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ROADMAP FOR THE DEFAULT AND TERMINATION PROCESS

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I. INTRODUCTION[1]

This paper outlines the factors a franchisor should evaluate in determining whether to terminate a franchise, explains the procedural and legal requirements for a termination, describes franchisees' potential defenses and counterclaims to termination, and identifies several alternatives to termination. In short, this paper provides a roadmap for the default and termination process for both franchisors and franchisees.

II. FRANCHISOR'S STRATEGIC AND DUE DILIGENCE CONSIDERATIONS

A franchisor's decision whether or not to terminate a franchise should not be taken lightly and should only be made after carefully considering the legal requirements and practical and business consequences of doing so. In many cases, franchisors should try to resolve problems with franchisees and find solutions short of termination, if at all possible, particularly during times of economic difficulties.

A. Early Warning Signs

Though franchisors do not always recognize them, certain types of events signal potential problems with a franchisee. The most common precursor to a termination is the franchisee's failure to pay royalties and other fees due to the franchisor, its affiliates, or suppliers. Franchisees who are in financial difficulty are more likely to cut corners and jeopardize product and service quality, thereby detrimentally impacting the entire system. Other signals include declining sales and purchases of product, personnel problems, employee layoffs, the imposition of liens on the franchisee's assets, indifference or a hostile attitude, rendition of poor quality products or services, failure to buy from approved or required suppliers, numerous customer complaints, failure to comply with pricing and/or promotional programs, complaints from other franchisees, unresponsiveness, failure to attend franchisee functions, and failure to cure defaults. Another red flag is a franchisee's hidden involvement in outside business activities, sometimes behind the scenes with a family member or friend as the front-man. Some disgruntled franchisees become rabble-rousers and encourage other franchisees to join their cause, giving each other support and validation of each other's concerns. Although franchisee associations are most often formed during periods of franchisee discontent, some franchisors have found that associations (particularly those that are formed when there is no strife in the system) can be an effective ally in helping solve or avoid future problems.

B. Weighing the Benefits and Risks of Termination

Since the termination decision is so important and can have so many consequences, franchisors must carefully weigh its benefits and risks. No franchisee is perfect, and the franchisor should make an honest good faith effort to avoid termination. The franchisor should be realistic in its expectations and cannot always expect the cure within the time period specified in the franchise agreement or applicable state law. Some degree of non-compliance

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with a franchise agreement and operations manual is inevitable, but when these situations become persistent or serious, termination may be unavoidable.

Benefits of termination may include: preserving the quality of a franchise system or brand, ensuring long-term financial viability of the system and brand, and eliminating poor performing franchisees. Termination is also a signal to other franchisees that bad conduct will not be tolerated and a non-compliant franchisee can serve as an example of how the franchisor will address problems. However, a franchisor should not ignore the potential impact that terminations might have on the morale of other franchisees. If a franchisor determines that termination is necessary, it should educate other franchisees on the importance of enforcing system standards and compliance with the franchise agreement for the benefit of the entire franchise system as well as individual franchisees. Furthermore, if a franchisor fails to enforce its rights under the franchise agreements, it may face claims of waiver and discrimination by other franchisees who are in breach of their agreements.

There are, of course, significant risks associated with termination. For example, the franchisor will incur the cost of finding replacement franchisees for a particular market and there can be a negative impact of not finding one, such as the loss of past due and future royalties, fewer franchise units, and an unserved, dark market. The franchisor is also exposed to the risks that a former franchisee will compete with its franchise system and that other franchisees may leave after seeing another franchisee depart. Sometimes embarrassing information about the franchisor could come to light in the process.

As noted in an article in the *Franchise Law Journal*:

> "Regardless of the reason, termination results in serious consequences. The investment made by both parties in the relationship will presumably be lost. The goodwill established through a combination of each party's hard work will also be lost. The relationship of the parties will forever be changed and, in most cases, they will never work together again. Customers may also be left in the lurch, innocent bystanders collaterally damaged by the actions of the parties, whether right or wrong."[2]

If the termination results in litigation, the parties both face risks, uncertainties, legal fees and expenses, and the franchisor can face the prospect of an unfavorable outcome that could serve to set a bad precedent and embolden other franchisees to jump on the bandwagon. As with any litigation, no matter how strong the case may appear, there are no guarantees of success. Once the parties become embroiled in a lawsuit, the case often takes on a life of its own. Unanticipated consequences can result no matter how strong the case or how thorough the preparation. The ultimate outcome can rest on something that may have appeared to be inconsequential. Legal fees can be substantial, and oftentimes significant additional costs of expert witnesses are incurred.

Terminations and poor relationships with other franchisees can also have a chilling effect on future franchise sales, particularly in view of disclosure obligations regarding terminations

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[2] Joseph J. Fittante Jr. and Meredith Bauer, *Defaults and Terminations: An Unfortunate Reality of a Challenging Economy*, 28 FRANCHISE L. J. 214 (Spring 2009).

and litigation in the Franchise Disclosure Document ("FDD"). As more fully described in the instructions for Item 3A, a franchisor is required to disclose certain prior and pending litigation and administrative proceedings, as well as actions that the franchisor brought against franchisees during the prior fiscal year. Even confidential settlements between the franchisor and former franchisees must be disclosed. The FDD disclosure requirements can serve as a powerful incentive to resolve a dispute short of litigation. Of course, the names of those franchisees who were terminated (or canceled, not renewed or otherwise ceased to do business) must nevertheless be disclosed, even if the termination was not the result of litigation. If the franchisor and franchisee settle a dispute that results in termination without litigation, the termination must still be disclosed in Item 20. However, if the settlement terms are subject to a confidentiality agreement, the Guidelines for Preparation of the Franchise Disclosure Document state that the following verbatim disclosure must be included: "In some instances, current and former franchisees sign provisions restricting their ability to speak only about their experience with [name of franchise system]. You may wish to speak with current and former franchisees, but be aware that not all such franchisees will be able to communicate with you."

The internet is an effective vehicle for franchisees to spread the word quickly and problems with the franchise system can go viral through sites such as www.bluemaumau.org and www.unhappyfranchisee.com. In addition, although the authors do not express their view regarding the ethical aspects of the practice, we have found that some franchisee attorneys actively solicit potential class members through these websites or other means on the internet. In some situations, a franchisor will also face the cessation of other relationships with the franchisee, including potential liability resulting from the termination. For example, if a franchisor subleases real estate to a terminated franchisee, the franchisor will have to deal with the loss of rental income and the consequences of a vacant space, including a possible default on its part if the lease contains an abandonment provision.

From a business perspective, it is often easier for a large franchisor to terminate a franchisee because the loss of a unit or several units will not have a significant impact on the franchisor's activities and revenues. However, smaller or regional franchisors may face a more difficult dilemma, since they could lose a critical source of income from royalties and product sales, and a significant presence in the area. On the other hand, allowing a franchisee to get further and further behind on payments only exacerbates a bad situation.

It may also be more difficult, at least from a business standpoint, to terminate a long-standing franchisee who has a history of compliance and suddenly runs into problems. In any event, regardless of the size of the system or the number of franchises involved, in some cases the decision to terminate may be inevitable. Certainly, most franchisors cannot tolerate a franchisee's prolonged failure to comply with the material terms of the franchise agreement. However, franchisors should consider the impact of the termination on the franchise system and the franchise community.

As further discussed in Section IV.B of this paper, franchisors should consider whether the franchisee in question has potential counterclaims or defenses against the franchisor (breach of contract, breach of the implied covenant of good faith and fair dealing, selective enforcement, waiver,[3] amendment by course of dealing, retaliation,[4] tortious interference with

[3] *CJ Restaurant Enterprises, Inc. v. FMS Management Systems, Inc.* 699 So. 2d 252 (Fla. Dist. Ct. App. 1997) (Where franchisor accepted late payments despite franchisee's repeated failures to remain current, court found franchisor waived its right to declare a default without prior notice because franchisee reasonably concluded that late payments would not be a default under a stipulated agreement addressing previous non-payments by franchisee); *Compare with Dunkin' Donuts, Inc. v. Panagakos*, 5 F. Supp. 2d 57 (D. Mass. 1998) (no waiver found).

business relationship, etc.). If a franchisee has recently made a significant investment in the business, it may claim that oral promises of a long term relationship were made and that the franchisor is thereby estopped from terminating. Franchisors should also beware of potentially creating new grounds for counterclaims during the termination process by failing to follow proper procedures for termination.

C. Preparing for Termination

1. Determining the Reasons for Franchisee's Non-Compliance

It is important for a franchisor to exercise its termination rights in a fair, reasonable, and consistent manner, with the goal of avoiding litigation. Some types of default are inadvertent or unintentional, while others are representative of a disgruntled franchisee who has no intention of complying. The manner in which a particular default will be handled by the franchisor involves both business and legal issues and the nature of the default will have a bearing on how the franchisor will act. When the default is inadvertent, unintentional, or due to economic or other conditions beyond the franchisee's control, the franchisor should try to work with the franchisee and be more lenient than in a case of an intentional breach of the franchise agreement by a disgruntled franchisee who clearly does not intend to honor its obligations.

2. Seeking Legal Advice and Approval Prior to Termination

Since franchise termination is influenced by complex, inconsistent laws and contract interpretation, franchisors should obtain legal guidance and approval before attempting to terminate a franchise. Special attention should be paid to: (a) whether the franchisor has grounds for terminating the franchise under applicable laws and the parties' franchise agreement; (b) whether notice and cure period requirements have been satisfied; (c) whether a franchise actually exists for the purposes of any state statutory definitions of a "franchise"; (d) potential counterclaims and defenses by the franchisee; and (e) whether the franchise agreement calls for a shortened statute of limitations.[5]

3. Accumulating Evidence Supporting Termination

If termination is contemplated, a franchisor should quickly begin gathering evidence of the default by the franchisee. Some franchisors may have lost or misplaced the most current version of the signed franchise agreement and/or amendments and other documents that could be viewed as altering the relationship. Some terminations are relatively straightforward and obvious; however, others may raise a variety of issues and concerns. Preparation can include review of the franchise agreement, amendments, the offering circular, pre-sale marketing materials, files, correspondence, default notices, inspection reports, customer complaints, correspondence and emails, and other key documents. In addition, some situations warrant interviews with potential witnesses who have information pertaining to a default. Franchisors

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[4] *Dunkin' Donuts of America, Inc. v. Minerva, Inc.,* 956 F.2d 1566 (11th Cir. 1992) (audit results of franchisor appeared to be retaliatory and used inaccurate methodology and therefore did not constitute "good cause" for terminating franchise).

[5] Some franchise agreements provide that in the event of a breach, the party asserting the breach must either notify the other party or initiate legal action within a specific period of time. This attempted "shortening" of the timeframe for terminating a franchise agreement may not be enforceable in some jurisdictions.

should also review their website, and if possible, see what was on the website at the time the franchise was sold. The franchisor may be able to obtain access to websites that are no longer active or have been revised through www.wayback.com, an internet site that stores previous versions of websites. Employees who had substantial contact with the franchisee should be consulted and may aid in making a determination as to whether the grounds for termination are in fact material and if the supporting documentation is reliable.

The importance of strictly following the notice procedures outlined in the franchise agreement, as well as the risks of using e-mail communications that fail to show proof of delivery, is highlighted in *Grosso Enterprises, Inc. v. Domino's Pizza, LLC*[6]. In this case, the court granted the franchisee's request for a temporary restraining order enjoining the termination because of flaws in the e-mail notices of breach.

As with preparation for any type of litigation, it is important to assess whether potential witnesses can be located, if they might be hostile, and if they will provide reliable information that could be helpful in terminating the franchise. Independent third-parties such as officials from governmental agencies, mystery shoppers, and former employees can be particularly helpful in demonstrating that an operational default is justified.[7] For example, in one case, local fire officials and a former employee of the franchisee provided convincing testimony about unsafe conditions in a trailer used as a classroom by a learning center franchisee.[8] Finally, key personnel who are involved in various aspects of the franchise relationship should be consulted and interviewed to be sure that the left hand knows what the right hand is doing.

4. <u>Communicating with Franchisees While Termination is Being Considered</u>

Franchisors should take extra care in communicating with franchisees when termination becomes a potential issue. Any written or oral communications during this time period could eventually become evidence if a dispute erupts into litigation. Further, franchisors should not make representations that may lead a franchisee to believe that the franchisee's wrongful conduct was acceptable, and should also avoid any implication that a replacement franchisee is waiting in the wings.

5. <u>Issuing a "New Day" Letter</u>

A franchisor intending to terminate a franchisee should anticipate possible defenses that a franchisee might raise. If a franchisee or a group of franchisees have engaged in the same or similar conduct that was ignored in the past, the franchisor should consider issuing a communication – sometimes referred to as a "new day" letter – to select franchisees advising them that it intends to strictly enforce the franchise agreement going forward.[9]

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6 2011 WL 816620 (U. S. Dist. Ct., E.D. Pa., March 9, 2011).

7 *See, e.g., Capriotti's Sandwich Shop, Inc. v. Taylor Family Holdings, Inc.*, Civ No. 12-28-SLR, 2012 WL 1448514 (D. Del. Apr. 25, 2012) (showing importance of information gathered from third party in dispute related to threatened termination of sandwich shop franchise).

8 *Carousel Systems, Inc. v. Ordway,* Civil Action No. 96-2558, 1996 U.S. Dist. LEXIS 5614 (E.D. Pa. April 25, 1996).

9 Joseph Schumacher et al., *Retaining and Improving Brand Equity by Enforcing System Standards,* 24 FRANCHISE L. J. 13 (Summer 2004).

6. **Franchisee Representative or Franchisee Committee**

Some commentators have suggested that certain situations justify the use of a franchisee representative or franchisee committee to assist in the decision-making process, particularly where non-compliance with system standards can have a serious negative impact on the franchise system. Demonstrating that other franchisees agree with the termination decision can help demonstrate that the franchisor acted in good faith and in a fair manner.[10]

7. **Acting Deliberately (and Quickly When Necessary)**

Franchisors who fail to enforce system standards and act promptly in the face of material non-compliance do so at their peril. For example, if a franchisor seeks injunctive relief, the failure to act quickly could result in a court refusing to grant the requested relief because of a failure to demonstrate irreparable harm. However, if a franchisor is not serious about pursuing termination, rather than threatening termination in an effort to force compliance, the safer course is to advise the franchisee that its conduct constitutes a default that may justify termination.

8. **Additional Concerns if Franchisee Bankruptcy is Imminent**

If the franchisor believes that the franchisee may file for bankruptcy, the optimal situation is one where the franchise agreement has been effectively terminated under applicable law before the filing of the bankruptcy either by the passage of time or by action of the franchisor. If this is not the case, then the situation is more complicated and requires the help of an experienced lawyer who understands both bankruptcy and franchise law. Two elements of bankruptcy law combine to require special attention. First, an automatic stay takes effect upon the filing of the bankruptcy which precludes the taking of certain otherwise lawful actions by the franchisor without permission of the court; second, a special set of rules governing the franchise agreement and other types of "executory contracts" define the ability of the franchisee to "cure" any defaults or to assume or reject that agreement.[11] For example, a PMPA case, *Moody v. Amoco Oil Co.*[12], dealt with a franchise agreement that provided for a 90 day notice period, but no opportunity to cure the specific default. In that case, the court found that gasoline dealer could not assume a franchise agreement in bankruptcy because the franchise agreement was terminated before the bankruptcy filing.

D. **Grounds for Termination**

A franchise agreement may incorporate terms permitting the franchisor to terminate the agreement for a variety of reasons, ranging from failure to make appropriate payments called for under the agreement to engaging in competitive activity. Franchise agreements will typically include a catch-all provision to permit termination due to a default by the franchisee of the material terms of the agreement.[13] It is advisable for the franchisor to demonstrate that good

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[10] James Goniea and Jeffrey Haff, *Termination, Nonrenewal and Transfer*, FRANCHISE LAW COMPLIANCE MANUAL 351 (Jeffrey Brimer ed., ABA 2d ed. 2011).

[11] Daniel Kaplan, *Protecting the Franchisor's Interests When a Franchisee Files for Bankruptcy Protection*, 21 FRANCHISE L. J. 79 (Fall 2001).

[12] 734 F.2d 1200 (7th Cir. 1984).

[13] *See, e.g., Maple Shade Motor Corp. v. Kia Motors America, Inc.,* 260 Fed. Appx. 517 (3d Cir. 2008) (finding termination for good cause where franchisee failed to build an exclusive Kia showroom, which was a material term of the franchise agreement).

cause exists for the termination and that the termination was based on legitimate business reasons. In fact, many jurisdictions require that good cause exists to support termination.

The following subsections describe some of the typical situations in which franchisors have sought to terminate franchisees. Although the grounds for termination are usually spelled out in the franchise agreement, a franchisor cannot always rely on the explicit terms of the agreement because state relationship laws will generally prevail despite more liberal language in the agreement.[14] Most franchise agreements identify specific grounds for termination and franchisors will not generally seek to terminate a franchisee if the franchisor does not believe it has sufficient grounds or good cause to do so.

1. Termination "With Cause"

a. Monetary Defaults

A monetary default is the most straightforward and least risky basis for a termination and will generally be considered material. Termination may be permitted for failure to meet monetary obligations, such as royalties, advertising fees, payments to suppliers, or other payments.[15] Generally, a franchisee cannot withhold royalties based on the franchisor's breach or perceived breach of contract.[16]

b. Operational Defaults

Terminations can result from the franchisee's failure to meet standards and comply with terms of the franchise agreement or the Operations Manual. Since these types of defaults can often be subjective, issues of materiality arise, and it is helpful for the franchisor to have documentary or photographic evidence to support the allegation of default. Franchisors who fail to enforce their standards consistently can face the risk of not being able to enforce standards retroactively if they have ignored previous similar violations. Special attention should be paid to the language contained in the franchise agreement – i.e. does the agreement provide that the specific default is to be based on a general standard or is it based on the franchisor's determination or discretion, in its sole judgment, as to whether or not a default exists?[17]

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[14] *See* Genevieve A. Beck and Ellen R. Lokker, *The Materiality Requirement for Franchise Terminations,* ABA FORUM ON FRANCHISING (2006).

[15] *See, e.g., Heating & Air Specialists, Inc. v. Jones*, 180 F.3d 923 (8th Cir. 1999) (finding termination for good cause occurred under Arkansas law where franchisee failed to pay amounts due under franchise agreement).

[16] *S & R Corp. v. Jiffy Lube Intern., Inc.,* 968 F.2d 371 (3d Cir. 1992) (franchisee improperly stopped paying royalties to franchisor when it believed franchisor had breached franchise agreement by failing to maintain the quality of its franchises in surrounding area); *but see G.M. Garrett Realty, Inc. v. Century 21 Real Estate Corp.*, 17 F. App'x 169 (4th Cir. 2001) (franchisee successfully argued that termination for failure to pay fees that were legitimately disputed did not constitute a reasonable basis for termination under the Virginia Retail Franchising Act.).

[17] *See* W. Michael Garner and Sarah A. Johnston, *Utilizing the Doctrine of Prior Material Breach to End a Franchise Relationship*, 24 FRANCHISE L. J. 23 (Summer 2004).

c. Performance and/or Quota Defaults

Terminations can arise because of the franchisee's failure to meet quotas or performance standards.[18] However, performance requirements and quotas should be reasonable.[19]

d. Failure to Devote Best Efforts

If the agreement requires the franchisee to devote its best efforts to the business, the failure to devote substantial full-time efforts to the franchise can be grounds for termination.[20]

e. Competing with Franchise System

Terminations may result in cases where a franchisee obtains an interest in a competing franchise system or otherwise competes with a franchisor's franchise system in violation of the terms of the franchise agreement[21] or as a result of trademark violations.

f. Unapproved Transfer of Franchise Interest

Termination may be permitted where a franchisee transfers its franchise rights to another party without approval from the franchisor.[22]

g. Violation of Law

Termination may be permitted where a franchisee violates state or federal law.[23]

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[18] *See, e.g., Rutman Winery Co. v. E & J Gallo Winery*, No. 90-15083, 1991 U.S. App. LEXIS 8824 (9th Cir. 1991) (franchise properly terminated where franchisee had substantial decline in sales performance); *Mills Datsun, Inc. v. Jaguar Cars, Inc*., 884 F.2d 579 (6th Cir. 1989) (finding termination for good cause where dealership had sold very few Jaguar automobiles as compared to other dealers in the same area); b*ut see Hartford Electric Supply Co. v. Allen Bradley Co.*, 736 A.2d 824 (Conn. 1999) (finding franchisor did not have good cause to terminate based on alleged insufficient performance by franchisee where the economy was depressed, the franchisor had previously praised the franchisee for its performance, the franchisor failed to demonstrate how the franchisee's performance compared to that of other franchisees, and the franchisee otherwise complied with requirements under the parties' franchise agreement).

[19] *See, e.g., Newell Puerto Rico, Ltd. v. Rubbermaid, Inc.,* 20 F.3d 15 (1st Cir. 1994) (finding assigned sales quotas unreasonable).

[20] *See, e.g., Day Enterprises, Inc. v. Crown Scent Petroleum Corp.,* 529 F. Supp. 1291 (D. Md. 1982) (termination appropriate where franchisee/dealer failed to devote "substantially his full time exclusively to the operation" of gas station).

[21] *See, e.g., Deutchland Enterprises, Ltd. v. Burger King Corp.,* 957 F.2d 449 (7th Cir. 1992) (finding termination for good cause under Wisconsin law where franchisee violated franchise agreement by acquiring and operating franchise locations for competitor at the same time franchisee operated Burger King franchise locations); *Keating v. Baskin-Robbins USA, Co.,* No. 5:99-CV-148-BR(3), 2001 U.S. Dist. LEXIS 26328 (E.D.N.C. Mar. 27, 2001) (termination of franchise agreement warranted where franchisee sold ice cream from competitor while operating Baskin Robbins franchise).

[22] *See, e.g., Stroh Brewery Co. v. Western Maryland Distributing Co.,* 131 F.3d 136 (4th Cir. 1997) (termination appropriate where franchise interest transferred without franchisor's approval); *Eastern of Maine, Inc. v. Vintners Group, Ltd.,* 495 A.2d 318 (Me. 1985).

[23] *See, e.g., Interstate Battery System of America v. Wright*, 811 F. Supp. 237 (N.D. Tex. 1993) (termination in case of counterfeiting and trademark infringement).

h. Action by Non-Franchisee

Termination may be permitted even if it results from a default not directly committed by franchisees,[24] such as by an employee. A federal district court in New Jersey held that termination of a franchise based on the conviction of its president and majority owner for endangering the welfare of a child was improper under New Jersey law because the conviction was not directly related to the business conducted pursuant to the franchise.[25]

i. Repeated Defaults

If the termination will be based on repeated defaults, the franchisor should carefully review the prior defaults and be sure that it has adequately complied with the notice provisions for them. The prior defaults should, of course, be material and the franchisor should not have ignored or overlooked the prior defaults.

2. Incurable Defaults

Section III.C. 5 of this paper addresses incurable defaults.

3. Termination "Without Cause"

Unlike distributorship agreements, which often provide for termination without cause,[26] franchise agreements are generally only terminated without cause under very limited circumstances. This may be because of the significant investment that franchisees make in the business. Many state franchise statutes require that good cause exist to terminate a franchise, and under those circumstances, good cause is frequently based on the franchisee's default. In this regard, changes in the franchisor's business plans or economic circumstances are often insufficient to support termination of a franchise or distributorship.[27] However, courts are divided on whether termination is permissible based on partial or total market withdrawal.[28]

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[24] *See, e.g., The Original Great American Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.*, 970 F. 2d 273 (7th Cir. 1992)(finding termination of franchise appropriate, even if largely based on acts committed by manager hired by franchisees).

[25] *Int'l House of Pancakes, LLC v. Parsippany Pancake House Inc.*, CIV. 12-3307 WJM, 2012 WL 2476407 (D.N.J. June 27, 2012).

[26] *See, e.g., Pennington's, Inc. v. Brown-Forman Corp.,* No. 92-35243, 1993 U.S. App. LEXIS 20638 (9th Cir. 1993) (distribution agreement that allowed termination of distributorship agreement without cause at discretion of parties found not to be unconscionable under California and Montana law.)

[27] *See, e.g., Wright-Moore Corp. v. Ricoh Corp.,* 908 F.2d 128 (7th Cir. 1990) (internal economic reasons alone do not constitute good cause for non-renewal of distributorship agreement under Indiana law); *Sims v. Brown-Foreman Corp*., 468 S.E.2d 905 (Va. 1996) (consolidation of brands by winery into fewer wholesalers over broader geographic area not "good cause" for terminating agreements without reasonable compensation to wholesalers under Virginia law where no evidence of deficiencies in wholesalers' performances shown). *But see Morley-Murphy v. Zenith Elec. Corp.,* 142 F.3d 373 (7th Cir. 1998) (television manufacturer had "good cause" to terminate distributorship under Wisconsin law based on changes in economic conditions provided that (1) an objectively ascertainable need for change existed; (2) a proportionate response to that need was implemented; and (3) the action taken was nondiscriminatory).

[28] *Compare Lee Beverage Co. v. I.S.C. Wines of California*, 623 F. Supp. 867 (E.D. Wis. 1985) (good cause existed under Wisconsin law for terminating exclusive distributorship agreement where product lines sold to another manufacturer) *with Delta Truck & Tractor, Inc. v. J.I. Case Co.,* 975 F.2d 1192 (5th Cir. 1992) (sale of farm equipment

4. Constructive Termination

Constructive termination may occur where a franchisor significantly alters the franchise relationship or takes other action that effectively terminates the parties' franchise agreement.[29] This type of termination claim has not been universally embraced by courts, with some requiring *actual* termination in order to state a claim against a franchisor.[30] In *Mac's Shell Service, Inc. v. Shell Oil Products Co.,*[31] the United States Supreme Court considered what constituted "constructive termination" under the Petroleum Marketing Practices Act ("PMPA"), which regulates motor fuel franchises. The court held that adding more burdensome terms to a dealership agreement on renewal would not amount to constructive termination where the dealers continued to operate. Although the *Mac's Shell* holding applies to motor fuel franchises subject to the PMPA, some have suggested that franchisors will try to apply the reasoning of that case to challenge claims of constructive termination where the non-PMPA franchisee remains in business.[32] For example, in a recent federal case out of the Northern District of Illinois,[33] although the court suggested that a constructive termination claim was viable under the Illinois Franchise Disclosure Act, the court cited *Mac's Shell,* and opined that the franchisee would have to go out of business in order to assert such a claim.

III. PROCEDURAL AND LEGAL REQUIREMENTS FOR DEFAULTS/TERMINATIONS

A. Are There Proper Legal Grounds for Termination?

If the franchisor and franchisee are unable to resolve their dispute and the franchisor decides to terminate the franchise, the franchisor needs to determine if it has proper legal grounds for the termination. In addition to reviewing the franchise agreement to determine whether the termination is proper, the franchisor or its counsel should determine whether any franchise relationship laws are applicable to the termination. A review of the controlling jurisdiction's law should be conducted as well. This section will provide a brief overview of some of the more common state relationship law issues that franchisors and franchisees might encounter.

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manufacturing business did not constitute good cause for termination of dealer agreement) and *Hobbs Farm Equipment, Inc. v. CNH America, LLC,* 291 S.W.3d 190 (Ark. 2009) (market withdrawal does not constitute "good cause" for termination under Arkansas Franchise Practices Act).

[29] *See* Ronald R. Fieldstone, *Franchise Encroachment Law*, 17 FRANCHISE L. J. 75 (Winter 1998).

[30] *Compare Maintainco, Inc. v. Mitsubishi Caterpillar Forklift America, Inc.,* 975 A.2d 510 (N.J. Sup. Ct. App. Div. 2009) (finding defendant violated New Jersey law by constructively terminating dealer) *with Adoph Coors Co. v. Rodrigues,* 780 S.W.2d 477, 480 (Tex. Ct. App. 1989) (no cause of action for wrongful termination occurs until *actual* termination of distributorship).

[31] 130 S.Ct. 1251 (2010).

[32] *See* Carmen D. Caruso, *Franchisee Claims for Constructive Termination Under the PMPA After Mac's Shell,* 30 FRANCHISE L. J. 139 (Winter 2011).

[33] *Bell v. Bimbo Foods Bakeries Distribution, Inc.,* Case No. 11 C 03343, 2012 U.S. Dist. LEXIS 90987 (N.D. Ill. July 2, 2012).

B. Necessity for Strict Compliance with Termination Procedures

Having proper grounds to terminate a franchise agreement is only the starting point in the termination process. It is imperative that the franchisor strictly comply with any termination procedures that are mandated either by the franchise agreement or applicable law. The franchisor's failure to strictly comply with these procedures may provide the franchisee with a valid defense to the termination, even if the franchisee's conduct otherwise justified termination.

C. State Relationship Laws

1. Introduction

Nineteen states,[34] in addition to the District of Columbia, Puerto Rico and the Virgin Islands, have enacted laws addressing various aspects of the franchise relationship relating to default, franchisee termination, and post-termination obligations. In general, these "state relationship laws" restrict or control the ability of a franchisor to terminate or refuse to renew a franchise or regulate other aspects of the relationship between the franchisee and franchisor. These statutes may be narrow or broad, and may govern numerous aspects of the franchise relationship, including, but not limited to, a franchisee's right to cure a default under the franchise agreement, governing law, jurisdiction and venue of litigation and arbitration, discrimination, the franchisor's right to injunctive relief, the franchisor's right to vary the terms of the franchise, inventory repurchase requirements, the right of a deceased franchisee's next of kin to continue the franchise after the original investor's death, the franchisee's right to form an association with other franchisees of the same brand, and the franchisor's right to a general release from a franchisee on condition of renewing or entering into a new agreement. Although general trends are apparent, no two state statutes are exactly the same. Thus, knowing whether any such state relationship law applies and the impact of such law is crucial before a franchisor decides to default or terminate the franchise relationship.

As an initial matter in analyzing state relationship laws, it is necessary to determine the jurisdictional application of the statute. Of the 19 states with franchise relationship laws, Hawaii, Mississippi, Washington, and the Virgin Islands do not have any specific provisions addressing the jurisdictional application of their statutes. The majority of states, however, do address jurisdiction, but the analysis varies by state depending on how narrow or broad the language of the statute is. For example, the relationship laws in Arkansas, Connecticut, Delaware, Iowa, Maryland, Missouri, Nebraska, New Jersey, Rhode Island, Virginia, Wisconsin, and Puerto Rico have the strictest statutory language governing jurisdictional application. In these jurisdictions, a franchisor must comply with the relevant relationship law's provisions <u>only</u> if the franchised unit is actually located within the state. The Illinois anti-fraud provision applies if the offer was made in the state, accepted in the state, the franchisee is domiciled in the state or the franchised unit is in the state.[35] Michigan[36] and Minnesota[37] have statutes with the most comprehensive jurisdictional application. In Michigan, the state relationship law applies if (1) the franchised unit

[34] These states include Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, New Jersey, Michigan, Minnesota, Mississippi, Missouri, Nebraska, North Dakota, South Dakota, Virginia, Washington, and Wisconsin.

[35] 815 ILCS 705/6.

[36] Mich. Comp. Laws § 445.1504.

[37] Minn. Stat. Ann. § 80C.19.

is in the state, (2) the franchisee is domiciled in the state, or (3) the offer to buy the franchise is accepted in the state. Minnesota has a similarly broad statute—the state's relationship law applies if (1) the franchised unit is in the state, (2) a sale is made in the state, or (3) an offer to sell or purchase is made or accepted in the state. California and Indiana have relationship laws that apply where the franchised unit is in the state. California's relationship law also applies if the franchisee is domiciled in the state while Indiana's relationship law applies if the franchisee is a resident of the state. Thus, because there is such wide variation in the jurisdictional application of state relationship laws, familiarity with the applicable provisions is essential.

2. <u>Good Cause Requirements</u>

Many state relationship statutes relating to termination are aimed at preventing unfair forfeiture of franchise rights without "good cause," recognizing the substantial business investment often made by franchisees. The relationship statutes vary both in their definitions of good cause and in the procedural prerequisites for termination. For example, the relationship laws of California, Connecticut, Hawaii, Illinois, Indiana, Michigan, Minnesota, Nebraska, New Jersey, Rhode Island and Washington provide a very general definition, that good cause includes the failure to comply with the lawful and material provisions of the franchise agreement. Many states define "good cause" non-exhaustively by way of examples.[38] Good cause typically includes situations such as the franchisee becoming insolvent, voluntarily abandoning the premises, being convicted of a crime relating to franchise operations, losing possession of the franchised premises, or failing to substantially comply with its material obligations under the franchise agreement.

Other states have more comprehensive good cause statutes. For example, Hawaii allows for termination for either good cause or if done in accordance with the franchisor's current terms and conditions if such standards are applied equally across the franchise system.[39] Iowa defines good cause as "a legitimate business reason" and also requires that the termination not be arbitrary and capricious.[40] Minnesota, Nebraska, New Jersey and Wisconsin bar bad faith terminations or terminations not made in "good faith." Wisconsin,[41] Minnesota,[42] and the Virgin Islands[43] define good cause as the failure of the franchisee to comply with material and reasonable requirements of the franchisor.[44] The Virgin Islands statute also provides that good cause exists if there is bad faith by the franchisee in carrying out the terms of the franchise.[45] The Delaware Franchise Security law prohibits franchise terminations that are "unjust," which means termination without good cause or in bad faith. Still, other states do not

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[38] *See, e.g.*, Cal. Bus. & Prof. Code §§ 20021 and 20025.

[39] Haw. Rev. Stat. § 428E-6(2)(H).

[40] Iowa Code § 523H.7.

[41] Wis. Stat. § 135.02(4)(a).

[42] Minn. Stat. § 80C.14.

[43] V.I. Code Ann. tit. 12A, § 132.

[44] Connecticut's relationship laws impose a good cause requirement that shall include but not be limited to the franchisee's refusal or failure to comply substantially with any material and reasonable obligations of the franchise agreement. Conn. Gen. Stat. § 42-133f(a).

[45] *Id.*

define a specific permissible standard and instead rely upon definitions of "good faith" found in common law. The Virginia Retail Franchising Act prohibits termination without "reasonable cause."[46] Puerto Rico has an exceptionally strict "good cause" standard by requiring "just cause" for termination.[47] Just cause occurs only when (1) the franchisee fails to perform under an essential provision of the franchise agreement, or (2) the acts or omissions of the franchisee adversely and substantially affect the interests of the franchisor in promoting the marketing or distribution of the merchandise or service. Missouri does not have a good cause requirement for termination, but does have notice requirements.[48]

Where a state statute has not specifically defined "good cause," state courts have been left to interpret "good cause" on a case-by-case basis. State courts have found good cause for termination where a franchisee has damaged the franchisor's reputation, sold competing products, failed to maintain standards, failed to meet sales and other performance criteria, underreported sales, and failed to report sales or pay royalties.[49] Some courts have allowed a nondiscriminatory, reasonable change in business practices applicable to all franchisees and compelled by business considerations to constitute good cause for termination.[50]

3. <u>Choice of Law</u>

It is critical for a franchisor to have an accurate understanding of the requirements of state law before commencing to do business in that state and before taking any action against an existing franchisee, such as terminating the franchise or exercising other rights and remedies. State relationship laws may override the express provisions of any franchise agreement, giving rise to the question of the effect of a contractual "choice of governing law" clause on the applicability of relationship laws. When a franchisor terminates a franchise agreement, the terminated franchisee may seek to invoke the protection of the franchise law of the state in which the franchisee is located, notwithstanding the fact that the agreement provides that the law of the franchisor's state applies. The effect of an attempt by a franchisor to avoid a franchise relationship statute by the contractual choice of law of another state is unpredictable.[51]

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[46] Va. Code Ann. § 13.1-564.

[47] P.R. Laws Ann. tit. 10, § 278a-1.

[48] Mo. Ann. Stat. §§ 407.400, et seq.

[49] *See, e.g., Biomedical Instrument and Equipment Co. v. Cordis Corp.*, 797 F.2d 16 (1st Cir. 1986) (holding that a franchisor who accepted late payments without objection does not have good cause to terminate a franchisee for untimely payments); *Eastern of Maine, Inc. v. Vintners Group Ltd.*, 495 A. 2d (1985) (holding that good cause for termination existed where a franchisee assigned the franchise without the contractually required consent).

[50] For example, in *Patterson*, the court held that termination was in good faith as part of a consolidation plan. *Patterson v. Ford Motor Co.*, 931 F. Supp. 98 (1st Cir. 1996). In *Remus*, although Wisconsin law required good cause in order to terminate or substantially change the competitive circumstances of a dealership agreement, the court held that good cause is established where a franchisor implements a non-discriminatory change among all of its franchisees based upon business exigencies unrelated to the franchisees. *Remus v. Amoco Oil Co.*, 611 F. Supp. 885 (E.D. Wis. 1985).

[51] *See,* Thomas M. Pitegoff, *Choice of Law in Franchise Relationships: Staying Within Bounds*, 14 FRANCHISE L.J. 89 (Spring 1995).

In some states, a waiver of compliance with the relationship laws is ineffective.[52] The Third Circuit Court of Appeals upheld the relationship laws of the franchisee's state, noting that the selection of the laws of another state was contrary to the fundamental policy of the franchisee's state, even though the contract called for the application of the franchisor's state law.[53] However, in other cases, the franchisor's choice of law was upheld, particularly where there was equality of bargaining power.[54] The Sixth Circuit similarly declined to apply the state relationship law, citing the contractual choice of the law of the franchisor's state.[55] This tension between contractual choice-of-law provisions and state relationship laws reflects longstanding concerns regarding disparity of bargaining power between franchisors and franchisees and whether freedom of contract will prevail over public policy decisions.

4. __Notice Requirements__

Many states have adopted franchise laws that require a franchisor to provide notice of termination to a franchisee.[56] Numerous state relationship laws require the franchisor to give the franchisee advanced notice of the proposed termination a specific number of days prior to

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52 *See*, e.g. Cal. Bus. & Prof. Code §§ 20010 and 20015, which specifically state that the California Franchise Relations Act applies when a franchisee resides in California or when the franchised business operated in California and voids any attempt to waive that provision.

53 *Instructional Sys., Inc. v. Computer Curriculum Corp*., 35 F.3d 813, 817 (3d Cir. 1994).

54 In *Modern Computer Systems*, the Eighth Circuit held that the franchisee state's anti-waiver provision did not render ineffective the parties' choice-of-law clauses and was ineffective to overcome the state's countervailing policy in favor of enforcing contractual choice-of-law provisions, particularly where there is no great disparity in the bargaining positions of the parties. *Modern Computer Sys., Inc. v. Modern Banking Sys., Inc.*, 871 F.2d 734, 738-40 (8th Cir. 1989). The court noted that some evidence of oppressive, unreasonable use of superior bargaining position is required before a court can justifiably disregard a mutually agreed upon choice of law clause. *Id.* at 739. In response to *Modern Computer Systems*, the Minnesota legislature amended the Franchise Act's anti-waiver provisions to explicitly provide that the protections of the Franchise Act cannot be waived through a contractual provision, including any choice of law provision purporting to waive compliance with the Franchise Act. Minn. Stat. § 80C.21. Despite this, a subsequent Eighth Circuit ruling upheld the parties' choice of law clause and refused to validate the state's anti-waiver provision because the choice of law provision did not violate the state's public policy. *JRT, Inc. v. TCBY Systems, Inc.*, 52 F.3d 734 (8th Cir. 1995); *see also Costa v. Carambola Partners, LLC*, 590 F. Supp. 2d 1141, 1152 (D. Minn. 2008)(noting that that interpreting statutes is the function of the judicial and not legislative branch, and that it would be "problematic" to rely on the legislature's amendment of the Act).

55 *See Highway Equip. Co. v. Caterpillar Inc.*, 908 F.2d 60 (6th Cir. 1990) (honoring the parties' choice of law provision while denying protection of state franchise act); *Banek v. Yogurt Ventures USA, Inc.*, 6 F. 3d 357 (6th Cir. 1993) (holding that the fundamental policy of the state franchise act did not override the parties' choice of law clause).

56 *See* Ark. Code Ann. § 4-72-202; Cal. Bus. & Prof. Code § 20020; Conn. Gen. Stat. § 42-133F; Del. Code Ann., Title 6, § 2552; Haw. Rev. Stat. § 482E-6; 815 Ill. Comp. Stat. 705/19; Ind. Code § 23-2-2.7-1; Iowa Code § 523H.7; MD. Code Ann. § 11-1302.1; Mich. Comp. Laws § 445.1527; Minn. Stat. § 80C.14; Miss. Code Ann. § 75-24-53; Mo. Rev. Stat. § 407.405.1; Neb. Rev. Stat. § 87-402; N.J. Stat. Ann. § 56:10-5; S.D. Codified Laws § 37-5A-51; Wash. Rev. Code §19.100.180; Wis. Stat. § 135.02.

termination, ranging among states from between 30 to 120 days.[57] Failure to give notice as required by statute can have drastic consequences.[58]

The notice period may also vary depending on the nature of the franchisee's default. Most state franchise relationship statutes provide that the franchisor may terminate the franchisee immediately, or on very short notice, if the franchisee has committed certain specified defaults. For example, Arkansas does not require any notice at all if the basis for termination is one of the examples of good cause outlined in the statute.[59] Wisconsin does not require prior notice and an opportunity to cure if the reason for termination is the dealer's insolvency.[60] However, the franchisor is not excused from the notice and cure requirements if it did not know of the insolvency at the time of termination or if the insolvency was not the reason for the termination as stated in the notice.[61] While every state defines a severe default differently, common examples include abandonment, conviction of a serious crime, declaration of bankruptcy[62], fraud, multiple breaches over a fixed period of time, or a violation that threatens public health or safety.

In some states, the termination notice must contain all of the reasons for termination. This requirement can cause later difficulties for franchisors. It forces the franchisor to take a position at the time that the franchisor gives notice of termination and may act as an estoppel with respect to any reasons not contained in the notice.[63]

In many states, having good cause to terminate does not excuse a franchisor from the notice requirements.[64] Even where the parties' contractual agreement permits a shorter notice period, a franchisor may be required to give the statutory notice and reinstate the relationship.[65]

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[57] Connecticut, Nebraska, and New Jersey require a notice period of 60 days; Delaware, Indiana, Wisconsin, Mississippi, and Missouri require a notice period of 90 days; the Virgin Islands requires a notice period of 120 days. *See* Ark. Stat. Ann., §4-72-204; Conn. Gen. Stat., tit. 42, ch. 739, §42-133a; N.J. Rev. Stat., §56:10-3(f); Del. Code Ann., tit. 6, §2554; Ind. Code, tit. 23, art. 2, ch. 2.7, §3; Wis. Stat. §135.04; Miss. Code Ann., tit. 75, ch. 24, §75-24-53; Mo. Rev. Stat., tit. 26, ch. 407, §407.405; V.I. Code Ann. tit. 12A, ch. 2, subch. III, §131.

[58] In *ABA Distributors*, state relationship laws required notice and an opportunity to cure prior to termination. The franchisor terminated for nonpayment without notice, as provided in the contract. The franchisee was entitled to an order permanently enjoining the franchisor from making any further attempt to terminate the agreement without the requisite 90 day notice mandated by Missouri state law. *ABA Distribs. Inc., v. Adolph Coors Co.*, 542 F. Supp. 1272, 1299 (W.D. Mo. 1982).

[59] Ark. Code Ann. § 4-72-204(c); 4-72-202.

[60] Wis. Stat. § 135.04.

[61] *See Bruno Wine & Spirits, Inc. v. Guimarra Vineyards*, 573 F. Supp. 337 (E.D. Wis. 1983); *Hammil v. Rickel Mfg. Corp.*, 719 F.2d 252 (7th Cir. 1983).

[62] *See,* Section II(C)(8), infra, for a discussion of other bankruptcy considerations.

[63] In *ABA Distributors*, for example, the franchisor was precluded from introducing evidence at trial concerning reasons for termination not contained in the notice. *ABA Distribs. Inc., v. Adolph Coors Co.*, 542 F. Supp. 1272 (W.D. Mo. 1982).

[64] *See Designs in Medicine, Inc. v. Xomed, Inc.*, 522 F. Supp. 1054 (E.D. Wis. 1981) (holding that failure to comply with notice requirements may constitute violation of the law, regardless of whether franchisor had good cause to terminate).

[65] *Maude v. Gen. Motors Corp.*, 626 F. Supp. 1081 (W.D. Mo. 1986).

5. <u>Cure Periods</u>

Franchisees are typically given a right to cure a default before facing a termination, except for repeated defaults or under certain egregious circumstances where a default is not capable of being cured. Some types of defaults, such as criminal activity or acts or omissions resulting in danger to health or safety, are so serious that they are incapable of being cured. Some state's laws will permit the franchisor to terminate immediately without opportunity to cure for certain specified defaults. However, state statutes differ considerably, and court decisions are far from uniform. Furthermore, even if explicitly permitted by state statute, if the franchise agreement fails to include such a default as one which is not curable, the franchisor will generally still be subject to the constraints of the franchise agreement as written.[66]

Many state relationship laws also provide the franchisee with an opportunity to cure the default, although there are often exceptions for incurable defaults such as voluntary abandonment, bankruptcy, and criminal conviction, which is discussed in more detail below. While some states mandate a specific number of days for the cure period, other states merely require the franchisee to be provided with a "reasonable" opportunity to cure. For example, the relationship laws of California, Hawaii, Illinois, Michigan, and Washington all compel the cure period to be "reasonable." The statutes of Arkansas, Iowa, Maryland, Minnesota, Rhode Island, and Wisconsin, on the other hand, expressly dictate the requisite number of days a franchisor is required to give a franchisee to cure the breach, ranging among states from 30 days to 120 days.[67] In *AAMCO Indus. Inc. v. De Wolf* the Supreme Court of Minnesota held that termination of the franchise agreement was proper and excused the franchisor from complying with the statutory 24-hour cure period because the franchisee had already damaged the franchisor's goodwill when the state attorney general's office obtained evidence of serious consumer fraud.[68] Courts interpreting Illinois and California law have also held that no cure period is required when the franchisee commits a crime.[69]

Finally, some states do not require a cure period at all but still require notice prior to termination, except in limited circumstances where no cure period is required.[70] Still, other states' cure periods may vary in time or even be eliminated depending on the nature of the breach. For example, Iowa ordinarily requires an opportunity to cure, but requires no cure period

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66 *See* Jason J. Stover, *No Cure, No Problem: State Franchise Laws and Termination for Incurable Defaults*, 23 FRANCHISE L.J. 217 (Spring 2004).

67 Arkansas and Maryland require a 30 day cure period; Rhode Island, Minnesota and Wisconsin require a 60 day cure period; Iowa requires a "reasonable" cure period that is between 30 and 90 days long. *See* Ark. Stat. Ann., §4-72-204; Md. Com. Laws, tit. 11, sub-tit. 13, §11-1305; R.I. Gen. Laws, §6-50-4; Minn. Stat., §80C.14; Wis. Stat. §135.04; Iowa Code, Tit. 13, sub-tit. 3, ch. 537A.10.

68 *AAMCO Indus. Inc. v. De Wolf*, 250 N.W.2d 835, 840 (Minn. 1977). The court held that giving the franchisee an opportunity to cure in this case would have been "futile." *Id.*

69 *See Dunkin' Donuts, Inc. v. Tejany & Tejany, Inc.*, No. 05 C 4770, 2006 WL 163019 (N.D. Ill. Jan. 18, 2006); Cal. Bus. & Prof. Code §20021(i).

70 Connecticut, Delaware, Indiana, Mississippi, Missouri, Nebraska, New Jersey, and the Virgin Islands do not mandate a cure period, although notice is required in these states. *See* Conn. Gen. Stat., tit. 42, ch. 739, §42-133a; Del. Code Ann., tit. 6, §2554; Ind. Code, tit. 23, art. 2, ch. 2.7, §3; Miss. Code Ann., tit. 75, ch. 24, §75-24-53; Mo. Rev. Stat., tit. 26, ch. 407, §407.405; Neb. Rev. Stat., §87-404; N.J. Rev. Stat., §56:10-3(f); V.I. Code Ann. tit. 12A, ch. 2, subch. III, §131.

when the franchisee has committed a serious breach of the agreement.[71] The cure periods in Rhode Island and Wisconsin decrease to 10 days in the case of monetary defaults. The cure period in Arkansas is reduced to 10 days if there are multiple defaults within a 12-month period. A chart outlining the various cure periods is included in the Appendix.

Where past conduct cannot be cured within the permitted cure period or at all, some courts will nonetheless impose a reasonable cure period, even where the termination notice technically complied with the notice requirements of state law and the agreement, if the notice is ambiguous and compliance is impossible as a practical matter.[72] Franchisors should, of course, continue to honor the parties' agreement during any cure period.[73]

6. Incurable Defaults/Breaches

State laws vary with regard to a franchisor's rights in dealing with incurable defaults. There are two forms of incurable default—(1) any default for which a contract or statute does not give the breaching party an opportunity to cure, and (2) any default that simply cannot possibly be fixed within the contractual or statutory cure period. State relationship laws typically exempt from notice an opportunity to cure breaches going to the core of the franchisor-franchisee relationship, but they may also authorize immediate termination for less egregious conduct.

Some courts have found that a default is incurable where the breach goes to the essence of the agreement and is so "exceedingly grave" that it has irreparably damaged the trust between the parties.[74] This reasoning has also been applied to cases involving willful criminal misconduct.[75] In a New Jersey case, the failure to report employees' taxable income was deemed incurable under an explicit provision in a franchise agreement requiring the franchisee to comply with all applicable laws and the state statute that defined good cause.[76] On the other hand, a federal district court rejected a franchisor's argument that an incurable breach is one that goes to the essence of the contract in a case involving a franchisor's attempt to terminate a franchisee for failure to provide I-9 forms to employees. Instead, the court found that "an incurable breach is either one for which 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."[77]

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[71] Iowa Code § 523H.7(3).

[72] *See Wadena Implement Co. v. Deere & Co., Inc.,* 480 N.W. 2d 383 (Minn. Ct. App. 1992) ("[S]ince market share performance is measured annually, a dealer logically should be entitled to a full year's time in which to comply with reasonable market share requirements.").

[73] *See, e.g., Am. Business Interiors v. Haworth*, 798 F.2d 1135 (8th Cir. 1986).

[74] *LJL Transportation, Inc. v. Pilot Air Freight Corp*., 962 A.2d 639, 652 (Pa. 2009).

[75] *Dunkin' Donuts, Inc. v. Chetminal, Inc.,* Bus. Franchise Guide (CCH) ¶11,290 (S.D. Fla. Nov. 26, 1997).

[76] *Dunkin' Donuts Franchised Restaurants LLC v. Strategic Venture Group, Inc.,* Civil Action No. 07-1923 (SRC), 2010 U.S. Dist. LEXIS 119417 (D.N.J. Nov. 10, 2010).

[77] *Manpower Inc. v. Mason*, 377 F. Supp. 2d 672, 677 (E.D. Wis. 2005).

Incurable breaches can include the failure to attain minimum sales, misuse of the franchisor's trademark, franchisee's commission of a crime, franchisee's insolvency, or damage to the franchisor's goodwill. Some state relationship laws specifically outline the circumstances under which immediate termination is lawful.[78] For example, California state relationship laws deem it reasonable for the franchisor to immediately terminate without giving an opportunity to cure if the franchisee is insolvent, the franchisee abandons the franchised business, the franchisee engages in conducts that reflects unfavorably on the franchise's reputation, the franchisee repeatedly fails to comply with franchise requirements, the franchisee is convicted of a crime relevant to franchise operations, or continued operation of the franchise by the franchisee will result in imminent danger to public health or safety.[79] Iowa's relationship statutes also provide a laundry list of incurable defaults similar to that of California.[80]

7. <u>Common Law Limitations</u>

Even if a written agreement states that it is the entire agreement between the parties, and that it may be terminated without cause on short notice, and no protective state relationship laws apply, termination without good cause may *still* be unlawful. The parties' franchise agreement is not necessarily limited to the written contract. First, in all jurisdictions, parol evidence may be admissible to explain or clarify ambiguous writings or if fraud is alleged.[81] Evidence of the custom and practice in the industry with respect to dealer terminations, and the course of dealing between the particular manufacturer and dealer, is commonly admissible to assist the jury in determining what was the agreement.[82] Courts have interpreted these provisions to permit introduction of evidence of course of performance, dealing and usage of trade when that evidence does not completely negate the terms of a written contract. Thus, evidence of oral communications concerning termination may be enforced to prevent termination even when the written agreement does not. Second, contrary terms may be implied by operation of law. An obligation of good faith is implied by the common law of most states, and often provides rights not expressly found in the written contracts. Waiver or estoppel may also prevent a franchisor from invoking a provision in its written contract where it has, by its conduct, led the franchisee to believe it would not rely on that clause against the franchisee.[83]

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[78] The statutes of Arkansas, Iowa, California, Illinois, Maryland, Minnesota, Rhode Island, Washington, and Wisconsin outline grounds for immediate termination. *See* Ark. Stat. Ann., §4-72-204; Iowa Code § 523H.7(3); Cal. Bus. & Prof. Code, §20021; 815 ILCS 705/19; Md. Com. Laws, tit. 11, sub-tit. 13, §11-1305; Minn. Stat., §80C.14; R.I. Gen. Laws, §6-50-4; Wash. Rev. Code, §19.100.180; Wis. Stat. §135.04.

[79] *See* Cal. Bus. & Prof. Code § 20012.

[80] Iowa Code § 523H.7(3).

[81] *See, e.g.*, *ICC Leasing Corp. v. Midwestern Mach. Co.*, 257 N.W.2d 551, 554 (Minn. 1977).

[82] *See* U.C.C. § 2-202; *Varni Bros. Corp. v. Wine World*, 35 Cal. App. 4th 880 (Cal. Ct. App. 1995) (holding that evidence of custom in the industry determined by the standards at the time of the alleged harm is admissible to supply the contract terms); *B.P.G. Autoland Jeep-Eagle, Inc. v. Chrysler Credit Corp.*, 785 F. Supp. 222 (D. Mass 1991), (*overruled on other grounds*, holding that an abrupt change in the parties' course of dealing regarding leniency constituted a breach of the covenant of good faith and fair dealing).

[83] *See, e.g.*, *Central Microfilm Serv. Corp. v. Basic/Four Corp.*, 688 F. 2d 1206 (8th Cir. 1982) (preventing franchisor from invoking franchise agreement clause where franchisor led its franchisee to believe that it would not rely on the clause against the franchisee).

Recoupment may also serve to limit the franchisor's reliance on the written franchise agreement. Recoupment implies a minimum term in an agreement defined as the length of time in which the franchisee can reasonably be expected to recoup its investment. It is a breach of contract if the agreement is terminated before that point. For example, a New York court held that because the distributor was required to make an investment of inventory and other assets, although the parties' agreement did not specify a term, the agreement was not terminable without reasonable notice and without reasonable duration.[84] In calculating unrecouped expenditures as recoupment damages, courts take into account the value of benefits derived from the arrangement during its existence or may derive after. Under Minnesota law, a claim for breach of contract may be stated where a dealer, at the insistence of the supplier, invested his resources and credit in establishment of a costly distribution facility for the supplier's product, and the supplier thereafter unreasonably terminates the contract without giving the dealer an opportunity to recoup his investment.[85]

8. Buyback Provisions

Some state relationship laws require a franchisor to repurchase excess inventory from the franchisee in the event of termination, as a remedy to the franchisee. Of the states with relationship laws, Arkansas, California, Connecticut, Hawaii, Iowa, Maryland, Michigan, Rhode Island, Washington, and Wisconsin all have repurchase obligations, but the laws differ among the states, depending on (1) whether repurchase is required where there is good cause for termination, (2) whether repurchase is required in the case of both termination and nonrenewal, (3) what must be repurchased, and (4) the price that must be paid.

For example, the franchise laws of Connecticut, Hawaii, Iowa, Washington, and Wisconsin all require the franchisor to repurchase inventory even if the termination was for good cause, while Arkansas and California only require a repurchase if the termination is without good cause. California also requires buyback if the franchisor fails to meet any of the terms of the California Franchise Relations Act. Maryland's repurchase provision applies in all cases of termination except for certain enumerated "egregious" acts or omissions by the franchisee.

Some states require repurchase of supplies, equipment, and furnishings, in addition to inventory, while other states, such as California and Wisconsin, only require repurchase of inventory. In some states, such as Arkansas, Connecticut, Hawaii, and Washington, the franchisor must repurchase inventory, supplies, equipment, and furnishings only if they were purchased from the franchisor or its approved suppliers. In other states, however, such as California, Rhode Island and Wisconsin, the franchisor must repurchase the franchisee's inventory regardless of whether it was purchased from the franchisor.

With regard to the repurchase price, Arkansas's franchise law states that the franchisor must repurchase at the franchisee's net cost, less a reasonable allowance for depreciation or obsolescence.[86] In California, the repurchase amount is the lower of the fair wholesale market

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[84] *Italian & French Wine Co. v. Negociants U.S.A., Inc.*, 842 F. Supp. 693 (W.D.N.Y. 1993).

[85] *Ag-Chem Equipment Co. v. Hahn, Inc*., 480 F.2d 482, 489 (1973) (noting that a jury may take into account unamortized capital investments and operating expenses attributable to future development when awarding damages to the franchisee); *see also Schultz v. Onan Corp.*, 737 F.2d 339 (1984).

[86] Ark. Stat. Ann. § 4-72-209.

value or the price paid by the franchisee.[87] Connecticut requires fair and reasonable compensation.[88] Hawaii[89] and Washington[90] provide the repurchase amount is the fair market value at the time of the termination or expiration.

D. Special Industry Laws

There are a number of industry-specific statutes governing franchisor-franchisee relationships with regard to protection from termination. Among the industries covered by specific franchisee protections are petroleum, automobiles, farm implements, construction of industrial equipment, and liquor, beer, or juice. These statutes often arise after an influx of termination litigation in a particular industry. For example, South Dakota's industry-specific legislation requires a franchisor not to cancel a farm, tractor, or implement dealership "unfairly, without due regard to the equities of the dealer and without just provocation."[91] North Dakota's industry-specific statute states that farm implement, automobile, or truck franchisors, wholesalers, or distributors may not cancel, terminate, or fail to renew any contract with retailers of those products who stock parts or whole goods without good cause.[92]

It is important to note that these industry-specific statutes can be overly broad and misleading. For example, in Minnesota, if a franchisee sells skid-steer loaders with backhoe attachments, the franchisee is technically governed by two industry-specific statutes—one governing skid-steer loaders and one governing backhoes.[93] Thus, it is crucial to research all possible applicable industry-specific relationship laws.

IV. FRANCHISEE'S RESPONSES TO AND POSSIBLE DEFENSES TO DEFAULT/TERMINATION

A. Avoiding Termination

A franchisee can avoid termination by complying with the parties' franchise agreement and timely curing any curable defaults. As explained above, franchise agreements and state statutes often give franchisees an opportunity to cure certain kinds of defaults within certain windows of time prior to termination. If a franchisee timely cures a curable default during the cure period, a franchisee may avoid termination on the grounds cured.

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[87] Cal. Bus. & Prof. Code § 20007.

[88] Conn. Gen. Stat. § 42-133f.

[89] Haw. Rev. Stat. § 482E-6(3).

[90] Wash. Rev. Code § 19.100.180(2)(i).

[91] S.D. Codif. L. § 37-5-3.

[92] N.D. Century Code § 51-07-01.1.

[93] *See* Minn. Stat. §§ 325E.061, 325E.068.

B. **Legal Claims and Defenses by Franchisees**

If a franchisor threatens an improper termination, the franchisee may seek injunctive relief to stop the termination and/or declaratory relief specifying that the termination would be improper. If an improper termination occurs, a franchisee may seek damages or other relief against the franchisor. Finally, where a franchisor sues a franchisee for unpaid royalties, trademark infringement, or other wrongdoing, a franchisee may assert counterclaims against the franchisor, if it has legitimate grounds for doing so. The following are examples of legal theories (both defenses and affirmative claims) franchisees often pursue in actions against franchisors.

1. **Failure to Comply with State's or Franchise Agreement's Termination Requirements**

As discussed above, the franchisor should strictly comply with any contractual or statutory termination requirements, whenever possible. For example, any notice of default should provide at least the number of days to cure required under the agreement and any applicable statute. Further, any notice should be served upon the franchisee in the manner required by the franchise agreement or statute (i.e. certified mail). Depending on the nature of the franchisee's breach and the amount of the franchisee's investment, a court is likely to require strict compliance by the franchisor with any contractual or statutory termination requirements and may invalidate any termination that does not strictly comply.[94]

2. **Waiver, Modification, or Estoppel by Oral Representation or Course of Dealing**[95]

When termination or default disputes arise, franchisees often allege that the parties' communications or course of dealing waived the franchisor's rights to enforce the disputed provisions, modified the franchise agreement's terms, or estops the franchisor from enforcing the disputed provisions as written. Franchisors often respond that it is not fair to penalize them for past leniency, that their actions were not intended to alter any terms in the franchise agreement, that the alleged promise was not detrimentally relied upon, or that the franchise agreement's standard no-waiver or no-oral-modification clauses bar any claim of waiver or modification. The victor in these disputes varies by jurisdiction and factual pattern.

a. **Waiver**

When a franchisor has not previously enforced a provision of the franchise agreement against the franchisee at issue or against other franchisees, franchisees often assert that the franchisor has waived the right to enforce that provision. The resolution of this argument is highly fact-dependent, as reflected in the following examples:

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[94] For example, in one California decision, the appellate court found that the trial court's determination that the franchisor had "good cause" to terminate the franchise was erroneous because state law prohibits termination unless the franchisee receives 60 days written notice of the action setting forth specific grounds for termination. *British Motor Car Distribs. v. New Motor Vehicle Bd.*, 194 Cal. App. 3d 81, 90 (1987). The court held that the franchisor's failure to comply with the notice requirements was itself sufficient to establish adequate grounds for upholding the franchisee's protest filed with the California New Motor Vehicle Board. *Id.* at 91.

[95] For a full discussion of waiver, modification and estoppel, please see Kerry L. Bundy and Scott H. Ideda, *How Waiver, Modification, and Estoppel May Alter Franchise Relationships*, FRANCHISE L.J. (Summer 2010). This paper draws heavily from it.

- No waiver found under Massachusetts law. The franchisor did not waive its right to terminate the franchise agreement for criminal conduct even if it waited six years after learning of the conduct - at most, there was "mere silence" by the franchisor; and absent evidence that the franchisor took affirmative steps to waive its contractual right to terminate, there was no waiver.[96]

- Waiver found under Indiana law. The franchisor waived its right to terminate based on the franchisee's failure to renew in writing, as required by the franchise agreement, where the franchisor allowed the franchisee to continue to operate in the two territories and even retroactively granted a limited extension of these territorial rights.[97]

- Waiver found under New York law. The franchisor waived its right to terminate a franchise agreement where the franchisor did not attempt to terminate until ten months after the franchisees' default on payment. In part, the court reasoned that because the franchisor repeatedly waived its right to payment and because the franchisees came to rely upon the additional sixty-day grace period, the franchisor could not require strict compliance "without first providing sufficient notice of the withdrawal and a reasonable time for [the franchisees] to alter their conduct."[98]

- Waiver found under Indiana law. The franchisor waived its right to object to non-franchisor food products being sold where it knew about and had not objected to the franchisee's sale of non-franchisor products for twenty-five years.[99]

Where a franchisor anticipates waiver arguments, the franchisor can attempt to retract a purported waiver by providing notice to the franchisee that it intends to enforce its rights going forward. However, under certain circumstances, courts may not allow the retraction if the other party has materially changed its position in reliance on the waiver.

b. <u>Modification</u>

Franchisees often argue that the parties' course of dealings, oral agreements, or conduct has modified the franchise agreement by introducing new terms or canceling or amending existing terms.[100] Again, the outcome of this argument is highly fact-dependent and turns on the laws of the state at issue.

In one case decided under Wisconsin law,[101] a franchisee sued a franchisor for unlawfully terminating a franchise agreement without cause. The franchisee argued that the

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[96] *Dunkin' Donuts Inc. v. Gav-Stra Donuts, Inc.,* 139 F. Supp. 2d 147, 157 (D. Mass. 2001).

[97] *Can. Dry Corp v. Nehi Beverage Co., Inc.*, 723 F.2d 512 (7th Cir. 1983).

[98] *LaGuardia Assocs. v. Holiday Hospitality Franchising*, 92 F. Supp. 2d 119 (E.D.N.Y. 2000).

[99] *Terry Int'l v. Dairy Queen, Inc.,* 554 F. Supp. 1088, 1095 (N.D. Ind. 1983).

[100] *See, e.g., Elliot & Frantz, Inc. v. Ingersoll-Rand Co.,* 457 F.3d 313, 322 (3d Cir. 2006); *Southern States Cooperative, Inc. v. Global AG Associates, Inc.,* No. 06-1494, 2008 WL 834389 (E.D. Pa. Mar. 28, 2008) (arguing parties modified contract by negotiating payment terms on an ongoing basis).

[101] *Haynes Trane Service Agency, Inc. v. American Standard, Inc*., 573 F.3d 947 (10th Cir. 2009).

franchisor's pattern of only terminating other franchisees with cause had modified the franchisor's contractual right to terminate the franchisee without cause. The Tenth Circuit rejected this argument, noting that evidence that the franchisor always emphasized cause for termination and only knew of terminations it had done with cause was not sufficiently inconsistent with the contract rights in dispute to constitute modification. The Tenth Circuit noted, "The Wisconsin Supreme Court has recognized that prior failure to exercise a contractual right is not unequivocally inconsistent with enforcing that right." For this court, modification turned on whether the acts of the contracting parties were inconsistent with the contract rights in dispute.[102]

c. Estoppel

Franchisees' estoppel arguments are closely related to waiver and modification. Estoppel generally requires (1) action or inaction, (2) on the part of one against whom estoppel is asserted, (3) which induced reasonable reliance thereon by the other, either in action or action, and (4) which is to his or her detriment.[103]

In one estoppel case illustrating the risk of making promises to a franchisee, a franchisor sought to terminate a development agreement because the development was not completed by the date set forth in the development agreement.[104] In response, the franchisee claimed that it relied upon the franchisor's promise of additional time to open the store. Despite the unambiguous expiration date in the development agreement, the court held that the franchisee was "entitled to show that [the franchisee] relied on [the franchisor]'s promise even if [the franchisor] prevail[ed] on the breach of contract claim. Because the parties dispute[d] whether [the franchisor] promised to extend the time limit for opening the new store, a genuine issue of material fact exist[ed] which…[had to]…be submitted to the trier of fact."[105]

Similarly, in a second estoppel case, the court denied summary judgment to a franchisor, reasoning the franchisee might be able to prove that the franchisor's oral promise to reconstruct the franchisee's store was enforceable on the grounds of estoppel or waiver.[106]

d. No Waiver / No Modification Clauses

In anticipation of the waiver, modification, and estoppel arguments above, many franchise agreements contain clauses that prohibit modifications except by certain prescribed methods (such as writings signed by both parties). While helpful, these no-waiver/no-

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[102] The same result with a finding of no modification, occurred in *KBQ, Inc. v. E.I. DuPont de Nemours & Co.,* 6 F. Supp. 2d 94, 98 (D. Mass. 1998). There, the parties disputed whether the franchisor's subsequent conduct modified the termination provision from an at-will provision to one that required cause and an opportunity to cure. The court refused to find modification, holding that the franchisor's conduct was not sufficiently specific under Delaware law to modify the terms of the agreement.

[103] *See, e.g., Am. Standard, Inc. v. Meehan,* 517 F. Supp. 2d 976 (N.D. Ohio 2007); *see also Cin-Doo, Inc. v. 7-Eleven, Inc*., Civ 04-cv-50-SM, 2005 WL 768592, at *4 (D.N.H. Apr. 6, 2005) (unpublished).

[104] *Stetzer v. Dunkin' Donuts, Inc.*, 87 F. Supp. 2d 104 (D. Conn. 2000).

[105] *Id.* at 116.

[106] *Cin-Doo, Inc. v. 7-Eleven, Inc*., Civ. 04-cv-50-SM, 2005 WL 768592 at *1 (D.N.H. Apr. 6, 2005) (unpublished).

modification provisions are far from bulletproof. In some instances, courts enforce them.[107] In other instances, courts refuse to enforce them.[108]

Thus, from a planning perspective, franchisors cannot assume that no-waiver/no-modification clauses will be enforced. Instead, they must train their operations and sales personnel to avoid conduct that could lead to waiver, modification, and estoppel arguments. In addition, franchisors should monitor and act promptly in response to violations of the franchise agreement, system standards, and other requirements.

3. <u>Selective Enforcement / Discrimination Claims</u>[109]

Franchisors do not always strictly and uniformly enforce the requirements of their franchise agreements and operations manuals. As a result, franchisees often attempt to assert unlawful discrimination as a defense to termination actions or as a claim or counterclaim for damages. In such cases, franchisees assert that franchisors' selective enforcement violates federal or state civil rights laws, federal or state antitrust laws, federal or state industry-specific laws, state relationship laws with antidiscrimination or good cause standards, the implied covenant of good faith and fair dealing, or other common law principles.[110]

The most common defense to a selective enforcement or discrimination claim is that the terminated franchisee is not similarly situated to other franchisees who were not terminated.[111]

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[107] *See, e.g., LeGuardia Assocs. v. Holiday Hospitality Franchising*, 92 F. Supp. 2d 119, 129 (E.D.N.Y. 2000); *Dunkin' Donuts Franchised Rests. LLC v. KEV Enters., Inc.*, 634 F. Supp. 2d 1324, 1334 (MD. Fla. 2009) (applying Massachusetts law); *Cohen Fashion Optical, Inc. v. V&M Optical, Inc.,* 858 N.Y.S.2d 260, 2601 (N.Y.App.Div. 2008); *Days Inn Worldwide, Inc. v. Adrian Motel Co., LLC*, No. 07-13523, 2009 WL 3199882, at *8 (E.D. Mich. Sept 30, 2009*); Super 8 Motels, Inc. v. Rahmatullah*, Civ. No. 07-01358, 2009 WL 2905463, at *8 (S.D. Ind. Sept. 9, 2009).

[108] *See, e.g., Can. Dry Corp v. Nehi Beverage Co., Inc.*, 723 F.2d 512 (7th Cir. 1983); *Cin-Doo, Inc. v. 7-Eleven, Inc*., Civ. 04-cv-50-SM, 2005 WL 768592 at *1 (D.N.H. Apr. 6, 2005) (unpublished); *Southern States Cooperative, Inc. v. Global AG Associates, Inc.,* No. 06-1494, 2008 WL 834389 (E.D. Pa. Mar. 28, 2008)

[109] For a full discussion of selective enforcement/discrimination claims, see (A) Mark J. Burzych and Emily L. Matthews, *Vive La Difference? Selective Enforcement of Franchise Agreement Terms and System Standards*, FRANCHISE L.J. (Fall 2003); (B) Jeffrey F. Haff, Kevin Morgan & Roger Schmidt, *Differential Treatment of Franchisees in Tough Economic Times*, ABA FORUM ON FRANCHISING (2011) and (C) Mark Burzych, Eric H. Karp & Karen B. Satterlee, *Discriminatory Treatment of Franchisees*, ABA FORUM ON FRANCHISING (2004). This paper draws heavily on all three.

[110] *See, e.g., Open Pantry Food Marts of Wisconsin v. Howell*, Bus. Franchise Guide (CCH) ¶ 8072 (Wis. Cir. Ct. Oct. 31, 1983) (franchisor engaged in discriminatory treatment in violation of the Wisconsin Fair Dealership Act by terminating franchisees that were in better financial condition than those that were not terminated).

[111] *See, e.g., Novus du Quebec v. Novus Franchising, Inc.*, Bus. Franchise Guide (CCH) ¶ 10,823 (D. Minn. Dec. 5, 1995) (Minnesota court, applying Minnesota law, rejected the franchisee's selective enforcement defense to a franchise termination; court reasoned that the franchisor's forbearance toward alleged breaches of certain contract requirements by other franchisees, but not by the plaintiff, was justified because the other franchisees' breaches were of a "lesser magnitude" than the plaintiff's breach); *Petland, Inc. v. Hendrix*, No. 204CV224, 2004 WL 3406089 (S.D. Ohio Sept. 14, 2004) (franchisor's selective enforcement of a non-competition clause was grounded in credible business reasons – other markets were not meant for re-franchising – and did not serve to render non-competes invalid against franchisee defendants). *Contrast with Basco, Inc. v. Buth-Na-Bodhaige*, 198 F.2d 1053 (8th Cir. 1999) (affirming verdict in favor of the franchisee and holding that there was sufficient evidence for a jury to determine whether The Body Shop had unreasonably withheld its consent to a transfer or had otherwise discriminated between franchisees in violation of the Minnesota statute; the rejected buyer was stronger financially than the majority of the accepted applicants, and the lack of retail experience and inability to work in the store full time had not prevented The Body Shop from approving other applicants.)

Each statute has its own rules and its own case law, and must be separately considered. However, most statutes allow the franchisor to treat franchisees differently if the franchisor can identify a legitimate business reason that distinguishes the franchisee at issue from other franchisees. Depending on the state statute and how it has been construed, some legitimate bases could be that the franchises were granted at different times (and the discriminatory treatment is reasonably related to such differences in time), or have different levels of capital or business experience. The "similarly situated" concept typically provides some flexibility for tailoring solutions to address individual franchisees' situations, so long as the franchisor is dealing in good faith, is acting based on legitimate business motives, and is not being arbitrary.

a. State Relationship Laws with Express Anti-Discrimination Provisions

At least six states (Arkansas, Hawaii, Illinois, Indiana, Washington, and Wisconsin) have general franchise statutes that expressly address franchisors' disparate treatment of franchisees.[112] One additional state, Minnesota, has an administrative rule expressly prohibiting discrimination.[113] The anti-discrimination provisions of the state relationship franchise statutes can be found in the appendix.

Typically, the franchise statutes address discriminatory treatment among similarly situated franchises, either because of explicit language in the statute (Arkansas, Hawaii, Illinois), or because courts have read such an interpretation into the statute.[114] Typically, the statutes allow franchisors to treat differently situated franchisees differently, so long as the different treatment is justifiable and is not unfair.[115]

b. State Motor Vehicle Statutes with Express Anti-Discrimination Provisions

Numerous states, including Delaware, Georgia, Nevada, New Mexico, Ohio, Vermont, Washington, and Wyoming, have motor vehicle franchise acts that prohibit a manufacturer/franchisor from discriminating among franchisees/dealers. The most explicit in the termination context is Ohio's statute, which provides, "In determining whether good cause has been established by the franchisor for terminating, cancelling, or failing to continue or renew a franchise, the motor vehicle dealers board shall take into consideration…whether the proposed termination, cancellation, discontinuance, or nonrenewal constitutes discriminatory enforcement of the franchise agreement"[116] The anti-discrimination provisions of the state motor vehicle franchise statutes can be found in the appendix.

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[112] Ark. Code Ann. § 4-72-202(7); 4-72-204(a); Hawaii Rev. Stat. §482E-6(2)(C),(H); 815 Ill. Rev. Stat. 705/18; Ind. Code, Tit. 23, Art. 2, ch. 2.7, §2; Rev. Code of Wash. § 19.100.180; Wis. Stat., §§ 135.0.

[113] Minn. Administrative Rules § 2860.4400.B.

[114] *See, e.g., Wright-Moore Corp. v. Ricoh Corp*., 908 F.2d 128, 139 (7th Cir. 1990) (interpreting Indiana act); *Deutschland Enterprises v. Burger King Corp*., 957 F.2d 449, 453 (7th Cir. 1992) (interpreting Wisconsin act).

[115] *See, e.g., Canada Dry Corp. v. Nehi Beverage Co.*, 723 F.2d 512 (7th Cir. 1983) (applying Indiana act), *Armstrong v. Taco Time International, Inc.,* 635 P.2d 1114 (Wash. Ct. App. 1981), *Deutchland Enterprises v. Burger King Corp*., 957 F.2d 449, 453 (7th Cir. 1992) (interpreting Wisconsin act).

[116] Ohio R.C. § 4517.55(A)(9).

c. Anti-Discrimination Claims Based on State Relationship Laws that Do Not Contain an Express Anti-Discriminatory Provision

In addition to the states above with express anti-discrimination provisions (Arkansas, Hawaii, Illinois, Indiana, Minnesota, Washington, and Wisconsin), several other states (for example California, Connecticut, and Michigan) have franchise relationship laws that require "good cause" for termination or nonrenewal, without including express anti-discrimination provisions. In these states, franchisees have argued that discriminatory treatment is not good cause to terminate.

Some courts have agreed with that argument. For example, in *Tractor and Farm Supply, Inc. v. Ford New Holland Inc*.,[117] the franchisee claimed that the franchisor's failure to renew its dealership was motivated by animosity towards the franchisee's son and a desire for consolidated dealerships in the franchisee's trade area. The court, applying Michigan's Franchise Investment Law ("MFIL"), held that the MFIL requires a legitimate, nondiscriminatory reason for nonrenewal of a franchise agreement and that all similarly situated franchisees must be treated similarly. The franchisee's evidence was found sufficient to create a material issue of fact as to whether the nonrenewal was unlawfully discriminatory.

Similarly, in *General Aviation v. Cessna Aircraft Co.,*[118] a franchisee claimed that Cessna discriminated against it in violation of the MFIL when it decided not to renew. The Sixth Circuit held that whenever a franchisor renews some franchisees and not others, the disparate treatment must meet a good cause standard. Cessna could have treated the franchisee differently from other franchisees with expired contracts if it had provided legitimate reasons for the treatment, but the court found insufficient grounds for nonrenewal when Cessna simply asserted that it "needed to cut back on the size of its operation by eliminating one dealer without any change in its policies regarding other dealers."[119]

d. Common Law Discrimination Claims

Franchisees also raise common law challenges to franchisors' allegedly discriminatory treatment of franchisees.

McDonald's was successful defeating such a claim in *Payne v. McDonald's Corp.*,[120] where a franchisee alleged that McDonald's had breached the implied covenant of good faith and fair dealing because it had not helped the franchisee to sell the units as it had helped other franchisees. The court found that the contract did not create an obligation for the franchisor to assist this franchisee to sell its units, and stated, "[t]he integration clause precludes this Court from considering extrinsic evidence disclosing what assistance McDonald's may have rendered to some other franchisee under different circumstances."

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[117] 898 F. Supp. 1198 (W.D. Ky. 1995).

[118] 13 F.3d 178 (6th Cir. 1993).

[119] *Id.* at 183.

[120] 957 F.Supp. 749 (D. Md. 1997).

Similarly, the franchisor was successful in *Bonanza International, Inc. v. Restaurant Management Consultants, Inc.,*[121] where the franchisee alleged that the franchisor had breached the covenant of good faith and fair dealing by selectively enforcing the default and termination provisions of the agreement. The court concluded that whether the franchisor treated other franchisees differently had no bearing on whether the franchisor had acted in good faith and dealt fairly with the aggrieved franchisee under its particular contract - "regardless of the relevancy or irrelevancy of Bonanza's dealings with third parties, any evidence of good faith and fair dealing cannot be used to override express provisions of the written contract."[122] Furthermore, the franchisor's disparate treatment of other franchisees was justified because the franchisor either had a long-standing relationship with such franchisees (where the delinquent royalty payments could be explained), or their defaults had been timely cured.

e. <u>Defense to Termination</u>

Many courts have ruled that a franchisor's disparate treatment of franchisees is not a defense to termination for breach of contract. [123]

However, in *Phillips v. Crown Central Petroleum Corp*., two dealers successfully blocked termination by pointing to evidence of selective enforcement.[124] The two dealers who had been successful in an antitrust suit later violated their dealer agreements, and Crown terminated. After reviewing the evidence of Crown's relationship with its other Maryland dealers, the Maryland federal court held that where there was evidence that Crown had not terminated other dealers that had committed the same (or worse) violations, the inference was that Crown had terminated the plaintiffs in retaliation for successful prosecution of their antitrust claims. The court therefore blocked the terminations.

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[121] 625 F.Supp. 1431 (E.D. La. 1986).

[122] *Id.* at 1448.

[123] *See, e.g., Original Great American Chocolate Chip Cookie Co v. River Valley Cookies*, 970 F.2d 273 (7th Cir. 1992) ("the fact that the Cookie Company may…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."); *McDonald's Corp v. Robertson*, 147 F.3d 1301, 1309 (11th Cir. 1998) ("[a] franchisor's right to terminate a franchisee exists independently of any claims the franchisee might have against the franchisor."). *See also* the following cases cited in Christine E. Connelly, Robert Lichtenstein, and M. Elizabeth Moore, *Franchise Default and Termination - Best Practices to Enforce the Contract and Protect the System*, INTERNATIONAL FRANCHISE ASSOCIATION 45TH ANNUAL LEGAL SYMPOSIUM, May 20-22, 2012: *Kilday v. Econo-Travel Motor Hotel Corp*., 516 F. Supp. 162, 163 (E.D.N.Y. 1981) (a contract provision giving a franchisor the right to require conformance with standards "does not appear to obligate the [franchisor] to require all of its franchisees to conform with the standards required of the [plaintiff franchisee]."); *Staten Island Rustproofing Inc. v. Zeibart Rustproofing Co.,* Bus. Franchise Guide (CCH) ¶ 8,492 (E.D.N.Y. Nov. 15, 1985) (affirming franchisor's termination of franchisee over franchisee's argument regarding selective enforcement; the agreement did not provide that the franchisor "promised to enforce its standards against other franchisees," and thus the franchisor was free to terminate the subject franchise without having to take action against other franchisees); *Chick-Fil-A, Inc. v. CFT Dev., LLC*, 652 F. Supp. 2d 1252 (M.D. Fla. 2009) (any inaction by franchisor or non-enforcement of other contracts was insufficient to estop the enforcement of a covenant not to compete against another franchisee); *Creel Enters., Ltd. v. Mr. Gatti's, Inc.*, Bus. Franchise Guide (CCH) ¶ 9,825 (N.D. Ala. June 26, 1990) (alleged non-enforcement of quality standards against some franchisees did not breach contract with another franchisee); *Quality Inns Int'l, Inc. v Dollar Inns of Am.,* Inc., Bus. Franchise Guide (CCH) ¶ 10,007 (D. Md. Feb. 10, 1989) (implied covenant of good faith and fair dealing not violated by selective enforcement of franchise agreement; the covenant does not require franchisors to deal with other franchisees in a particular manner).

[124] Civil No. 73-303-H, 1976 WL 1380 (D. Md. Aug. 2, 1976)

f. <u>Contractual Language's Effect on Anti-Discrimination / Selective Enforcement Claims</u>

Many franchise agreements include explicit acknowledgments by the franchisee that franchise agreements entered into by other franchisees may include different terms, and that the franchisor's decisions with respect to other franchisees - including its enforcement or non-enforcement of other franchise agreements - do not waive any rights the franchisor may have with respect to the signatory franchisee. While helpful, these provisions do not provide a bulletproof defense against anti-discrimination or selective enforcement claims.

4. <u>Substantial Compliance / Substantial Efforts to Cure / Breach Not Material</u>

While in many cases a franchisee makes no effort to cure a noticed default, a more complicated situation occurs where a franchisee has substantially, but not completely, complied with the requirements necessary to cure a default. In one case applying Minnesota law, the court noted that cure does not require perfect performance.[125] Only if the contractual breach is not cured to the level of substantial performance may the injured party terminate the contract. In *Anacapa*, the licensee undertook affirmative steps to cure its breach, such as obtaining an injunction against the third party to comply with the licensor's restrictions, requiring the third party through severe restrictions in the settlement agreement to treat as confidential the licensor's confidential information, and mandating the third party to assign ownership to the licensor of the third party's patent that had incorporated the licensor's technology. Further, the licensee had implemented procedures to prevent the unauthorized disclosure of the licensor's confidential information by securing audit rights over the third party and control over the third party's future development efforts. Because of these efforts, the court held that the licensee had substantially cured its breach.

In *Volvo Trucks*, the dealer planned to sell its franchise and tried to convert all customer fleets in its sales area to a competitor's trucks. The dealer then decided to keep the franchise and took steps to increase the sales of the manufacturer's trucks. The court required the manufacturer to rescind the termination notice it issued to the dealer and found that the dealer's material breach of the parties' dealer agreement was cured within a reasonable time. The court held that the cure statute did not require restoration to the status quo ante or repair of all harm done by the breach. Instead, a reasonable interpretation of the statutory word "cured" meant that the breaching party was to stop the offending conduct and to substantially perform the contract.[126]

5. <u>Impossible to Complete Cure Within Cure Period Allowed By Statute or Agreement</u>

In one case, a Wisconsin court enjoined a franchisor from terminating the franchise agreement even though the requisite 60-day period was given to the franchisee. The court held that the statutory cure requirements were not met because although the franchisee failed to meet its minimum sales goals (which the court determined was "good cause" for termination), it would have been impossible for the franchisee to increase its yearly sales to the required level

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[125] *Anacapa Tech., Inc. v. ADC Telcoms., Inc.*, 241 F. Supp. 2d 1016, 1020-21 (D. Minn. 2003).

[126] *Volvo Trucks N. Am. v. State DOT*, 323 Wis. 2d 294 (2010).

in only 60 days. Thus, complete cure by the franchisee may be unnecessary—reasonable steps by the franchisee to rectify the deficiency could be adequate to void termination.[127]

Similarly, in *Wadena*, the court found that the corporation improperly terminated the dealership where the cure provisions were unreasonable and impossible to achieve in the time allotted. Here, the dealership was required to increase market share by 500% in one year. The court held that the corporation's notice was "defective in a practical way" because the steps the dealer was required to take to cure were "impossible to meet and thus were unreasonable as a matter of law."[128]

6. <u>Breach of Contract and/or Breach of the Covenant of Good Faith and Fair Dealing</u>

A franchisee may attempt to assert a claim for breach of the parties' franchise agreement, including breach of good faith obligations implied therein. In evaluating these types of claims, courts look to the justifiable expectations of the parties. If one party acts arbitrarily, capriciously, or unreasonably, the expectations of the other party will be exceeded. [129]

Claimed breaches of the parties' franchise agreement are governed by and interpreted under state contract laws and principles. Typically, this means that a reviewing court will look at the language of the agreement and, absent ambiguities, will enforce its terms as written without reviewing outside evidence. In many jurisdictions, breaches of the covenant of "good faith" or "good faith and fair dealing" cannot, alone, form the basis of a legal claim against a franchisor.[130] Such claims must often be incorporated into breach of contract claims and be based on express language contained within a franchise agreement.[131] Further, "good faith" claims cannot generally override express terms within, or rights under, a contract.[132]

7. <u>Breach of Fiduciary Duty</u>

Franchisees may also attempt to assert breach of fiduciary duty claims against the franchisor. Generally, a franchisor and franchisee do not have a fiduciary or other special relationship that could form the basis of a breach of fiduciary duty claim.[133] However, courts have found the opposite on rare occasions.[134] In a recent case, *Desert Buy Palm Springs, Inc. v.*

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[127] *Al Bishop Agency, Inc. v. Lithonia Div. of Nat'l Serv. Indus. Inc.*, 474 F. Supp. 828, 834 (E.D. Wis. 1979).

[128] *Wadena Implement Co. v. Deere & Co.*, 480 N.W.2d 383 (1992).

[129] *First Texas Sav. Assoc. v. Comprop Inv.t Props, Ltd.,* 752 F. Supp. 1568, 1574 (M.D. Fla. 1990).

[130] *See, e.g., Am. Casual Dining, L.P. v. Moe's Southwest Grill, LLC,* 42 F. Supp. 2d 1356 (N.D. Ga. 2006).

[131] *Id.*

[132] *See, e.g., Wendy's Int'l, Inc. v. Saverin*, No. 08-4245, 2009 U.S. App. LEXIS 15354 (6th Cir. 2009); *Dollar Rent a Car Sys., Inc. v. P.R.P. Enterprises, Inc.,* No. 01-cv-698-JHP-FHM, 2006 U.S. Dist. LEXIS 29857 (N.D. Okla. May 8, 2006).

[133] *See, e.g., Fitzpatrick v. Teleflex, Inc.,* 763 F. Supp. 2d 224 (D. Me. 2011) (finding no fiduciary relationship between manufacturer and distributor/franchisee under Maine law).

[134] *See, e.g., Arnott v. American Oil,* 609 F.2d 873 (8th Cir. 1979) (fiduciary relationship found to exist between franchisor/oil company and franchisee/dealer under South Dakota law); *Holiday Inn Franchising, Inc. v. Hotel Assocs., Inc.,* No. CA10-21, 2011 Ark. App. 147 (Ark. Ct. App. Feb. 23, 2011).

DirectBuy, Inc.,[135] an Indiana federal court noted that a fiduciary relationship requires the existence of a relationship of trust and confidence between the parties. However, the court found that allegations of the franchisee that the franchisor and its parent regarding the use of escrow funds stated a claim for breach of trust because the claim plausibly suggested the existence of a fiduciary relationship and breach of trust. In combating a fiduciary duty claim, a franchisor may point to independent contractor language in the parties' franchise agreement and argue that no "special relationship" exists between the parties.[136] Furthermore, a good faith requirement does not give rise to a fiduciary duty.

8. <u>Termination is Pre-Textual</u>

A franchisee may also try to argue that the franchisor has an ulterior motive for terminating its franchise. As long as there are adequate grounds to support termination under the terms of the parties' franchise agreement, the weight of authority suggests that courts will not ordinarily consider the franchisor's motive for terminating.[137] However, the assertion of a pretextual reason for termination has been found improper under some circumstances.[138]

V. ALTERNATIVES TO TERMINATION[139]

A. <u>Resolve Dispute Informally or Through Mediation</u>

Litigation is expensive and disruptive. It can also be slow and unpredictable.

Thus, the franchisor and franchisee should first consider negotiating, or – if a neutral third party would be helpful – mediating, to attempt to achieve a workout, a mutually agreed upon termination, a buyout, a consent to transfer to another franchisee, or other options.

Although most franchise agreements contain non-waiver provisions, the franchisor should nonetheless clearly document in writing, by letter or by written agreement of the parties, that any forbearance during the negotiation or mediation period does not constitute a waiver of franchisors' right to strictly enforce the franchise agreement in the future.

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[135] 2:11-CV-132 RLM, 2012 WL 2130558 (N.D. Ind. June 12, 2012).

[136] *See, e.g., Burger King v. Austin,* 805 F. Supp. 1007, 1020 (S.D. Fla. 1992) (no fiduciary relationship found).

[137] *See, e.g., Kerns, Inc. v. Wella Corp.,* 114 F.3d 566 (6th Cir. 1997).

[138] *See, e.g., Bronx Auto Mall, Inc. v. American Honda Motor Co., Inc.,* 113 F.3d 329 (2d Cir. 1997) (affirming judgment enjoining franchisor from terminating franchise agreement on pretextual grounds and noting that stating a false reason for termination of a dealership franchise violates New York's Franchised Dealer Act.)*; see also Tuf Racing Products, Inc. v. American Suzuki Motor Corp.,* 223 F.3d 585 (7th Cir. 2000) (affirming verdict in favor of franchisee where franchisor's reasons for terminating franchisee were entirely pretextual).

[139] For a full discussion of alternatives to termination, see (A) Les Wharton and Sharon Lewonski, *Working with Financially Distressed Franchisees*, FRANCHISE L.J. (Fall 2011) and (B) Van Elmore and Daniel Eliades, *The Financially Distressed Franchisee: Advanced Strategies for Franchisors and Franchisees*, ABA FORUM ON FRANCHISING (2007). This paper draws heavily on both.

B. Seek Redress Without Terminating

A franchisor is not obligated to terminate a franchise because of a default. In some circumstances, a franchisor may decide to respond to a default by taking remedial action short of termination. For example, if a franchisee is delinquent on royalties, a franchisor could file suit for the delinquency, without terminating, to try and get the franchisee's attention. Similarly, if a franchisee has failed to maintain adequate insurance, the franchisor may pay for the insurance and seek reimbursement from the franchisee without terminating the agreement.

C. Extended Cure Period

If the franchisee needs more time to cure financial or operational defaults than the franchise agreement provides, the parties can agree to an extended cure period. The franchisor should clearly document in writing that the extended cure period does not waive the franchisor's right to strictly enforce the franchise agreement.

An extended cure period can give the franchisee an opportunity to fix underlying problems. For example, during an extended cure period, the franchisee could receive turnaround consulting on cost-control, marketing, or other operations issues. The franchisor's operations team or a third party could provide this consulting, which should be paid for by the franchisee.

D. Mutually Agreed Upon Termination

When possible, a mutually agreed upon termination may avoid the risk of litigation and may avoid the automatic stay under bankruptcy laws. As part of a mutually agreed upon termination, the franchisor may be able to retain the location of the outlet, and the franchisee may be able to receive some concessions, like waiver of a post-termination non-competition provision or a longer period of operation before termination. The franchisor and franchisee can agree upon issues of mutual release, de-identification, the transfer of telephone numbers and trademarked inventory, and advertising.

E. Workout Agreements / Payment Plans

Workout agreements can be a win/win for franchisees and franchisors seeking to resolve franchisee defaults. The franchisor benefits by receiving additional protections, such as new security and a streamlined termination process, if the franchisee financially deteriorates. The franchisee benefits from a restructuring opportunity without the consequences or expenses associated with a bankruptcy filing.

With a workout agreement, the franchisor can provide the franchisee with an extended payment plan, or a temporary reduction or forgiveness of royalties or other fees. A permanent change in the royalty rate is typically only appropriate where there has been a fundamental change in the economics of the franchise, such as a permanent change in the profit margins of a business.

1. Typical Provisions in Workout Agreements

Workout agreements should always be in writing. They frequently include the following provisions:

- Franchisee's/guarantors' reaffirmation of pre-existing agreements and acknowledgment of obligations under pre-existing agreements. This typically includes a statement that except as specifically set forth in the workout agreement, the franchise agreements, guarantees, and any related agreements are not modified, are affirmed in their entirety, and are legally binding and enforceable. The reaffirmation should also include a clear statement of those financial obligations that are and are not being compromised, including whether the franchisee must pay all other sums that are or become due. There is usually an acknowledgment that payment of the existing indebtedness covered by the workout agreement does not relieve the franchisee of its obligations to pay going forward obligations to the franchisor or to otherwise perform under the franchise agreement.

- Franchisee's/guarantors' acknowledgment of all monetary and non-monetary defaults, of the validity of outstanding royalties or other indebtedness, of the lack of defenses or setoff to the existing defaults, and of the lack of any claims by the franchisee or guarantor against the franchisor.

- Franchisee's/guarantors' acknowledgment of franchisor's remedies. This typically includes all the factual predicates required for the remedies, an acknowledgment that the franchisor is entitled to the remedies, and a list of the remedies the franchisor is entitled to exercise.

- Agreed repayment terms. This normally includes the amount of debt as of a certain date, the rate of interest, the time/place/manner of payment, any prepayment provisions, a late fee provision, and any other payment terms. The repayment plan may or may not be contingent on performance benchmarks. A formal promissory note is often attached and included by reference.

- Agreed terms of franchisee's cure of any non-monetary defaults.

- Franchisor's agreement to forbear from exercise of franchisor remedies. Through workout agreements, franchisors are often paid on account of "antecedent debts" and/or obtain a security interest in collateral which was not provided under the initial franchise agreement. To reduce the risk that these transfers are attacked as preferential payments or fraudulent conveyances, the agreement should detail the consideration which the franchisor is providing to the franchisee as part of the forbearance/workout agreement: the franchisor's agreement to forbear from terminating the franchise agreement or enforcing other remedies available to it as a result of the franchisee's acknowledged uncured defaults.[140]

- Security for performance and repayment. Some common forms of security include (a) security interests/liens in collateral, including accounts receivables, deposit accounts, furniture, fixtures, equipment, and other property of the franchisee, its

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[140] *See* Van Elmore and Daniel Eliades, *The Financially Distressed Franchisee: Advanced Strategies for Franchisors and Franchisees*, ABA FORUM ON FRANCHISING (2007), citing *Anand v. Nat'l Republic Bank of Chicago*, 239 B.R. 511, 517-518 (N.D. Ill. 1999) (holding that debtor received reasonably equivalent value when bank agreed to forbear on pursuing remedies for default, waived past-due principal payment, and extended maturity date of notes in return for debtor's assignment of interest in real property as collateral to secure loans); *In re Ward*, 36 B.R. 794, 799 (D.S.D. 1984) (creditors' voluntary forbearance from pursuing remedies was reasonably equivalent value in exchange for debtor's mortgage to secure antecedent debt).

principals, or its guarantors, (b) executed confessions of judgment of the franchisee, its principals, or its guarantors to be held in escrow and only filed upon default, (c) guarantees from additional guarantors, and (d) mortgage liens on real property owned by the franchisee, its principals, or its guarantors. The workout agreement may secure payment and performance of the obligations under the workout agreement, the franchise agreement, and other agreements between the franchisor and the franchisee, its principals, and/or guarantors. When a franchisee is financially distressed, its assets are often already pledged or encumbered, making a subordinate security interest of no or limited value – if so, the franchisor can consider approaching the lender with a senior security interest to assess interest in an intercreditor agreement.

- Franchisee's, its principals' and guarantors' release of all claims against the franchisor.

- Modifications of terms in the franchise agreement. The workout agreement can be an opportunity to restructure the terms of the franchise agreement, such as agreeing upon non-renewal at the conclusion of the term, shortening notice and cure periods, withdrawing incentives and discounts, removing opportunities for additional units, and eliminating exclusive territories.

- Waiver of the automatic stay if the franchisee subsequently files bankruptcy. Such provisions can be difficult to enforce,[141] should be clear and conspicuous, and should specify the consideration being given by the franchisor in exchange for the stay waiver.

- Cross default provision addressing defaults of the franchise agreement, the forbearance agreement, and other agreements.

2. <u>Disclosure Considerations with Workout</u>

If the workout involves any financing arrangement, it may need to be disclosed in Item 10 of the FDD.[142] The franchisor must disclose "the term of each financing arrangement, including leases and installment contracts, that the franchisor, its agent, or affiliates offer directly or indirectly to the franchisee."[143] Indirect offers of financing include a written arrangement between a franchisor or its affiliate for a lender to offer financing to a franchisee, an arrangement in which a franchisor or its affiliate receives a benefit from a lender in exchange for financing a franchise purchase, and a franchisor's guarantee of a note, lease, or other obligation of the franchisee.[144]

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[141] *See* Les Wharton and Sharon Lewonski, *Working with Financially Distressed Franchisees*, FRANCHISE L.J. (Fall 2011), *citing In re Frye*, 320 B.R. 786 (Bankr. D. Vt. 2005) (surveying seven other cases to develop a list of ten factors to review in determining enforceability of pre-petition waiver); *In re Excelsior Henderson Motorcycle Mfg. Co., Inc*., 273 B.R. 920, 924 (B.R. S.D. Fla 2002); *In re Cheecks,* 167 B.R. 817, 819 (Bankr. D.S.C. 1994); *In re McBride Estates, Ltd.,* 154 B.R. 339, 341 (Bankr. N.D. Fla. 1993*); In re Stanton,* 121 B.R. 438 (Bankr. S.D.N.Y. 1990); *In re Citadel Props., Inc.,* 86 B.R. 275 (Bankr. M.D. Fla. 1988); *In re Sompo Land Indust. (Haw.), Inc*., 41 B.R. 358 (Bankr. D. Haw. 1984).

[142] 16 CFR 436.5(j).

[143] *Id.*

[144] *Id.*

F. Non-renewal[145]

If the franchise agreement and state law do not provide a franchisee with any renewal rights, a franchisor's simplest approach with a defaulting franchisee near the end of its term may be to let the franchisee's term expire and then not renew - the franchisor has greater flexibility in deciding whether a particular franchisee should be granted another franchise term than it does in deciding whether to end a franchise relationship before the contractual term expires. Of course, the franchisor should comply with all applicable state franchise relationship laws regarding the form and timing of notice of nonrenewal.[146]

If the franchise agreement grants a right to renew, either generally or under certain circumstances, the franchisor will have to honor that right unless the franchisee has materially defaulted or failed to meet the required conditions for renewal. If the agreement provides that the franchisor can decide whether to renew, in its sole and absolute discretion, with or without cause, the franchisor should be able to decide not to renew for any rational business reason exercised in good faith.[147]

The franchisor must comply with any restrictions state relationship laws impose on non-renewal, such as good cause restrictions, requirements that the franchisor repurchase the franchise or its assets, prohibitions on enforcement of non-competition provisions, or provisions designed to enable a franchisee to recoup, at least in part, under some circumstances, its investment in the franchised business if the franchisor elects not to renew the franchise. Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Louisiana, Michigan, Minnesota, Nebraska, New Jersey, Rhode Island, Virginia, Washington, and Wisconsin have such laws. One state, New Jersey, prohibits the franchisor from failing to renew a franchisee unless the franchisee has failed to substantially comply with those requirements imposed upon the franchisee by the franchise agreement.[148] Although state relationship laws often address both termination and nonrenewal, these provisions are not always parallel.

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[145] For a full discussion of special issues pertaining to nonrenewal of franchise agreements, see (A) James Goniea and Jeffrey Haff, *Termination, Nonrenewal and Transfer,* FRANCHISE LAW COMPLIANCE MANUAL 351 (Jeffrey Brimer ed., ABA 2d ed. 2011) and (B) Rossell Barrios and William Killion, *State Franchise Relationship Laws on Termination: Issues In Litigation*, ABA FORUM ON FRANCHISING (2001). This paper draws heavily on both.

[146] States containing minimum notice requirements for non-renewal include Arkansas (90 days), California (180 days), Connecticut (60 days), Delaware (90 days), Illinois (6 months), Indiana (90 days), Iowa (6 months), Minnesota (180 days), Mississippi (90 days), Missouri (90 days), Nebraska (90 days), New Jersey (60 days), Rhode Island (60 days), Washington (1 year), and Wisconsin (90 days).)

[147] *See, e.g, Gen. Aviation, Inc. v. Cessna Aircraft Co.*, 915 F.2d 1038 (6th Cir. 1990) (rejecting challenge to nonrenewal where distributorship agreement expressly allowed for nonrenewal without cause); *accord Hubbard Chevrolet Co. v. Gen. Motors Corp.,* 873 F.2d 873 (5th Cir. 1989) (reversing jury award to dealer; holding that, where contract provided that franchisor had unrestricted authority to approve or disapprove franchise relocation, court could not reevaluate the wisdom of the parties' decision to leave relocation decisions to the franchisor); *Carvel Corp. v. Baker*, 79 F. Supp. 2d 53 (D.Conn. July 22, 1997) (despite language in agreement that franchisor had sole discretion to sell through other distribution channels, franchisor had to exercise this discretion reasonably and in good faith); *In re Vylene Enters., Inc*., 90 F.3d 1472 (9th Cir. 1996) (implied covenant of good faith and fair dealing prevents party from exercising its discretion in bad faith, arbitrarily, or from improper purpose so as to defeat the other party's reasonable expectations under the contract); *Dayan v. McDonald's Corp*., 466 N.E.2d 958 (Ill. App. Ct. 1984) (implied covenant requires that franchisor's exercise of discretion be reasonable under the circumstances).

[148] N.J. Stat. Ann. § 56:10-5.

Industry-specific statutes can also impose restrictions on non-renewal. Non-renewals must be disclosed in Item 20 of the FDD.[149]

G. Sale of Franchise

To ensure that the franchise outlet stays in the network and to facilitate an orderly transition, the franchisor can assist the franchisee in finding a buyer (another existing franchisee or a third party) through marketing support, adding the franchise outlet to the franchisor's list of available outlets, communicating with neighboring franchisees, and introductions to brokers. Alternatively, the franchisor can approve an appropriate buyer that the franchisee has indentified without the assistance of the franchisor. Alternatively, the franchisor can buy back the franchise outlet itself and then sell it to a third party.

If the franchisor assists with the sale from the franchisee to a third party, the franchisor should confirm in writing what it is and is not doing for the franchisee - the franchisor should state in writing that although the franchisor will attempt to assist with the sale, the responsibility for the sale lies with the franchisee, not the franchisor.

Sales should be disclosed in the tables in Item 20 of the FDD.[150] In addition, at least for sales where the franchisor has bought back the franchise outlet and is reselling it, the franchisor should follow the Instructions for Item 20: "if a franchisor is selling a previously-owned franchised unit now under its control, disclose the following additional information for the outlet for the last five fiscal years. This information may be attached as an addendum to a disclosure document, or, if disclosure has already been made, then in a supplement to the previously furnished disclosure document: (i) the name, city and state, current business telephone number, or if unknown, last known home telephone number of each previous owner of the outlet; (ii) the time period when each previous owner controlled the outlet; (iii) the reason for each previous change in ownership (for example, termination, non-renewal, voluntary transfer, ceased operations); and (iv) the time period(s) when the franchisor retained control of the outlet (for example, after termination, non-renewal, or reacquisition)."[151]

H. Buy-back by Franchisor

If the franchisor wishes to keep the franchise outlet in the network and to avoid litigation over termination, one option is for the franchisor to purchase the franchise outlet, either as part of a franchise termination or as an alternative to termination. The franchisor will typically want to keep the outlet open continuously, which means that the franchisor must be in a position to conduct the outlet's ongoing operations and meet its ongoing financial obligations. Where the landlord is not the franchisor, the landlord often must consent to a transfer of the lease.

Before buying the outlet, the franchisor should address whether the assets are free and clear of all liens and encumbrances. The franchisor should run a lien check before trying to take the furniture, fixtures and equipment (FF&E), even if it has a claim to the FF&E under the franchise agreement or through a security agreement. The existence of any lien that is senior to

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[149] 16 C.F.R. § 436.5(t).

[150] 16 C.F.R. § 436.5(t).

[151] 16 C.F.R. § 436.5(t).

liens filed by the franchisor must be resolved before the franchisor can take possession of the FF&E.

Successor liability is a consideration when structuring franchise buybacks. Successor liability varies by state. For example, in Illinois, a successor company that purchases the assets of another company is not automatically responsible for the debts and liabilities of the predecessor company, but can be responsible, under certain circumstances, where (i) there is an express or implied agreement of assumption of liabilities, (ii) the transaction is a consolidation, merger or de facto merger of the seller and purchaser, (iii) the purchaser is merely a continuation of the seller, or (iv) the transaction is engaged in for the fraudulent purpose of escaping liability for the seller's obligations**.**[152] In addition to facing claims from other creditors, if the franchisor acquires the franchisee's assets, the franchisor may be liable to pay the franchisee's unpaid taxes pursuant to 26 U.S.C. § 6901 if the transfer of assets renders the franchisee insolvent or if the transfer is deemed to be fraudulent to avoid taxes.[153] If the franchisor assumes the franchisee's lease, the franchisor may become liable for the environmental clean-up costs for any contamination at the location.[154] The franchise buyback should be properly structured to minimize the risk of successor liability, and buybacks by franchisors must be disclosed in Item 20 of the FDD.[155]

I. <u>Franchisor Taking Over Operations</u>

If the franchisor wishes to keep a franchise outlet open, but does not want to purchase the outlet and cannot find another appropriate franchisee to acquire the outlet, the franchisor can take over part or all of the operations of the outlet for a short or long term. This is typically accomplished pursuant to a management agreement between the franchisee and the franchisor. The end objective can be the sale of the franchise or the turnaround of the business.

The management agreement should specify the management team, which could be the franchisor's operations personnel, a third party, or individuals from another franchisee. The management agreement should also address how the franchisee will pay the cost of the management - for example, the franchisor could be paid by retaining the profit generated by the outlet or by receiving the proceeds from a future sale of the outlet. The management agreement should also specify what happens if goals are not achieved within certain periods of time - for example, does the location revert to the franchisee, close (with or without the franchisee's consent), or does something else happen. The management agreement should also address the franchisee's obligation to provide insurance coverage and indemnification, but the franchisor should also consider acquiring appropriate insurance.

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[152] *Green v. Firestone Tire and Rubber Co., Inc.,* 460 N.E.2d 895, 899 (Ill. App. Ct. 1984); *Hernandez v. Johnson Press Corp*., 388 N.E.2d 778, 780 (Ill. App. Ct. 1979); *Park v. Towson & Alexander, Inc.*, 679 N.E.2d 107, 109 (Ill. App. Ct. 1997).

[153] *See First Nat'l Bank of Chicago v. Comm'r of Internal Revenue*, 255 F.2d 759, 762-63 (7th Cir. 1958), *Hatch v. Morosco Holding Co*., 50 F.2d 138, 139 (2d Cir. 1931).

[154] See Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), 52 U.S.C. § 9601 *et seq.*

[155] 16 C.F.R. § 436.5(t).

J. Declaratory Judgment

To avoid liability for wrongful termination, a franchisor can seek a declaratory judgment that rules the franchisor is entitled to terminate the franchise.

K. Permit Franchisee to Exit System and Compete

To avoid a fight over termination, the franchisor can agree to permit a franchisee to exit the system and compete with the franchisor and other franchisees.

L. Considerations With Alternatives to Termination

In assessing alternatives to termination, the franchisor should consider the risks of waiver, the applicability of anti-discrimination statutes, the need for compliance with disclosure requirements, and the reactions of other franchisees in the system, as well as other factors.

1. Risk of Waiver

If the termination alternative involves forbearance of termination, forgiveness of royalties or other money, or the failure to enforce any clause of the franchise agreement, the franchisee may claim that the franchisor has waived its right to collect the past due amount and to later enforce contractual rights. Though not a bulletproof solution, any workout agreement, management agreement, or other agreement providing the basis for the alternative to termination should guard against waiver by including an anti-waiver clause that acknowledges that any forbearance by the franchisor does not constitute a waiver of future enforcement rights.

2. Risk of Anti-Discrimination Claims

By offering a struggling franchisee an extended payment plan, royalty abatement, consulting services, or other concessions or assistance, a franchisor risks other franchisees asserting that they are entitled to the same concessions or assistance under the anti-discrimination principles discussed above in Section IV.B.3. As explained above, one key defense to anti-discrimination/selective enforcement claims is demonstrating that the franchisees who are being treated differently are not similarly situated.

3. Risk of Vicarious Liability

During a workout, the franchisor can become more involved in the day-to-day operations of the franchise outlet, in some cases increasing its “control” over the franchise outlet and hence its exposure to vicarious liability claims.[156] This is particularly a concern in the employment law arena - if the franchisor becomes involved in hiring and firing decisions and/or employee supervision, the risk of vicarious liability claims increases. To mitigate this risk, the franchisor should ensure it has appropriate insurance coverage during a workout.

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[156] The level of “control” is one of the key elements in evaluating the legitimacy of vicarious liability claims. *See, e.g., Viches v. MLT, Inc.,* 127 F. Supp. 2d 828 (E.D. Mich. 2000) (whether a principal-agent relationship exists will be determined by whether the franchisor controlled the day-to-day operations of the franchisee). In addition, some courts have looked at whether the franchise is obligated to pay the franchisee’s debts as a factor for vicarious liability. *See, e.g., Schlotzky’s, Inc. v. Hyde*, 538 S.E. 2d 561 (Ga. App. 2000) (the “law… is well settled… in order to impose liability on the franchisor for the obligations of the franchisee, it must be shown that: (1) the franchisor, has, by some act or conduct, obligated itself to pay the debts of the franchisee…”

VIII. CONCLUSION

Although each termination decision is unique, terminations often raise similar issues and share common threads. Careful analysis of the risks and an objective review of the facts, the documents, key personnel, and the law are critical. Since there are so many potential landmines in the termination process, franchisors should lay out a roadmap for the process and obtain competent legal advice along the way.

Appendix A

NOTICE OF TERMINATION FOR FINANCIAL DEFAULT

DATE

CERTIFIED MAIL XXX

Return Receipt Requested and U.S. Mail

Franchisee	Guarantors
XXX	XXX
XXX	XXX

Re: FRANCHISE AGREEMENT: XXX
FRANCHISEE: XXX
FRANCHISED RESTAURANT: *Unit No. XXX*LOCATION: XXX
CONTRACT NO: XXX

NOTICE OF TERMINATION FOR FINANCIAL DEFAULT

Dear Franchisee and Guarantors:

On XXX, Franchisee, entered into a Franchise Agreement for Unit No. XXX (hereinafter referred to as the "**Franchise Agreement**") with Franchisor. Further, on or about XXX Franchisee's principals, individually, executed a Guaranty and Subordination Agreement agreeing to be bound jointly and severally with Franchisee for any indebtedness and obligations to Franchisor arising under the Franchise Agreement.

Notice is hereby given that Franchisee is in DEFAULT under the terms and conditions of Paragraph XXX. ("**Fees**") of the above-referenced Franchise Agreement for failure to pay Royalty Fees, Advertising Fund Fees, Finance Charges and other financial obligations to the Franchisor, in the amounts set forth on EXHIBIT "A" which is attached hereto and incorporated herein by reference (hereinafter referred to as the "**Financial Default**").

Please be advised that this letter constitutes a formal "NOTICE OF TERMINATION" pursuant to Paragraph XXX of the Franchise Agreement. In the event the foregoing Financial Default is not cured within ten (10) days of Franchisee's receipt of this Notice, the Franchise Agreement shall terminate without further notice, effective immediately upon the expiration of such ten (10) day period, or such longer period as applicable law may require.

Please be further advised that upon termination of the Franchise Agreement, Franchisee will be expected to comply with the provisions of Paragraph XXX of the Franchise Agreement, which sets forth the Franchisee's obligations upon termination. Franchisee's post-termination obligations include the following:

1. Franchisee must immediately cease and forever discontinue any and all operations at that location under the name of Franchisor or any name confusingly similar thereto;
2. Franchisee must immediately and forever cease to use any proprietary materials, information, equipment, procedures and techniques associated with the Franchisor's System, including any and all trademarks and service marks associated with this Company;
3. Franchisee must immediately de-image the restaurant premises to completely disassociate those premises from the Franchisor's System, including, without limitation, the removal of all signs bearing the Franchisor's name;
4. Franchisee must immediately surrender the Confidential Operations Manual, and all copies thereof, together with all records, files, instructions, correspondence and any and all other materials relating to the operation of the Franchised Restaurant; and
5. Franchisee must immediately pay any and all sums which are owed to this Company as a result of the operation of the Franchised Restaurant.

Franchisor waives no other defaults under the above-referenced Franchise Agreement and reserves all rights and remedies it may have under the Franchise Agreement or otherwise. Please feel free to contact me in the event you have any questions regarding this matter.

Sincerely,

FRANCHISOR

By: ________________________________

<u>**Appendix B**</u>

NOTICE OF TERMINATION FOR OPERATIONAL DEFAULT

DATE

CERTIFIED MAIL XXX

Return Receipt Requested and

U.S. Mail

Franchisee

XXX XXX

RE: **FRANCHISE AGREEMENT DATED:** XXX
FRANCHISEE: XXX
FRANCHISED RESTAURANT:
Unit XXX located at XXX
CONTRACT NO.: XXX

NOTICE OF TERMINATION FOR OPERATIONAL DEFAULT

Dear Franchisee:

On **___**, Franchisee entered into a certain Franchise Agreement for Unit No. XXX (hereinafter referred to as the "Franchise Agreement") with Franchisor.

On **___**, Franchisor conducted operational assessments of Unit No. XXX (copies of the assessment forms are attached hereto as **EXHIBIT "A"**). Notice is hereby given that Franchisee is currently in DEFAULT under the terms and conditions of Paragraph XXX. ("Duties Of The Franchisee") of the above-referenced Franchise Agreement for failure to operate the Franchised Unit and/or maintain the premises of the Franchised Unit in conformity with Franchisor's standards and specifications for the operation of a restaurant (hereinafter referred to as the "Operational Default"). The foregoing Operational Default includes, but is not limited to, Franchisee's failure to maintain the premises, equipment, etc., in conformity with Franchisor's high standards and public image and failure to make repairs and replacement thereto.

Please be advised that this Notice constitutes a formal "NOTICE OF TERMINATION" pursuant to Paragraph XXX. ("Termination") of the Franchise Agreement. In the event the foregoing Operational Default is not cured within thirty (30) days of Franchisee's receipt of this Notice, or such longer period as applicable law may require, the Franchise Agreement shall terminate upon the expiration of the thirty (30) day period or such long period as applicable law may require.

Please be further advised that upon termination of the above-referenced Franchise Agreement, Franchisee will be expected to comply with the provisions of Paragraph XXX of the Franchise Agreement which set forth the Franchisee's obligations upon termination. Franchisee's post-termination obligations include the following:

1. Franchisee must immediately cease and forever discontinue any and all operations at that location shown on EXHIBIT "A" operating under the name of Franchisor or any name confusingly similar thereto;
2. Franchisee must immediately and forever cease to use any proprietary materials, information, equipment, procedures and techniques associated with the Franchisor's System, including any and all trademarks and service marks associated with this Company;
3. Franchisee must immediately de-image the restaurant premises to completely disassociate those premises from the Franchisor's System, including, without limitation, the removal of all signs bearing the Franchisor's name and logo;
4. Franchisee must immediately surrender the Confidential Operations Manual, and all copies thereof, together with all records, files, instructions, correspondence and any and all other materials relating to the operation of the Franchised Restaurant; and
5. Franchisee must immediately pay any and all sums which are owed to this Company as a result of the operation of the Franchised Restaurant.

Franchisor waives no other defaults under the above-referenced Franchise Agreement and reserves all rights and remedies it may have under the Franchise Agreement or otherwise.

Please feel free to contact me in the event you have any further questions regarding this matter.

Sincerely,

FRANCHISOR

By: ______________________________________

Appendix C

NOTICE OF TERMINATION

DATE

CERTIFIED/REGISTERED MAIL

RETURN RECEIPT REQUESTED

and U.S. Mail

Franchisee

XXX XXX

Re: **FRANCHISE AGREEMENT DATED:** XXX
FRANCHISEE: XXX
FRANCHISED RESTAURANT:
Unit No. XXX
CONTRACT NO. XXX

NOTICE OF TERMINATION

Gentlemen:

On XXX, Franchisor, entered into a certain Franchise Agreement for Unit No. XXX at the above-referenced location (hereinafter referred to as the “Franchise Agreement for Unit No. XXX”) with XXX Franchisee. Further, on or about XXX, by Guaranty and Subordination Agreement, Franchisee’s principals, individually, agreed to be bound jointly and severally with Franchisee for any such indebtedness and obligations to Franchisor arising under the Franchise Agreement.

It has come to Franchisor’s attention that the above-referenced Franchised Restaurant was permanently closed for business on XXX by Franchisee without the consent of Franchisor. Pursuant to Paragraph XXX (“Termination”) of the Franchise Agreement, Franchisor hereby elects to terminate the Franchise Agreement and all rights granted there under, effective immediately upon Franchisee’s receipt of this Notice of Termination.

POST- TERMINATION OBLIGATIONS OF FRANCHISEE

Accordingly, you must **IMMEDIATELY** comply with the post-termination provisions of Paragraph XXX of the Franchise Agreement, which include but are not limited to the following:

1. Franchisee must immediately cease and forever discontinue any and all operations at this location under the name of XXX or any name confusingly similar thereto; Franchisee must immediately and forever cease to use any proprietary materials, information,

equipment, procedures, and techniques associated with the XXX System, including any and all trademarks and service marks associated with this Company;

2. Franchisee must immediately de-image the restaurant premises to completely disassociate those premises from the XXX System, including, without limitation, the removal of all signs bearing the XXX name and logo;
3. Franchisee must immediately surrender the Confidential Operations Manual, and all copies thereof, together with all records, files, instructions, correspondence and any and all other materials relating to the operation of the Franchised Restaurant; and
4. Franchisee must immediately pay any and all sums which are owed to this Company as a result of the operation of the Franchised Restaurant. A Statement of Account for Franchised Restaurant No. XXX indicating a total amount due by Franchisee to Franchisor of $XXX, is attached hereto as EXHIBIT "A" and incorporated herein by reference.

Franchisor waives no other default under the above-referenced Franchise Agreement for and reserves all rights and remedies it may have under the Franchise Agreement or otherwise.

Please contact me to discuss the immediate de-identification of the premises formerly occupied by the Franchised Restaurant. In the event Franchisee fails to voluntarily comply with all post-termination obligations, the Franchisor will institute legal proceedings to enforce these obligations and seek all damages, costs and expenses, including reasonable attorney's fees incurred by Franchisor in seeking damages and/or in obtaining injunctive relief for the enforcement of the Post-Termination Obligations set forth in Paragraph XXX of the Franchise Agreement.

Please feel free to contact me in the event you have any further questions regarding this matter.

Sincerely,

FRANCHISOR

By: ______________________________________

Appendix D

TERMINATION AGREEMENT

TERMINATION AGREEMENT (the "Agreement") is made effective this _____ day of ____________, 20__, by and between __________________________________ a ___________________("FRANCHISEE"), ________________ (individually "Guarantor") and ________________________, a ________________________ ("FRANCHISOR") All capitalized terms not otherwise defined in this Agreement shall have the definition set forth in the Franchise Agreement defined below.

WHEREAS, FRANCHISEE entered into a Franchise Agreement, as amended, with FRANCHISOR on or about __________________, for the operation of a Franchise Store to be located in _______________________________, which is personally guaranteed by the Guarantor ("Franchise Agreement"); and

WHEREAS, FRANCHISEE and FRANCHISOR have agreed to terminate the Franchise Agreement and FRANCHISOR is willing to terminate the Franchise Agreement upon the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the terms and conditions hereinafter set forth herein, the Parties hereto agree as follows:

1. Termination of Franchise Agreement. FRANCHISEE and FRANCHISOR mutually agree to terminate the Franchise Agreement effective upon the execution of this Agreement. The Franchise Agreement and any other rights and obligations between FRANCHISOR and FRANCHISEE are hereby terminated, and FRANCHISOR and FRANCHISEE shall have no further obligations or duties to each other, however characterized or described, regarding this Franchise Agreement except as are set forth in this Agreement.

2. Post-Termination Obligations. FRANCHISEE and Guarantor acknowledge and agree that notwithstanding the terms of this Agreement, FRANCHISEE and Guarantor must:

A. Immediately pay the following FRANCHISOR the sum of $_________ for past due Royalties and $_________ for unpaid Advertising Assessments.

B. Comply with all of the post-term obligations contained in the Franchise Agreement and with requirements of the Franchise Agreement, which, by their nature, are intended to survive the termination or expiration of the Franchise Agreement, including, but not limited to: Non-Competition (Section ____), Trade Secrets (Section ____), Independent Contractor Status and Indemnification (Section _____) and Consequences of Termination (Section _____). FRANCHISEE will also cancel the fictitious name registration, return to FRANCHISOR the Confidential Operations Manual and any other materials which contain Confidential Information and Trade Secrets and de-identify the location within ten (10) days after execution of this Agreement.

3. **Representations and Warranties.** The Parties represent to each other, that, as of the date of this Agreement, this Agreement constitutes the legal, valid and binding obligation of each of them, enforceable against said party in accordance with its terms, and that said party has not transferred or assigned the Franchise Agreement, any of the rights licensed therein, or any claims, demands or causes of action which they have or may have against the other parties under said Franchise Agreement. Further, all parties represent and warrant to the other party that the party who so represents and warrants has full capacity and authority to enter into this Agreement. Each party agrees to defend, indemnify and hold the other parties harmless from any claims of any such transferee or assigns.

4. **Release.** As further consideration for the execution of this Agreement, as of the date of this Agreement:

A. **By FRANCHISEE Parties.** FRANCHISEE on behalf of itself, and its predecessors, successors, present and former officers, directors, affiliates, members, parent and subsidiary companies, shareholders, employees, agents, representatives and attorneys, (“FRANCHISEE Parties”), do hereby release, relieve, acquit and forever discharge FRANCHISOR, and any and all of FRANCHISOR's predecessors, successors, present and former officers, members, affiliates, parent and subsidiary companies, shareholders, members, employees, agents, representatives, and brokers (collectively the "FRANCHISOR Parties”) and FRANCHISOR's attorneys and franchisees, of and from all claims, demands, actions, liabilities and causes of action and damages of whatever kind or nature, known or unknown, vested or contingent, suspected or unsuspected, dependent in any way on any fact or event occurring on or prior to the date of this Agreement, that FRANCHISEE Parties has, or ever had against the FRANCHISOR Parties. Without limiting the foregoing, FRANCHISEE Parties specifically release and forever discharge the FRANCHISOR Parties of and from all monies which may be due to FRANCHISEE Parties and all other claims, demands, actions, liabilities and causes of action of whatever kind or nature, known or unknown, vested or contingent, suspected or unsuspected, arising at any time, which FRANCHISEE Parties have now, may have in the future, or ever had pertaining to, or arising from the Franchise Agreement, from the beginning of time until the date of this Agreement.

B. **By FRANCHISOR Parties**. FRANCHISOR on behalf of itself and the FRANCHISOR Parties do hereby release, relieve, acquit and forever discharge FRANCHISEE Parties of and from all claims, demands, actions, liabilities and causes of action and damages of whatever kind or nature, known or unknown, vested or contingent, suspected or unsuspected, dependent in any way on any fact or event occurring on or prior to the date of this Agreement, that FRANCHISOR Parties have, or ever had against the FRANCHISEE Parties. Without limiting the foregoing, FRANCHISOR Parties specifically release and forever discharge the FRANCHISEE Parties of and from all monies which may be due to FRANCHISOR Parties and all other claims, demands, actions, liabilities and causes of action of whatever kind or nature, known or unknown, vested or contingent, suspected or unsuspected, arising at any time, which FRANCHISOR Parties have now, may have in the future, or ever had pertaining to, or arising from the Franchise Agreement, from the beginning of time until the date of this Agreement, except with respect to any obligations set forth in this Agreement.

5. **Settlement and Confidentiality**. This Agreement shall be regarded as part of settlement negotiations. Any communication relating to the subject matter of this Agreement, the disputes that resulted in the parties entering into this Agreement, and communications made during the resolution process shall be a confidential communication. No admission, representation, statement or other confidential communication made herein or in connection with this Agreement shall be admissible as evidence or subject to discovery. Nothing herein shall be deemed an admission by any of the parties. Except as required by judicial process, arbitration, administrative process, applicable law, and/or to enforce their respective rights, FRANCHISOR on the one hand, and FRANCHISEE and GUARANTOR, jointly and severally, on the other hand, agree that they shall maintain strict confidentiality with respect to all aspects of this Agreement and the conditions and circumstances underlying its creation and execution. Prior to making any permitted disclosure, the person or entity to whom a request is directed will give FRANCHISOR written notice of the circumstances and the proposed disclosures at least ten (10) days before any information or opinions are to be furnished to others, or so long in advance as possible if the situation does not permit such full period of notice. If FRANCHISE or GUARANTOR is asked any question regarding, and/or invited to discuss, any aspect of their experiences and dealings with the other parties, said party shall respond only as follows: “We have agreed to a voluntary termination of the Franchise Agreement on amicable terms which are subject to a confidentiality agreement.” Notwithstanding the foregoing, FRANCHISOR may, in its sole discretion, make any disclosures regarding this matter that it deems appropriate, including, but not limited to, disclosures in any franchise disclosure documents or any filings or disclosures required by applicable law, FRANCHISEE and GUARANTOR may disclose otherwise confidential information to its accountants, attorneys and principals, but must first instruct all such accountants, attorneys and principals that the information is confidential and must not be disclosed to any third party

6. **Non-Disparagement**. FRANCHISOR on the one hand, and FRANCHISOR and GUARANTOR, on the other hand, jointly and severally, agree not to disparage or defame, in writing or orally, each other.

7. **Binding Effect.** This Agreement shall be binding upon and inure to the benefit of the successors, assigns, trustees, receivers, personal representatives, legatees and devisees of the parties hereto.

8. **Notice.** All notices, requests, consents, claims, demands, waivers and other communications hereunder shall be in writing and addressed to the parties at the addresses set forth in the Franchise Agreement (or to such other address that may be designated by the receiving party from time to time in accordance with this section). All Notices shall be delivered by personal delivery, nationally recognized overnight courier (with all fees pre-paid), facsimile or e-mail of a PDF document (with confirmation of transmission) or certified or registered mail (in each case, return receipt requested, postage prepaid).

9. **Entire Agreement.** The terms contained herein constitute the entire agreement between the Parties regarding this subject matter, and there are no representations, inducements, promises, or agreements, oral or otherwise, between the parties not embodied herein (other than those written disclosures required by law), and all pre-contractual representations, negotiations, and understandings are merged into this Agreement. No amendment to this Agreement is binding unless executed in writing by all of the Parties.

10. **Governing Law.** This Agreement shall be interpreted in accordance with the laws of the State of ______________.

11. **Severability.** Should any provision of this Agreement be construed or declared invalid, such decision shall not affect the validity of any remaining portion which shall remain in full force and effect as if this Agreement had been executed with such invalid portion eliminated. If any restriction contained in this Agreement is deemed too broad to be capable of enforcement, a court of competent jurisdiction is hereby authorized to modify or limit such restriction to the extent necessary to permit its enforcement.

12. **Attorney's Fees.** The prevailing party in any suit brought to enforce the terms of this Agreement to recover damages as a result of a breach of this Agreement shall be entitled, in addition to such other remedies as may be available at law or in equity, to recover its reasonable attorneys' fees and costs incurred in bringing and prosecuting such action.

13. **Counterparts.** This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together shall be deemed to be one and the same agreement. A signed copy of this Agreement delivered by facsimile, e-mail or other means of electronic transmission shall be deemed to have the same legal effect as delivery of an original signed copy of this Agreement.

14. **Joint and Several Liability.** The liability of FRANCHISEE and Guarantor for any breach of this Agreement shall be joint and several.

IN WITNESS WHEREOF, the Parties have caused this Agreement to be made effective on the day and year first above written.

FRANCHISOR:	FRANCHISEE:
______________________________	______________________________
By:____________________________	By:____________________________
__________________, ________	____________________, _____
	Guarantor:
	______________________________
	______________________________

Appendix E

FORBEARANCE AGREEMENT

This Agreement ("Agreement") is entered into this _____ day of _____________, 20___, in _________________ by ______________________ ("Franchisor"); ________________________ (referred to as "Franchisee"); and _______________ ("Guarantor").

WHEREAS, Franchisee currently operates a _________________ franchise ("Business") located in ______________________ pursuant to a Franchise Agreement with Franchisor dated ____________ ("Franchise Agreement"), and Guarantor has executed a Guaranty in connection therewith; and

WHEREAS, the Business operates pursuant to the terms of a lease dated __________, with ______________, as landlord ("Lease'"); and

WHEREAS, on _______________ a notice (the "Notice") was sent to Franchisee giving Franchisee thirty (30) days to cure certain defaults under the Franchise Agreement and advising Franchisee that absent a cure, the Franchise Agreement would terminate 60 days after the Notice.

WHEREAS, Franchisee failed to cure the defaults and pursuant to the Notice, the Franchise Agreement is due to terminate on _________; and

WHEREAS, in an effort to ensure an orderly winding down of the business for the benefit of all parties, to protect the Franchisor marks and goodwill, and to give Franchisee an opportunity to realize value for the Business, Franchisor and Franchisee have entered into this Agreement and have agreed that the date of termination will be extended in accordance with the terms set forth below;

NOW THEREFORE, in consideration of the mutual promises contained herein and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties, intending to be legally bound, agree as follows:

1. **Confirmation of Notice of Termination.** Franchisee acknowledges and confirms the effectiveness of the Notice and Franchisor's right to immediately terminate the Franchise Agreement and upon expiration of the applicable 60 day period, which expiration is acknowledged to be _________________, to terminate the Franchise Agreements. Franchisee hereby agrees to such termination subject to the provisions set forth herein.

2. **Forbearance From Termination.** Franchisor will forbear from exercising its rights to terminate the Franchise Agreement pursuant to Paragraph 1 and the termination as to the Business shall not be effective until the earlier to occur of:

(i) Franchisee ceasing business operations at the Business or the sale by Franchisee of all or substantially all of the assets associated with the operation of the Business;

(ii) a material breach by Franchisee under this Agreement, or the Franchise Agreement, subject to any notice and cure rights provided in Paragraph 7 hereof;

(iii) the failure of Franchisee to satisfy the Sale Requirements within the time periods set forth in Paragraph 4 below; or

(iv) ________________ (the "Outside Termination Date").

3. **Lease.** Notwithstanding any other provision of this Agreement Franchisor reserves all of its rights and remedies under the Lease associated with the Business subject to the requirement that Franchisor will consent to Franchisee's assignment of the Lease to a transferee approved in writing by Franchisor for the operation of the Business associated with such Leases and who closes on the transaction to own and operate the Business in accordance with this Agreement.

4. **Sale Requirements.** Franchisee agrees to use diligent, good faith efforts to find a bona fide buyer for the Business as soon as reasonably possible. Within 48 hours of a request by Franchisor, Franchisee shall in writing advise Franchisor of the status of such efforts as to the Business. Franchisor shall not be required to forbear from exercising any rights pursuant to paragraph 2 as to the Business if: (i) Franchisee does not obtain a fully executed and binding agreement for the purchase of the Business, and (ii) Franchisee does not close on the sale of any such Business by _____________________.

5. **Commitment of Franchisor.** Franchisor will promptly direct any interested buyers to Franchisee. Franchisor shall make reasonable efforts to promptly complete its consent process and agrees to review any proposal consistent with its policies and the Franchise Agreement except as otherwise provided herein. Franchisor agrees that the ___ day time period associated with its right of first refusal as set forth in the Franchise Agreement shall be limited to ten (10) business days and otherwise in accordance with the Franchise Agreements. With respect to any remodeling that Franchisor may require pursuant to its transfer policies, Franchisor agrees that if the amount of such remodeling for a certain Business exceeds $________________, Franchisor agrees to provide to an approved transferee a reasonable remodel time schedule as to that Business, with certain items required to be completed within ___ (__) days and quarterly requirements thereafter, not to exceed ______ (__) months to complete the required remodeling.

6. **De-identification Absent a Sale.** If Franchisee does not sell the Business to a qualified franchisee approved by Franchisor, Franchisee shall remove all Franchisor signs within 5 days of the applicable Termination Date and shall de-identify the Business and comply with the post termination provisions set forth in paragraphs ____, ____, and ____ of the

Franchise Agreement within thirty (30) days of the applicable Termination Date. Franchisee will also comply with the post-term covenants set forth in paragraphs ____ and ____ of the Franchise Agreement for the period of time set forth in the Franchise Agreement.

7. **Interim Operations.** Until the applicable Outside Termination Date and except as otherwise specifically provided herein, Franchisee shall operate the Business (except those that are voluntarily closed and de-identified by Franchisee with prior written notice to Franchisor) in compliance with the Franchise Agreement, Confidential Operations Manual, and the Lease, including without limitation, timely payment of ongoing royalties, lease obligations, and national advertising fees. Franchisor and Franchisee agree that (i) in the event of a material default under paragraph ____ of the Franchise Agreement (or any provisions under the Lease for which no cure period currently exists), no notice or opportunity to cure shall exist, (ii) in the event of a material default under this Agreement, paragraph ____ of the Franchise Agreement, or under the provisions of the Lease for which a cure period currently exists, Franchisor shall give to Franchisee a three (3) business day written notice and opportunity to cure, provided however, if such default is a non-monetary default of a type that cannot be cured in three (3) days, and Franchisee shall take all reasonable steps to commence a cure within such three (3) days and shall diligently proceed to complete such cure as soon as practicable thereafter, the opportunity to cure extending only so long as Franchisee is diligently pursuing such cure. All payments hereunder shall be made to Franchisor via wire transfer. It is understood that in the event a receiver is appointed over the Business Franchisor intends to terminate the Franchise Agreement.

8. **Sale of Tangible Assets.** During the period preceding the Outside Termination Date Franchisee may elect to sell tangible assets associated with the operation of the Business for a non-Franchisor use, subject to the Lease, the non-competition provision of the Franchise Agreement and Franchisor's right of first refusal contained in the Franchise Agreement. Franchisee further agrees that Franchisor reserves all of its rights under the Lease with respect to use restrictions and covenants. Nothing is this paragraph is intended to waive or otherwise limit the enforcement of the covenants contained in the Franchise Agreement or the Lease as to Franchisee and Guarantor except in the specific instance and as specifically provided herein.

9. **Breach.** If Franchisee breaches this Agreement, Franchisor shall have the write to terminate the Franchise Agreement immediately upon written notice and Franchisee shall comply with the terms of paragraph 6 of this Agreement.

10. **Payment.**

A. Franchisor and Franchisee acknowledge and agree that subject to the terms hereof a total of $_____________ is owed to Franchisor through _____________. Any balance of the sale proceeds from the sale of the Business available after satisfying amounts due to the following creditors shall be applied to the amount owed to Franchisor: _____________, _________________, and ______________.

B. Except as otherwise specifically provided herein obligations due under the Franchise Agreement shall hereafter be paid in accordance with the Franchise Agreements until the Termination Date. Payment of any kind under this Agreement or otherwise shall not constitute a cure and nothing herein shall create a right to cure by Franchisee or in any way prejudice Franchisor's right to terminate the Franchise Agreements on the Outside Termination Date. Franchisee shall continue to comply with and be obligated under all terms and conditions of the Lease and shall timely comply with all obligations thereunder.

11. Consent to Temporary Restraining Order. Franchisee consents to a temporary restraining order and permanent injunction against operating the Business after the applicable Termination Date. Franchisee further consents to a temporary restraining order and permanent injunction against any failure to remove the Franchisor signs or complete de-identification of the Business in accordance with this Agreement.

12. Franchisee Release. Franchisee and Guarantor, any and all of their subsidiaries, predecessors, successors, owners, members, shareholders, officers, directors, legal representatives, heirs, and agents (all such persons and entities hereinafter referred to individually and collectively as the "Franchisee Releasors") hereby release and discharge Franchisor, any and all of its subsidiaries, predecessors, successors, shareholders, officers, directors, legal representatives, agents, (all such persons and entities hereinafter referred to individually and collectively as the "Franchisor Releasees") from any and all claims, demands, causes of action, judgments, and executions that the Franchisee Releasors may now have or claim to have against the Franchisor Releasees, or any of them, whether known or unknown, excluding only the obligations under this Agreement.

13. Notice. All notices, requests, consents, claims, demands, waivers and other communications hereunder shall be in writing and addressed to the parties at the addresses set forth in the Franchise Agreement (or to such other address that may be designated by the receiving party from time to time in accordance with this section). All Notices shall be delivered by personal delivery, nationally recognized overnight courier (with all fees pre-paid), facsimile or e-mail of a PDF document (with confirmation of transmission) or certified or registered mail (in each case, return receipt requested, postage prepaid).

14. Waiver. No waiver by Franchisor of any of the provisions hereof shall be effective unless explicitly set forth in writing and signed by the Franchisor. No waiver by Franchisor shall operate or be construed as a waiver in respect of any failure, breach or default not expressly identified by such written waiver, whether of a similar or different character, and whether occurring before or after that waiver. No failure of Franchisor to exercise, or delay in exercising, any right, remedy, power or privilege arising from this Agreement shall operate or be construed as a waiver thereof; nor shall any single or partial exercise of any right, remedy, power or privilege hereunder preclude any other or further exercise thereof or the exercise of any other right, remedy, power or privilege.

15. Entire Agreement. This Agreement sets forth the entire understanding between the parties concerning the subject matter referenced herein and incorporates all prior discussions and understandings. There are no covenants, promises or agreements either oral or written related to the subject matter of this Agreement other than those set forth herein. No amendment or change to this Agreement shall be binding upon either party unless it is in writing and signed by the party being charged.

16. **Attorney's Fees.** The prevailing party in any suit brought to enforce the terms of this Agreement to recover damages as a result of a breach of this Agreement shall be entitled, in addition to such other remedies as may be available at law or in equity, to recover its reasonable attorneys' fees and costs incurred in bringing and prosecuting such action.

17. **Counterparts.** This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together shall be deemed to be one and the same agreement. A signed copy of this Agreement delivered by facsimile, e-mail or other means of electronic transmission shall be deemed to have the same legal effect as delivery of an original signed copy of this Agreement.

18. **Joint and Several Liability.** The liability of Franchisor and Guarantor for any breach of this Agreement shall be joint and several.

IN WITNESS WHEREOF, this Agreement is effective as of the date it is executed by all parties.

Franchisor:____________________________

By: __________________________________
Title: ________________________________

Franchisee:____________________________

By:___________________________________
Title: ________________________________

Guarantor:____________________________

____
Individually, as Guarantor

Appendix F

STATE RELATIONSHIP STATUTES ADDRESSING TERMINATION

STATE	COVERAGE
Alaska Citation: Alas. Stat., tit. 45, art. 9A, §§ 45.45.700-45.45.790	Notice: N/A Cure: N/A Good Cause: N/A Inventory Repurchase: Yes
Arkansas Citation: Ark. Stat. Ann., §§4-72-201 - 4-27-210	Notice: Yes Cure: Yes Good Cause: Yes Inventory Repurchase: Yes
California Citation: Cal. Bus. & Prof. Code, §§20000-20043	Notice: Yes Cure: Yes Good Cause: Yes Inventory Repurchase: Yes
Connecticut Citation: Conn. Gen. Stat., tit. 42, ch. 739, §§42-133e - 42-133h	Notice: Yes Cure: N/A Good Cause: Yes Inventory Repurchase: Yes
Delaware Citation: Del. Code Ann., tit. 6, §§2551-2556	Notice: Yes Cure: N/A Good Cause: Yes Inventory Repurchase: N/A
Hawaii Citation: Haw. Rev. Stat., tit. 26, §§482E-6	Notice: Reasonable Cure: N/A Good Cause: Yes Inventory Repurchase: Yes
Illinois Citation: 815 ILCS 705/19 - 705/20	Notice: Yes Cure: Yes Good Cause: Yes Inventory Repurchase: Yes

STATE	COVERAGE
Indiana Citation: Ind. Code, tit. 23, art. 2, ch. 2.7, §§1-7	Notice: Yes Cure: N/A Good Cause: Yes Inventory Repurchase: N/A
Iowa **(for contracts entered into prior to July 1, 2000)** Citation: Iowa Code, Tit. 13, sub-tit. 1, ch. 523H, §§.1-.17	Notice: Yes Cure: Yes Good Cause: Yes Inventory Repurchase: Yes
Iowa **(for contracts entered into on or after July 1, 2000)** Citation: Iowa Code, Tit. 13, sub-tit. 3, ch 537A.10	Notice: Yes Cure: Yes Good Cause: Yes Inventory Repurchase: N/A
Louisiana Citation: La. Rev. Stats., tit. 12, ch. 13, §1042, and La. Rev. Stats., tit. 23, ch. 9, §921	Notice: N/A Cure: N/A Good Cause: N/A Inventory Repurchase: N/A
Maryland Citation: Md. Com. Laws, tit. 11, sub-tit. 13, §§11-1301 – 11-1307	Notice: Yes Cure: Yes Good Cause: N/A Inventory Repurchase: N/A
Michigan Citation: Mich. Comp. Laws, ch. 445, act 269 of 1974, §445.1527	Notice: Yes Cure: Yes Good Cause: Yes Inventory Repurchase: Yes
Minnesota Citation: Minn. Stat., §80C.14	Notice: Yes Cure: Yes Good Cause: Yes Inventory Repurchase: N/A
Mississippi Citation: Miss. Code Ann., tit. 75, ch. 24, §§75-24-51 - 75-24-63	Notice: Yes Cure: N/A Good Cause: N/A Inventory Repurchase: N/A

STATE	COVERAGE
Missouri Citation: Mo. Rev. Stat., tit. 26, ch. 407, §§407.400 - 407.420	Notice: Yes Cure: N/A Good Cause: N/A Inventory Repurchase: N/A
Nebraska Citation: Neb. Rev. Stat., ch. 87, §§87-401 - 87-409	Notice: Yes Cure: N/A Good Cause: Yes Inventory Repurchase: N/A
New Jersey Citation: N.J. Rev. Stat., §§56:10-1 - 56:10-31	Notice: Yes Cure: N/A Good Cause: Yes Inventory Repurchase: N/A
North Dakota Citation: N.D. Century Code Ann., tit. 51, §§51-20.2-01 to 51-20.2.03	Notice: N/A Cure: N/A Good Cause: N/A Inventory Repurchase: Yes
Puerto Rico Citation: P.R. Laws Ann., tit. 10, ch. 14, §§278 - 278d	Notice: N/A Cure: N/A Good Cause: Yes Inventory Repurchase: Yes
Rhode Island Citation: R.I. Gen. Laws, tit. 5, ch. 50, §§6-50-2 to 6-50-9	Notice: Yes Cure: Yes Good Cause: Yes* Inventory Repurchase: Yes
Virgin Islands Citation: V.I. Code Ann. tit. 12A, ch. 2, subch. III, §§130-139	Notice: Yes Cure: N/A Good Cause: Yes Inventory Repurchase: N/A
Virginia Citation: Va. Code Ann. §13.1-564	Notice: N/A Cure: N/A Good Cause: Yes Inventory Repurchase: N/A

STATE	COVERAGE
Washington Citation: Wash. Rev. Code, §§19.100.180, 19.100.190	Notice: Yes Cure: Yes Good Cause: Yes Inventory Repurchase: Yes
Wisconsin Citation: Wis. Stat. §§135.01 - 135.07	Notice: Yes Cure: Yes Good Cause: Yes Inventory Repurchase: Yes

NOTES:

* = Good cause only defined; not needed to terminate.

This chart does not include special industry laws relating to wholesalers or dealers selling motor vehicles, petroleum products, farm and industrial equipment, lawn and garden equipment, outdoor power equipment, liquor, wine or beer, hotels, campgrounds, etc.

Since state laws are subject to change, you should refer to the specific statute.

Appendix G

ANTI-DISCRIMINATION PROVISIONS OF THE STATE FRANCHISE RELATIONSHIP STATUTES

Arkansas Ark. Code Ann. § 4-72-202(7), §4-72-204(a)	(7) “Good cause” means: (A) Failure by a franchisee to comply substantially with the requirements imposed upon him or her by the franchisor, or sought to be imposed by the franchisor, which requirements are not discriminatory as compared with the requirements imposed on other similarly situated franchisees, either by their terms or in the manner of their enforcement (a) It shall be a violation of this subchapter for a franchisor to: (1) Terminate or cancel a franchise without good cause; or (2) Fail to renew a franchise except for good cause or except in accordance with the current policies, practices, and standards established by the franchisor which in their establishment, operation, or application are not arbitrary or capricious.
Hawaii Haw. Rev. Stat. § 482E-6(2)(C), (H)	It shall be an unfair or deceptive act or practice or an unfair method of competition for a franchisor or subfranchisor to: (C) Discriminate between franchisees in the charges offered or made for royalties, goods, services, equipment, rentals, advertising services, or in any other business dealing, unless and to the extent that any classification of or discrimination between franchisees is: (i) Based on franchises granted at materially different times, and such discrimination is reasonably related to such differences in time; (ii) Is related to one or more programs for making franchises available to persons with insufficient capital, training, business experience, education or lacking other qualifications; (iii) Is related to local or regional experimentation with or variations in product or service lines or business formats or designs; (iv) Is related to efforts by one or more franchisees to cure deficiencies in the operation of franchise businesses or defaults in franchise agreements; or (v) Is based on other reasonable distinctions considering the purposes of this chapter and is not arbitrary. (H) Terminate or refuse to renew a franchise 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 considering the purposes of this chapter, and is not arbitrary. For purposes of this paragraph, good cause in a termination case shall include, but not be limited to, the failure of the franchisee 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 815 Ill. Comp. Stat. 705/18	It shall be an unfair franchise practice and a violation of this Act for any franchisor to unreasonably and materially discriminate between franchisees operating a franchised business located in this State in the charges offered or made for franchise fees, royalties, goods, services, equipment, rentals or advertising services, if such discrimination will cause competitive harm to a franchisee who competes with a franchisee that received the benefit of the discrimination, unless and to the extent that any classification of or discrimination between franchisees is: (a) based on franchises granted at different times, and such discrimination is reasonably related to such differences in time; (b) related to one or more programs for making franchises available to persons with insufficient capital, training, business experience or education, or lacking other qualifications; (c) related to local or regional experimentation with or variations in product or service lines or business formats or designs; (d) related to efforts by one or more franchisees to cure deficiencies in the operation of franchise businesses or defaults in franchise agreements; or (e) based on other reasonable distinctions considering the purposes of this Act and is not arbitrary.
Indiana IC 23-2-2.7-2	It is unlawful for any franchisor who has entered into any franchise agreement with a franchisee who is either a resident of Indiana or a nonresident operating a franchise in Indiana to engage in any of the following acts and practices in relation to the agreement: (5) Discriminating unfairly among its franchisees or unreasonably failing or refusing to comply with any terms of a franchise agreement.
Minnesota Minn. Administrative Rules § 2860.4400(B)	All franchise contracts or agreements and any other device or practice of a franchisor, shall conform to the following provisions. It shall be unfair and inequitable for any person to: B. discriminate between franchisees in the charges offered or made for royalties, goods, services, equipment, rentals, advertising services, or in any business dealing, unless any classification of or discrimination between franchisees is based on franchises granted at different times, geographic, market, volume, or size differences, costs incurred by the franchisor, or other reasonable grounds considering the purposes of Minnesota Statutes 1973 Supplement, sections 80C.01 to 80C.22;
Washington Rev. Code Wash. 19.100.180	(2) For the purposes of this chapter and without limiting its general application, it shall be an unfair or deceptive act or practice or an unfair method of competition and therefore unlawful and a violation of this chapter for any person to: (c) Discriminate between franchisees in the charges offered or made for royalties, goods, services, equipment, rentals, advertising services, or in any other business dealing, unless and to the extent that the franchisor satisfies the burden of proving that any classification of or discrimination between franchisees is: (i) Reasonable, (ii) based on franchises granted at materially different times and such discrimination is reasonably related to such difference in time, or is based on other proper and justifiable distinctions considering the purposes of this chapter, and (iii) is not arbitrary. However, nothing in (c) of this subsection precludes negotiation of the terms and conditions of a franchise at the initiative of the franchisees.
Wisconsin Wis. Stat. 135.02, 135.03	No grantor, directly or through any officer, agent or employee, may terminate, cancel, fail to renew or substantially change the competitive circumstances of a dealership agreement without good cause. The burden of proving good cause is on the grantor (4) “Good cause” means: (a) Failure by a dealer to comply substantially with essential and reasonable requirements imposed upon the dealer 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.

Appendix H

ANTI-DISCRIMINATION PROVISIONS OF THE STATE MOTOR VEHICLE STATUTES

Delaware Del. Code Ann. Tit. 6 §4913(b)(8), (12)	(b) It shall be a violation of this chapter for any manufacturer: (8) To unfairly discriminate among its new motor vehicle dealers with respect to warranty reimbursement. (12) To engage in any predatory practice or discrimination against any new motor vehicle dealer or unreasonably discriminate between or among dealers in the sale of a motor vehicle owned by the manufacturer or distributor.
Georgia Ga. Code Ann. § 10-1-662(a)(9)	(a) It shall be unlawful for any franchisor: (9) To engage in any predatory practice or discrimination against any dealer;
Nevada Nev. Rev. Stat. § 482.36385(2)	It is an unfair act or practice for any manufacturer, distributor or factory branch, directly or through any representative, to: 2. Discriminate unfairly among its dealers, or fail without good cause to comply with franchise agreements, with respect to warranty reimbursement or authority granted to its dealers to make warranty adjustments with retail customers.

KAREN MARCHIANO

Karen Marchiano is a Senior Managing Associate in the Silicon Valley and San Francisco offices of SNR Denton (the international firm formed by the 2010 combination of Sonnenschein Nath & Rosenthal LLP and Denton Wilde Sapte). Karen's national litigation practice focuses on franchise litigation and class action defense, and their intersection (defending franchisors against class actions), as well as other complex civil litigation. Karen also advises franchisors on compliance with franchise laws across the country, on vicarious liability issues, and on systemwide issues, such as best practices for implementing systemwide changes, working with franchise associations, and enforcing system standards. Karen represents franchisors in litigation arising out of the termination of the franchise relationship, including defending against statutory and common law claims, and seeking affirmative relief to protect franchisors' trademarks against unauthorized use by former franchisees. She also defends franchisors against third party claims alleging that the franchisor is legally responsible for acts of the franchisee. Karen is currently serving as an appointed member of the Franchise Law Committee, California State Bar Business Section, and recently spoke at the IFA Legal Symposium on the topic of arbitration. She received her J.D. from the University of California, Berkeley, where she graduated in the top 10% of her class.

GLENN PLATTNER

Glenn Plattner is a Partner in the Los Angeles office of Bryan Cave LLP. Glenn is a trial attorney with broad experience in franchise and distribution litigation. Glenn frequently represents franchisors in termination proceedings, enforcement of contractual terms, such as covenants not to compete and protection of trademarks and trade secrets. Glenn is certified by the California State Bar as a California Franchise Law Specialist and has also been recognized by both Who's Who and Super Lawyers in the field of franchising. Glenn recently completed a term as an Associate Editor of the ABA's Franchise Lawyer magazine. Glenn is currently the Chair of the Franchise and Distribution Law Advisory Commission and was previously a Co-Chair of the Franchise Law Committee for the California State Bar Business Law Section.

LEONARD D. VINES

Leonard D. Vines is an officer and shareholder in the St. Louis law firm of Greensfelder, Hemker and Gale, P.C. He concentrates his practice in franchise and distribution and general business and corporate law and has served as counsel for developers of major retail developments. Mr. Vines is listed in the Chambers USA (Leading Franchise Lawyers nationwide), Best Lawyers of America, the International Who's Who of Franchise Lawyers, Who's Who in American Law and Kansas Missouri Super Lawyers. Mr. Vines is a former member of the Governing Committee of the American Bar Association Forum on Franchising, and a member of the franchise advisory board of the North American Securities Administrators Association (NASAA). He is a panel member of the Westlaw Round Table Group Expert Network, served as a member of the IFA Legal Symposium Planning Committee, and is an Editorial Board Member for LJN's Franchising Business & Law Alert. He is also a frequent lecturer on franchise topics for various organizations and has spoken at programs sponsored by the American Bar Association Forums Committee on Franchising, International Franchise Association, the Bar Association of Metropolitan St. Louis, Missouri Bar and the National Franchise Law Institute. He served as editor for chapters on "Business Franchises" and "Sale of Assets" for Rabkin & Johnson Current Legal Forms (Matthew Bender) and for the American Bar Association publication, Mergers and Acquisitions of Franchise Companies. He has also written articles for various legal publications such as the ABA Journal, The Franchise Lawyer, Journal of the Missouri Bar, St. Louis Bar Journal, LJN's Franchising Business and Law Alert and the Franchise Law Journal. Mr. Vines graduated from the University of Illinois in 1969 with a B.S. in accounting with honors and from Washington University School of Law in 1972.