Good Faith and Fair Dealing
Alive and Well or is it a Matter of Business Judgment?

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Ongoing, long-term relationship changes over time

- Disparate power for franchisor
- Express terms cannot cover everything
- Discretion in performing some duties
Franchisees expect fair treatment

Franchisors expect flexibility to exercise business judgment

Implied covenant of good faith and fair dealing [“GFFD”]
Where does GFFD come from?
Covenant of good faith and fair dealing

Measured by the parties’

“justifiable expectations”
Covenant of good faith and fair dealing

- Free floating, independent duty?
- Create new substantive terms?
- Perform express duties in good faith?

Exception

statutory duties notwithstanding contract terms
What is good faith and fair dealing?

**Common law:** the absence of bad faith

- evasion of the spirit of the bargain
- lack of diligence and slacking off
- willfully imperfect performance
- abuse of a power to specify terms
- interfere / fail to cooperate with performance
What is good faith and fair dealing?

**Common law examples**

- attempting to force dealer out of business
- concealing true ownership of franchise
- refusing to comply with campaign
Express Contract

- Implied Covenant will not contravene a contract if there are express terms addressing the particular issue.

- The closer that express terms address a particular issue, the better chance there is of foreclosing a claim for breach of the implied covenant.
<table>
<thead>
<tr>
<th>Terms &amp; Clauses</th>
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<tr>
<td><strong>“Sole Discretion”</strong></td>
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<td>terms help because many courts will not imply a fair dealing requirement contrary to the express terms providing the franchisor with unbridled discretion</td>
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<td><strong>Waiver Clauses</strong></td>
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Tension between franchisor and franchisee

- Strict and consistent interpretation of the franchise agreement
- Franchisors typically have discretion with numerous matters
- Interpretation of the contract that requires fair treatment even if it goes beyond the strict letter of the contract
- The implied covenant is viewed as a catch-all means to address any perceived unfair treatment
Examples of where the implied covenant appears

- Training of franchisees
- Advertising
- Introduction of new products or campaigns
- Requiring franchisees to upgrade facilities
- Discriminatory treatment and favoritism
- System changes
- Withdrawals from a region or the entire market
Examples [cont.]

- Territorial encroachment through competing outlets
- Unjust termination of a franchise
- The refusal to extend a franchise agreement
- Limiting the franchisor’s ability to sell through other distribution channels
- Limiting the franchisor’s ability to change policies and procedures
- Enforcing contractual reasonableness requirements
Reining in the implied covenant

- Define the standard by **contract**
- **Defer** to the franchisor’s decision-making

Contractual
Business
Judgment
Rule
Business Judgment Rule—Corporate Law

Presume directors and officers acted ...

1. On an informed basis
2. In good faith
3. Honest belief, best interests of the company

But ...
Business Judgment Rule—Corporate Law

Rebut the presumption ...

1. Conflict of interest
2. Lack of independence

But ...
Rebut the rebuttal...

Fair and Reasonable
BJR applied to franchise law

- **Define the standard by** contract
- **Defer** to the franchisor’s decision-making ...

**even if** it promotes the franchisor’s financial or other individual interests
**BJR applied to franchise law**

Presume franchisor...

1. disinterested & independent
2. is informed
3. acted in good faith
4. did not abuse discretion
5. Reasonable belief action was in the system’s best interests
Why BJR in franchising?

- Bad decision ≠ bad faith
- Franchisors should be able to take risks
- Courts should not second-guess franchisors
- Litigation should not dictate franchisor’s decisions
Why BJR in franchising? [cont.]

- Franchisors are self-interested
- No fiduciary relationship
- Cannot create a true rebuttable presumption by contract
Why shouldn’t BJR apply in franchising?

- Multi-factor fact-based test makes summary judgment difficult
- Unintended consequence of possible duty to investigate
- Still brings you back to good faith
Modern Trends

- Motions to Dismiss
- Motions for Summary Judgment
- Settlement
Trials

- Dunkin’ Donuts Franchising, LLC v. Claudia I, LLC
- Meltzer/Austin Rest. Corp. v. Benihana Nat’l Corp.
- DRL, LLC v. Dunkin’ Brands, Inc.
Cycle City, Ltd. v. Harley-Davidson

- The distributorship agreement’s express language provided for automatic termination and unilateral price changes.

- The court refused to find that Harley-Davidson could not be liable as a matter of law for failing to renew or for imposing increased prices on its distributor.
The General Rule

Courts continue to hold that the implied covenant cannot contradict express contract language, but it can be considered in how the express term is performed.
Implied covenant and BJR

The intersection of the Implied Covenant of Good Faith & Fair Dealing with the Business Judgment Rule in franchising
Novel theories of breach of the implied covenant

What are some of the novel theories you have seen in your practice and what contract term were the theories based upon?