conditions also change constantly. Franchisors are continuously faced with the challenge of revising existing standards and implementing new standards on a system-wide basis.

The impetus for change may come from within a franchise system or from external forces. Internal catalysts for change include new leadership, a desire to reposition the brand within the market to remain competitive, research and development, and the advent of system improvements devised by franchisees. External catalysts for change can include the development of new technology, the rise of new industry disruptors or middlemen, actions taken by competitors, the advent of new competitors, changes in consumer preference, new
regulations on business practices and other changes in the law, the availability of raw materials, currency fluctuations, and tariffs, to name a few. Regardless of the genesis of change, change generally comes at a cost, and franchisees may be reluctant to bear such costs.

The process of implementing change within a franchise system is as much an art as it is a science. Franchisors should consider establishing a governance process for the administration of the franchise system, including the implementation of new standards and modifications to existing standards. Ideally, a committee consisting of key stakeholders within the franchisor’s organization (i.e., franchise development, operations, account management, information technology, human resources, finance, legal, etc.) should meet on a periodic basis to review and approve material initiatives. Further, the franchisor’s form franchise agreement should include provisions that (a) permit the franchisor to unilaterally revise the standards; and (b) require franchisees to implement changes prescribed by the franchisor promptly upon notice, at the franchisees’ expense.

When considering changes to standards, franchisors should engage in diligence to confirm that change is appropriate and to identify the specific actions that must be taken by the franchisor and the franchisee to implement the change, the anticipated cost of the change on an outlet and system-wide basis, the anticipated timing for implementation, and any other facts that are material to the franchisor and franchise system. When feasible for the contemplated change in a standard, franchisors may also wish to test the proposed change through a pilot program at select company-owned and franchised outlets. If the change requires a cash outlay, franchisors may offer incentives to entice franchise outlets to participate in the pilot program. Franchisors can use pilot programs to identify and address problems in advance of a system wide rollout. The results of the diligence and any pilot program(s) may be documented in a case study. While extended diligence periods and concept testing may not be possible in all instances, case studies may prove invaluable in the event of litigation, or if the franchisor’s good faith is otherwise called into question.

In approving a change to the standards, the franchisor should determine the intended timing for implementation and the resources the franchisor will allocate to executing the plan and enforcing compliance. If the franchisor has committed to including franchisee advisory committees in the decision-making process, the franchise advisory committee should be notified of the proposed change. It may also be advisable to discuss the proposed change with larger system franchisees and other leaders within the franchisee community prior to implementation. Franchisors that engage in diligence prior to implementing change often have a more comprehensive narrative to share with franchisees when implementing change on a system-wide basis.

The franchisor should then issue a formal notice of a change in the standards in accordance with the notice provision in the franchise agreement. The communication should be made as far in advance of the expected implementation date as possible. The notice should

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4 Typical incentives include a contribution towards the implementation of the change or credits on future royalty fees or other fees due to the franchisor.

5 Fairview Donut Inc. and Brule Foods Ltd. v. The TDL Group Corp. and Tim Hortons Inc., Bus. Franchise Guide (CCH) ¶7414 (Ontario Court of Appeal December 7, 2012) (a change to system standards does not constitute a breach of the common law duty of good faith and fair dealing or the statutory duty of good faith and fair dealing under the Ontario Arthur Wishart Franchise Disclosure Act (and comparable provisions in other Canadian jurisdictions) where the change was a rational business decision made by the franchisor for valid economic and strategic reasons, having regard to both its own interests and the interests of its franchisee).
clearly outline the need for the change, the specific actions the franchisee must take to implement the change, the timeline for implementation, and the contact information of the person(s) within the franchisor’s organization that will respond to inquiries regarding the change. The operations manual should also be updated to reflect the change.6

III. SOURCES OF STANDARDS

It is critical that franchisors clearly describe their system standards and the requirement that franchisees follow them. The primary source of this requirement is the franchise agreement. In order to be able to make changes to the standards, the franchise agreement should reference and define them as contained in the operations manual, which itself is broadly defined to include written communications, and further directly provide that the system standards may be changed by the franchisor.

The franchise agreement should contain several provisions that describe the source and nature of the system standards, as well as purpose and import, including the following:

First, in the recitals and definitions, it is advisable to define and state the value of the standards. A typical definition includes:

“System” means, collectively, Franchisor’s valuable know-how, information, trade secrets, methods, Manuals, standards, designs, methods of trademark usage, copyrightable works, rental space sources and specifications, software, confidential electronic and other communications, methods of Internet usage, marketing programs, and research and development connected with the operation and promotion of the Franchised Business, as modified by Franchisor at any time.

Second, under the franchisee’s obligations, the franchise agreement should specifically and directly require compliance with all standards. These points can be addressed in both the grant of the license and franchisee’s obligations:

Grant of License. Subject to the terms and conditions of this Agreement, Franchisor grants to Franchisee an exclusive license to operate a Franchise using the System and the Marks for the term of this Agreement. Franchisee may use the Marks and System only in accordance with the terms and conditions of this Agreement.

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System Compliance. Franchisee must comply with the System, the Manual, and all systems, procedures and forms, as in effect from time to time and as may be amended or revised from time to time. All mandatory specifications, standards, and operating procedures prescribed by Franchisor in the Manual, or otherwise communicated to Franchisee in writing, shall constitute provisions of this Agreement as if fully set forth herein. Accordingly, all references in this Agreement to Franchisee’s obligations under this Agreement, shall include such mandatory specifications, standards, and operating procedures contained in the Manual.

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6 For discussion on legal ability to make and enforce standard changes, see Section II(D), supra.
Uniformity and Image. In order to maintain uniform standards of quality, appearance, and marketing, it is essential that Franchisee conform to Franchisor’s standards and specifications set forth in the Manual and the System, as these may be amended or revised from time to time.

Operations. Franchisee must maintain and operate the Business in accordance with the System and Manual, as amended by us in our discretion. Franchisee or a fully trained and qualified manager (“Manager”) approved by Franchisor must participate personally and full-time in the Business.

Third, the franchise agreement should specifically and expressly provide that the franchisor has the right to change the standards. As noted above, this relates in part to the operations manual, which should be broadly defined to include written communications and other directives to franchisees. These provisions should expressly provide that the franchisor may change system standards and the operations manual periodically and that the franchisee remains obligated to comply with the system standards as modified, even if it results in increased costs to operate for franchisees. Examples include:

Modification of System. Franchisor reserves the right to periodically change, improve, or further develop the System, or any part of the System. Franchisee must promptly accept and comply with any change to the System and make any reasonable expenditure as necessary to comply.

Manual. Franchisor will loan to Franchisee during the term of the franchise one (1) copy of Franchisor’s confidential operating Manual, which may be in print, on an access code-protected company intranet or extranet, or through other media. Franchisor reserves the right to require Franchisee to use the Manual in only an electronic format. The Manual will at all times remain the property of Franchisor, and Franchisee must immediately return the Manual to Franchisor upon expiration, termination, or Transfer of this Agreement. Franchisor may periodically update and revise the Manual. Franchisee acknowledges that its entire knowledge of the operation of the System is and shall be derived from information disclosed to Franchisee by Franchisor and that certain of such information is Confidential Information of Franchisor. Franchisee shall maintain the absolute confidentiality of all such Trade Secrets during and after the term of this Agreement, and shall not use any such information in any other business or in any manner not specifically authorized or approved in writing by Franchisor. Franchisee is bound by the standards for maintaining the privacy of the Manual in the same manner as all other Confidential Information as provided in this Agreement.

Additional helpful provisions in the franchise agreement include an acknowledgement by the franchisee both of the value and trade secret nature of the system standards and of the importance of consistency and following system standards.

Updating and communicating the system standards through the operations manual (including through memoranda, directives, and other communications) is the next critical step to maintaining system standards as they may change, as well as enforcing those updated system standards. Where the franchise agreement contains these types of provisions, courts have
generally upheld the right of a franchisor to unilaterally make reasonable changes to its system standards.

IV. COMPLIANCE AND ENFORCEMENT

A. Importance of Ensuring Compliance

As discussed above, standards are an important part of a franchisor’s goodwill and brand identity. Because customers and clients rightly expect a uniform experience at franchised locations, including the “look and feel” of the business, the branding, the product and service offerings, the level of service, cleanliness, and other system standards issues, ensuring consistent compliance is essential to maintaining brand value.

1. Creating a Culture of Compliance

While franchisees are independent businesspersons, they join franchise systems rather than starting their own businesses in order to take advantage of the system’s brand, processes, and standards. However, at some point during the franchise relationship, a franchisee may decide that it wants to adopt a different approach, which conflicts with the system’s standards. Such decisions may arise from a variety of different motivations, including: (a) the franchisee believes that it has determined a better way to operate the business, or at least certain aspects of the business; (b) the franchisee has been operating for a number of years and has become less attuned to the importance of following system standards; (c) the franchisee may be attempting to cut costs by devoting less resources to complying with standards; or (d) the franchisee may have delegated responsibilities to employees who lack an understanding of the importance of, or motivation to maintain, compliance with standards. Creating a culture of compliance with respect to standards is important in ensuring compliance without regard to the length of time a franchisee has belonged to the system or a particular franchisee’s motivations.

In the vein of the saying that “An ounce of prevention is worth a pound of cure,” fostering a culture of compliance may be the most effective method of ensuring maintenance of standards, as it focuses on encouraging voluntary compliance, rather than employing corrective or enforcement efforts, which are likely to be more resource intensive. Fostering a culture of compliance, therefore, should be a priority for franchise systems.

In order to truly foster a culture of compliance, a franchisor should emphasize compliance with standards during the franchisee-recruitment process, devote part of the training program to compliance, and ensure that it allocates adequate resources to monitoring compliance and taking steps to ensure instances of non-compliance are corrected in a timely and satisfactory manner. In short, compliance should be part of all facets of the franchisor’s business. Ensuring that compliance is a demonstrated part of the franchisor’s corporate culture helps motivate further compliance. Successful compliance programs include processes whereby the franchisor will “check, coach, check, and enforce (if necessary).”

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7 Burger King Corp. v. E-Z Eating, 41 Corp., 572 F.3d 1306 (11th Cir. 2009) (franchisor did not breach franchise agreements by requiring its franchisees to take part in a system-wide program; agreements required franchisees to accept and comply with such modifications, revisions and additions to franchiser’s Manual of Operating Data as franchisor, in the good faith exercise of its judgment, believed to be desirable and reasonably necessary).

Establishing a culture of compliance at the developmental stages of a franchise system, rather than attempting to adopt such a culture as the franchise system reaches a certain size or scale, is a best practice. By making it clear to prospective franchisees from the inception of the concept that a franchisor is committed to system standards, franchise systems may even impact the pool of interested franchisees through self-selection. However, it is never too late to develop a culture of compliance in systems that have not historically devoted attention to standards compliance.

2. Avoiding Waiver Arguments

Waiver arguments are a difficult path for a franchisee seeking to avoid compliance with a franchisor’s standards, particularly when the franchise agreement contains clear anti-waiver provisions, as illustrated by the case of Lokhandwala v. KFC Corp.\(^9\) Lokhandwala involved a dispute between KFC and one of its franchisees arising from the franchisee’s promotion of its sales of Halal chicken, which is chicken prepared in accordance with Islamic law and customs. In 2009, KFC adopted a policy that prohibited franchisees from making religious dietary claims about KFC products. Lokhandwala, one of KFC’s franchisees, had been promoting its sale of Halal chicken products both prior to and following KFC’s adoption of the 2009 policy. According to Lokhandwala, “from 2003 until late 2016 or early 2017, [KFC] approved the sale of Halal chicken in [his] stores, helped him find Halal-certified processors and distributors, and allowed him to obtain the annual ISWA certificates,” which certify foods as being Halal-compliant. However, in late 2016 or early 2017, KFC “changed course and demanded that [Lokhandwala] stop marketing his products as Halal.”

While Lokhandwala asserted claims for declaratory and injunctive relief, breach of contract, and promissory estoppel, his theory was essentially that KFC had waived the right to require him to comply as he argued that KFC’s 2009 policy “contradicts representations that [KFC] made to him when he opened stores in 2010 and 2012, and runs contrary to [KFC] allowing him to continue advertising Halal products in his stores after the 2009 policy took effect.”\(^10\) However, citing provisions in the franchise agreement requiring franchisees to comply with KFC’s requirements and instructions relating to the use of KFC’s trademarks and advertising, various non-waiver provisions, and an integration clause, the court held that “[u]nder the franchise agreement, [KFC] has every right to bar [Lokhandwala] from advertising his products as Halal, even if [KFC] allowed that advertising in the past.”\(^11\) And, because the court found that the franchise agreement specifically addressed the conduct at issue, the franchisee could not assert a claim for promissory estoppel under Kentucky law. Accordingly, the court dismissed the complaint with prejudice.

However, where supported by strong facts, franchisees have succeeded in making waiver arguments in the context of system standards. For example, a Dairy Queen sublicensee successfully argued waiver as to the requirement to obtain prior written approval for the sale of non-Dairy Queen food items.\(^12\) After considering the evidence, including more than 25 years of the sublicensor permitting the sublicensee to sell non-Dairy Queen food items without prior approval, the court held that defendants “waived any right to approve or disapprove the sale of food items in plaintiffs’ store. Such a waiver cannot be recalled or expunged.” Id. at 1096.

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\(^10\) Id. at *2.
\(^11\) Id. at *4.
\(^12\) Terry v. Intl Dairy Queen, Inc., 554 F. Supp. 1088, 1095 (N.D. Ind. 1983).
Similarly, while most franchise agreements contain anti-waiver provisions, such provisions will not necessarily stop a franchisee who is motivated to avoid compliance from arguing that the franchisor waived compliance with a particular standard, or system standards generally, through an extended period of non-enforcement.\(^\text{13}\)

Accordingly, franchisors should not discount the importance of consistently maintaining standards to avoid franchisees raising waiver arguments that succeed or, at a minimum, that expand the issues in the litigation, lead to additional discovery, raise a disputed issue of fact, and increase the costs of litigation.

3. **Avoiding Discrimination Allegations**

While the inherent benefits of consistent enforcement of standards should be the primary motivation underlying monitoring compliance with, and enforcement of, standards, a franchisor may also be motivated by the concerns of alleged discrimination in enforcement of standards.\(^\text{14}\) When a franchise system’s commitment to standards is uneven, sporadic, or inconsistent, this opens the door to a franchisee arguing that it should not be obligated to comply with a standard because the franchisor applies and enforces its standards on a discriminatory basis.

Discrimination arguments intended to excuse a franchisee’s breach of its obligations are generally difficult arguments for the franchisee to press. For example, in *Mr. Steak, Inc. v. Bellevue Steak, Inc.*,\(^\text{15}\) the court rejected a franchisee’s argument that it should be permitted to sell alcoholic beverages based upon the franchisor’s actions with respect to other franchisees whose agreements contained similar provisions. In *Mr. Steak*, the franchisor filed a complaint to enjoin a franchisee from selling alcoholic beverages, which was prohibited by the terms of its franchise agreement. The franchisee successfully argued to the trial court that the prohibition should not be enforceable, among other reasons, because the franchisor should be estopped based upon its waiver of the prohibition against other franchisees. Subsequently, the court of appeals reversed the trial court’s holding and rejected the franchisee’s arguments as to waiver, estoppel, and fiduciary arguments that all franchisees should be “accord[ed] . . . the same options in conducting the business of a restaurant,” finding that the franchisor’s “actions with regard to other franchisees cannot sustain a finding that it waived its rights under the specific terms of its agreement with these defendants.”\(^\text{16}\)

However, a franchisor is certainly better off when it consistently enforces its standards, thereby avoiding the creation of a factual record that a franchisee may use to support a

\(^{13}\) *In 33 Flavors of Greater Delaware Valley, Inc. v. Bresler’s 33 Flavors, Inc.*, 475 F. Supp. 217 (D. Del. 1979), when the franchisor refrained for more than a year from terminating a territorial licensee based upon its failure to meet its requirements for opening and supporting a certain number of stores, the court held that “Illinois courts would give no effect to the [non-waiver] clause in the circumstances of this case.” Id. at 229 n.38.

\(^{14}\) See Jess A. Dance, Robert M. Einhorn & Heather Carson Perkins, *Enforcing System Standards--A Franchisor’s Prerogative?*, ABA 41st Annual Forum on Franchising W-10, at 21 (2018) (noting that while there are challenges to such arguments, franchisees may argue that a franchisor’s selective enforcement of agreement provisions violates the anti-discrimination provisions contained in some state franchise relationship laws and regulations).

\(^{15}\) 555 P.2d 179 (Colo. App. 1976).

\(^{16}\) Id. at 182. Similarly, in the context of a franchise agreement termination based upon underreporting of sales, the Seventh Circuit rejected the franchisee’s challenge to the termination based upon the franchisor’s failure to terminate other franchisees who underreported sales. *Great American Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.*, 970 F.2d 273, 279 (7th Cir. 1992) (“The 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 speeding ticket.”).
discrimination argument to support various claims, such as the waiver, estoppel, and fiduciary duty arguments raised by the franchisee in Mr. Steak.

4. **“New Day” Letters**

Does a franchisor lose the right to enforce a system standard if it has not been actively enforcing the standard for a period of time? Generally, the answer is no. The question then arises as to how a franchisor effectively resumes (or begins) actively enforcing a standard after a period of non-enforcement. The answer to that question is a “new day” letter. The “new day” letter is a communication from the franchisor that advises franchisees that a standard that may not have been actively enforced in the past will be enforced in the future, after an appropriate transition period.\(^\text{17}\)

The length of the transition period will vary depending upon the nature of the standard and a reasonable time period to allow franchisees to commence compliance. For example, in 33 Flavors of Greater Delaware Valley, Inc. v. Bresler’s 33 Flavors, Inc.,\(^\text{18}\) the franchise agreement required an area developer to open 27 stores within six years. After the franchisee failed to satisfy the development schedule, the franchisor did not enforce the provision. Subsequently, the franchisor provided a general notice to the system that it would enforce such provisions in the future. The court found that the general notice was too vague, given the nature of the provision at issue, and that in order to successfully revoke the waiver, the franchisor needed to provide notice with specific goals and specific reasonable time periods. For the notice to be effective, it would have needed to provide clear notice that the provision would be enforced in the future, while also providing a reasonable period of time to achieve compliance.\(^\text{19}\)

**B. Monitoring Compliance with System Standards**

1. **Quality Assurance Evaluations**

Most franchisors have developed their own quality assurance evaluation forms that are tailored to the system’s particular standards and requirements. The quality assurance evaluation forms provide a scorecard that informs both the franchisor and the franchisee as to how the franchisee is performing with respect to compliance with the franchisor’s system standards. Such scorecards can serve the important role of evidencing the franchisee’s failure to comply with the franchisor’s standards, while also providing notice of the specific defaults and how they may be remedied.

For example, in Huang v. Holiday Inns, Inc.,\(^\text{20}\) the franchisee sought an injunction to bar the franchisor’s termination of the franchise agreement based upon the franchisee’s failure to

\(^{17}\) Dance, et al., supra, note 15, at 27 (“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.”).


\(^{19}\) Id. at 230 (holding that general notice to the system that Breslers would be evaluating each territorial licensee’s progress toward its quotas was not “the type of clear notice that is needed in order to eliminate a waiver” because it did not give the territorial licensee “clear notice that they would no longer tolerate his defaults and that he would be expected to meet his contract quota within a specified reasonable period of time”).

comply with standards, arguing that the franchisor “did not provide them with adequate notice of the nature of the deficiencies and the appropriate corrective measures to be taken.” In rejecting the franchisee’s argument, the court observed that the franchisor’s quality assurance notices advising the franchisee that it had received an “Unacceptable” rating on its quality assurance evaluations, accompanied by charts that “divided the hotel into 86 separate areas, identified the issue, and stated the deficiency” adequately supplied the franchisee with information regarding the nature of the defaults and how they could be remedied.

Following the quality assurance inspection, the franchisee should be provided with a copy of the inspection report. As a best practice, the franchisee should be required to sign an acknowledgment that they received the report and should be provided an opportunity to discuss any of the items recorded as needing improvement. In this way, the franchisor helps ensure that the franchisee is fully aware of the system standards defaults and what is needed to cure such defaults. If the franchisee fails to cure, the signed acknowledgment then becomes important evidence demonstrating that the franchisee had been provided notice of the various system standards defaults.

A key question confronting franchisors is who should perform the quality assurance evaluations. There are three primary options that most franchisors choose. The first option is the franchisor’s franchise support personnel. These individuals are familiar with the standards and the franchisee’s business. They also usually make regular visits to the franchised location, presenting a convenient and cost-effective opportunity to perform a quality assurance evaluation. However, such evaluations may not always provide the most accurate assessment of the franchisee’s performance given that the evaluator is the same person who provides support to the franchisee and who may also have a relationship with the franchisee that may impact the evaluation, whether consciously or sub-consciously.

The second option is to have the evaluations performed by different franchisor personnel. In many instances, this could be a person who provides franchise support services to a different geographic region. Such individuals will also be familiar with the franchisor’s standards, while perhaps being more objective in their assessments, given the lack of regular interaction with the franchisee. While this option may appear, on its face, to be a superior approach to quality assurance evaluations performed by the franchisee’s regular support personnel, it is more costly and requires more resources. In many systems, particularly smaller systems, this would not be a viable option. Moreover, it also has the disadvantage of removing the opportunity for the franchisee’s designated support person to provide real-time feedback and guidance on improving compliance with standards.

The third option is to hire a third-party service to perform the quality assurance evaluation. This approach has the benefit of providing evaluations that are independent of any other franchisor-franchisee relationships or dynamics, and many such third parties can provide such services in a more cost-effective manner because they may be providing a number of evaluations in a small geographic area for a number of different companies. Of course, depending upon the third-party’s experience with the franchisor’s standards and the level of turnover at the third party, familiarity with the franchisor’s standards is likely to be lower than it would be for the franchisor’s personnel.

21 Id. at 356.

22 Id. at 356-57. The franchisee was also invited to accompany the inspector as he made his rounds, and the franchisee never previously objected to any purported vagueness of the inspection reports prior to bringing its action seeking to enjoin termination.
2. **Secret Shoppers**

Secret shopper evaluations are most similar to the third approach to quality assurance evaluations discussed in the preceding section. However, there are two key distinctions. First, while quality assurance evaluations are often (although not always) scheduled or announced, secret shopper visits— as the name suggests—are not announced and may provide a more accurate perspective on how the franchisee operates in the ordinary course of business. Second, secret shopper visits tend to have a more limited scope. The secret shopper is not going to have access to non-public areas of the franchisee’s operations and the duration of the visit is inherently limited by the amount of time that a typical customer would spend in the location.

3. **Customer Surveys and Complaints**

Customer surveys can be used to obtain information about a franchisee’s performance with respect to targeted system standards. However, the average customer will generally answer a limited number of questions. Accordingly, while surveys may be helpful for assessing compliance with a small number of specific standards, they generally will not provide a comprehensive assessment of the franchisee’s compliance with all standards. Similarly, customer complaints may alert a franchisor to one or more standards violation issues at a franchise location, but such complaints are inherently limited to the issues that led the customer to contact the franchisor.

4. **Reporting and Documenting Defaults**

Whatever tools a franchisor uses to monitor compliance with system standards, including some or all of the above, reporting and documenting areas of non-compliance is critical. From the perspective of correction and guidance, having documentation of the particular standards violations can be central to a meaningful dialogue between the franchisor and the franchisee regarding how to improve compliance. And, in the event the franchisor needs to take more formal steps in the event of repeated non-compliance, including issuing notices of default and potential termination, documentation is critical. Guidelines for effective documentation and the reasons for such documentation are discussed in more detail below.

C. **Tools for Fostering Compliance**

1. **Sharing of Best Practices**

One of the many advantages of franchising, compared to an independent non-franchised business, is that the franchisees gain access not only to the franchisor’s system, but to the experience of dozens, hundreds, or thousands of other franchisees who are implementing the same standards. Whether through stories shared at conventions or specific “best practices” entries on a franchisor’s intranet, franchisees can learn from other franchisees both the importance of complying with standards as well as some tips for effective and efficient compliance. Sharing of such best practices can be formalized through the franchisor gathering and posting information that is available to franchisees, or it can be less formal and organic, such as by establishing a franchisee group chat area.

2. **Counseling**
When a franchisor learns that a franchisee is facing challenges in complying with system standards, whether through one of the monitoring approaches discussed above, or in another manner (such as a complaint from a neighboring franchisee), counseling and instruction can be an important tool to foster compliance with standards. By attempting to provide corrective counseling or instruction, a franchisor may also be able to determine whether the compliance issues are caused by a lack of understanding or a lack of motivation, which may help guide the best approach to fostering compliance.

3. **Incentives and Awards**

When a franchisee’s lack of compliance is more a function of motivation than understanding, some franchisors have found that incentives and awards create a direct motivation and can also foster positive competition that creates further motivation. While they are not likely to equally motivate all franchisees, the right incentives and awards can have a material impact on the average compliance baseline.

4. **Positive Reinforcement**

Franchise support personnel can help motivate compliance with standards through positive reinforcement with the franchisees they support. As noted above, the flipside of this tool is that the franchise support personnel may find it challenging to walk the line between being an objective monitor or evaluator of compliance, on the one hand, while also being a cheerleader for the franchisees.

5. **System Communications**

Like any relationship, communication is important to the franchisor-franchisee relationship. Communicating system standards, the reasons for the standards, and the benefits of the standards can go a long way to fostering compliance. Particularly when a system is changing system standards or adopting new standards, clear and timely communication from the franchisor is essential.

6. **Franchisee Advisory Council**

Franchisee advisory councils can serve a similar role to more formal communications regarding system standards from the franchisor, with the added benefits of being less formal, more organic, and coming from someone who can provide first-hand testimony to the importance and benefits of compliance with standards.

7. **Peer Reinforcement Among Franchisees**

Similar to communications from a franchisee advisory counsel, but even less formal, peer conversations that emphasize the importance and benefits of complying with standards can facilitate compliance.

D. **Documenting Compliance Issues**

1. **How**

The adage that “a picture is worth a thousand words” is certainly true when it comes to documenting compliance with system standards. When the standards violations lend
themselves to visual assessment, such as cleanliness of the business or signage standards, the best documentation is time-stamped photographs.

The various monitoring tools discussed above, such as quality assurance evaluations, secret shopper reports, and customer complaint forms, are also useful for documenting standards compliance. Ideally, such reports will be accompanied by photographs, particularly of significant system standards issues.

System standards relating to the required supply of specified documents, such as financial statements or insurance certificates, can be documented through brief letters or requests for compliance.

2. **Why**

   a. **Continuity through Changes in Personnel**

   Effective documentation of system standards violations creates business records that are accessible to multiple team members and can be particularly important in the event of changes in personnel. While a live witness with first-hand recollection of observed standards violations can provide irreplaceable detail and context, documentation of past violations can be very helpful to refreshing a witness's recollection or to providing a business record that can be relied upon in the event of changes in personnel.

   Whether due to employee departures or due to reassignments as territories covered by franchise support personnel are reconfigured, most franchisees will likely be supported by more than one franchise business consultant during the term of their franchise agreement. Copies of quality assurance evaluations and other documentation of standards noncompliance can provide invaluable background to a new franchise business consultant assigned to a particular franchisee.

   b. **Facilitates Counseling**

   Well-documented examples of system standards issues can help focus franchisees on key business issues to address. They can also foster more meaningful dialogue between the franchisor and its franchisees regarding specific steps for improvement.

   Having a series of quality assurance evaluations over a period of time can also reveal trends that are helpful in providing guidance for continued improvement.

   c. **Important Evidence in Litigation**

   Because many standards violations may be a bit more amorphous compared to obligations like the payment of royalties, it is helpful to have as much evidence as possible, reflecting both the magnitude of any violations and the longevity of violations, when the franchisee repeatedly fails to address them.

   As noted above, photographs, copies of reports, and other documentation of standards violations are very important in the context of litigation. Photographs provide an objective record of the violation, while quality assurance evaluations and letters notifying franchisees of failures to provide required documentation constitute contemporaneous evidence of the failure to provide required items or comply with particular standards.
If the violations pose a substantial threat of irreparable harm to the system or the franchisor's brand, leading a franchisor to seek temporary or preliminary injunctive relief, the request for such relief may rise or fall on the strength of the franchisor’s documentation of the standards violations. Such documentation is equally important when a franchisee seeks an injunction to contest a termination based upon standards violations.

The value of such documentation is illustrated by the case of *Pooniwala v. Wyndham Worldwide, Corp.* 23 In *Pooniwala*, the franchisor terminated two hotel franchise agreements based upon repeated failing scores on quality assurance inspections. The franchisee filed a complaint and sought a preliminary injunction to enjoin the terminations of the two franchise agreements, asserting claims under the Minnesota Franchise Act and for alleged retaliation by the franchisor based upon a separate lawsuit between the parties relating to another hotel property. The franchisor performed multiple quality assurance inspections at two different hotels operated by the franchisee that resulted in failing scores. Following the quality assurance inspections, the franchisor sent notices to cure. The franchisee "repeatedly contested the QA inspections with respect to their processes, contents, results, and the adequacy of the notice associated with the termination notice." 24 The Court summarized the franchisor's evidence as follows:

Defendants point to a long history of QA inspection failures-six failures for the Super 8 Roseville and eight failures for the Travelodge Burnsville-in support of their claim that the terminations were supported by good cause. Specifically, Defendants present documents showing that the Super 8 Roseville failures date back to January 2012 and continues up to the final failure in December 2013, and that the Travelodge Burnsville failures date back to November 2010 and also continues up to the final failure in December 2013. . . . In addition to the QA reports, Defendants also present a number of letters and notices relating to these inspections. 25

Notwithstanding the franchisee's challenges to the quality assurance inspections as a proper basis for termination, the court found that the franchisor's inspection reports and subsequent notices to cure provided substantial evidence supporting good cause for the terminations, leading the court to hold that the franchisee failed to establish a likelihood of success on the merits of its claims and denying its request to enjoin the terminations. 26 Accordingly, the *Pooniwala* decision demonstrates the value of documented evidence of a franchisee’s standards violations in connection with terminations based upon such violations.

The importance of such evidence is not limited to requests for temporary or preliminary relief. After any proceedings for temporary or preliminary relief, or even where such relief is not at issue, effective documentation will also be invaluable at the summary judgment stage or during a trial or arbitration hearing.

And, whether in the context of an ongoing franchise relationship or a terminated one, such evidence will have an important impact in assessing the strength of each side’s arguments in connection with any potential negotiated resolution of the parties’ dispute.

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24 *Id.* at *3.
25 *Id.* at *6.
26 *Id.*
E. Joint Employer Considerations

As noted above, franchisors should consider vicarious liability risks in developing standards. In a similar vein, when working with their franchisees to foster compliance with standards, franchisors should give consideration to joint employment issues, which have been evolving over the past few years. These concerns may be particularly acute when a franchisor representative performing a quality assurance evaluation observes a franchisee employee failing to comply with an important system standard. Should the franchisor representative merely document the violation or provide real-time feedback directly to the franchisee’s employee? Conventional wisdom in recent years, with the increased focus on joint employer issues, is that the franchisor should address such issues directly with the franchisee or the franchisee’s designated manager, who in turn should address the issue with the franchisee’s employee. However, different systems may take different approaches to guiding their franchisees in correcting standards issues, depending upon the nature of the system, the standard at issue, and the options for obtaining successful remediation of violation.27

V. WHEN THE FRANCHISEE FAILS TO COMPLY – EVALUATING OPTIONS

A. Investigating Potential Non-Compliance

1. Reviewing the File

If a franchisor becomes aware of a potential default, it should engage in a comprehensive review of the data relevant to the alleged non-compliance, including operating reports, mystery shopper reports, customer satisfaction reports, and audit and inspection reports. The franchisor should analyze as much historical data as is available to identify trends in behavior and performance (as opposed to focusing on a single instance of non-compliance). In addition to operating reports, the franchisor should review copies of all correspondence between the franchisor and franchisee relating to the non-compliance and speak with the franchisor’s staff that serve as the principal points of contact with the franchisee, such as regional operations support personnel and regional franchise account managers. Franchisors occasionally fail to interview their staff and review emails and files, only to discover in litigation that a field representative of the franchisor has condoned the non-compliant behavior or otherwise corresponded with the franchisee in an improper manner.

2. Understanding the Franchisee’s Position

If, after analyzing the relevant data, the franchisor determines that a default has occurred, the franchisor should issue a written notice of non-compliance describing the nature of the default, any concerning trends in operations or compliance that it has observed, and the steps that are necessary to cure the non-compliance. The written notice should invite a dialogue between the parties. Ideally, the written notice should be accompanied by an email or phone call soliciting an in-person meeting or telephone call with the franchisee and the franchisee’s management team. The franchisor should also explain why the standard is important to the brand and to the administration of the franchise system. Finally, the franchisee should be given an opportunity to explain how and why the default occurred. Franchisees appreciate the

27 For a recent article addressing the current status of joint employer issues in the franchising context and their impact on franchisor relationships with their franchisees, including in the areas of support and maintaining brand standards, see Mazero, et al., Drawing Lines in Franchisor Support--Is It Necessary and Where Are the Lines to Draw in Today’s Joint-Employment Environment?, 38 Franchise L. J. 327-58 (Winter 2019).
opportunity to be heard, and such dialogue may reveal shortcomings in the franchisor’s operations (e.g., inadequate training or support, failure to adequately communicate changes to standards, endemic non-compliance within the franchisee’s region or the system as a whole). When possible, the parties should work together to develop a mutually acceptable action plan to bring the franchised business into compliance with the franchise agreement and the standards.

If the parties are unable to reach an amicable resolution, then the franchisor must determine whether it will issue a notice of default or take other formal steps to compel compliance with the standards. In larger systems, these decisions may be made by a committee consisting of key stakeholders within the franchisor’s organization (i.e., operations, account management, finance, and legal). When a franchisor has a committee that addresses defaults and terminations, a process should be established to transition or escalate a matter from field personnel to the committee.

B. **Does Non-Compliance Rise to the Level of Default?**

A default is the “omission or failure to fulfill a duty, observe a promise, discharge an obligation, or perform an agreement.”28 Most franchise agreements require compliance with the standards. Arguably, the failure to comply with any standard may constitute a default under a franchise agreement. How does a franchisor determine whether failure to comply with a particular standard or standards constitutes a material default meriting further action and possibly termination of the franchise agreement? Generally, the decision involves the careful examination of numerous practical and legal considerations.

1. **Practical Considerations When Considering Termination**

First, the franchisor should assess the nature of the standard. The more important the standard is to the health and safety of customers, the customer experience, and the value of the franchisor’s brand and its goodwill, the stronger the franchisor’s argument that non-compliance constitutes a material breach of the franchise agreement. For example, violations of standards in the areas of health and safety are defaults that are likely to be considered material by most judges, juries, and arbitrators. Second, the franchisor should assess the degree of non-compliance. For example, a franchisor may reach a different determination as to whether it decides to issue a notice of default to a franchisee who failed to submit a required report for the month of February, but timely provided subsequent reports for the remainder of the year when compared with a franchisee that has failed to submit required reports for many months and after repeated notices of non-compliance. Third, a franchisor may want to consider timing and life-cycle issues in evaluating a particular breach. If a non-complaint franchisee is new to the franchise system and only recently completed training, a franchisor may decide that additional training would be a more effective tool than a formal notice of default. At the other end of the spectrum, if a franchisee is delinquent in performing mandatory upgrades to its location, but only has a few months remaining on its franchise agreement and has already advised the franchisor of its intent not to renew the franchise agreement, a franchisor may reach a different conclusion about the materiality of the breach than it would in the context of a franchisee that is in the middle of the term of its franchise agreement. Other more esoteric factors may also be important to the analysis, depending upon the circumstances and nature of the business of a particular franchisor.

2. **Legal Considerations When Considering Termination**

The first legal consideration when issuing a notice of default is to examine the franchisor’s rights under the franchise agreement. Specifically, the franchisor should ascertain whether: (i) the franchisee’s act or omission is an enumerated ground for termination of the franchise agreement; (ii) whether the franchisor is contractually obligated to provide notice of default and termination; and (iii) whether the franchisor is contractually obligated to provide the franchisee with an opportunity to cure the default. If the act or omission is not an enumerated ground for termination of the franchise agreement, the franchisor should consider whether the act or omission is nonetheless a material default. In determining whether a default is material, the franchisor should consider: (a) whether the franchisor has been deprived of the benefit which it could reasonably expect under the contract; (b) whether the franchisor can be adequately compensated for the breach; and (c) the likelihood that the franchisee will cure the default (taking into account all of the circumstances, including any reasonable assurances).  

The franchisor should also assess its rights and obligations under applicable law. Many states attribute a duty of good faith and fair dealing to all contracts. In addition, approximately 16 states have established franchise “relationship laws” governing material aspects of the franchise relationship, including transfers, terminations, and non-renewals. In many instances, these laws supersede the terms of the franchise agreement. State relationship laws generally permit a franchisor to terminate the franchise agreement only if there is “good cause” for the termination. Good cause is generally defined as the franchisee’s failure to substantially comply with any lawful requirement of the franchise agreement. State relationship laws generally also require the franchisor to provide the franchisee with notice of default and intent to terminate at least 30 to 90 days prior to termination and require the franchisor to provide the franchisee with an opportunity to cure ranging from 30 to 90 days. Statutorily enumerated grounds for termination under state relationship laws often include: bankruptcy or insolvency of the franchised business, or assignment of the franchised business’s assets to creditors, franchisee’s voluntary abandonment of the franchised business, repeated breaches of the franchise agreement, and felony convictions or fraud or misrepresentation in connection with the acquisition of a franchised business, among other factors. A chart summary of state franchise relationship laws requirements for termination is attached as Appendix A to this paper.

VI. **BUSINESS ALTERNATIVES TO DEFAULT AND TERMINATION**

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29 Restatement (Second) of Contracts, § 241 (1985).


32 California Franchise Relations Act, Cal. Code Ann. § 8-5.5-20000-20043.

Termination is often a painful process for the franchisor and the franchisee. In analyzing whether termination is truly the right option, franchisors should consider: (i) whether the franchisee’s non-compliance presents a risk of harm to associates, customers, or the general public; (ii) whether the franchisee’s non-compliance threatens the goodwill associated with the franchisor’s brand and franchise system; (iii) the likelihood that the franchised business can be brought into compliance with the franchise agreement and system standards; (iv) the likelihood that the franchisee will remain compliant with the franchise agreement; (v) the franchisee’s willingness to remain within the system; (vi) whether forbearance in one instance may constitute a discriminatory practice with respect to the administration of a franchise system (see above); and (vii) how forbearance will affect system franchisees that have voluntarily complied with the standards at their expense. If it is possible and worthwhile to salvage the relationship, a franchisor may wish to consider alternatives to termination, certain of which are described below.

A. Additional Training

Franchisors often attempt to “rehabilitate” non-compliant franchisees by providing supplemental training, with the understanding that the franchisees will use the training to resolve operating issues and become compliant with the franchise agreement and the standards. If a franchisor chooses to provide additional training, it should still issue a notice of default to the franchisee as described in Section VII below. The notice should describe the training programs that must be completed (including any proficiency tests that must be completed to the franchisor’s satisfaction), the persons that must complete additional training, the date by which additional training must be completed, the fees associated with additional training, and the date by which the franchisee must cure any defaults under the franchise agreement. Many franchisors consider the provision of additional training to be a negotiated settlement in the event of a default and so do not enumerate training as an alternative to termination in the franchise agreement. Other franchisors prefer to expressly reference additional training as a potential remedy in the event of a default by the franchisee in the franchise agreement.

B. Service Agreements and Lend-Lease Agreements

Franchisors with robust operating divisions occasionally take more drastic measures by providing operating support to struggling franchisees. Operating support may take the form of consulting or advisory services arrangements for specific types of support or lend-lease arrangements to share personnel. Such arrangements should be entered into after much deliberation, careful evaluation of the franchisor’s available resources and the franchisee’s operating needs, careful evaluation of the franchisor’s insurance coverage, and consultation with labor and employment counsel. If a franchisor chooses to provide operating assistance, it should still issue a notice of default (described below) and enter into a service agreement or “lend-lease” agreement that describes the scope of services to be rendered and the date by which the franchisee must cure any defaults under the franchise agreement.

Service agreements and lend-lease agreements should be non-renewable and of a short duration, so that both parties may periodically re-evaluate their relationship and the status of the franchised business’s operations. Such arrangements should be used sparingly so that franchisees do not become reliant upon the franchisor in operating their franchised businesses. To limit the franchisor’s liability, the franchisor’s advisors or operating personnel on premises should not have control over product pricing or employment matters for the franchisee’s employees. This can be accomplished by “lending” consultants, supervisors, and assistant supervisors as opposed to general managers of the franchised business.
Consulting and lend-lease agreements generally permit the franchisor’s personnel to provide suggestions or guidance relating to the operation of the business but place ultimate decision-making authority and sole responsibility for the day-to-day management of the franchised business in the hands of the franchisee. These agreements should include provisions narrowly defining the scope of the services to be rendered, the cost of such services (including travel and lodging costs for the franchisor’s personnel), and the timing and manner of payment for such services. Franchisors should retain control over their personnel and be solely responsible for the provision of payroll services and insurance, retirement, and other benefits to the franchisors’ employees.

These agreements should also include an indemnification provisions holding franchisees solely responsible for all third-party claims arising out of the operating support arrangement. Lend-lease agreements should also include a provision indemnifying the franchisor for all claims made by the franchisor’s employees resulting from the actions of the franchisee or the franchisee's employees. Any guarantors under the franchise agreement should execute a joinder to the consulting services agreement or lend-lease agreement, as applicable. The consulting services agreement or lend-lease agreement should also include a provision stating that the franchisor is an independent contractor retained for a specific purpose with no fiduciary duty towards the franchisee. The consulting agreement or lend-lease agreement should include an anti-waiver provision noting that the waiver of the franchisor’s rights in this instance does not constitute a waiver of the franchisor’s rights and remedies in the event of a future default by franchisee under the franchise agreement. Finally, both parties should be aware that the provision of operating assistance is not a guaranty that the franchised business can be brought into compliance, or that the franchised business will achieve a particular level of sales or profits. Franchisors should consider including “no guaranty” provisions in consulting agreement or lend-lease agreement, as applicable.

C. Management Agreements and Franchisor Cures (Self-Help)

In limited circumstances, a franchisor may assume operation of a franchised business if a franchisee commits a material default under the franchise agreement. This alternative to termination may be arranged by mutual agreement of the parties when a default arises. Some franchise agreements also include a provision permitting the franchisor to unilaterally “step-in” and operate a franchised business if certain enumerated defaults occur (e.g., if the franchisee or one of its principles dies, if the franchisee’s default poses a health or safety risk, if the franchisee loses any permits or licenses necessary to operate the business, or if the franchisee abandons the franchised business). Step-in rights provisions in franchise agreements should:
(i) identify the circumstances under which the franchisor may assume operation of the business;
(ii) include a “cooperation” clause pursuant to which the franchisee agrees to take such steps as franchisor deems appropriate to facilitate the transition of management to the franchisor; (iii) specify the length of time the franchisor may step in to operate the business (with provisions for periodic re-evaluations and renewal options); and (iv) address how the franchisor will be paid.

Even if the franchise agreement provides the franchisor with step-in rights, the franchisor should issue a notice of default and, whenever possible, require the franchisee to enter into a management agreement that specifies the parties' responsibilities, an initial operating budget, the timetable for curing existing defaults under the franchise agreement, and the franchisor’s compensation for operating the franchised business. Prior to entering into a management agreement, the franchisor should ensure that it has obtained the necessary licenses and permits to assume the operation of the franchised business, and that it has sufficient resources to manage the franchised business. The franchisee should review its corporate governance
documents (shareholder agreement, operating agreement, partnership agreement, etc.), lease agreements, vendor licenses and agreements, and financing agreements, including any Small Business Administration financing agreements, to identify the approvals necessary to enter into the management agreement and to ensure that the management agreement does not violate its existing covenants with key stakeholders. The franchisor should obtain a covenant and warranty from the franchisee that the management agreement will not violate the franchisee’s obligations under any agreements with third parties.

Under a management agreement, the franchisor generally has exclusive control, or a high degree of control, over the day-to-day operation of the franchised business. In order to effectively exercise this control, franchisors often include a “non-interference” provision in the management agreement that grants the franchisor: (i) the right to occupy the franchised business premises during the term of the management agreement; and (ii) exclusive supervision, discretion, and control over the franchised business. The management agreement should identify the matters that require franchisee approval (i.e., expenses or investments above a certain sum, the sale of real property, a change in the location of the franchised business, new lines of business, discontinuance of operations, etc.). Under a management agreement, the franchisor’s personnel operate the business and the franchisor is generally responsible for all employment related decision-making. The management agreement should contemplate periodic meetings between the franchisor’s management team and the franchisee, periodic inspections of the franchised business by the franchisee, periodic reporting requirements, and an annual budgeting process.

The franchisor may exert such a high degree of control under a management agreement as to render the franchise agreement redundant. If the management arrangement is intended to be of a long duration, then the parties should consider mutually terminating the franchise agreement.

D. Selective Enforcement of System Standards

The alternatives to termination discussed above require a franchisor to expend a significant amount of time, effort, and money to bring the franchised business into compliance with the franchise agreement and the standards. Not all franchisors are equipped to provide that level of operating assistance. Even if a franchisor has the time, money, and resources to provide operating assistance, it may be reluctant to invest resources in what it perceives to be a lost cause. Franchisors often find themselves asking whether it is legal or advisable to waive compliance with a standard in lieu of terminating a franchise agreement. In making such a decision, a franchisor must consider how its failure to enforce a system standard will affect not only the non-compliant franchisee, but also the system as a whole, the brand image, and the customer experience. For this reason, the selective enforcement of standards is often inherently problematic.34

This is particularly true if the franchisor has taken action to enforce system standards with respect to certain franchisees but not all franchisees. Franchisees may view the franchisor’s selective enforcement of system standards as a breach of their franchise agreements, a discriminatory practice, or a violation of the duty of good faith and fair dealing. Franchisees generally do not prevail on breach of contract claims in such circumstances. It is well settled that a contractual provision granting the franchisor a right to enforce system standards

34 See Mark J. Burzych and Emily L. Mathews, Vive La Difference? Selective Enforcement of Franchise Agreement Terms and System Standards, 23 Franchise L.J. 110 (Fall 2003).
standards against one franchisee does not obligate the franchisor to consistently enforce system standards amongst all franchisees. As discussed above, franchisees also have difficulty prevailing on claims of discrimination. Although at least five states have adopted laws banning “discriminatory treatment,” such statutes generally permit disparate treatment of franchisees within the same system if the disparate treatment is reasonable and not arbitrary, and if the franchisees are not similarly situated (e.g., if the franchisees signed agreements at different times, or if a standard does not translate well in the franchisee’s local market).

If a franchisor chooses to waive compliance with a system standard, it should document its reasons for doing so. Common examples include the following circumstances: when the standard has a disproportionately negative impact on the particular franchised business; when the franchisee’s market has different consumer preferences that render the standard untenable; or if the cost of compliance in the franchisee’s market is significantly higher than systemwide average cost to comply.

E. Restricting Access to Certain Services

The above alternatives to termination are generally utilized if a franchisor has investigated a default and determined that the franchisee desires to comply with the franchise agreement and standards but is unable to do so (i.e., that the franchisee is not willfully non-compliant). If a franchisor cannot identify the underlying cause for the franchisee’s non-compliance, it may seek alternatives to termination that are intended to drive compliance. One such alternative is restricting the franchisee’s access to services or products that the franchisor provides, such as supply arrangements, national accounts, logistics systems, and other technology systems. The franchisor should communicate its intent to withhold services in its notice of default to the franchisee, and the franchisor should not withhold services until the cure periods under the franchise agreement and applicable law have passed.

If the franchise agreement does not expressly permit a franchisor to withhold services in the event of a default by the franchisee, the franchisor may be vulnerable to a claim that it breached the duty of good faith and fair dealing by withholding services. In Interim Health Care of Northern Illinois, Inc. v. Interim Health Care, Inc., the Seventh Circuit found that a franchisor had violated the duty of good faith and fair dealing by withholding a non-complaint franchisee’s access to certain “national account” customers because the franchise agreement was silent as to the link between performance and account leads and the franchisor failed to notify the franchisee that non-compliance would result in loss of access to national account customers.

Withholding services may also be argued to constitute a constructive termination. If restricting access to services constitutes a constructive termination, then the franchisor may be liable for damages (including rescission) under certain state relationship laws. State laws differ in that regard. For example, constructive terminations are not actionable under the Washington Franchise Investment Law until a franchise agreement is bought to an end by terminating the

36 Illinois Franchise Disclosure Act, 815 ILL. COMP. STAT. 705/18. See also HAW. REV. STAT. § 428E-6(2)(C); IND. CODE § 23-2-27-2(5); MINN. R. 28560 4400(b); WASH. REV. CODE § 19.100.180.
37 HAW. REV. STAT. § 428E-6(2)(C).
franchisee’s right to use the franchisor’s trademark, trade name, or service mark. Conversely, constructive terminations are actionable under the Wisconsin Fair Dealership Law. For this reason, franchisors are strongly encouraged to wait until the franchisee has been provided with a notice of default and the cure periods under the franchise agreement and applicable law have passed before withholding access to services that the franchisor or its affiliates provide.

VII. THE DEFAULT PROCESS

As noted above, monitoring and documenting compliance issues should be an on-going pervasive part of the day to day management of the franchise system. When it comes to decisions on notices of default, fact gathering is critical for the decision. The franchisor should have the relevant facts and information relating to the franchisee and its current issues. The files, including those from legal, franchise sales and operations, accounting, and any other department having relevant information about the franchisee, will provide some background and an assessment of whether the default is sufficiently demonstrated to support issuing the notice of default. The franchisor should review both the history and context as well as, of course, the specific circumstances that gave rise to the possible default or termination by reviewing inspection or incident reports and related email correspondence. It should also consider interviewing relevant personnel who have specific knowledge of the situation. It is important to understand any additional circumstances or points that will be raised by the franchisee. When done properly, courts have consistently held that a franchisee’s failure to maintain system standards constitutes good cause for termination.

The decision surrounding issuing a notice of default further requires assessment of the substantive and procedural requirements of the franchise agreement and compliance with any added requirements of any applicable state relationship laws. The default process should follow the requirements of the franchise agreement and any applicable state relationship laws.

A. Basics of a Notice of Default

Once it is determined that the franchisor will send a notice of default, the following is a list of considerations associated with the notice.

- The content of the notice should specify the conduct constituting the default and tie the default to specific provisions of the Franchise Agreement (and, where applicable the Operations Manual). The notice should also specify the actions (or cessation of actions) necessary to cure the enumerated default(s). The notice should further state how long the franchisee has to cure the defaults.

42 See, e.g., Culligan Int’l Co. v. Culligan Water Conditioning, Inc., 563 F. Supp. 1265, 1270 (D. Minn. 1983) (finding that under Minnesota law, a notice of termination was insufficient because the notice did not state with particularity what the franchisee was required to do to cure. The notice at issue provided that the franchisee owed sums past due but did not state the specific amounts). But see Novus Franchising, Inc. v. Taylor, 795 F. Supp. 122, 130 (E.D. Pa. 1992).
• The notice should further clearly state and identify the consequences if the franchisee fails to comply.

• The notice should also clearly state that its terms cannot be waived or amended by the franchisor unless the waiver/amendment is in writing and signed by an officer of the franchisor. This avoids situations where an employee or area representative of the franchisor—who may not even be aware that the franchisee is in default—may do or say something that the franchisee would later claim waived or changed the required cure, timing to cure, or even the designation of the conduct as a default.

• Notices of default should include an express reservation of rights and claims, note that it does not necessarily cover all defaults, and specify that the franchisor reserves the right to enforce any other defaults, known or unknown, at any time going forward.

• Finally, the notice should specifically reference any personal guarantees and state that neither the notice nor a subsequent termination will waive, and the franchisor specifically reserves, any rights and claims it may have against the guarantors of the franchise agreement. This should prevent guarantors from successfully arguing that the termination in some way released them from their obligations under their guaranties.

B. Opportunity to Cure

It is important to review with precision the notice requirements — both method of transmission and timing, to ensure that the franchisor provides the required time period to cure the operational default. This requires review of the applicable law, which will supersede the time period in the franchise agreement if different, as well as the franchise agreement for the number of days required to cure the default.

Many notice provisions in franchise agreements provide that the notice is not effective until a specified number of days after it is sent, which many times further depends on the delivery method. If the franchisor does not take these additional days into account when calculating the time period for curing a default, a franchisee will be able to claim the franchisor failed to provide the franchisee with the appropriate time period. Further, if the notice was sent by improper means, it could be argued that the time period never started to run.

After the notice has been sent, the franchisor must monitor and evaluate the franchisee’s compliance or non-compliance with the required cure. Compliance with standards generally requires on-the-ground inspection of the franchisee’s operations and often requires more than one visit. As discussed above, inspections should be documented and, where appropriate, photographic evidence should be gathered to show non-cure if the franchisor chooses to terminate based on the failure to cure.

An issue that sometimes arises in the context of curing standards defaults is partial cures. If a franchisee materially cures a default, but has not fully cured, the franchisor will need to carefully evaluate the degree of cure and assess the harm to the brand and the remaining

1992) (holding that when the unpaid amount is clear, the specific amount does not need to be included in the termination notice).

aspects of non-compliance to weigh whether to continue to work with the franchisee or exercise a termination. Whatever the decision is, documenting the conclusion and communication is very important for the going forward relationship and rights, especially in circumstances where the franchisee is permitted to continue in the system but subsequently falls out of compliance with standards again.

C. **Incurable Defaults**

Sometimes a franchisee’s default is not capable of being cured. This generally arises in circumstances where the conduct or harm is particularly egregious or the act cannot be undone. For example, defaults that are particularly damaging to the franchise system or trademarks can be considered incurable, as well as acts like commission of a crime by the franchisee, a declaration of bankruptcy by the franchisee, or a violation of standards that affect health and safety.44

Some states with statutes that require cure periods (see below) exclude the notice requirement for certain incurable defaults and permit franchisors to immediately terminate without providing a cure period for certain identified defaults.45 Washington, for example, allows for termination without giving the otherwise required notice or cure period if the franchisee (i) is bankrupt or insolvent, (ii) assigns the assets of the franchised business to creditors, (iii) voluntarily abandons the franchised business, or (iv) is convicted of violating any law relating to the franchised business.46

Under common law, incurable defaults are also recognized as exceptions to notice requirements. Generally, if the default goes to the essence of the contract, the default is incurable. For example, in *LJL Transportation, Inc. v. Pilot Air Freight Corp.*, a franchisee deliberately diverted business to a subsidiary to hide profits and avoid paying royalties to the franchisor.47 Even though the franchise agreement required notice of termination and an opportunity to cure,48 the court held that the franchisor could terminate without providing the otherwise required notice and cure periods because the franchisee’s breach went to the essence of the contract and irreparably damaged the trust between the contracting parties.49

Not every court, however, has embraced the “essence of the contract” argument as a basis for immediate termination. In *Manpower Inc. v. Mason*50, an employment agency franchisee failed to require employers to complete and retain I-9 forms verifying each employee’s eligibility for employment. The franchisor argued that this breach was material to the

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44 See generally Jason J. Stover, *No Cure, No Problem: State Franchise Laws and Termination for Incurable Defaults*, 23 Franchise L.J. 217 (Spring 2004); see, e.g., *Pella Prod., Inc. v. Pella Corp.*, No. 3:18-CV-01030, 2018 WL 2734820, at *10 (M.D. Pa. June 7, 2018) (when evaluating distributor’s motion for a preliminary injunction, the court concluded that supplier was likely within its contractual rights to issue a termination notice because distributor’s sexually inappropriate comments to employees were inconsistent with his obligations to preserve supplier’s good name and protect the goodwill of the brand).

45 Arkansas, California, Illinois, Maryland, Minnesota, Rhode Island, Washington, and Wisconsin allow for immediate termination in certain circumstances.

46 WASH. REV. CODE § 19.100.180(2)(j).


48 Id.

49 Id.

50 377 F. Supp. 2d 672, 674 (E.D. Wis. 2005).
essence of the contract given that the business supplied temporary personnel to employers and sought to terminate the franchise agreement immediately without notice and opportunity to cure. The court disagreed, defining an incurable breach as one that the contract provides no opportunity to cure or “one that cannot logically be cured, such as a franchisee’s failure to meet a sales quota within a specified time.”

Some courts have also found that the franchisee’s actions may excuse the franchisor from complying with notice and opportunity to cure requirements. In Harnischfeger Corp. v. Superior Crane Corp., a dealer misappropriated a manufacturer’s designs and proprietary information to manufacture its own unauthorized replacement parts for the manufacturer’s equipment. The court held that the manufacturer was not required to provide the dealer an opportunity to cure, as required under Wisconsin’s relationship law, because the dealer’s “bad faith” acts were not subject to the cure provision.

D. Additional Considerations Under State Relationship Statutes

Currently 18 states, plus Puerto Rico and the Virgin Islands, have enacted franchise statutes that govern termination of the franchise relationship by the franchisor. The notice of default content and timing must comply with any applicable state relationship law provisions in this regard. Further, many state relationship laws provide that the franchisor must have good cause to terminate, and any notice of default should ensure it articulates a default which, if uncured, would meet the state definition of good cause. The definition of good cause varies.

Among the states that have a good cause requirement, several provide a definition of good cause. The various state definitions vary. However, most provide in some manner that good cause includes a failure to comply with the lawful and material provisions of the franchise agreement. Some states go further and outline specific situations that constitute “good cause” for termination.

51 ld. at 679. Plaintiffs also presented other reasons for immediate termination, including breach of and inability to meet the sales quota and insolvency. Id. at 674.

52 ld. at 677-79. However, the court also found that breaches that go to the “essence of a contract” allow for rescission—just not termination.


54 ld. See also NOVUS du Quebec, Inc. v. NOVUS Franchising, Inc., where the court held the franchisor did not need to comply with the applicable statute’s notice and cure period because it would have been “futile” given the numerous and material violations by the subfranchisor—it had failed to require its franchisees to comply with the franchise system and had also franchised units associated with another franchisor. Bus. Franchise Guide (CCH) ¶ 10,823 (D. Minn. 1995). See also, AAMCO Industries, Inc. v. DeWolf, 250 N. W. 2d 835 (Minn. 1977).

55 These states include California, Connecticut, Hawaii, Illinois, Indiana, Michigan, Minnesota, Nebraska, New Jersey, Rhode Island and Washington. For franchise agreements entered into or renewed on or after January 1, 2016, California limits “good cause” for terminations to a franchisee’s failure to substantially comply with the lawful requirements imposed upon the franchisee by the franchise agreement. Iowa, in addition to good cause, requires that the termination not be arbitrary and capricious. Iowa Code § 523H.7. The Virgin Islands define good cause as the failure of the franchisee to substantially comply with essential and reasonable requirements of the franchise agreement. V.I. Code Ann. tit. 12A, § 132. Wisconsin likewise provides that good cause is “(a) [f]ailure by a dealer to comply substantially with essential and reasonable requirements imposed upon him by the grantor, or sought to be imposed by the grantor, which requirements are not discriminatory as compared with requirements imposed on other similarly situated dealers either by their terms or in the manner of their enforcement; or (b) [b]ad faith by the dealer in carrying out terms of the dealership.” Wis. Stat. § 135.02(4);

56 The states that outline specific examples of circumstances constituting good cause include Connecticut, Illinois, Minnesota and Rhode Island. Hawaii allows termination for either good cause or if done in accordance with the
Puerto Rico has arguably the highest “good cause” standard. The state relationship law requires “just cause” for termination, which occurs only when (i) the franchisee fails to perform under an essential provision of the franchise agreement or (ii) the acts or omissions of the franchisee “adversely and substantially” affects the interests of the franchisor in promoting the marketing or distribution of the merchandise or service. If the termination is based on a provision of the franchise agreement relating to certain changes in the operation of the franchise, the franchisor must demonstrate that the franchisee has affected or may affect the interests of the franchisor in an adverse or substantial manner. If the termination is based on a provision in the franchise agreement outlining rules or conduct or distribution goals, the franchisor must show that the rule or conduct or distribution goal was reasonable in light of the “realities of the Puerto Rican market” at the time of the violation.

Two states, Delaware and Virginia, impose a requirement of good cause for terminations but do not further define what constitutes good cause.

Many state relationship laws impose an obligation on the franchisor to provide the franchisee with notice, an opportunity to cure the breach, or both before the franchise relationship can be terminated. Like the good cause requirement, the time periods required to be provided by a franchisor to cure a default or terminate the relationship vary widely.

For example, Hawaii, Illinois, Michigan, and Washington impose an obligation on the franchisor to provide the franchisee with a “reasonable” cure period but do not provide a specific, mandatory period. In each of these states, except Hawaii, this cure period need not be more than thirty days long, implying that it could be much shorter as long as it is deemed reasonable.

On the other hand, Arkansas, Maryland, Minnesota, Rhode Island, and Wisconsin impose a cure period of a specified number of days depending upon the default. Generally speaking, Arkansas, Maryland, and Rhode Island require thirty days, and Minnesota and Wisconsin require sixty days for failure to meet system standards. Arkansas further provides that if the default follows a series of repeated operational defaults in a twelve-month period, or if

franchisor’s current terms and conditions if such standards are applied equally across the franchise system. See HAW. REV. STAT. § 482E-6(2)(H).

57 P.R. LAWS ANN. tit. 10, § 278a-1.
58 Id. at § 278a-1(a).
59 Id. at § 278a-1(c).
60 DEL. CODE ANN. tit. 6, § 2552; Virginia actually requires “reasonable cause.” See VA. CODE ANN. § 13.1564.
61 However, California, Illinois, and Washington do not require the franchisor to provide the franchisee with any opportunity to cure in certain specified circumstances, which include the franchisee’s bankruptcy or assignment on behalf of creditors, noncompliance with laws after notification, criminal misconduct or violation of franchise laws, repeated defaults, failure to pay sums due within five days of an overdue notice, or the existence of an imminent danger to public health. These types of defaults would be classified as incurable defaults and are discussed below in section I.B.
62 Iowa is a hybrid state in that it arguably fits into each of the first two categories, requiring a reasonable opportunity to cure that must be at least thirty days long but no more than ninety days.
63 Just like the statutes in California, Illinois, and Washington, the statutes of Arkansas, Maryland, Minnesota, Rhode Island, and Wisconsin allow for immediate termination without any cure period in certain situations.
the franchisee does not act in good faith and in a commercially reasonable manner, a 10-day notice is permitted.\textsuperscript{64}

VIII. TERMINATION

A. Basics of the Notice of Termination

1. Ensure Notice Complies with Franchise Agreement Provisions

When a franchisor has determined that a system standards violation, or multiple such violations, requires termination, the first place the franchisor or its counsel should turn to is the section of the franchise agreement governing termination. Most franchise agreements contain detailed provisions setting forth a variety of terms relating to termination issues, including: the potential grounds for termination, including those that may be cured and those that are not curable; timing issues for cure periods; and notice provisions governing the form of delivery. While compliance with the agreement provisions governing termination is not the sole concern in the context of a termination, as other issues such as applicable franchise relationship laws must also be considered, adherence to the franchise agreement's provisions is an important threshold process.

a. Grounds for Termination

Most franchise agreements set forth a variety of specific grounds for termination. Given the importance of system standards, a number of bases for termination usually relate to standards issues. Below are examples of some termination provisions relating to standards defaults:

1. You or your designated manager fail to successfully complete the initial training program;
2. You maintain false books, records, or financial or operating statements;
3. You submit false reports or statements to us;
4. You fail to submit required reports or statements to us;
5. You use our trademarks in a manner not authorized by this agreement;
6. You fail to comply with any of the standards, specifications, procedures, or policies that we prescribe in the franchise agreement, the operations manual, or otherwise in writing from time to time;
7. You fail to comply with any health or safety standard;
8. You fail to offer any required product or service;

\textsuperscript{64} Some states also require a notice period prior to termination in addition to the cure period. For example, in Minnesota, although a sixty-day cure period is required, the franchisor must also provide ninety days’ notice prior to termination of the relationship. The notice periods range from ninety days in Arkansas and Wisconsin to sixty days in Maryland and Rhode Island. However, as with the cure periods specified above, in many cases these notice periods decrease depending upon the type of default.
9. You offer unapproved products or services;

10. You fail to obtain or maintain the types and amounts of insurance coverage required by this agreement or the operations manual; fail to name us as an additional insured; or fail to provide us with copies of insurance certificates; and

11. You fail to keep the franchised business open and in operation during the minimum days and hours as specified from time to time in the operations manual.

Assessing compliance with some of these provisions is objective, such as with respect to the required provision of reports, financial statements, or insurance certificates, or relating to the offering of unauthorized products or services or the failure to offer required products or services. However, compliance with many standards will involve some level of subjectivity. Examples of such standards include those relating to the cleanliness of the franchised premises, failure to obtain minimum scores on quality assurance evaluations, or failure to satisfactorily address customer complaints. In the context of standards violations that involve some potential degree of subjectivity, quality documentation of the defaults, including with respect to magnitude and frequency are particularly important.

While standards violations may involve some level of subjectivity, failures to comply with such standards, supported by documentation of such violations, are adequate bases for termination of the franchise agreement. For example, the court in McDonald's Corp. v. Robertson held that “there can be no real doubt that repeated and continued serious violations of the QSC and safety standards, such as those alleged by McDonald’s and unchallenged by the [franchisee], constituted material breaches of the franchise agreement warranting termination.” A franchisor's assessment of whether to terminate based upon the violation of system standards that are likely to be considered subjective should take into consideration and include a review of the type and quality of the documented violations of such standards.

While most franchise agreements comprehensively and specifically address the most common types of standards violations that may arise during the course of a franchise relationship, it is nearly impossible to foresee and address every potential possible violation, particularly where a franchisee acts in a manner intended to obscure its violations. When a franchisor learns of such a standard violation, and there is no franchise agreement provision specifically permitting termination, the franchisor should consider whether the violation is such a fundamental violation of the material purposes of the franchise agreement that the franchisor must terminate the agreement and rely upon common law principles in order to protect the brand and the system.

b. Opportunity to Cure

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65 147 F.3d 1301 (11th Cir. 1998).
66 Id. at 1309.
67 See, e.g., 7-Eleven v. Khan, 977 F. Supp. 2d 214 (E.D.N.Y. 2013) (termination was proper, without opportunity to cure, where sufficient evidence of fraud was presented); Southland Corp. v. Froelich, 41 F. Supp. 2d 227, 246-47 (E.D.N.Y. 1999) (franchisees had no right to cure breach where they used a “money order scam” to misrepresent and conceal store revenues and deprive franchisor of its contractual share of gross profits).
While some termination provisions relating to standards violations, such as significant health or safety violations, may provide a franchisor with the right to immediately terminate the franchise agreement without an opportunity to cure, most termination provisions based upon system standards violations require the franchisor to provide the franchisee with notice and an opportunity to cure.

Accordingly, when a franchisor determines that a franchisee is in violation of the franchisor’s standards, before proceeding straight to a notice of immediate termination, the franchisor should review the franchise agreement to determine whether the violation is of the type that specifically provides the franchisee with an opportunity to cure. If the agreement provides the franchisee with an opportunity to cure, the notice of potential termination should provide the franchisee with information regarding what actions the franchisee needs to take in order to cure the standards violation.

In circumstances where a franchisee repeatedly violates, but then cures, standards violations, the franchisor should determine whether the franchise agreement contains the right to terminate based upon multiple violations of the same or a similar type on multiple occasions within a specified period of time. Most franchise agreements contain such provisions, which are reasonably intended to prevent a franchisee from becoming a serial violator of system standards who presents a material risk of harming the system and brand, notwithstanding that they ultimately cure the violations after receiving notice.

c. **Timing of Notice and Termination Date**

When a franchisor proceeds with a termination based upon a termination provision in the franchise agreement, the franchisor should determine whether termination may be effected immediately upon notice or, particularly when there is an opportunity to cure, what length of notice must be provided in advance of termination.

When the franchise agreement provides that termination may be effected a specified number of days following receipt of notice, the franchisor must ensure any termination date specified in the letter accounts for the delivery time prior to receipt of the termination notice. In light of such considerations, and in order to avoid inadvertently providing too short of a notice period, some franchisors elect not to include a specific termination date. Instead, they specify that the termination will be effective a certain number of days following receipt. While this approach has the advantage of avoiding the risk of providing too short of a notice period, the franchisor will need to take additional steps to determine the delivery date and track the termination date calculated based upon the delivery date. In such circumstances, it may also be helpful for the franchisor to send a confirmation of termination that sets forth the specific termination date. Such a letter also provides a good opportunity for the franchisor to remind the franchisee of its various post-termination obligations under the franchise agreement.

d. **Form of Delivery**

Most franchise agreements contain notice provisions that set forth the available methods for delivery of notices, as well as the designated recipient of notices. While most franchise agreements comprehensively cover the range of potential delivery options that a franchisor may consider, a franchisor should take the time to review the provision to confirm that it delivers the termination notice in accordance with the permissible forms of delivery. This is particularly important in connection with older forms of agreements that may have different notice provisions than the form with which the franchisor is most familiar. While this may appear to be a hyper-
technical point, particularly in circumstances where the franchisee actually receives the notice of termination, it is worthwhile to ensure this box is checked in order to avoid inadvertently providing a franchisee with an argument that it may use to challenge the termination.

2. **State Relationship Statutes**

A number of the states that have franchise relationship statutes specifically address some of the issues discussed above, including permissible grounds for termination, whether a franchisee has a right to cure, as well as timing and notice requirements. Where such statutes apply, a franchisor must ensure compliance with the statutory provisions, as well as the terms of the franchise agreement.

A few examples illustrate the importance of complying with the terms of applicable franchise relationship statutes, rather than relying solely on compliance with any agreement provisions. First, under the California Franchise Relations Act (“CFRA”) as amended to apply to franchise agreements entered on or after January 1, 2016, if a franchisor terminates a franchisee in violation of the CFRA, “the franchisee shall be entitled to receive from the franchisor the fair market value of the franchised business and franchise assets and any other damages caused by the violation of this chapter.”

In addition, some franchise relationship statutes have termination-related provisions that are not typically contained in franchise agreements and require additional attention and analysis in connection with any planned termination. Two such examples are: (1) provisions with different notice and cure periods; and (2) provisions requiring the franchisor to purchase inventories or other assets of the franchise business.

a. **Termination Periods may Vary from Cure Periods Under State Relationship Statutes**

In addition to the fact that a state franchise relationship statute may mandate a longer time period for cure or termination than the time period provided under the franchise agreement, franchisors should take note that some statutes, like Minnesota, have different timing requirements for cure and notice periods. Under the Minnesota Franchise Law, even though a franchisee is permitted 60 days to cure most defaults prior to termination, a franchisor may not terminate such franchisee on less than 90 days’ notice. Similarly, under the Arkansas Franchise Protection Act, while a franchisor is only required to provide 30 days for the franchisee to cure defaults, it must provide 90 days’ advance notice of the bases for termination. Presumably, these differences in time periods allow for a wind-down period leading up to the implementation of the termination, in the event a franchisee fails to cure its defaults. However, such differences may also cause a trap for the unwary franchisor.

b. **Statutory Requirements upon Termination, Including Potential Repurchase or Payment Requirements**

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68 [CAL. BUS. & PROF. CODE, Division 8, Chapter 5.5, §§ 20000 through 20043.](#)

69 [Id., at § 20035(a).](#)

70 [MINN. STATS., Chapter 80C, §§ 80C.01 through 80C.22.](#)

71 [ARK. CODE of 1987, Title 4, Ch. 72, §§ 4-72-201 through 4-72-210.](#)
Franchisors should also be aware of unique termination-related requirements under several state franchise relationship statutes, including requirements that the franchisor purchase certain items or make certain payments to the franchisee. Such provisions should be consulted prior to sending a notice of termination, as the provisions may impact the manner in which the franchisor elects to implement the termination or whether it wants to exercise rights collateral to the termination, such as any right to assume the franchisee’s lease.

For example, the California Franchise Relations Act\(^72\) contains comprehensive requirements relating to purchases that the franchisor is required to make from the franchisee upon termination. Pursuant to Section 20022(a), under amendments applicable to agreements entered on or after January 1, 2016, except as provided elsewhere in the section, upon a lawful termination of a franchise, the franchisor is required to “purchase from the franchisee, at the value of price paid, minus depreciation, all inventory, supplies, equipment, fixtures, and furnishings purchased or paid for under the terms of the franchise agreement or any ancillary or collateral agreement by the franchisee to the franchisor or its approved suppliers and sources, that are, at the time of the notice of termination or nonrenewal, in the possession of the franchisee or used by the franchisee in the franchise business.” One of the specified exceptions applies when “the franchisor does not prevent the franchisee from retaining control of the principal place of the franchise business.”\(^73\) Accordingly, in connection with a termination of a franchisee located in California, a franchisor with a right to assume the franchisee’s lease upon termination must weigh the costs and benefits of exercising such a right, which may trigger the purchase requirement under the CFRA.

The franchise laws of Arkansas, Connecticut, Hawaii, Maryland, Rhode Island, Washington, and Wisconsin also all contain buy back requirements. These laws each vary with respect to: their applicability, whether repurchase is mandatory or contingent, what items must be purchased, and valuation of the items to be purchased. Accordingly, a franchisor considering termination in one of these states should evaluate all of these factors in connection with any termination decision.

3. **Importance of Non-waiver Language where Declaratory Judgment Path may be Pursued**

In any notice of termination, it is a best practice to include language stating that the franchisor is not waiving any other defaults or bases for termination. However, in the event a franchisor pursues a declaratory judgment, it is particularly important to include language stating that, if a franchisee refuses to comply with the termination, the franchisor reserves all rights and is not waiving any defaults or the termination by accepting royalty payments during the resolution of any court proceedings. The following is an example of such language that can be included in the notice of termination:

If you contest termination of the franchise agreement, any and all amounts paid and to be paid by you while in possession of the premises and operating under Franchisor’s trademarks may be accepted by Franchisor without waiver of its rights and claims, including with respect to termination of the franchise agreement. Franchisor reserves all of its post-termination rights. Nothing in this

\(^{72}\) *CAL. BUS. & PROF. CODE*, Division 8, Chapter 5.5, §§ 20000 through 20043.

\(^{73}\) *Id.*, § 20022(d).
Notice constitutes acquiescence by Franchisor to your continued use of Franchisor’s trademarks.

B. Termination Checklist

Because of multiple potential pitfalls in the termination process, particularly where the termination is based upon a standards violation, franchisors may find a termination checklist to be a helpful tool. Such a checklist can help ensure that the franchisor has thought through the key issues leading up to a termination and can help the franchisor decide, often in consultation with its counsel, whether termination is advisable in a particular circumstance. A sample termination checklist, which can be tailored to fit the particular circumstances of individual franchisors, is attached as Appendix B to this paper.

C. Cease and Desist Letters

After a termination letter has been sent, any cure periods have expired, and the termination has become effective, additional action is often required when the franchisee does not voluntarily comply with the termination. Prior to initiating formal litigation or dispute resolution procedures, sending a cease and desist letter is often an efficient and effective next step. Sometimes the cease and desist letter is sufficient to bring the terminated franchisee into compliance.

An effective cease and desist letter will generally summarize the events that led to the termination; reference any default notices and the notice of termination; advise the franchisee that continued operation of the franchise or use of the franchisor’s marks or system constitutes a violation of the franchise agreement and other applicable laws, including the Lanham Act; and advise the franchisee that failure to comply will result in the franchisor pursuing litigation to enforce the franchisee’s obligations, as well as seeking attorneys’ fees, to the extent permitted under the franchise agreement or applicable law.

When the franchisor itself sends out notices of termination, having the franchisor’s outside counsel send the cease and desist letter may be particularly effective because such approach puts the franchisee on notice that litigation will likely ensue if they do not comply. In circumstances where a franchisee does not comply with a notice of termination and a subsequent cease and desist letter, the cease and desist letter also serves as a useful exhibit in any necessary legal proceedings.

IX. LEGAL ACTION OPTIONS AND LEGAL ALTERNATIVES TO TERMINATION

A. Seeking an Injunction to Enforce the Termination

To enforce termination and compliance with the franchise agreement, franchisors often seek preliminary and permanent injunctive relief from the courts. Court’s consider injunctions an extraordinary remedy and closely scrutinize whether a movant has met the burden of proof with respect to each element in all contexts, and post-termination franchise actions are no different.74

The necessary elements to obtain injunctive relief vary slightly from state to state and under federal law, but can generally be summarized as requiring the moving party to demonstrate (i) a likelihood of success (ii) that it will be irreparably harmed if the injunction is

denied, (iii) that the harm to it if the injunction is denied is greater than the harm to the non-moving party if the injunction is granted, and (iv) that the public interest favors issuance of the injunction.\textsuperscript{75} State and federal courts vary in how these factors are applied and weighed, such as whether each must clearly favor the moving party or if a sliding scale approach is more appropriate.\textsuperscript{76}

Many courts focus on the ability of the franchisor to establish the first two elements: the franchisor’s likelihood of success on the merits and ability to demonstrate irreparable harm. Where a holdover franchisee continues to use the trademark, a showing of reasonable likelihood of success is generally established. As one leading commentator explained: “[i]f, as a matter of contract law, a service mark or a trademark license has ended, the licensee has no right to continue use of the licensed mark. Any such use is without the trademark owner’s consent and constitutes infringement.”\textsuperscript{77} In cases where the holdover franchisee challenges the propriety of the termination and/or has removed the trademarks but continues operating a competing business, showing likelihood of success will require the franchisor to prove breach; often both to justify the termination and also to show breach of the post-termination covenants, like the covenant not to compete. When a franchisor has terminated for uncured standards violations, satisfying the likelihood of success element rests on establishing the failure. This often requires evidence of a failed inspection – or several failed inspections – through inspection reports and testimony from the operations personnel who inspected the unit. The better documented and more objective the evidence, the more likely a court will find a reasonable likelihood of success.

Even when the franchisor establishes a likelihood of success, proving irreparable harm is met with scrutiny. This element requires that the franchisor demonstrate that the harm it is suffering cannot be remedied by a subsequent award of monetary damages.\textsuperscript{78} Courts historically were willing to presume that trademark infringement constitutes irreparable harm as a matter of law.\textsuperscript{79} Increasingly, however, courts are rejecting the concept of presumed irreparable harm.\textsuperscript{80} Arguments to support a finding of irreparable harm include that the franchisee’s unauthorized use of trademarks causes a loss of control over the franchisor’s


\textsuperscript{76} For example, under California state law the elements and application are articulated as: (1) a likelihood of success on the merits, and (2) the balance of interim harms favors the plaintiff. Jay Bharat Developers, Inc. v. Minidis, 167 Cal.App.4th 437, 443, 84 Cal.Rptr.3d 267, 271 (2008) (citing White v. Davis, 30 Cal.4th 528, 554, 133 Cal. Rptr.2d 648, 68 P.3d 74 (2003)). The preliminary injunction elements operate on a sliding scale, such that the more likely a plaintiff is to ultimately prevail, the less severe the harm must be in the event an injunction is not employed. Integrated Dynamic Solutions, Inc. v. VitaVet Labs, Inc., 6 Cal.App.5th 1178, 1183, 211 Cal.Rptr.3d 873, 877 (2016) (citing King v. Meese, 43 Cal.3d 1217, 1227, 240 Cal.Rptr. 829, 743 P.2d 889 (1987)).


\textsuperscript{78} GNC Franchising, LLC v. Masson, No. CIV.A. 05-1613, 2005 WL 3434076, at *3 (W.D. Pa. Dec. 13, 2005) (denying franchisor’s request for preliminary injunction, finding that any harm suffered could be remediated by monetary damages and therefore was not irreparable).

\textsuperscript{79} See, e.g., Pappan Enterprises, Inc. v. Hardee’s Food Sys., Inc., 143 F.3d 800, 805 (3d Cir. 1998) (“[w]e have concluded that [the franchisor] is likely to prove at trial that [the franchisee] is infringing its trademark, we find that [the franchisor] has a fortiori alleged irreparable injury.”).

reputation. Courts also have recognized that a franchisee’s continued unauthorized operations constitutes irreparable harm because it inhibits the franchisor’s ability to secure a legitimate franchisee in the same territory and that the ongoing breach, if permitted, would threaten the stability of the franchise system. In the case of a termination for system standards violations, while not necessary so long as the franchisor asserts loss of control or inability to refranchise, it is often persuasive if the materiality of the system standards to the brand or a threat to health and safety is caused by the system standards failure.

In challenging the franchisor’s request for injunctive relief relating to a termination or seeking its own injunctive relief to prevent the termination, the franchisee may emphasize the irreparable harm that it will suffer from enforcement of the termination of the franchise agreement. Courts will balance these harms as contemplated in the third prong of the test. With holdover franchisees, courts generally find the harms are self-inflicted and not cognizable, such that a franchisor would not be precluded from enforcing its rights.

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81 See J. Thomas McCarthy, TRADEMARKS AND UNFAIR COMPETITION § 30:47 (4th ed. 2011) (there is irreparable harm because the owner “will probably lose control of its reputation because this reputation rests upon the quality of defendant’s activities as a result of a likelihood of confusion of purchasers. Such a likelihood of damage to reputation is by its nature ‘irreparable.’”). See also Herb Reed Enters., LLC v. Fla. Entm’t Mgmt., Inc., 736 F.3d 1239, 1250 (9th Cir. 2013) (“loss of control over business reputation and damage to goodwill could constitute irreparable harm”); IHOP IP, LLC, 2010 WL 11597634, at *5 (where the court reasoned that based on the former franchisee’s use of the franchisor’s trademarks, customers would “inevitably attribute an experience at [the franchisee’s business] to the [franchisor]”; CytoSport, Inc. v. Vital Pharmaceuticals, Inc., 617 F. Supp. 2d 1051, 1080 (E.D. Cal. 2009), aff’d 348 Fed.Appx. 288 (9th Cir. 2009) (stating that “[p]otential damages to reputation constitutes irreparable injury for the purpose of granting a preliminary injunction in a trademark case”) citing Opticians Ass’n of Am. v. Indep. Opticians of Am., 920 F.2d 187, 195 (3rd Cir.1990).

82 P.P. & K., Inc. v. McCumber, 46 F.3d 1134 (7th Cir. 1995) (finding that franchisor would lose goodwill and reputation associated with franchised location if the franchisee was not ordered to vacate the premises, and noting that any harm suffered by franchisee was “part of her own making, since she refused to sign a new franchise agreement.”); 7-Eleven, Inc. v. Spear, 2011 WL 830089, at *6 (N.D. Ill. March 3, 2011) (same); Persaud v. Exxon Corp., 867 F. Supp. 128, 141 (E.D.N.Y. 1994) (finding irreparable harm where the franchisee continued to occupy the premises, depriving the franchisor of the ability to make productive use of the site); Merry Maids, L.P. v. WWJD Enterprises, Inc., No. 8:06CV36, 2006 WL 1720487, at *11 (D. Neb. June 20, 2006) on reconsideration in part, 2006 WL 2040245 (D. Neb. July 20, 2006) (holding that ‘Merry Maids’ ability to re-franchise the area will be compromised if a former franchisee is allowed to operate in the area under a different name” and finding irreparable harm); Quizno’s Corp. v. Kampendahl, No. 01 C 6433, 2002 WL 1012997, at *7 (N.D. Ill. May 20, 2002) (franchisor “will not be able to reenter the market as long as Bob’s Deli is in operation and will therefore lose sales, goodwill, and market presence it once had in the area”).

83 See Bad Ass Coffee Co. of Haw., Inc. v. JH Nterprises, L.L.C., 636 F. Supp. 2d 1237, 1249 (D. Utah 2009) (“overnight switch to [new brand] may send the message to potential customers that [franchisor] endorses [new brand], or that the Defendants no longer stand by [franchisor]”; either way, “[s]uch messages are likely to erode [franchisor’s] goodwill in the marketplace”), id., at 1246–1249; Flip Flop Shops Franchise Company, LLC v. Neb., No. CV 16-7259-JFW (EX), 2016 WL 9975403, *9 (C.D. Cal., Dec. 5, 2016) (stating that “[i]t is reasonable to conclude that other [] franchisees will be emboldened to follow in Defendants’ footsteps, which would jeopardize Plaintiff’s entire business model...” and that “[s]uch harms would be ‘virtually impossible to quantify . . . if an injunction is not issued.’”).

84 See Pappan, 143 F.3d at 805 (awarding preliminary injunction to franchisor where any difficulties faced by the franchisee “were brought on by its own conduct in continuing to use the [] marks despite the termination of the franchise agreements”); Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd., 970 F.2d 273, 277 (7th Cir. 1992) (awarding preliminary injunction to franchisor where franchisees “have only themselves to blame” and franchisees “‘dubious showing’ is balanced against the ‘real though unquantified harm to the [franchisor] of being forced to continue doing business with [such a franchisee]’”; S&R Corp., 968 F.2d at 379 (affirming preliminary injunction where former franchisee “brought much of the difficulties of which he complains upon himself”); Huang v. Holiday Inns, Inc., 594 F. Supp. 352, 356 (C.D. Cal. 1984) (“a franchisor is not precluded from exercising its right to terminate a franchise in a reasonable, good faith manner merely because the franchisee will suffer great hardship as a result of the termination.”).
The final factor considers the public interest. A franchisor might argue that the public has an interest in the enforcement of valid contracts to avoid confusion about a formerly-authorized unit.\footnote{In the trademark context, public interest “is most often a synonym for the right of the public not to be deceived or confused.” \textit{Pappan}, 143 F.3d at 807; \textit{Opticians Ass'n of Am. v. Indep. Opticians of Am.}, 920 F.2d 187, 198 (3d Cir. 1990) (“Having already established that there is a likelihood of consumer confusion created by the concurrent use of the ... marks, it follows that if such use continues, the public interest would be damaged. Conversely, a prohibition upon [defendants’] use of the marks would eliminate that confusion.”).}

\textbf{B. Other Options}

\textbf{1. Declaratory Judgment Alternative}

In the circumstance where a franchisor is concerned as to whether it has the right to terminate the franchise agreement based on failure to comply with standards and/or if the franchisor is concerned that the franchisee will commence an action disputing the termination in a forum other than the forum desired by the franchisor, the franchisor has the option of initiating a declaratory judgment action in the forum of its choice. A declaratory judgment action is available when the parties have a dispute on an issue as to which it is appropriate for the court to declare the parties’ respective rights (often termed a “judiciable controversy”). Stated differently, a declaratory judgment is a judicial proceeding to declare rights of parties who disagree about their obligations. Its purpose is to provide a forum for businesses and individuals to seek a court’s direction at the early stages of a controversy, especially where there is uncertainty over legal obligations or rights associated with a potential future course of conduct. The declaratory relief provides a mechanism to resolve the controversy or uncertainty.

In federal courts, declaratory judgments are governed by Rule 57 of the Federal Rules of Civil Procedure and Title 28, Section 2201 of the U.S. Code.\footnote{28 U.S.C. § 2201 provides: In a case of actual controversy within its jurisdiction,... any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.}

\textbf{2. Forbearance Agreement Permitting Transfer}

Another option to be considered in connection with a termination is a forbearance agreement whereby the franchisor—often simultaneously with the notice of termination—offers that the franchisee be permitted a limited period of time to continue operating while it attempts to sell the location and franchise rights. These agreements usually include an agreement that the franchisee will sell to an approved new franchisee within a period of time during which the franchisor will forbear acting on the termination. The franchisee agrees to abide by system standards and other obligations of the franchise agreement during the forbearance period, and that if it does not sell by the end of the forbearance period, it will close and abide by the post-termination obligations of the franchise agreement. This agreement has several advantages, including permitting the franchisee to recoup the value of the franchise business and allowing the brand to keep the location in the system, as well as resolving or avoiding litigation over a dispute over the propriety of the termination.

\footnote{85 In the trademark context, public interest “is most often a synonym for the right of the public not to be deceived or confused.” \textit{Pappan}, 143 F.3d at 807; \textit{Opticians Ass’n of Am. v. Indep. Opticians of Am.}, 920 F.2d 187, 198 (3d Cir. 1990) (“Having already established that there is a likelihood of consumer confusion created by the concurrent use of the ... marks, it follows that if such use continues, the public interest would be damaged. Conversely, a prohibition upon [defendants’] use of the marks would eliminate that confusion.”).}

\footnote{86 28 U.S.C. § 2201 provides: In a case of actual controversy within its jurisdiction,... any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.}
3. **Specific Performance Action to Enforce System Standards**

Another option available to a franchisor who wants to ensure compliance with system standards, while avoiding termination, is an action for specific performance. This is an action seeking a court order compelling a franchisee to comply with standards. In general, specific performance is an equitable remedy in the law of contract, whereby a court issues an order requiring a party to perform a specific act. This can be employed to compel a party to perform obligations under a contract. The elements required for specific performance vary slightly by jurisdiction, but generally require a plaintiff to establish (a) that the parties are bound by an enforceable contract, sufficiently certain in its terms and supported by adequate consideration; (b) plaintiff's performance, tender or excuse for nonperformance of the contract; (c) defendant's breach of the contract; and (d) inadequacy of a remedy at law.\(^87\) This type of claim has been used successfully by franchisors.\(^88\)

X. **CONCLUSION**

System standards are integrally linked to the franchisor’s brand and its goodwill. Accordingly, it is important for franchisors to maintain standards within their system. The best approach to maintaining a high level of system standards is to foster a culture of compliance. Obtaining compliance through proactive efforts is more sustainable and provides greater value at a lower cost than resorting to remedial corrective efforts or, in particular, the use of litigation to require compliance or to enforce a termination where the franchisee has failed to comply. However, even in systems with high standards for compliance, litigation and enforcement may be required. In such circumstances, it is of critical importance that the franchisor has established a documentary record of the franchisee’s failure to comply with standards. And, when proceeding with defaults and termination, the franchisor must ensure that it complies not only with the requirements of the franchise agreement, but also any applicable franchise relationship laws, in order to avoid providing the franchisee with a potential escape hatch notwithstanding its system standards violations.

### APPENDIX A

#### SUMMARY OF STATE FRANCHISE RELATIONSHIP LAWS REQUIREMENTS FOR TERMINATION

<table>
<thead>
<tr>
<th>State</th>
<th>Statute</th>
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<tbody>
<tr>
<td>Arkansas</td>
<td>Arkansas Franchise Practices Act, Ark. Code Ann. § 4-72-201-210</td>
<td>Franchisor may not terminate a franchise agreement without: (a) good cause; (b) 90 days’ written notice; and (c) a 30-day cure period (10-day cure period for repeated deficiencies occurring within a 12-month period). The Arkansas Franchise Practices Act does not apply to franchises subject to the Federal Trade Commission regulations “Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures”, 16 C.F.R. 436.1 et seq.</td>
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| California | California Franchise Relations Act, Cal. Code Ann. § 8-5.5-20000-20043 | Franchisor may not terminate a franchise agreement without good cause (defined as failure of the franchisee to substantially comply with any lawful requirement of the franchise agreement after 60 days’ notice and a 60-day opportunity to cure); except that franchisor may immediately terminate the franchise agreement with notice upon:  
  - bankruptcy or insolvency of the franchised business;  
  - abandonment of the franchised business by the franchisee for more than five consecutive days;  
  - franchisee’s failure to comply with applicable law (after 10 days’ notice);  
  - franchisee’s repeated failure to comply with the terms of the franchise agreement;  
  - seizure of the franchised business’s assets;  
  - termination by written agreement of the parties;  
  - franchisee’s conviction for a felony or conduct that reflects materially and unfavorably upon the operation and reputation of the franchise business or system;  
  - franchisor’s reasonable determination that the franchised business poses an imminent danger to public health or safety;  
  - franchisee’s material misrepresentations in connection with the acquisition of the franchise; and  
  - lawful termination of a motor fuel franchise governed by provisions of the Petroleum Marketing Practices Act (15 U.S.C. Secs. 2801 to 2807, inclusive) that is operated by the franchisee or affiliate of the franchisee located at the same business premises.  

  Notices of termination must be: (i) in writing; (ii) posted by registered, certified or other receipted mail; (iii) delivered by telegram or personally delivered to the franchisee; (iii) contain a statement of intent to terminate and the reasons therefore; and (iv) specify the effective date of termination.  

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89 This chart does not summarize state distributorship, sales representative, and business opportunity laws that may also apply. This summary also does not address the franchisee’s rights and remedies in the event of a lawful or unlawful termination of a franchise agreement under applicable law, which may include damages, attorneys’ fees, and the franchisor’s obligation to buy the franchised business or all or a portion of the franchised business’s assets.

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### SUMMARY OF STATE FRANCHISE RELATIONSHIP LAWS REQUIREMENTS FOR TERMINATION

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| Connecticut   | Connecticut Franchises Act, Conn. Code Ann. § 42-739-42-133e-h           | Franchisor may not terminate the franchise agreement without (i) good cause (including, without limitation, franchisee’s refusal or failure to comply substantially with any material and reasonable obligation of the franchise agreement); and (ii) 60 days’ notice, except that:  
  - franchisor may immediately terminate the franchise agreement with notice if franchisee is convicted by a court of competent jurisdiction of an offense punishable by a term of imprisonment in excess of one year directly related to the franchised business, and  
  - franchisor may terminate the franchise agreement with 30 days’ written notice if franchisee abandons the franchise relationship.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| Delaware      | Delaware Franchise Security Law, Del. Code Ann. § 6-25-2551 -2556        | Franchisor may not unjustly terminate a franchise (unjust is defined as without good cause or in bad faith) and must provide at least 90 days’ notice of termination.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| Hawaii        | Hawaii Franchise Rights and Prohibitions, Haw. Code Ann. § 26-482E-6     | Franchisor may not terminate the franchise agreement except for good cause, or in accordance with the current terms and standards established by the franchisor then equally applicable to all franchisees, unless and to the extent that the franchisor satisfies the burden of proving that any classification of or discrimination between franchisees is reasonable, is based on proper and justifiable distinctions and is not arbitrary. Good cause includes, but is not limited to, franchisee’s failure to comply with any lawful, material provision of the franchise agreement after having been given written notice thereof and an opportunity to cure the failure within a reasonable period of time.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| Illinois      | Illinois Franchise Disclosure Act of 1987; Il Code Ann § 85-7051 – 705/44 | Franchisor may not terminate a franchise agreement without good cause, which includes but is not limited to, franchisee’s failure to comply with any lawful provision of the franchise or other agreement after 30 days’ notice and opportunity to cure, except that no notice or opportunity to cure is required if franchisee:  
  - makes an assignment for the benefit of creditors or a similar disposition of the assets of the franchised business;  
  - voluntarily abandons the franchise business;  
  - is convicted of a felony or other crime which substantially impairs the good will associated with the franchisor’s trademark, service mark, trade name or commercial symbol; or  
  - repeatedly fails to comply with the lawful provisions of the franchise or other agreement.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
# APPENDIX A

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<td>Indiana</td>
<td>Indiana Deceptive Franchises Act, Ind. Code Ann. § 23-2-2.7-1-7</td>
<td>Franchisor may not include a provision in the franchise agreement permitting it to unilaterally terminate if such termination is without good cause (defined as failure to comply with any material provision of the franchise agreement). Unless otherwise provided for in the franchise agreement, franchisor may not terminate the franchise agreement without providing at least 90 days’ notice of termination.</td>
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| Iowa        | Iowa Franchises Law, Iowa Code Ann. § 13-523H-523H1-523H.17            | Franchisor may not terminate a franchise agreement without good cause and at least 30 days’ notice and opportunity to cure. Good cause is cause based upon a legitimate business reason and may not be arbitrary or capricious when compared to the franchisor’s actions in similar situations. Franchisor may terminate with written notice but without an opportunity to cure upon:  
  - bankruptcy or insolvency of the franchised business, or the assignment of all or substantially all of the franchised business’s assets to a creditor;  
  - voluntary abandonment of the franchised business by the franchisee for more than five consecutive days;  
  - termination by written agreement of the parties;  
  - franchisee knowingly makes material misrepresentations in connection with the acquisition, ownership, or operation of the franchise;  
  - franchisee commits 3 breaches of the franchise agreement in any 12-month period;  
  - seizure of the franchised business; and  
  - franchisee is convicted of a felony or engages in conduct which materially and adversely affects the operation, maintenance, or goodwill of the franchise; or franchisee operates the business in a manner that imminently endangers public health and safety. |
<p>| Michigan    | Michigan Franchise Investment Law, Mich. Code Ann. § 445-445.1572      | Franchisor may not terminate the franchise agreement without good cause, including franchisee's failure to comply with any material and reasonable obligation of the franchise agreement, after being given written notice and a reasonable cure period of up to 30 days.                                                                                                                                                                                                                              |</p>
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<td>Minnesota</td>
<td>Minnesota Franchises Act, Minn. Code Ann. § 80C-80C.01-80C.22</td>
<td>Franchisor may not terminate the franchise agreement without: (i) good cause (defined as failure of franchisee to substantially comply with material and reasonable franchise requirements imposed by the franchisor); (ii) 90 days’ written notice; and (iii) a 60-day opportunity to cure.</td>
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<td>Termination may be effective immediately with notice upon:</td>
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<td>- voluntary abandonment of the franchise relationship by the franchisee;</td>
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<td>- franchisee’s conviction for an offense directly related to the business conducted pursuant to the franchise;</td>
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<td>- franchisee’s failure to cure a default under the franchise agreement that materially impairs the goodwill associated with the franchisor's trade name, trademark, service mark, logotype or other commercial symbol after the franchisee has received written notice and a 24-hour opportunity to cure.</td>
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<td>Statutorily enumerated examples of good cause include: (i) bankruptcy or insolvency of the franchisee; (ii) assignment for the benefit of creditors or similar disposition of the assets of the franchised business; (ii) voluntary abandonment of the franchised business; (iii) conviction or a plea of guilty or no contest to a charge of violating any law relating to the franchise business; and (iv) any act by or conduct of the franchisee which materially impairs the goodwill associated with the franchisor's trademark, trade name, service mark, logotype or other commercial symbol.</td>
</tr>
<tr>
<td>Mississippi</td>
<td>Mississippi Franchises Act, Miss. Code Ann. § 75-24-71 to 75-24-63</td>
<td>Franchisor may not terminate a franchise agreement without 90 days’ written notice of termination, provided that 90 days’ notice is not required in the event of criminal misconduct, fraud, abandonment, bankruptcy or insolvency of the franchisee, or the giving of a no account or insufficient funds check.</td>
</tr>
<tr>
<td>Missouri</td>
<td>Missouri Franchises Act, Mo. Code Ann. § 407-407.400 through 407.410, 407.413, and 407.420</td>
<td>Franchisor may not terminate a franchise agreement without 90 days’ written notice of termination, provided that 90 days’ notice is not required in the event of criminal misconduct, fraud, abandonment, bankruptcy or insolvency of the franchisee, or the giving of a no account or insufficient funds check.</td>
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## APPENDIX A

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| Nebraska     | Nebraska Franchise Practices Act; Ne. Code Ann. § 87-4-87-401 to 87-410 | Franchisor may not terminate a franchise agreement without good cause (defined as franchisee’s failure to substantially comply with the requirements imposed upon him or her by the franchise) and 60 days’ written notice of termination, except that:  
  - franchisor may terminate the franchise agreement with 15 days’ written notice if franchisee voluntarily abandons the franchised business; and  
  - franchisor may terminate the franchise agreement immediately with notice upon:  
    - franchisee’s conviction for an indictable offense directly relating to the business conducted pursuant to the franchise;  
    - franchisee’s insolvency or the institution of bankruptcy or receivership proceedings;  
    - franchisee’s default in payment of an obligation or failure to account for the proceeds of a sale of goods by the franchisee to the franchisor or a subsidiary of the franchisor;  
    - franchisee’s falsification of records and reports required by the franchisor;  
    - the existence of an imminent danger to public health or safety; or  
    - loss of the right to occupy the premises from which the franchise is operated.  
Statute applies when (1) the business is located in Nebraska; (2) the gross sales of products or services between the franchisor and franchisee covered by such franchise exceed thirty-five thousand dollars for the twelve months next preceding the institution of suit pursuant to sections 87-401 to 87-410, and (3) when more than twenty percent of the franchisee's gross sales are intended to be or are derived from the franchise. |
| New Jersey   | New Jersey Franchise Practices Act; NJ. Code Ann. § 56-10-56: 10-1 to § 56-10-56: 10-31 | Franchisor may not terminate a franchise agreement without good cause (limited to failure by the franchisee to substantially comply with the requirements imposed upon franchisee by the franchise) and 60 days’ written notice of termination, except that:  
  - franchisor may terminate the franchise agreement with 15 days’ written notice if franchisee voluntarily abandons the franchise relationship; and  
  - franchisor may terminate the franchise agreement immediately with notice upon franchisee’s conviction for an indictable offense directly relating to the business conducted pursuant to the franchise. |
| Virginia     | Virginia Retail Franchising Act; Va. Code Ann. § 13.1-8-13.1-557 to 574 | Franchisor may not terminate a franchise without reasonable cause or use undue influence to induce a franchisee to surrender any right given to franchisee by any provision contained in the franchise. |
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Franchisor may not terminate a franchise agreement without good cause, including, without limitation, franchisee’s: (i) failure to comply with lawful material provisions of the franchise or other agreement between the parties; and (ii) franchisee’s failure cure such default after 30 days’ notice and opportunity to cure, or if such default cannot reasonably be cured within 30 days, the failure of the franchisee to initiate a cure within 30 days, except that franchisor may terminate the franchise agreement immediately with notice if franchisee:

- commits of four willful and material breaches of same term of the franchise agreement in any 12-month period (after notice and opportunity to cure on the first three breaches);
- is adjudicated bankrupt or insolvent, or makes an assignment for the benefit of creditors or similar disposition of the assets of the franchised business;
- voluntarily abandons the franchised business; or
- is convicted of or pleads guilty or no contest to a charge of violating any law relating to the franchised business.
APPENDIX B

TERMINATION CHECKLIST

Review of Default Process

- Did Notice of Default identify the material defaults under the Franchise Agreement upon which the intended termination is based?
- Did Notice of Default explain what actions must be taken or what requirements must be satisfied in order to cure the default?
- Did Notice of Default identify period of time within which defaults must be cured?
- Was Notice of Default sent in accordance with notice provision in the Franchise Agreement?
- Was Notice of Default sent to current address provided by franchisee in accordance with notice provision in Franchise Agreement?
- Did Notice of Default specify defaults and identify how such defaults constitute “good cause” for termination when the applicable state relationship law contains a “good cause” for termination requirement?
- Did Notice of Default comply with any applicable state relationship law requirements regarding notice and opportunity to cure defaults?

Considerations in Sending Termination Notice

- Ensure that the full cure period has run, based upon the longest of any cure period provided in the Franchise Agreement or any applicable law, plus any additional time based upon the manner of delivery of the Notice of Default.
- Did the franchisee fully cure all defaults specified in the Notice of Default?
- If the defaults referenced in the Notice of Default were inherently incapable of cure during the specified cure period, did the franchisee promptly take steps to cure the defaults and make substantial and material progress towards curing the defaults?
- What evidence does the franchisor have that demonstrates the defaults were not cured?
- Was the Notice of Default self-executing in the event of a failure to cure, or is a separate Notice of Termination required under either the Franchise Agreement or any applicable state relationship law?
- If the Notice of Default included a self-executing termination provision, consider sending a notice that confirms the termination and reminds the franchisee of its post-termination obligations.
- If the franchisor determines a separate Notice of Termination is required pursuant to the Franchise Agreement or any applicable state relationship law, ensure the Notice of Termination satisfies all requirements regarding the form of notice, the form of delivery, and any separate timing requirements. Such Notice of Termination should also remind the franchisee of its post-termination obligations.
- Consider any state relationship law requirements triggered by a termination, such as an obligation to repurchase inventories or to make other payments to the terminated franchisee.
LEN MACPHEE

Len MacPhee is a shareholder and Co-Chair of Polsinelli’s Global Franchise and Supply Network practice. Len focuses on analyzing and advising clients on significant supply network matters, including on a pre-litigation basis. He frequently represents national and global clients in structuring and negotiating business strategies for the rollout of products and diverse distribution methods on global and national supply network franchise and distribution matters, as well as transitions and wind-down of franchise and distribution systems. Representing franchisors, suppliers, manufacturers and other businesses before state, federal and appellate courts, as well as in arbitration panels, Len frequently litigates commercial issues and business disputes related to termination and non-renewal and defends brands in claims challenging system-wide practices. His counseling and litigation practice includes disputes related to: franchise, licensing and supply network and distribution; trade secrets; trade dress; covenants not to compete; and enforcement of trademark rights under both contracts and the Lanham Act.

Len is active in the ABA Forum of Franchising and currently serves as an associate editor for The Franchise Lawyer and frequently speaks and writes on franchise topics. He is recognized in: Chambers USA: America’s Leading Lawyers, Franchise Law (2011-2019); Best Lawyers®, Franchise Law (2010-2018), and Recognized as Denver Lawyer of the Year by Best Lawyers® Franchise Law (2014, 2017, 2019); Colorado Super Lawyers®, Franchise/Dealership (2012-2018); and Franchise Times Legal Eagles.
SCOTT MCINTOSH

Scott McIntosh is a partner in the Washington, D.C. office of Quarles & Brady LLP and serves as the office chair of its Litigation & Dispute Resolution Group. He is a franchise law attorney possessing significant experience dealing with the most complex cases among the business, litigation, and regulatory issues that confront franchising companies. He certainly and routinely helps to resolve common, discrete disputes between franchisors and franchisees, but when issues rise to the level of class actions, multiparty disputes, and matters spanning litigation and binding arbitration at the same time, Scott is an invaluable resource. He manages all the logistics, maintains consistency across all the actions pertaining to the matter, and retains control of the costs while pursuing the best possible outcomes for his clients.

Scott's franchise dispute resolution practice is national in scope, and he has handled franchise litigation matters in more than 20 states, in both state and federal courts and at both the trial court and appellate levels. He has also arbitrated cases before various arbitral bodies, including the American Arbitration Association (AAA), the International Centre for Dispute Resolution (ICDR), JAMS, and United States Arbitration & Mediation. Scott has represented clients in the mediation of disputes that involved as few as two parties and as many as 155 parties. Scott also has extensive experience with judicial proceedings that frequently arise collateral to alternative means of dispute resolution, including motions for injunctions, motions to compel arbitration, and motions to enforce arbitration awards.

Scott also counsels clients on franchise relations, terminations, transfers, and regulatory compliance. He advises clients on changes and updates to their systems, transitioning to new forms of franchise agreements, and enforcement of system standards. Scott has assisted clients with the preparation of various transactional documents to evolve and strengthen their systems.

Scott frequently writes and speaks on franchising and related issues. Scott has written articles published in the Franchise Law Journal, The Franchise Lawyer, and Franchising World Magazine, among other publications. Most recently, he was a contributing co-author for the Maryland chapter of the Franchise Desk Book, Third Edition. He is also a member of the ABA Forum on Franchising's Publications Committee.

Scott obtained his Juris Doctor degree, with honors, from the Georgetown University Law Center, as well as a Masters Degree in Foreign Service from the Edmund A. Walsh School of Foreign Service at Georgetown University, in 1998. He graduated in 1993, with honors, from the University of California, Los Angeles, with a Bachelors Degree in Political Science. He also received a Certificate of Executive Management from the University of Notre Dame, Mendoza College of Business, in 2013 and became a Certified Franchise Executive with the Institute of Certified Franchise Executives in 2012.
Janaki Parmar is Vice President and Senior Counsel at Marriott International, Inc., a Fortune® 200 company located in Bethesda, Maryland. Janaki manages Marriott’s franchise legal and regulatory compliance program for its 20 franchised brands in the United States and Canada. She also negotiates franchise agreements for new-build hotels and provides advice and counseling on transfers, terminations, renewals, the implementation of system change, and the general operation of franchise systems. For over 13 years, she has represented established and start-up franchisors in structuring, negotiating and enforcing U.S. and international franchise, licensing, joint venture, and distribution agreements. She has also represented Marriott and other clients in connection with complex M&A transactions.

Janaki obtained her Juris Doctorate Degree in 2006 from Villanova University School of Law. She graduated in 2003, magna cum laude, from King’s College in Wilkes Barre Pennsylvania, with bachelor’s degrees and Accounting and Business Administration. She frequently writes and speaks on franchising and related issues.