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Basics Track: Handling Franchise Defaults and Terminations

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I. Introduction

This paper addresses the basics of franchise defaults and terminations.[1] But we note that best practices for addressing default and termination issues are extensive and that there are many nuances to the default and termination process. Any party seeking to issue, or defend against, default and termination notices should consult the applicable franchise agreement, state relationship statute(s), and relevant case law, as well as investigate and evaluate the specific facts, history and current relationship between the parties. Any party receiving a default or termination notice should ensure familiarity with the applicable agreements and state relationship laws.

This paper follows the typical chronology of default and termination. We start with a focus on some of the common signs that precede franchisee defaults and examine how franchisors might manage and/or resolve potential issues before they rise to the level of default. The paper then identifies certain business and legal issues for franchisors to consider before deciding to issue a default or termination notice.

We next discuss the applicability of state relationship statutes as complying with such statutes is an important aspect of issuing a default or termination notice. If protections provided to franchisees under applicable state relationship laws exceed those offered under the franchise agreement, then the relationship law controls.

While we will examine state relationship statutes, this paper does not address the many other similar statutes that may govern or be implicated in default or termination situations, such as business opportunity investment statutes, unfair trade practices acts, consumer protection statutes, and "Little FTC Acts." Additionally, this paper does not address statutes governing special industry sectors like alcohol, automotive, farm equipment, and sales representatives, except to cite some case law interpreting those statutes, which may inform the interpretation of similar relationship act provisions.

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[1] This paper borrows heavily from the many papers that have thoroughly addressed this same topic for the IFA Legal Symposium during the last ten years. See Brian Balconi and Christina Kennedy, Handling Franchise Defaults and Terminations. 56th Annual Legal Symposium. May 5-7, 2024; Evan Colbert, Leonard MacPhee, and Maureen O'Brien, Handling Franchise Defaults and Terminations, 55th Annual Legal Symposium. May 7-9, 2023; Sean McClosky and Jessica W. Rosen, Handling Franchise Defaults and Terminations, 54th Annual Legal Symposium. May 15-17, 2022; Jennifer L. Gross, Scott Kuykendall, and David E. Worthen, Handling Franchise Defaults and Terminations, 53rd Annual Legal Symposium. May 2-5, 2019; Sarah Osborn Hill, Nicole Ligouri Micklich, and Aaron-Michael Sapp, Handling Franchise Defaults and Terminations, 52nd Annual Legal Symposium. May 5-7, 2019; Alyssa Barnes and Michael Einbinder, Franchise Defaults and Terminations – Best Practices, 51st Annual Legal Symposium, May 6¬8, 2018; Judy Marsh, Eunice Nakamura, and Leslie Smith, Basics Track: Handling Defaults and Terminations, 50th Annual Legal Symposium, May 7-9, 2017; Christine E. Connelly, Aron Friedman and Mark Inzetta, Franchise Default and Termination – Best Practices to Enforce the Contract and Protect the System, 49th Annual Legal Symposium, May 15-17, 2016; Judy A. Rost, Dawn Newton, Glenn J. Plattner, and Meredith Flynn, Basic Track: Best Practices For Handling Defaults and Terminations, 48th Annual Legal Symposium, May 3-5, 2015; Harris J. Chernow, Stephen Hagedorn, and Leslie Smith, Best Practices for Handling Defaults and Terminations, 47th Annual Legal Symposium, May 4-6, 2014.

The paper concludes with a discussion of what happens after the franchisor issues the default or termination notice. Franchisors must consider how these notices might impact other franchisees and the system as well. Franchisors should also be prepared to enforce their default or termination notices or otherwise resolve the dispute.

II. Identifying Potential Problems Before They Arise

While some conduct warrants an immediate notice of default or termination, the parties to a franchise agreement are typically better off if issues are addressed before the franchisor issues a default or termination notice. By identifying potential problems early, the parties may find a business solution, with the franchisee escaping default – an outcome that is generally cheaper and less disruptive to the franchise system. Also, franchisees often respond better to informal discussions rather than a formal default process, which—even if cured by the franchisee—may weaken the parties' relationship.

A. Early Warning Signs of Problems in the Relationship

To identify potential problems before they necessitate the issuance of a default or termination notice, franchisors should monitor the system for conduct and signs that often precede franchisee defaults. Here are some examples of both financial and non-financial warning signs.

1. Financial Red Flags

Warning signs relating to possible financial issues are typically easier for franchisors to detect as compared to non-financial red flags. They often include the following:

- <u>Failure to Report Sales</u>. Many systems automate the reporting process or provide franchisors real-time access to franchisee sales data. For systems that require the submission of sales reports, however, a struggling franchisee may not produce such reports in a timely manner to delay or otherwise avoid paying amounts owed to the franchisor.

- <u>Underreporting</u>. Underreporting sales may likewise signal an issue. This may be uncovered by the franchisor during a routine audit or suspected by the franchisor and subsequently verified by an audit undertaken pursuant to the franchise agreement.

- <u>Failure to Make Payments to Franchisor</u>. Similarly, a struggling franchisee may repeatedly fail to make royalty, marketing, lease, or any other recurring payments required under the franchise agreement. Even if a franchisee ultimately pays all amounts owed, a franchisee who formerly paid on time and begins paying late is a concern.

- <u>Decreased Financial Performance</u>. Particularly in systems where franchisors have real-time access to sales data, franchisors should be concerned by any significant decline in franchisee sales.

- Failure to Comply with Financial Reporting. A franchisee's failure to timely provide required financial reports is another good indicator of financial issues.

- Payment Defaults with Third Parties. A struggling franchisee may choose not to pay third parties before it stops paying the franchisor. Franchisors should be concerned if they discover late or unpaid payments to a franchisee's lenders, landlords, or third-party suppliers.[2]

- Canceled or Nonrenewed Insurance. Insurance premiums are another example of payments that a financially struggling franchisee may stop paying before it stops paying the franchisor.

- Liens and Assessments. Unpaid third parties may obtain judgments and place liens on the franchisee's business, business assets, or personal assets. This is a clear indicator that the franchisee is in financial distress and may default on payments owed to the franchisor.

- Failure to Upgrade. A financially-struggling franchisee may be unable or unwilling to participate in mandatory upgrades of software, décor, goods or services for sale, or to adhere to other directives of the franchisor related to system enhancements or improvements.

- Unexplained Borrowing. A franchisee struggling to make any of the above-described payments or investments may borrow the funds needed to make those payments, which often leads to further trouble later.

- Decreased Inventory Purchases. In product-based systems where franchisors have access to purchase histories and patterns, franchisors might be concerned by any significant decline in inventory and product purchases from the franchisee.

2. Non-Financial Red Flags

Non-financial indicators of potential problems with franchisees are often more difficult for franchisors to detect. Nevertheless, franchisors should endeavor to identify and address any of the below warning signs.

- Disinterest in System. If a franchisee develops a reputation as a "loner" and does not participate in optional programs, attend conventions, or otherwise engage in system-wide activities, the franchisor should be aware of the franchisee's apparent disengagement and disinterest.

[2] Franchisors should note any changes to credit terms. Many vendors, for example, will require franchisees to pay for goods by cash on delivery if the franchisee has missed too many payments.

- Failure to Follow System Standards. Franchisors should note minor deviations from system standards—which may not alone warrant issuing a default—as precursors to potential and more significant problems.

- Decline in Operational Performance. Examples include failing to maintain a clean and updated premises, satisfy health code requirements, maintain business records, train employees, or prioritize customer satisfaction in operations.

- Increase in Customer Complaints. If customer complaints at the business increase or if a franchisee fails to address customer complaints in a timely manner, then the franchisee is likely experiencing problems that may result in default notices later.

- Increase in Employee Turnover. Some employee turnover is unavoidable; however, if a franchisee is constantly losing employees—particularly at the manager level—then something is likely wrong.

- Attempts to Operate Outside Territory. In systems that grant franchisees exclusive territories, a franchisee's improper attempt to operate outside its territory may indicate larger underlying issues.

- Attempts to Violate Trademark, Confidentiality, or Other Restrictions. A franchisee's refusal to adhere to key limitations on how it can use components of the franchise system, such as the franchisor's intellectual property and trade secrets, is often a sign of a much larger problem and could mean that the franchisee may plan to compete against the franchisor.

B. How to Respond to the Early Warning Signs

A strong internal process is critical to effectively manage and potentially remediate franchisee problems before a default notice or stronger action is required.

The first step should always be contacting the franchisee to discuss the red flags and to learn more about the franchisee's specific situation. Effective and well-trained field representatives are critical in this regard. Field representatives should be trained to (i) gather facts and context; (ii) be reassuring about the franchisor's intent, (iii) avoid agreeing to conditions, waiving rights or compromising the franchisor's ability to respond, and (iv) escalate the results of the investigation when appropriate. In-house counsel, if available, should be consulted before the field representative meets with the franchisee and should be present for the post-investigation review of the franchisee's situation.

One process that facilitates internal communication is to have a regular (how often depends on the size of the system, but monthly should be the least frequent cadence) cross-functional meeting to discuss "red flags" and franchisee problems. Often the finance or accounting staff are aware of payment issues before operations, or the field representative has observed management or operational defects that would escape the

notice of remote observers. Bringing legal, finance, technology, franchise sales, operations and the field team together ensures a broad perspective and cross-training on the franchisor's policies and practices.

It is crucial for the franchisor to manage expectations – both franchisee expectations and internal expectations.[3] Franchisors should recognize that franchisees cannot always resolve their issues immediately, or at all, without reasonable self-examination and support from the franchisor, nor can franchisors devote unlimited resources to a single franchisee. It is also important for both sides to have a mutual understanding of priorities when there are multiple problems at stake. It is always more cost-effective for the parties to reach a realistic and mutually acceptable business solution than to pursue a formal dispute resolution or legal process. Additionally, franchisors may consider implementing improvements or probationary plans in advance of issuing a default or termination. Before the final decision is made to default or terminate, a softer toned notice of noncompliance or other form of formal communication may be desirable to maintain the franchise relationship.

III. Considerations in Deciding to Default/Terminate

If a franchisee will not, or cannot, comply with its franchise agreement, then the franchisor must decide whether to issue a default or termination notice.

Even where the franchisee's conduct obviously constitutes a default (*e.g.*, if the franchisee has failed to pay royalties or been convicted of a serious crime), deciding whether to issue a default notice and/or terminate the franchise agreement may be difficult.

The franchisor must weigh the potential loss of a unit against potential harm to its brand while additionally considering resources required to support non-compliant franchisees. This is particularly true in situations where the franchisor has invested considerable time and resources in training, assisting the franchisee, and/or in developing the territory. Termination is a statement that the franchise relationship has failed, and such notices can reflect on the franchisor as much as on the franchisee.

There are also concerns that relate to non-action on a notice of default when the franchisee does not cure. As discussed below, arguments of waiver, estoppel and acquiescence are bolstered by evidence of a franchisor not following through on uncured default notices or repeated defaults after repeated cures. However, many franchise agreements and some relationship laws permit repeated non-compliance, even if the default is cured, as a basis to terminate. One of the best forms of evidence that a franchisee has repeatedly defaulted is multiple default notices. Even if a franchisor might

[3] For example, if a franchisee has failed to upgrade her location by the due date, but her lease for the location expires soon and the landlord has indicated it will not renew, default or termination may not be appropriate.

not be prepared to terminate if the default is not cured, it may be advantageous to issue a notice of default.

Franchisors must also consider other risks associated with issuing default or termination notices. From a business standpoint, the notice might impact not only the relationship with the receiving franchisee, but also other franchisees in the system (that will likely hear about it). There are legal risks as well. If, for example, there is an insufficient basis for sending the notice under the terms of the franchise agreement or applicable state law, then the franchisor might expose itself to claims for wrongful termination, breach of contract, and violation of applicable state relationship statute(s). Given these risks, the franchisor should ensure their notices also comply with applicable statutory notice provisions and other laws applicable to the default or concern.

Before issuing any default or termination notice, franchisors should do each of the following:

A. Review the Situation

As noted in the prior section, an effective process will involve stakeholders from across the franchisor's business. If the franchisor has a regular meeting to review franchisee "red flags", then that group, led by the business decision maker with ultimate authority, should be driving the default or remediation process. Avoiding mixed messages from the franchisor is critical for all parties.

B. Gather Facts and Information

Once the decision is made to pursue a potential default or termination, the franchisor needs to develop the fact record that justifies this action. The franchisor might start by issuing an improvement plan to the franchisee, detailing the observed deficiencies and affording the franchisee an opportunity to take corrective action. This can be done in conjunction with a default notice, or as a precursor to a formal action under the franchise agreement. The benefits of having a formal improvement process include documenting issues early in the process, ensuring that the franchisee is not caught by surprise and building a stronger case if legal action is later necessary. If the franchisor does not have in-house counsel to review the record, taking time to assemble the factual record will still be necessary to engage outside counsel and will save both the franchisor and their counsel time and money later in the process.

If the franchisor doesn't have a formal improvement process, then the franchisor will need to gather documentation of the problem and the communications around it from within the records of the franchisor's support teams. Legal, franchise sales, operations, training, accounting, and IT may all have communications and correspondence with the franchisee and relevant information about the franchisee.

Assuming the franchisor has been speaking to the franchisee, no further communication may be warranted. But, if the franchisor is unsure that the franchisee understands the problems, or if the franchisor is concerned there is "another side to the story," the franchisor may benefit from interviewing the franchisee about the franchisor's

evidence. The franchisor should take a broad approach to interviewing the franchisee. The full history of the relationship can inform possible counterarguments the franchisee may raise or help franchisors identify alternative means of resolving an issue ahead of issuing a default or termination notice.

An interim step to a default may be considered—an audit. Many franchise agreements permit audits and impose the costs of the audit on the franchisee if misconduct is established. Further, many franchise agreements prescribe specific remedies for conduct subject to audit that may obviate the need for a default. Lastly, for complex questions of damages or disputes around revenue or royalties, an audit will add necessary technical details that the franchisor will need to pursue its interests; or may vindicate the franchisee's perspective before legal process is initiated. A secret-shopper or private investigator may serve a similar function if the nature of the problem warrants those actions – but typically, if an "undercover" investigation is required, the franchisee and franchisor are no longer communicating effectively enough to avoid a default.

Finally, the franchisor should consider the cost-benefit of pursuing a default. It is critical to understand if a particular problem is important, urgent or existential. A franchisee that fails at basic operational issues may present an important problem that is easy to prove, but the costs of pursuing a default may not be justified. Conversely, a matter related to public health or a trademark infringement may justify immediate or very aggressive action by the franchisor, even if a full investigation has not been completed..[4] Ultimately, the franchisor should make sure that the punishment fits the crime.[5]

C. Review the Franchise Agreement

If the conduct warrants further attention, the franchisor must then confirm that there is an actual basis under the applicable franchise agreement to issue a default notice. Any failure to follow the franchise agreement's requirements may create substantial legal risk.

The following are common breaches under franchise agreements:

- Monetary Defaults: Where a franchisee fails to comply with its monetary obligations to the franchisor or its affiliates, such as royalties, advertising fees, or marketing fund contributions, or to third-party suppliers.

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[4] See *Peterbrooke Franchising of America LLC v. Miami Chocolates LLC* , No. 21-10242, 2022 WL 6635136 (11th Cir., Oct. 11, 2022) (reversing trial court's grant of summary judgment to franchisor on franchisee's claim of wrongful termination and finding that there were material issues of fact as to whether franchisee's breach by not implementing a required POS system was a material breach warranting termination).

[5] Franchisors should track their defaults and the results of default actions, both to ensure that deadlines and action items are not missed and also to create a data set to provide perspective on the best avenue to resolve issues that tend to recur. Although it is perhaps too early to tell, if certain information is recorded routinely in a franchise management software or spreadsheet (defined issue type, franchisor action, length of time to resolve, nature of the resolution, costs) an AI search tool might be able to provide analysis that could be used to drive process or decision making or budgeting.

- Operational Defaults: Where a franchisee fails to meet standards and comply with terms of the franchise agreement or operations manual. Typically, franchise agreements require such non-compliance to be material as opposed to minor or common issues.

- Competing with the Franchise System: Where a franchisee obtains an interest in a competing business (whether franchised or not) or otherwise competes with the franchise system in violation of the franchise agreement's terms.

- Sale of Unauthorized Goods or Services or Failure to Sell Required Goods or Services. Where the franchisee offers for sale or sells at the franchised location unauthorized goods or services or, conversely, fails to offer for sale and sell required goods and services.

- Unapproved Transfer: Where a franchisee transfers its rights in the franchise or ownership interests in the franchisee entity to a third party without the franchisor's prior, usually written, approval.

- Performance and/or Quota Defaults: Where a franchisee fails to meet sales or purchase quotas or performance standards.

- Underreporting of Sales: Where a franchisee fails to comply with its reporting obligations to the franchisor or its affiliates by underreporting or falsely reporting gross sales.

- Failure to Devote Best Efforts/Supervise: Where a franchisee fails to devote substantial full-time efforts to the franchise or otherwise supervise the day-to-day operations of the business in a manner required pursuant to its franchise agreement or the brand's operations manual.

- Violation of Law: Where a franchisee violates local, state, or federal law, especially if related to health or public safety.

- Repeated Defaults: Where a franchisee has committed a prescribed number of defaults within a defined time period.

- Material Misrepresentation: Where a franchisee makes a material misrepresentation or omits material facts in the application process.

- Adverse Impact on Goodwill of the Brand: Where a franchisee's conduct casts the brand in an unfavorable light, often where the franchisee has had legal problems, such as criminal behavior or behavior that materially impacts the brand.

After identifying a contractual basis, the next step is to review the required timing and mechanics of the default or termination process in the franchise agreement. For

instance, does the agreement require the franchisor to provide the franchisee notice and/or an opportunity to cure and how long is the cure period? How and to where should the franchisor deliver the notice? When is the notice effective? Do any applicable guarantees require the franchisor to provide notice to the guarantor? Do any applicable tri-party agreements require the franchisor to provide notice to the franchisee's primary lender? Do any state relationship laws provide a required notice or cure period? Franchisors should also review the franchisee's post-termination obligations.

In some cases, the franchisor might provide an interim notice of noncompliance before issuing a formal default. This might help in four ways. First, a warning letter or similar notice of noncompliance could sufficiently resolve the issue without further escalation. Second, a warning letter could provide the franchisee an opportunity to correct or add facts, allowing the franchisor to make a more informed decision about its next steps if continued escalation is necessary. Third, if the franchisee cannot rebut the allegations or otherwise refuses to acknowledge that its acts or omissions are problematic, then the franchisor may develop more confidence to enforce its rights under the agreement. Fourth, it strengthens the franchisor's record if the franchisor does proceed to default.

At this point in the process, in-house counsel should consider involving litigation counsel since default and termination notices may result in litigation. Best practices include consulting with litigation counsel before issuing such notices. Litigation counsel, among other things, can ensure a proper record, confirm compliance with the franchise agreement and applicable state laws, and highlight the facts and arguments that comprise the key points of the franchisor's story in the event of litigation. A small investment in time and legal fees at this point could save the franchisor a great deal in the long run.

D. Review State Relationship Laws

Many states have relationship laws which govern the franchise relationship, including the default and termination of franchisees. Before issuing a default or termination notice, franchisors must review any potentially applicable state relationship laws. Section IV discusses this issue in greater detail.

E. Review Potential Counterclaims and Defenses

Before deciding to issue a default or termination notice, a franchisor should evaluate potential defenses and counterclaims that the franchisee is likely to raise. If strong defenses or counterclaims exist, then the franchisor might consider other actions. A franchisee receiving a notice of default or termination should promptly review the history and evaluate defenses and potential claims as may be appropriate. We discuss some examples of franchisee arguments below. These are in addition to potential challenges to the termination on the basis of the franchise agreement terms (i.e. breach of contract claims for improper termination).

1. Good Faith and Fair Dealing/Good Cause

One common franchisee argument is that the franchisor acted in bad faith. This allegation may be used to support a claim for breach of the implied covenant of good faith and fair dealing and to argue that the franchisor lacked good cause to terminate. The elements of the implied covenant of good faith and fair dealing vary between states, but generally provide that a party to a contract cannot exercise its discretion so as to prevent the other party from receiving the benefits of the contract.[6] Good cause for termination is often required under applicable state relationship laws or by the terms of the franchise agreement.[7] Additionally, some states implement a statutory requirement for the franchisor to deal with a franchisee "in a commercially reasonable manner and in good faith."[8]

The general rule also provides, however, that the implied covenant of good faith and fair dealing cannot be used to circumvent the clear terms of a contract, and courts generally uphold terminations where the franchisor complies with the express terms of the franchise agreement.[9] In *Pennington's, Inc. v. Brown-Forman Corp.*, the court held that a supplier did not violate the distributorship agreement by terminating it without cause because the agreement expressly provided for no-cause termination.[10] The dealer therefore could not use the covenant of good faith and fair dealing to negate the express terms of the contract.[11] Similarly, in *Dayan v. McDonald's Corp.*, the franchisee argued that a franchisor's bad motives could violate the implied covenant of good faith and fair

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[6] See Restatement (Second) of Contracts § 205 (1981); see also, *Kazi v. KFC US, LLC*, 76 F.4th 993 (10th Cir. 2023) (concluding that "under Kentucky law, to bring a claim for breach of the implied duty of good faith and fair dealing, the party must point to an expectation created by the language of the contract . . . that was defeated by the bad faith of the other party" and noting that " when the covenant of good faith and fair dealing comes into play, it restricts the discretion of the party bound by the covenant"); *Spitzer Autoworld Akron, LLC v. FCA US LLC*, No. 1:22-CV-01755-PAB, 2023 WL 6809935 (N.D. Ohio Oct. 12, 2023) (granting a motion to dismiss a claim for breach of the duty of good faith and fair dealing because there was "neither unbridled nor conditional discretion in the [governing letter of intent] which would require FCA to act 'honestly and in good faith'" under Michigan law).

[7] See *infra* Section IV (explaining state relationship laws).

[8] See *e.g.,* Ark. Code § 4-72-206(a)(6) ("refusing to deal with a franchise in a commercial reasonable manner and in good faith" is an unlawful practice in violation of the Arkansas Franchise Practices Act); Ark. Code § 4-72-212.

[9] See e.g., *Garrand Brothers, LLC v. America Honda Motor Co.*, No. 8:22-CV-0924, 2023 WL 5835793 (N.D.N.Y. Sept. 8, 2023) (dismissing a claim for "breach of the implied covenant of good faith and fair dealing because it was directly at odds with Honda's express right under the dealer agreement to terminate for abandonment").

[10] 2 F.3d 1157, 1993 WL 306155 (9th Cir. 1993).

[11] Id.; *see also 7 Eleven, Inc v. Sodhi*, 706 F. App'x 777, 780 (3d Cir. 2017) (unpublished) (affirming termination of franchisee for failure to comply with express terms of franchise agreement to pay taxes) ("7-Eleven had good cause to terminate the agreement, whatever its motivation in doing so").

dealing even if the franchisor had good cause for termination.[12] The court disagreed; if good cause exists, then there can be no bad faith regardless of the franchisor's motives.[13] Likewise, in *Fleetwood v. Stanley Steemer Intern., Inc.*, the court rejected a franchisee's argument that the franchisor's termination was improper since it had a duty under the implied covenant of good faith and fair dealing to allow the franchisee to sell the franchise despite being in default of its franchise agreements.[14]

In other instances, franchisees have been successful in challenging a termination. For example, in *Dunkin' Donuts of America, Inc. v. Minerva, Inc.*, the franchisor attempted to terminate the franchisee based on underreporting discovered after several financial audits.[15] The magistrate judge denied the franchisor's motion for judgment notwithstanding the verdict on the issue of its liability for breach of good faith and fair dealing.[16] The Eleventh Circuit affirmed because sufficient evidence existed for a reasonable jury to find that: (i) the audits were substantially motivated by the franchisee's refusal to sign a franchise renewal agreement, (ii) the method used by the franchisor to audit the stores had not been disclosed in the franchise agreement, and (iii) the termination was not based on good cause because there was no intentional underreporting.[17]

In *In re Globe Distribs., Inc.*, a bankruptcy court found that a brewer breached the duty of good faith and fair dealing owed to a distributor by terminating the distributor for allegedly being insolvent.[18] The court held that at the time of termination, the brewer did not know whether the distributor was, in fact, insolvent.[19] Instead, the brewer used the

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[12] Bus. Franchise Guide (CCH) ¶ 8,223 (Ill. App. Ct. 1984).

[13] *Id*.

[14] 725 F.Supp.2d 1258 (E.D. Wa. 2010). Cf. *Rogers Fam. Foods, LLC v. DFO, LLC*, No. CV 19-1476 (DWF/ECW), 2020 WL 5816589, at *11 (D. Minn. Sept. 30, 2020) (slip copy) (granting summary judgment in favor of franchisor and rejecting franchisee's argument that implied covenant of good faith and fair dealing required franchisor to renew the Franchise Agreement on identical terms as original agreement because the implied covenant cannot be used to alter express terms of an agreement, and [the] franchise agreement "unambiguously incorporates the MFA and its renewal provisions."). *See also* Restatement (Second) of Contracts § 205 (1981).

[15] 956 F.2d 1566, 1569 (11th Cir. 1992).

[16] *Id*. at 1570.

[17] *Id.*

[18] 129 B.R. 304, 317 (Bankr. D.N.H. 1991).

[19] *Id.*

insolvency of the distributor as a pretext to terminate the distributor.[20] The court held that these actions violated the spirit of the distributorship agreement.[21]

More recently, in *Jack in the Box Inc. v. San-Tex Restaurants, Inc.*, a federal court in Texas permitted a franchisee to proceed with counterclaims against the franchisor who initiated litigation against the franchisee after termination of 49 franchise agreements for the franchisee's failure to cure operational issues.[22] The district court denied in part the franchisor's motion to dismiss, finding the franchisee sufficiently alleged that the franchisor breached the implied covenant of good faith and fair dealing by manufacturing a pretextual default after inducing the franchisee to invest millions of dollars to renovate and improve the locations without affording the franchisee "an opportunity to recoup and earn a reasonable return on its investment."[23]

To avoid similar outcomes, franchisors should refrain from issuing a default or termination notice in response to some other unrelated conduct or position taken by the franchisee. Avoiding the appearance of retaliation can be difficult in franchise relationships that have long been contentious.

2. Discrimination and Inconsistent Treatment

Franchisees may have causes of action for breach of the implied covenant of good faith and fair dealing where franchisors discriminated between franchisees.[24] Moreover, at least eight states specifically prohibit franchisors from treating similarly-situated franchisees in an inconsistent manner: Arkansas, Connecticut, Hawaii, Illinois, Indiana, Minnesota, Washington, and Wisconsin.[25] This prohibition applies to the inconsistent enforcement of contractual provisions, including the required royalty and inconsistent

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[20] *Id.*

[21] *Id.*

[22] *Jack in the Box Inc. v. San-Tex Restaurants, Inc.*, No. SA-20-CV-00328-XR, 2021 WL 148058 (W.D. Tex. Jan. 14, 2021) (slip copy).

[23] *Id.* at *2. See also, *Shepard and Associates, Inc. v. Lokring Technology, LLC* No. 20-cv-02488, 2022 WL 2359294 (N.D. Ohio June 30, 2022) (while dismissing the separate implied covenant of good faith and fair dealing claim associated with distributor's claim of wrongful termination, the court held that the distributor could maintain the claim in connection with the breach of contract claim, which the court did not dismiss).

[24] See, e.g., *D&K Foods, Inc. v. Bruegger's Corp.*, Bus. Franchise Guide (CCH) ¶ 11, 506 (D. Md. 1998) (denying franchisor's motion to dismiss claim for breach of the implied covenant where bagel shop franchisor allegedly discriminated against franchisees in extending financial assistance); *Venta, Inc. v. Frontier Oil & Ref. Co.*, 827 F. Supp. 1526, 1530-31 (D. Colo. 1993) (supplier allegedly charging two distributors a higher price than its other distributors could support breach of implied covenant claim).

[25] Arkansas (Ark. Code § 4-72-202(5)(A)); Connecticut (Conn. Gen. Stat. § 42-133l(f)(9)); Hawaii (Haw. Rev. Stat. § 482E-6(2)(C)); Illinois (815 Ill. Comp. Stat. 705/18); Indiana (Ind. Code § 23 2-2.7-2(5)); Minnesota (Minn. R. 2860.4400(B)); Washington (Wash. Rev. Code § 19.100.180(2)(c)) and Wisconsin (Wis. Stat. Ann. § 135.02(4)(a)).

amounts charged for goods, services, or advertisements. However, in practice, these claims rarely succeed.[26] Typically, as discussed further in Section VI. A., courts reject claims that a franchisor cannot terminate based on a material breach of the franchise agreement due to more lenient treatment of other franchisees (especially if there is appropriate anti-waiver language in the franchise agreement).[27]

Claims alleging discrimination often turn on whether the terminated franchisee is similarly-situated to other franchisees that were not terminated. This is often quite difficult to show in practice.

For example, in *Canada Dry Corp. v. Nehi Beverage Co. of Indianapolis*, the Seventh Circuit held that a soft drink franchisee's discrimination claim failed as a matter of law because the franchisee did not produce any "evidence of more favorable treatment of similar bottlers under similar marketing conditions."[28] The franchisee argued that the franchisor unfairly discriminated against it by refusing to offer the franchisee an advertising program and by prematurely terminating its franchise agreement.[29] The court noted that the franchisee failed to demonstrate (i) that it was either as qualified to initiate the advertisement as those bottlers who were offered the program, or (ii) that it was more qualified than the bottlers who were also excluded from the program.[30] The court held similarly on the issue of termination, stating that there was insufficient evidence under the Indiana Deceptive Franchise Practice Act that the franchisor had never terminated any of its other bottlers with the same deficiencies.[31]

In *Implement Serv., Inc. v. Tecumseh Prod. Co.*, a franchisor required the plaintiff distributor to obtain products from a specific central warehouse but allowed other distributors to choose from two warehouses.[32] The franchisor argued that geographical considerations drove the distinction. Because, the court held, plaintiff distributor was not in a similar geographical area as the other distributors, the plaintiff was unable to show that it was similarly-situated to those distributors and therefore could not claim discrimination.[33]

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[26] See Brian Schnell, Leslie Curran, and Jason Bauman. *Survey of Franchise Sales Programs*. 56th Annual Legal Symposium. May 5-7, 2024.

[27] Jeffery S. Haff, Kevin Moran and Roger Schmidt. *Differential Treatment of Franchisees in Rough Economic Times*. ABA 34th Annual Forum on Franchising (2011). p. 19.

[28] 723 F.2d 512, 521-22 (7th Cir. 1983).

[29] *Canada Dry*, 723 F.2d at 521.

[30] *Id.* at 522.

[31] *Id.*

[32] 726 F. Supp. 1171, 1174 (S.D. Ind. 1989).

[33] *Id.* at 1181.

Federal discrimination statutes also protect franchisees in certain instances, although these claims are difficult to prove. Title 42 U.S.C. § 1981, for example, prohibits discrimination on the basis of race in the formation, performance, modification and termination of a contract. To state a *prima facie* claim of discrimination under § 1981, a franchisee must show that he or she is (i) a member of a protected class, (ii) suffered an adverse decision in connection with a franchise agreement, and (iii) was treated differently than similarly-situated nonprotected franchisees.[34]

3. Waiver

If a franchisor has not previously enforced a provision of the franchise agreement against a franchisee, that franchisee may assert that the franchisor has waived the right to enforce the provision. In *CJ Rest. Enterprises, Inc. v. FMS Mgmt. Sys., Inc.*, a franchisor commenced an action for breach and immediate possession of the franchisee's restaurants when the franchisee repeatedly failed to pay royalties. Rather than litigate, the franchisor and franchisee settled by entering into a stipulation and agreed to an order requiring specific scheduled payments to the franchisor.[35] Thereafter, the franchisee continued to pay late, which the franchisor accepted without sending a notice of default.[36] Eventually, the franchisor changed course and sought termination for untimely payments, but the court held that the franchisor had waived its right to terminate on that basis.[37] The court reasoned that, based on the franchisor's pattern of accepting late payments, the franchisee reasonably concluded that the late payments were not a default.[38]

Similarly, in *E2W, LLC v. Kidzania Operations, S.a.r.l.*,[39] the court enjoined a franchisor's attempted termination on the basis that the franchisee showed a reasonable likelihood of success on its waiver and estoppel claims given the franchisor's conduct and statements. The franchisee owned the development rights for educational amusement parks in malls in the United States and owed past due fees to the franchisor. The franchisee was in the process of obtaining financing for two new leases in two major transactions, and the franchisor had permitted multiple extensions of those payments, was cooperating with and directly negotiated aspects of the financing and leasing, and indicated generally that it would accept the past due amounts at the closing of the financing deals. However, when COVID-19 shutdown those negotiations and the likelihood of commencing construction promptly, the franchisor sent a notice of termination on the basis of the past due amounts. The franchisee sought injunctive relief

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[34] Carla Wong McMillan and Kelly J. Baker, *Discrimination Claims and Diversity Initiatives: What's a Franchisor to Do?* 28 Franchise L.J. 71, 72 (Fall 2008).

[35] 699 So.2d 252, 253 (Fla. Dist. Ct. App. 1997).

[36] *Id.*

[37] *Id.*

[38] *Id.* at 255.

[39] No. 1:20CV02866 (S.D.N.Y., April 9, 2020).

preventing the termination pending an arbitration, arguing that the COVID-19 shutdowns constituted a force majeure and that the franchisor by its conduct waived the right to immediately terminate for non-payment. The court agreed finding the franchisee reasonably relied on the conduct of the franchisor, which indicated that the franchisee had more time and could make its payments upon closing of the financing transaction.

To combat such an outcome, most franchise agreements include an anti-waiver provision.[40] But a terminated franchisee may still argue that the inconsistent enforcement of the agreement was improper. And that may be enough to survive a motion to dismiss and prolong litigation. Accordingly, franchisors must balance the risk of defaulting without enforcing—a concern discussed earlier—with not defaulting at all. There are drawbacks to both approaches. If the franchisor historically applied inconsistent enforcement or allowed certain default-worthy conduct in the past, the parties may consider a "new day letter" to reset franchisee expectations and provide a stronger basis for future enforcement.

Franchisees may also look to other conduct by the franchisor to argue waiver. For example, a franchisee argued that the franchisor had waived its right to terminate the franchise agreement and enforce a liquidated damages provision because the franchisor continued to supply ingredients to the franchisee after the franchisor had terminated the franchise agreement.[41] Both the district court and Sixth Circuit rejected the franchisee's argument based, in part, on the fact that the termination notice expressly informed the franchisee that any continued course of conduct was not a "waiver" of the franchisor's rights and claims, including enforcement of any provision of the franchise agreement.[42] Similarly, in *Beach Street Foods, Inc. v. Grandy's, LLC*[43], the court rejected a former franchisee's claim that the franchisor/landlord had waived claims against it because it had transferred the business and, even though franchisor had not approved the transfer, had accepted payments from the transferee with knowledge of the purported transfer. Nonetheless, the court held that, even after a period of years, the franchisor could seek payment from the former franchisee. Accordingly, franchisors should expressly reserve all rights and claims, including, but not limited to, rights and claims under the franchise agreement, in notices of default and termination, as this is especially important if a franchisor intends to continue relations as the parties attempt to resolve a termination dispute, whether informally or through judicial enforcement.

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[40] See *Wirtgen America, Inc. v. Hayden-Murphy Equipment Co.*, No.3:22-cv-00308, 2023 WL 591704 (M.D. Tenn. Sept. 11, 2023) (refusing to grant a dealer's motion to strike a waiver defense for conduct that occurred three years prior when the anti-waiver was broad enough to include belated actions on older violations and later/newer violations).

[41] *Little Caesar Enterprises, Inc. v. Little Caesars ASF Corp.*, 842 F. App'x 955, 958 (6th Cir. 2021) (unpublished).

[42] *Id.*

[43] No. 02-20-00135-CV,2022WL187988 (Tex. Ct. App. Jan 20, 2022).

4. Tortious Interference

A terminated franchisee may also assert that the franchisor tortiously interfered with the franchisee's other business relationships. In *Mach. Maint. & Equip. Co. v. Cooper Indus., Inc.*, a court upheld a jury verdict stating that a manufacturer tortiously interfered with one of its distributor's business relationships.[44] The manufacturer had terminated the distributorship without providing the full notice period required under the agreement.[45] The manufacturer also attempted to poach the distributor's customers before the termination notice.[46] A jury awarded the distributor actual and punitive damages as a result.[47]

And, at the pleading stage, in *Planet Fitness Int'l Franchise v. JEG-United, LLC*, a court denied the franchisor's effort to dismiss as a matter of law the franchisee's counterclaim against the franchisor for interference of prospective business contracts.[48] The franchisor argued it could not be liable for interference because it would be a party to those prospective contracts by virtue of being a franchisor and having the right to pre-approve new locations.[49] The court disagreed in part because the allegations identified the franchisor as a third party to the franchisee's contracts with three other businesses (landlords/developers for new locations) at issue and in part that a franchisor's interest in future locations cannot insulate a franchisor from liability for interfering with relationships between franchisees and third parties especially when, as alleged, the interference is for an improper gain.[50] The court concluded the franchisor's right to reject future locations is "not fatal" to the interference claim.[51]

Tortious interference claims, however, are difficult to prove. In *Romacorp, Inc. v.TR Acquisition Corp.*, the court did not find tortious interference by the franchisor because the state law required a showing of malice.[52] Absent malice, the franchisor's legitimate business reason for terminating the franchise agreements could not support a claim for

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[44] 661 F. Supp. 1112 (E.D. Mo. 1987).

[45] *Id.* at 1116.

[46] *Id.*

[47] *Id.* at 112.

[48] 561 F. Supp. 3d 182, 186 (D.N.H. 2021).(denying franchisor's motion for judgment on the pleadings on franchisee's interference counterclaim).

[49] *Id.* at *3.

[50] *Id.* at *3.

[51] *Id.* at *3.

[52] No. 93 CIV. 5394 (MEL), 1993 WL 497969, at *15 (S.D.N.Y. Dec. 1, 1993), *aff'd*, 29 F.3d 620 (2d Cir. 1994).

tortious interference.[53] In another case, a farm equipment dealer's tortious interference claim was unsuccessful where the manufacturer complied with the termination provisions of the contract.[54]

5. Compliance with State Relationship, State Disclosure Laws, and Common Law Claims of Misrepresentation

As described more fully in Section IV.A, below, there are a number of state laws addressing aspects of the franchise relationship, including defaults, franchisee terminations, and post-termination obligations.[55] A franchisor must consider these laws in deciding and implementing notices of default and termination. A fundamental question is which such laws may apply. Most franchise agreements provide that the law of the state where the franchisor is located governs. In some cases, the franchisor must also comply with other states' laws, often including states where its franchisees are located. If franchisors overlook applicable state laws, franchisees may have a basis to defend against default or termination (or assert affirmative claims under the statute).

For example, if the franchise agreement is governed by Illinois law, but the franchisee is located in Connecticut, the franchisor must comply with both Illinois and Connecticut's state relationship act, including giving proper notice under each state's law. Although providing 30 days' notice with opportunity to cure a default is sufficient to terminate under Illinois's relationship act, Connecticut law requires that the franchisor give the franchisee written notice of termination or intent not to renew at least 60 days in advance, with the cause stated on the notice.[56] The franchisor's failure to comply with Connecticut law may prevent the termination and entitle the franchisee to damages, injunctive relief, and reasonable attorney's fees.[57]

Further, it is common for a terminated franchisee to assert that she was induced to sign the franchise agreement by relying on a fraudulent or negligent misrepresentation by the franchisor. These claims are often coupled with alleged violations of any applicable

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[53] *Id.*

[54] *Crosthwait Equip. Co., Inc. v. John Deere Co.*, 992 F.2d 525, 529 (5th Cir. 1993).

[55] State disclosure laws regulate the offer and sale of franchises.

[56] 815 Ill. Comp. Stat. Ann. 705/19 (Illinois requires good cause for termination, but there are four situations where notice is not required); Gen. Stat. Ann. § 42-133(f)(a) (Connecticut also requires good cause for termination). Also, such a claim that would otherwise be barred by the statute of limitation may be revived if the franchisor commences an action to enforce a termination. *See Styne v. Stevens,* 26 P.3d 343, 350 (Cal. 2001) ("Under well-established authority, a defense may be raised at any time, even if the matter alleged would be barred by a statute of limitations if asserted as the basis for affirmative relief. The rule applies in particular to contract actions. One sued on a contract may urge defenses that render the contract unenforceable, even if the same matters, alleged as grounds for restitution after rescission, would be untimely.").

[57] Conn. Gen. Stat. Ann. § 42-133g(a).

state franchise disclosure laws[58]. Recently, a terminated franchisee brought these claims after the franchisor terminated the franchise agreement in *Prestige Insurance Group v. Allstate Insurance Co*.[59] Prestige alleged that Allstate fraudulently concealed, among other things, that it was planning to compete with its agents and that it was developing policies that would reduce the commissions and bonuses paid to agents.[60] Prestige asserted claims for both fraudulent concealment and violation of the Florida Franchise Act (the "FFA"), which makes it unlawful to make a misrepresentation regarding the prospects or chance for success of the proposed or existing franchise.[61] The court granted Allstate's motion to dismiss these claims on the basis that the FFA required an affirmative misrepresentation and that the plaintiff had not alleged the required level of detail to support a fraud claim.[62] Franchisors should note that, when terminating a franchise agreement, these are the types of claims often advanced by the terminated franchisee.

In evaluating termination options, Franchisors should also note that some states limit the enforceability of certain covenants in franchise agreements, such as noncompetition provisions. In California, for example, most noncompetition agreements are invalid.[63] Other states place different limitations on the parameters of such provisions.[64]

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[58] *See Brader v. Minute Muffler,* 914 P.2d 1220, 1222 (Wash. Ct. App. 1996) (affirming trial court's order granting rescission and franchisee's summary judgment motion because the franchisor violated Washington's disclosure statute by failing to register and distribute required pre-sale information); 815 Ill. Comp. Stat. 705/6 (making it unlawful for any person to "make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading" or "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person").

[59] No. 21-60515-CIV-MORENO, 2022 EL 1091825 (S.D. Fla. Apr. 12, 2022).

[60] *Id*. at *1.

[61] *Id*. at *3.

[62] *Id*. at *4.

[63] Cal. Bus. & Prof. Code § 16600. However, the door to arguing that non-competes are enforceable in franchise relationships may be found in *Ixchel Pharma, LLC v. Biogen, Inc.*, a recent 2020 California Supreme Court opinion. 470 P.3d 571 (2020). When discussing covenants against competition, the California Supreme Court identified franchise agreements using exclusive dealing provisions as an example of potentially enforceable restrictions. *Id.* at 589. In exchange for the right to sell a franchisor's products, franchisees often agree to buy from a particular supplier or operate in a particular geographic area, and franchisees are often prohibited from selling a third party's products. The court would not "call such arrangements into question simply because they restrain trade in some way" since there are possible procompetitive effects of such provisions. The court concluded that § 16600 "is best read not to render void per se all contractual restraints on business dealings," and held the rule of reason applies to contractual restraints on business operations and commercial dealings under § 16600. *Id.* at 582, 590.

[64] *Window Gang Ventures, Corp., Plaintiff, v. Gabriel Salinas; the Gang Grp., Inc.; & Window Ninjas, LLC; Red Window, LLC; Blue Window, LLC; & Orange Window, LLC, Defendants.*, No. 18 CVS 107, 2019 WL 1471073, at *8 (N.C. Super. Apr. 2, 2019) (franchise agreement non-compete provision was found

6. Force Majeure, Impracticability/Impossibility, Frustration of Purpose

A terminated franchisee might also attempt to invoke the contractual defense of force majeure or the common law defenses of impracticability, impossibility, or frustration of purpose to excuse nonperformance that results in default of the franchise agreement.[65] While such defenses are not new, they took on much greater significance in recent years during the COVID-19 pandemic. These defenses may also be invoked in any number of other global or local circumstances, including war, civil/social unrest, acts of governmental authority, and extraordinary weather.

Whether force majeure applies will hinge on the express contract terms, which are "typically narrowly construed" by courts,[66] and applicable state law, as some states have different elements or standards to enforce force majeure provisions. The provisions themselves can vary widely in terms of notice requirements, triggering events, and the extent and duration of the excuse, if any, to perform contractual obligations. In the event that a force majeure defense may be at issue, a franchisor should carefully review the force majeure provision of the franchise agreement and applicable case law in the jurisdiction.

The common law defenses of impossibility, impracticability, and frustration of purpose are not contractual, would arise in litigation, and could be invoked in addition to force majeure. A full review of these common law defenses is beyond the scope of this paper, but franchisors should know, at least, that courts' reactions to these defenses varies widely by jurisdiction.

F. Evaluate Benefits to Avoiding Termination

Even where the franchisor has good cause for termination and is unaware of any potential defenses or counterclaims, the analysis should not stop there. The franchisor should also assess possible benefits from not terminating a problematic franchisee.

One primary reason why franchisors may not terminate is to maintain the flow of royalties, advertising fees, and other payments. While a franchisee's failure to pay royalties and other amounts due under the franchise agreement in a timely manner constitutes a default, which may permit the franchisor to terminate (typically upon the

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overbroad and unenforceable where prohibition extended to businesses that are "the same" or "similar to" franchisor, not simply to those that are "competitive").

[65] *See, e.g.*, *E2W, LLC v. Kidzania Operations, S.a.r.l.*, No. 1:20CV02866 (S.D.N.Y., April 9, 2020) (temporarily restraining and enjoining franchisor from terminating franchise agreement).

[66] *Lampo Grp., LLC v. Marriott Hotel Servs., Inc.*, No. 3:20-CV-00641, 2021 WL 3490063, at *7 (M.D. Tenn. Aug. 9, 2021) ("*Force majeure* clauses are typically narrowly construed and will generally only excuse a party's nonperformance if the event that caused the party's nonperformance is specifically identified.").

expiration of a specified cure period), termination of course permanently concludes the franchisor's opportunities to receive such payments.[67]

By examining alternatives, the franchisor may continue receiving payments from the franchisee. In the case of franchisees that have fallen behind on their payments, the threat of termination coupled with alternative solutions could increase the payments collected by the franchisor.

In addition to potentially cutting off royalties, a franchisor could incur legal fees in pursuing termination. Even terminations based on obvious violations can quickly become expensive. If a franchisee does not immediately cease operations under the franchise, injunctions and litigation will likely follow. By pursuing an alternative to termination, franchisors can avoid these costs.

G. Evaluate Impact on System and Other Franchisees

Franchisors should also consider the impact of termination on their systems. There is no guarantee that customers of a terminated unit will return should a different franchisee reopen the business, nor will those customers necessarily seek out another franchised location. Additionally, customers may associate the now-closed unit with the franchisor's trademarks, which could reflect poorly on the entire franchise system.

Termination may also have a tangible effect on the franchise system and other franchisees. This is of particular concern in relatively small systems or shrinking systems. In both cases, the impact of a termination on the franchisee community could be substantial. The franchisor should therefore be cautious in announcing terminations to other franchisees. By casting the termination as a benefit to the entire franchise system—for example, to protect the brand's goodwill—the franchisor can frame the issue positively. Other franchisees may even appreciate the termination of poor operators.

Terminations may also lead to increased supplier costs and negative public scrutiny of the brand. They could impact nationwide accounts serviced by that franchisee, require notice to relevant lenders and landlords, and affect relationships with those parties.

Terminations could also affect prospective franchisees. Franchisors must disclose the number of franchisees who have left the system in Item 20 of its Franchise Disclosure Document ("FDD").[68] They must also disclose certain litigation—which may occur as a

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[67] While the franchisor could seek lost future royalties, such claims can be difficult to obtain. See, e.g., *Postal Instant Press, Inc. v. Sealy,* 51 Cal. Rptr. 2d 365, 369, 371 (1996) (court held that lost future royalties were not a proper element of contract damages because: (1) the franchisor's termination of the agreement, not the franchisee's non-payment, was the proximate cause of the lost future royalties; (2) regardless of proximate cause, it was "inappropriate to award lost future profits where it would result in damages which are unreasonable, unconscionable and oppressive"; and (3) the calculation of future royalties was too speculative to be allowed as contract damages). For further discussion see infra, Section VII.B.2.

[68] FDDs are presented to prospective buyers of franchises in the pre-sale disclosure process and their contents are outlined by 16 C.F.R. § 436.5(t). The most recent North American Securities Administrators

result of terminations—in Item 3.[69] In extreme cases, if the franchisor terminates a large number of franchisees, the FDD may need to be amended.[70] These disclosures could impact prospective franchisees. Further, for franchisors seeking to sell their systems to third-party buyers, publicly-disputed or otherwise notable terminations, or, more commonly, a significant number of terminations, may be construed as indicators of an unhealthy franchise system, thereby limiting potential sales opportunities.

H. Assess Viable Alternatives to Termination

One common alternative to termination is a workout. A workout, or forbearance, is an agreement between the franchisee and franchisor, and any other relevant parties, where the franchisor provides some assistance to the franchisee or agrees to waive certain obligations or payments. A workout can be as simple as the franchisor deferring or forgiving certain franchise payments, or it can involve complex financing and leasing arrangements. In addition, the franchisor may provide a period of time for a current franchisee to sell the business to a new or different qualifying and approved franchisee. The franchisor may offer some assistance in the effort to locate that buyer and may offer other incentives, like waiver of the transfer fee. A workout agreement typically includes the franchisee's reaffirmation of the franchise agreement and acknowledgement of: (i) its obligations under the franchise agreement, (ii) all defaults, (iii) the franchisor's remedies, (iv) agreed repayment terms or agreed terms for the cure of non-monetary defaults, (v) a general release in favor of the franchisor and its affiliates, (vi) any modification of terms of the franchise agreement, and (vii) a cross-default provision providing that a default under the workout agreement would be a default under the franchise agreement.

The goal of the workout agreement is to provide the franchisee a path to staying in the system despite its admitted prior defaults while helping the franchisor achieve more of its compliance objectives prior to further escalation.

Association's commentary on financial performance representations ("FPRs") states that when franchisors make an FPR in Item 19 of its FDD, it may exclude data from franchise outlets that closed during the time period covered by the FPR but only if the franchisor also discloses (i) the number of franchise outlets that closed during the time period covered by the FPR, and (ii) the number of excluded outlets that closed during the same time period after being open less than 12 months. NASAA Franchise Commentary Financial Performance Representations, dated May 8, 2017. That data also, therefore, will be available to prospective franchisees.

[69] *Id*. at § 436.5(c).

[70] See Maryland Regulations § 02.02.08.01(9)(a)-(b) (termination, within a three month period, of either 10% of the franchisees in Maryland or 5% of all franchisees, is a material charge); Haw. Code R. § 16-37-1 (termination, closing, or failure to renew during any three-month period of either 1% or 5 of all franchises regardless of location or 15% or two of the franchises located in Hawaii requires a material update); Ind. Code Ann. § 23-2-2.5-13.1 (termination, closing, or failure to renew within a three month period 10% of all franchisees regardless of location or 10% of franchisees located in Indiana is a material change); Wis. Admin. Code DFI-Sec § 31.01 (termination, closing, or failure to renew during any three-month period of either 1% or 5 of all franchises regardless of location or 15% or two of the franchises located in Wisconsin is a material change).

IV. Navigating the Labyrinth of State Relationship Laws

As noted in Section III.C., a number of states have laws addressing the franchise relationship, including defaults, franchisee terminations, and post-termination obligations. These laws restrict the ability of the franchisor to place the franchisee in default under, or terminate (or refuse to renew), the franchise agreement. They also regulate other aspects of the franchisor-franchisee relationship, which are outside the scope of this paper. It is critical that a franchisor determine which, if any, state relationship laws apply before the franchisor decides to default the franchisee or terminate the franchise agreement as failure to do so could result in substantial liability.[71]

A. Which State Relationship Laws Apply – No Two Statutes Are Identical

Currently, 20 U.S. jurisdictions[72] have enacted franchise statutes that govern some aspects of terminations and nonrenewals of the franchise relationship by the franchisor.[73] The statutes vary materially, although there are some general trends. For example, under most of these statutes, a franchisor may not terminate (or fail to renew) without "good cause." However, the definition of "good cause" varies among the applicable states. Similarly, some statutes require the franchisor to give the franchisee notice and an opportunity to cure the default prior to termination. The length of the prescribed notice period and termination process, along with exceptions to these requirements, likewise differ among the applicable states. A chart of required notice and cure periods under generally applicable state franchise laws is included at the end of this paper.

B. Jurisdictional Scope of State Relationship Laws

The first step of the analysis, of course, is to determine which, if any, state relationship laws apply. The jurisdictional scope of the termination restrictions of applicable state relationship laws may be broadly divided into three categories. The scope of the majority of state relationship laws—including Arkansas, Connecticut, Illinois, Iowa, Missouri, Nebraska, New Jersey, Rhode Island, Virginia, Wisconsin, and Puerto Rico—is narrow. These termination restrictions only apply if the franchised unit is located within the state.[74] The scope of the next group—including California, Hawaii, and Indiana—is

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[71] For example, the Washington Franchise Investment Protection Act provides that the commission of any unfair or deceptive act or practice prohibited by the Act's relationship provisions is also an unfair or deceptive act or practice under the Washington Consumer Protection Act.

[72] The Maryland Fair Distributorship Act does not apply to a franchisor regulated under the Maryland Franchise Registration and Disclosure Law. Similarly, North Dakota's distributor relationship law entitled "Franchise Merchandise Return" does not apply to franchises governed by the North Dakota Franchise Investment Law. Accordingly, neither law is included in the referenced 20 U.S. jurisdictions.

[73] New franchise disclosure and relationship laws in New Mexico, Oregon, and Utah and amendments to the current versions of Virginia, New Jersey, and Maryland are pending and may impact obligations for defaults and termination in specific circumstances.

[74] Ark. Code Ann. § 4-72-203; Conn. Gen. Stat. Ann. § 42-133h; 815 Ill. Comp. Stat. Ann. 705/19; Iowa Code Ann. §§ 523H.2, 537A10; Mo. Ann. Stat. § 407.400; Neb. Rev. Stat. Ann. § 87-403; N.J. Stat. Ann.

slightly broader. These termination restrictions apply if the franchised unit is located within the state or if the franchisee lives in that state.[75] The scope of the last group—including Michigan, Minnesota, and Washington—is the most comprehensive in terms of scope. The Michigan relationship law applies if (i) the offer to sell is made in the state, (ii) the offer to buy is accepted in the state, or (iii) if the franchisee is domiciled in the state, the franchised business is operated in the state.[76] The Minnesota relationship law applies if (i) the sale or offer is made in the state, (ii) the offer is made or accepted in the state, or (iii) the franchise is located in the state.[77] The Washington law applies if (i) the offer is directed into the state and received where it is directed, (ii) the offer originates from the state and violates the franchise or business opportunity law of the state in which it is directed, (iii) the franchisee is a resident of the state, or (iv) the franchised business is operated, at least in part, in Washington.[78] Note, however, that certain states, such as Nebraska and New Jersey, include additional jurisdictional elements. It is also important to evaluate whether there are any available exemptions or exclusions from an applicable state relationship law.

Franchisors should also note that, if the franchise agreement has a choice of law provision designating the law of a state that has a relationship law, a franchisee may attempt to argue that the relationship law applies even if the franchisee and its franchised business is not within the relationship law's jurisdictional scope. To limit such claims, the best practice is to exclude in the choice of law provision the application of the state relationship law where its jurisdictional elements are not independently met.

C. Conditions Required Prior to Termination

Underlying most state relationship laws is recognition of the significant investment that a franchisee undertakes when entering into a franchise relationship. Consequently, most state relationship laws relating to termination prevent a franchisor from unfairly terminating a franchise without "good cause." As with the jurisdictional scope, the relationship laws vary as to what constitutes good cause for termination and the procedural requirements for terminating the franchise.

1. Good Cause

Of the states that have a good cause requirement, several provide definitions.[79] While these definitions vary slightly, they generally provide that good cause is a failure to

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§§ 56:10-3, 56:10-4; 6 R.I. Gen. Laws Ann. § 6-50-2; Va. Code Ann. § 13.1-559; Wis. Stat. Ann. § 135.02; 10 L.P.R.A. § 278.

[75] Cal. Bus. & Prof. Code § 20015; Haw. Rev. Stat. Ann. § 482E-4, 6; Ind. Code. Ann. § 23-2-2.5-2.

[76] Mich. Comp. Laws § 445.1504.

[77] Minn. Stat. Ann. § 80C.19.

[78] Wash. Rev. Code § 19.100.020(2).

[79] These states include California, Connecticut, Hawaii, Illinois, Indiana, Michigan, Minnesota, Nebraska, New Jersey, Rhode Island, and Washington. For franchise agreements entered into or renewed on or after

comply with lawful and material provisions of the franchise agreement. Some states go further and outline specific situations that constitute "good cause" for termination.[80] These situations typically include a franchisee's bankruptcy, abandonment of the franchise, failure to pay amounts due, material impairment of the goodwill of the franchise system or the franchisor's trademarks, or repeated defaults of the franchise agreement. A list of such situations in a statute is not necessarily exhaustive.[81]

Iowa, in addition to good cause, requires that the termination not be arbitrary and capricious.[82] The Virgin Islands define good cause as the failure of the franchisee to substantially comply with the essential and reasonable requirements of the franchise agreement or the franchisee's use of bad faith in carrying out the terms of the franchise.[83] Delaware prohibits franchise terminations that are "unjust," *i.e.*, terminations that are without good cause or in bad faith.[84] Virginia prohibits termination without "reasonable cause."[85]

Puerto Rico arguably has the highest "good cause" standard.[86] Its state relationship law requires "just cause" for termination, which occurs only when (i) the franchisee fails to perform an essential provision of the franchise agreement or (ii) the franchisee's actions or failure to act "adversely and substantially" affect the interests of the franchisor in promoting the marketing or distribution of the merchandise or service. If the termination is based on a breach of a provision in the franchise agreement that prevents or restricts changes in the structure, control, or financing of the franchised business, the franchisor must demonstrate that the franchisee has affected, or may affect, the interests of the franchisor in an adverse or substantial manner in the development of the market, distribution of the merchandise, or rendering of services.[87] If the termination is based on a provision in the franchise

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January 1, 2016, California limits "good cause" for terminations to a franchisee's failure to substantially comply with the lawful requirements imposed upon the franchisee by the franchise agreement.

[80] The states that outline specific examples of circumstances constituting good cause include Connecticut, Illinois, Minnesota and Rhode Island. Hawaii allows termination for either good cause or if done in accordance with the franchisor's current terms and conditions if such standards are applied equally across the franchise system. *See* Haw. Rev. Stat. § 482E-6(2)(H).

[81] *See*, *e.g.*, Conn. Gen. Stat. § 42-133f(a) ("good cause . . . shall include, but not be limited to the franchisee's refusal or failure to comply substantially with any material and reasonable obligation of the franchise agreement . . . .").

[82] Iowa Code § 523H.7.

[83] V.I. Code Ann. tit. 12A, § 132.

[84] Del. Code Ann. tit. 6, § 2552.

[85] Va. Code Ann. § 13.1-564.

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

[87] *Id.* § 278a-1(a).

agreement fixing rules of conduct or distribution quotas or goals, the franchisor must show that the rule or conduct or distribution goal was reasonable in light of the "realities of the Puerto Rican market" at the time of the violation.[88]

2. Cure and Termination Periods

In addition to good cause, many states require mandatory cure and notice periods. Mandatory cure periods vary, but three general trends exist. First, a number of states do not require a cure period but do require notice of termination (also known as a "wind down" period). Second, some states mandate a "reasonable" cure period but not a specific number of days to cure. Finally, some states require a specific number of days to cure certain types of defaults.

Connecticut, Delaware, Indiana, Mississippi, Missouri, Nebraska, New Jersey, and the Virgin Islands do not require any cure period but do require, with certain exceptions, notice before termination becomes effective. In Connecticut, Nebraska, and New Jersey, the wind down period is 60 days, with certain exceptions. In Delaware, Mississippi, and Missouri, the wind down period is 90 days, with certain exceptions. Although Indiana's statute contains a 90 day-notice requirement, it rarely applies because any different notice period in the franchise agreement, including no notice period, overrides the statutory requirement.[89] The Virgin Islands require 120 days' notice.

The second group of states—California,[90] Hawaii, Illinois, Michigan, and Washington—require a cure period of unspecified duration. These states require a "reasonable" cure period, which generally means that the period need not be longer than 30 days.[91] These states also require that a franchisor provide a notice of termination but, unlike the prior group, do not require any notice period before termination becomes effective.

The final group of states—Arkansas, California, Iowa, Minnesota, Rhode Island, and Wisconsin—specify a cure period for certain defaults. Arkansas and Rhode Island require a 30-day cure period for such defaults. Minnesota and Wisconsin require a 60-day cure period for such defaults. California requires a "reasonable" cure period of at least

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[88] *Id.* § 278a-1(c).

[89] *See* Ind. Code Ann. § 23-2-2.7-3 ("Unless otherwise provided in the agreement, any termination of a franchise . . . must be made on at least ninety (90) days' notice.")

[90] This requirement applies to franchise agreements entered into before January 1, 2016. For franchise agreements entered into or renewed after January 1, 2016 or that are for an indefinite period of time, California requires a "reasonable" cure period of at least 60 days or more than 75 days. California Business and Professions Code, Division 8, Chapter 5.5, §20020.

[91] Washington provides that, with respect to defaults that cannot be cured within the statutorily mandated cure period, the franchisee must initiate "substantial and continuing action" to cure the default within the 30-day cure period. *See* Wash. Rev. Code § 19.100.180(2)(j).

60 days but not more than 75 days for such defaults.[92] Iowa requires a "reasonable" cure period between 30 and 90 days long. These states also require franchisors to provide notice of termination to the franchisee. The termination notice period generally ranges from 60 to 90 days depending on the state. Certain states allow for the termination notice period to run concurrently with the cure period.[93]

It is important to reiterate that the cure and termination notice periods discussed above apply to specified types of defaults. These statutes often provide for shorter (or even no[94]) cure/termination notice periods for other types of defaults. Before issuing a default to which one or more state relationship laws applies, franchisors must carefully review the statute and determine if the cure/termination notice applies to the specific default. A chart of notice periods under the various state relationship laws is included for reference at the end of this paper.

D. Incurable Defaults

In some instances, franchisees cannot cure defaults, such as where the default is particularly damaging to the franchise system or the franchisor's trademarks. Additional examples of incurable defaults include the commission of a crime by the franchisee, a declaration of bankruptcy by the franchisee, fraud, or a violation of standards that affects health and safety.[95]

Many states that require cure periods recognize the reality of incurable defaults and, with respect to certain types of defaults, permit the franchisor to terminate immediately without providing a cure period.[96] Washington, for example, allows for termination without giving the required notice or cure period if the franchisee (i) is adjudicated as bankrupt or insolvent, (ii) assigns the assets of the franchised business to

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[92] This requirement applies to franchise agreements entered into or renewed on or after January 1, 2016. For franchise agreements entered into or renewed prior to January 1, 2016, California requires a "reasonable" cure period which need not be longer than 30 days. California Business and Professions Code, Division 8, Chapter 5.5, §20020.

[93] These states include Arkansas, California, Minnesota, Rhode Island, and Wisconsin.

[94] For example, Arkansas's notice provisions do not apply if the basis of termination is one of certain specific examples of "good cause" under the statute. Ark. Code. Ann. §§ 4-72-202(7)(C)-(H), 4-72-204(c).

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

[96] Arkansas, California, Illinois, Minnesota, Rhode Island, Washington, and Wisconsin are among the states that permit termination without the state's required notice/opportunity to cure in certain circumstances.

creditors, (iii) voluntarily abandons the franchised business, or (iv) is convicted of violating any law relating to the franchised business.[97]

If a franchisor believes a default is incurable, case law also may provide guidance. Generally, if the default goes to the essence of the contract, the default is incurable. In *LJL Transportation, Inc. v. Pilot Air Freight Corp.*, a franchisee admitted that it had deliberately diverted business to a subsidiary to hide profits and avoid paying royalties to the franchisor.[98] No franchise relationship law applied, but the franchise agreement required notice of termination and an opportunity to cure.[99] Despite these provisions in the franchise agreement, the court held that the franchisor could terminate without providing the contractually required notice and cure periods because the franchisee's breach went to the essence of the contract and irreparably damaged the trust between the contracting parties.[100]

Not every court, however, has embraced the "essence of the contract" argument as a basis for termination. In *Manpower Inc. v. Mason*, an employment agency franchisee failed to require employers to complete and retain I-9 forms verifying each employee's eligibility for employment.[101] The franchisor contended that this was essential because the franchised business supplied temporary personnel to various employers and sought to terminate primarily on that incurable basis.[102] The court disagreed, defining an incurable breach as one with respect to 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."[103] The court ultimately held that breaches that go to the "essence of a contract," while not permitting termination, did justify rescission.[104]

In states with relationship laws, courts have also found that the franchisee's actions may excuse the franchisor from complying with the applicable statute. In *Harnischfeger Corp. v. Superior Crane Corp.*, a dealer misappropriated a manufacturer's designs and proprietary information to manufacture its own unauthorized replacement parts for the manufacturer's equipment.[105] The court held that the manufacturer was not

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[97] Wash. Rev. Code § 19.100.180(2)(j).

[98] *LJL Transp., Inc. v. Pilot Air Freight Corp*., 599 Pa. 546, 962 A.2d 639 (Pa. 2009).

[99] *Id*.

[100] *Id*.

[101] 377 F. Supp. 2d 672, 674 (E.D. Wis. 2005).

[102] *Id.* at 679. Plaintiffs also presented other reasons for immediate termination, such as the franchisee's inability to meet a minimum sales quota and insolvency. *Id.* at 674.

[103] *Id.* at 677.

[104] *Id.* at 679.

[105] Bus. Franchise Guide (CCH) ¶ 10,618 (E.D. Wis. 1995).

required to provide the dealer an opportunity to cure, as required under Wisconsin's relationship law, because the dealer's "bad faith" acts were not subject to the cure provision.[106]

Similarly, in *NOVUS du Quebec, Inc. v. NOVUS Franchising, Inc.*, a subfranchisor failed to require its franchisees to comply with the franchise system and also franchised units associated with another franchisor.[107] The court excused the franchisor from complying with the statute's cure period, which would have been "futile" given the widespread violations by the subfranchisor.[108]

E. Buyback Provisions

Some state relationship laws also require the franchisor to repurchase or "buyback" certain items upon termination of the franchisee. The states with these provisions are Arkansas, California, Connecticut, Hawaii, Rhode Island, Washington, and Wisconsin.[109] As with the good cause and notice/cure provisions, these buyback provisions vary.

Hawaii, Rhode Island, Washington, and Wisconsin have absolute buyback provisions that apply in all cases of termination, but generally at the option of the franchisee. In contrast, Arkansas requires a franchisor to repurchase items if the franchisee was not terminated with good cause. In California, even upon a lawful termination, the franchisor must repurchase items from the franchisee except under certain defined scenarios.[110]

In Rhode Island and Wisconsin, the franchisor must repurchase only the inventory items sold by the franchisor to the franchisee for resale that bear the franchisor's name, trademark, label, or other mark identifying the franchisor. In Arkansas, Connecticut,

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[106] *Id.*

[107] Bus. Franchise Guide (CCH) ¶ 10,823 (D. Minn. 1995).

[108] *Id.*

[109] Under Iowa's state relationship law, a franchisor may not prohibit a franchisee from, or enforce a prohibition against a franchisee from, engaging in any lawful business at any location after termination, unless the business relies on a substantially similar marketing program as the terminated franchisee or the franchisor offers in writing no later than 10 business days before expiration of the franchise to purchase the assets of the franchised business for its fair market value as a going concern. *See* Iowa Code § 523H.11.

[110] This requirement applies to franchise agreements entered into or renewed on or after January 1, 2016 or that are for an indefinite period of time. For franchise agreements entered into or renewed prior to January 1, 2016, California requires a franchisor to repurchase items if the franchisee was not terminated with good cause and if the franchisor fails to meet any of the terms of the California Franchise Relations Act.

Hawaii, and Washington,[111] the franchisor has to buyback inventory, supplies, equipment, and furnishings that were purchased from the franchisor or its approved suppliers. In California, the franchisor must repurchase the franchisee's inventory, supplies, equipment, fixtures, and furnishings that were purchased from the franchisor or its approved suppliers and sources that are, at the time of the notice of termination, in possession of the franchisee or used by the franchisee in the franchised business.[112] Arkansas, California, Connecticut, Hawaii, and Washington do not require the repurchase of any personalized items of the franchisee. In Washington, franchisors do not have to repurchase items that are not reasonably required in the operation of the franchise business.

State buyback provisions differ as to what price a franchisor must pay to repurchase the required items. The fair market value or the fair wholesale market value is commonly used as a valuation method. Other states use a different valuation calculation. In Arkansas, the purchase price for the applicable items is the franchisee's net cost less a reasonable deduction for depreciation or obsolescence. In California, the price is the price paid minus depreciation.

It is important to evaluate whether there are any available exclusions to these repurchase requirements. For example, in California, the repurchase obligation does not apply: (i) if the franchisor does not prevent the franchisee from retaining control of the principal place of the franchised business; (ii) to any termination due to a publicly announced and nondiscriminatory decision by the franchisor to withdraw from all franchise activity within the applicable geographic market in which the franchise is located; (iii) to any personalized items, inventory, supplies, equipment, fixtures, or furnishings not reasonably required to conduct the operation of the franchise business; or (vi) to inventory, supplies, equipment, fixtures, or furnishings to which the franchisee, cannot lawfully, or does not, grant the franchisor clear title and possession.[113]

V. Steps in the Default/Termination Process

This Section provides an overview of the default and termination process. A franchisee's failure to comply with a franchise agreement typically falls into two categories: monetary defaults and non-monetary defaults. The steps that begin the default/termination process vary for each.

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[111] Under the Washington state relationship law, the franchisor is required to purchase inventory and supplies not purchased from the franchisor or on its express requirement only if the franchisee is to retain control of the premises of the franchised business.

[112] This requirement applies to franchise agreements entered into or renewed on or after January 1, 2016 or that are for an indefinite period of time. For franchise agreements entered into or renewed prior to January 1, 2016, California requires the franchisor to repurchase items if the franchisee was not terminated with good cause, as well as requires buybacks if the franchisor fails to comply with the California Franchise Relations Act.

[113] Cal. Bus. & Prof. Code § 20022(d), (e). The Washington relationship law includes a similar concept. *See* Note 105.

A. Pre-Default Procedures

As discussed above, a franchisee's breach of its franchise agreement will not necessarily compel the franchisor to immediately place the franchisee in default. Instead, the franchisor may take various "pre-default" actions to encourage the franchisee to remedy its non-compliant behavior.

1. Monetary Defaults

The franchisor's accounting department is the first line of defense when a franchisee fails to timely fulfill its monetary obligations under the franchise agreement. If a payment from a franchisee was not timely received or could not be successfully debited from the franchisee's account, the accounting department, in consultation with the applicable franchisor personnel, should consider informally contacting the franchisee. An initial "friendly warning" by the franchisor can put the franchisee on notice without escalating the situation.

This warning may assume a variety of forms, depending on the nature and gravity of the default, as well as the franchisee's history. For a first-time offender, a simple inquiry may be all that is necessary to secure payment. If that is unsuccessful, the franchisor's legal department may need to step in.

Even then, however, the franchisor may not choose to send a notice of default to the franchisee. Instead, a more informal notice, or request for compliance, can be sent. This less adversarial approach may encourage the franchisee to respond in kind. Such leniency may also build a positive record of communication, which will benefit the franchisor in the event of litigation.

2. Non-Monetary Defaults

Like accounting representatives for monetary defaults, franchise business consultants and field representatives are key for handling non-monetary or operational defaults. A franchisor's field representative is typically the one who will first identify such a default during a routine visit or a formal inspection. The next step depends on the severity of the default.

For run-of-the-mill operational deficiencies, the field representative may provide the franchisee with a task list noting the deficiencies and required actions for addressing each. If the franchisee corrects them, once confirmed by the field representative, the situation typically ends there. Many brands have an operational assessment or quality assurance scorecard or checklist setting forth the areas and specific items within each area that will be reviewed during an inspection (such as whether the equipment is fully functional, the bathrooms are cleaned and stocked, or the required marketing collateral is on display). This written operational assessment report, typically signed and dated by the franchise business consultant and the franchisee upon the conclusion of the inspection, permits the franchisor to identify clearly the deficiencies observed and provides the franchisee a clear roadmap of what it must to do to bring the franchised

business up to standards. The scorecard can also be attached to an informal notice or request for compliance and a formal notice of default.

If the franchisee does not comply, the franchisor's administration and legal department should be notified. A formal default may be necessary to enforce compliance. If, however, the franchisee's actions, or failure to act, is jeopardizing the health or safety of customers and/or the franchisee's employees, the franchise business consultant should immediately notify the franchisor's legal department. In contrast, a defective lobby television may be adequately addressed through communications between the franchisee's franchise business consultant and the franchisee without further escalation and similarly would likely not qualify as good cause for a default and termination.

The franchisor and its personnel should ensure that all issues are thoroughly and carefully documented in writing in all cases. Establishing a complete written record is essential and will be critical if the franchisee's non-compliance persists or litigation is initiated.

B. Notice of Default

Assuming that the default is not so severe as to require immediate termination in accordance with the franchise agreement, the franchisor's next step is to prepare a default notice. The notice serves three primary functions. First, it notifies the franchisee of a default of the franchise agreement, referencing specific provisions that have been breached and identifying the actions constituting such violations. Second, it identifies what corrective action the franchisee must take to cure the default and the time period in which the default must be cured, as determined in accordance with the franchise agreement and any applicable state relationship law(s). Finally, it previews the consequences if the franchisee fails to cure the default by the applicable deadline, including termination or other legal action.

1. Franchise Agreement/State Statutes

The most critical aspect of issuing a default notice is confirming that the notice satisfies *both* the requirements under the franchise agreement *and* any applicable state relationship laws. First, the franchisor must identify a contractual basis for issuing a default and ensure that the default is consistent with any applicable state relationship law – for example, does the cited default constitute "good cause" under the applicable statute? Second, the franchisor must identify the cure period under the franchise agreement (if any) and ensure that any applicable relationship law does not afford the franchisee a longer cure period for the specific default. If the contractual and statutory cure periods conflict, the franchisor must grant the franchisee the longer cure period to satisfy both the franchise agreement and applicable statute.

The franchisor must also review the agreement to determine how and to whom to send the default notice. Franchise agreements almost always include a "notice" section that lists exactly how the notice of default must be delivered (*e.g.*, first-class mail, courier, email, etc.) and where to send the notice. These provisions may also indicate when to

start the cure period (if any), including from the day the notice is sent, received, or some other date. State statutes may prevent franchisors from starting the clock before the notice is received by the franchisee.

2. Content

A notice of default must clearly state the facts forming the basis for the default, the steps that must be taken to cure the default, the deadline for curing the default, and the consequences of failing to cure the default.[114] The notice, of course, must also identify the date of the franchise agreement, the franchisee of record, and the address of the franchised business. If the franchisee operates multiple franchised businesses under the brand, the notice should state if the franchisor intends to exercise any right it may have under those other franchise agreement to cross-default those other franchise agreements based on the applicable default or, at minimum, "remind" the franchisee that the franchisor has such rights.[115] Reminding the franchisee that <u>all</u> of its franchised businesses are in jeopardy should it fail to remedy the default under one agreement, as required, may compel compliance.

The franchisor should ensure that the relevant parties actually receive the notice of default. If there is any doubt as to the continuing validity of the notice address in the franchise agreement, a duplicate notice should be sent to any address that the franchisor deems necessary to effectuate actual notice. The franchisor should also forward the notice to any guarantors. In most cases, proof of delivery to the franchisee is necessary to calculate when the cure period began. Consequently, franchisors should retain copies of all available delivery receipts.

C. Notice of Termination

Franchisors send notices of termination to provide formal notice that the franchise relationship has ended and identify the effective date of termination. These notices usually follow a notice of default when the franchisee has failed to cure such default timely and/or properly. They may also be sent in situations where neither the franchise agreement nor an applicable state relationship law requires a cure period, and the franchisor wants to terminate without providing one. In other situations, a franchisor may

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[114] Under New York law, a default notice must specify the default, state that failure to cure will result in termination, and be sent in accordance with the notice provision. *In re 4Kids Ent., Inc. v. TV Tokyo Corp.,* 463 B.R. 610, 688–89 (Bankr. S.D.N.Y. 2011) (finding licensor failed to send the notices by overnight carrier as required).

[115] Often, franchise agreements contain a "cross default" provision, which is typically in the termination section. A standard cross-default provision will permit the franchisor to terminate that agreement if the franchisee or the franchisee's affiliate breaches another franchise agreement with the franchisor. If the franchisor chooses to terminate multiple agreements with the same franchisee for breach at only one location or under only one agreement, it is important to review and follow the requirements of the cross default provision, including with respect to notice and opportunity to cure (if any), and ensure that the cross-default provision is enforceable under applicable law.

send a hybrid notice of default and termination.[116] Such notices are often called "self-executing default notices" because they provide notice of the default and automatically terminate the franchise relationship if the default is not cured.[117] Termination notices generally entail the same considerations as default notices, except, of course, with respect to cure periods. In addition, franchisors should consider the following issues.

1. Franchise Agreement/State Statutes

If a notice of default was previously sent (or not required) the franchisor should already be familiar with any relevant parameters under state relationship laws. Even so, the franchisor will want to revisit the relevant state statute and the franchise agreement to determine any information that specifically needs to be included in the termination notice. For instance, states that require a notice of termination typically include a requirement that the notice explain the reasons for it.[118] Any notice of default or termination, however, should always be clear as to the basis for such default or termination, regardless of whether an applicable state relationship law mandates the inclusion of such details. Other states may require a valid notice of termination "to be clear and unambiguous."[119]

Additionally, if an expired franchisee is operating as a holdover franchisee or on a month to month basis, the franchisor should ensure compliance with both nonrenewal and termination requirements under both the applicable franchise agreement and the relevant state relationship laws.

The franchisor must also review state relationship laws and the franchise agreement to determine the parties' post-termination obligations. As previously noted, certain state relationship laws have buyback provisions that require the franchisor to repurchase certain goods from the franchisee in the event of termination under certain conditions.[120] Franchise agreements typically require the franchisee to comply with a number of post-termination obligations, including payment of all amounts owed to the franchisor and its affiliates and de-identification of the franchised location.

2. Content

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[116] The most common situation when hybrid notices are used is when a state relationship law requires both a cure period and notice of termination period and allows for them to run concurrently. *See*, *e.g.*, Minn. Stat. Ann. § 80C.14 (requiring a 60-day cure period and 90 days' notice prior to termination).

[117] If a self-executing notice is used, the franchisor may want to send a "confirmation of termination" after the notice period expires.

[118] Arkansas, Connecticut, Iowa, Minnesota, Nebraska, New Jersey, Rhode Island and Wisconsin are among the states requiring that a notice of termination describe the basis of the franchisee termination.

[119] *See, e.g.*, *In re RMH Franchise Holdings, Inc. v. Dine Brands Global, Inc.*, 590 B.R. 655, 662 (Bankr. D. Del. 2018) (discussing the validity of a notice of termination in view of a cure extension).

[120] *See* Section IV.E.

Many state relationship laws require a notice of termination to include all bases for termination. As stated above, even if not expressly required under applicable law, a franchisor should always detail the bases for termination in a notice. The notice of termination should also specifically state the effective date of termination.[121] This date could be upon the franchisee's receipt of the termination notice, the expiration of any required cure period, or some other date.

Additionally, the termination notice should "remind" the franchisee of its post-termination obligations, as set forth in the franchise agreement, including any post-termination covenants. Franchise agreements also often include a provision requiring the franchisee to provide the franchisor certain documentation demonstrating that the franchisee has complied with its post-termination obligations, which may include photographic evidence of de-identification. If applicable, this obligation should also be referenced in the notice, along with a description of the documentation or proof of franchisee's compliance that the franchisor requires.

As with a notice of default, the franchisor should ensure that the notice of termination is sent to the franchisee's notice address and that duplicates are sent to any such additional address(es) to effect actual notice. Duplicates should be sent to any guarantors.

D. Cease and Desist

In some cases, a terminated franchisee may ignore a notice of termination and continue to operate the franchised business. Before initiating legal action, franchisors may opt to send a "cease and desist" letter. A standard letter briefly recounts the events leading up to the default and termination, emphasizing that the continued operation of the franchised business and unauthorized use of the franchisor's marks constitute a breach of the franchise agreement and a violation of federal law, including the Lanham Act.[122] At this stage, the franchisor should collect evidence of continued operation, including the franchisee's unauthorized use of the marks and unauthorized sale of the franchisor's products or services. The letter should demand that the franchisee not only cease operations and comply with its post-termination obligations, but also certify the franchisee's compliance with those obligations.

The effect of a cease and desist demand will depend on the specific franchisee. If the letter does not result in compliance, the franchisor may need to consider other enforcement avenues.[123]

[121] California expressly requires that the notice of termination include the effective date of the termination. *See* Cal. Bus. & Prof. Code § 20030(c)(2).

[122] 15 U.S.C. § 1051 *et seq*.

[123] *See* Section VII.

E. Workout Agreements

Workout agreements can be an effective alternative to termination.[124] Even if the franchisor and franchisee have already agreed to the terms of a workout, the franchisor may still want to send a notice of default to the franchisee. The notice can lay the groundwork for a later termination if the franchisee repeats the defaults. If the parties have not yet executed a workout agreement, a default notice can lay out the details of a proposed workout agreement and require the execution of the workout agreement in order to cure the default.

VI. Dealing With Other Franchisees

A. Selective Enforcement

Franchisors should consider not only how their decisions might affect the non-compliant franchisee, but also how other franchisees might view any responsive action. Among other things, when a franchisor decides to enforce a standard that is not widely observed in its system against a particular franchisee, that franchisee and other franchisees may view the franchisor's individualized treatment as discriminatory.

Many franchise agreements address this issue with explicit acknowledgements by the franchisee that other franchise agreements may include different terms, and that the franchisor's decisions regarding other franchisees do not constitute a waiver of any rights the franchisor may have under their own franchise agreement. Despite these provisions, franchisees may still complain about a franchisor's selective treatment, particularly in situations where a franchisor decides to forgive one franchisee's breach of a certain contractual obligation but seeks to enforce the same obligation against another.[125]

Courts typically reject claims that selective enforcement by a franchisor is improper. For example, in *Original Great American Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.*, the Seventh Circuit rejected a franchisee's defense of selective enforcement, noting that "[t]he fact that the [franchisor] may have treated other franchisees more leniently is no more a defense to breach of contract than laxity in

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[124] See Section III.G.

[125] For a comprehensive discussion of issues relating to selective enforcement in the franchise context, see Mark J. Burzych and Emily L. Matthews, *Vive La Difference? Selective Enforcement of Franchise Agreement Terms and System Standards*, 23 Franchise L.J. 110 (Fall 2003).

enforcing the speed limit is a defense to a speeding ticket."[126] Other courts have reached similar conclusions.[127]

Complaints of selective enforcement have also been unsuccessful where the franchisor demonstrates a legitimate reason for not taking similar actions against other franchisees that may have committed similar violations. For example, in *Bonanza Int'l, Inc. v. Rest. Mgmt. Consultants, Inc.*, the court reasoned that a franchisor's disparate treatment of other franchisees was justified because the franchisor either had a long-standing relationship with such franchisees or their defaults had been timely cured.[128]

As discussed in Section III.D., two common franchisee arguments related to selective enforcement include waiver and discrimination. Franchisees may sometimes contend that the franchisor excused or waived the franchisee's non-compliance by failing

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[126] 970 F.2d 273, 279 (7th Cir. 1992); *see also KAM Dev., LLC v. Marco's Franchising, LLC*, No. 3:20-CV-2024, 2021 WL 5599362, at *12 (N.D. Ohio Nov. 30, 2021) (slip copy) (relying on *Original Great American Chocolate Chip Cookie* and to conclude franchisee "cannot avoid the consequences of its nonperformance by arguing, or even showing, that other ARs [Area Representatives] may have been renewed despite not having strictly complied with their development obligations").

[127] *See also*, *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 its franchisees to conform to 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. 1985) (affirming franchisor's termination of franchisee over franchisee's argument regarding selective enforcement because 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, 1262 (M.D. Fla. 2009), *aff'd*, 370 F. App'x 55 (11th Cir. 2010) (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. 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. 1989) (implied covenant of good faith and fair dealing not violated by selective enforcement of franchise agreement because the covenant does not require franchisors to deal with other franchisees in a particular manner). In certain contexts, however, selective enforcement can inhibit a franchisor's ability to exercise its rights. *See*, *e.g.*, *Surgidev Corp. v. Eye Tech., Inc.*, 648 F. Supp. 661 (D. Minn. 1986) (accepting selective enforcement evidence as a defense to enforcement of a non-compete because "[u]nder the circumstances, it would be inequitable to permit plaintiff to now rely on a non-compete agreement which it has so blithely ignored in the past.").

[128] 625 F. Supp. 1431 (E.D. La. 1986); *See also Baskin Robbins v. D&L Ice Cream Co., Inc.*, 576 F. Supp. 1055, 1059 (E.D.N.Y. 1983) (allowing selective enforcement when other franchisee who sold unauthorized products removed the products within 24 hours); *NOVUS du Quebec, Inc.*, Bus. Franchise Guide (CCH) ¶ 10,823 (D. Minn. 1995) (failure to enforce quality standards with respect to some franchisees did not prevent termination of another franchisee for standard violations since the violations of terminated franchisee were more serious, and the franchisor had warned the offending franchisee); *Petland, Inc. v. Hendrix*, No. 204CV224, 2004 WL 3406089, at *7 (S.D. Ohio Sept. 14, 2004) (franchisor's selective enforcement of non-competition clause was grounded in credible business reasons, *e.g.*, other markets were not meant for re-franchising, and did not serve to render non-competes invalid against franchisee defendants).

to strictly enforce the franchise agreement. This argument is generally unsuccessful when the franchise agreement contains standard anti-waiver language.[129]

Discrimination claims are closely related to complaints of selective enforcement. Franchisees may assert that the franchisor's selective enforcement of its franchise agreements constitutes a violation of state or federal anti-discrimination statutes. The statutes in this area and the case law interpreting these statutes give a franchisor a great deal of leeway in dealing with its franchisees, provided the franchisor treats "similarly-situated" franchisees in approximately the same manner and it has rational, non-arbitrary reasons for engaging in the alleged discrimination between franchisees.[130]

B. Communication with Other Franchisees

Franchisors should also aim to be reasonable and fair and to demonstrate this before other franchisees. Communications with other franchisees regarding system defaults and terminations can take various forms. In some instances, there may be a very public issue regarding a particular franchisee's breach of its agreement – *e.g.*, a health and safety issue, or some other aspect of the franchisee's conduct that garners press attention. Particularly in situations where there is negative publicity surrounding a franchisee's defaults, it is important that a franchisor reassure its franchisees and the public that it is responding to the offensive conduct and acting to protect the system.

Most franchise defaults do not draw outside attention. In these routine circumstances, franchisors may elect to be the primary source of information to franchisees regarding system defaults and terminations. Franchisors may present enforcement efforts at annual franchisee conventions or update the franchisee advisory council. Such communication serves two purposes: (i) it reassures franchisees that the franchisor is actively working to protect the system and goodwill of all franchisees by enforcing franchise agreements and system standards, and (ii) it warns franchisees that the franchisor takes defaults seriously.

Franchisors should be mindful of the perception of unfair or bad faith actions, including a perception of "bullying". This is especially necessary in a climate where social media allows individuals to quickly and publicly spread their side of any story, while others weigh-in with comments and criticisms. Accordingly, franchisors should strategically craft their message to other franchisees regarding defaults and be careful to manage the perception they give other franchisees and their customers. At the same time, any messaging to franchisees about a specific default or termination should be carefully controlled by the franchisor. It is important to protect franchisee confidentiality. Franchisor

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[129] *See, e.g.*, *In re Keelboat Concepts, Inc. v. C.O.W., Inc.*, Bus. Franchise Guide (CCH) ¶ 13,216 (Ala. 2005) (where the franchise agreement has an anti-waiver provision, the franchisor's failure to strictly enforce some terms of the contract against the franchisee cannot amount to a waiver of other requirements); *Subaru Distribs. Corp. v. Subaru of Am., Inc.*, Bus. Franchise Guide (CCH) ¶ 12, 264 (S.D.N.Y. 2002) ("no waiver" clause protected importers right to demand exact compliance with contractual provisions).

[130] *See supra* Section III.D.2.

employees should not feel automatically authorized to share information about particular franchisees with others.

VII. Enforcing Termination

Most franchise agreements impose various post-termination obligations on the franchisee, such as the obligation to cease operations, to discontinue use of the franchisor's confidential information and proprietary trademarks, trade secrets and trade dress, to cancel phone listings, and to de-identify the franchised premises (meaning remove signs, symbols, logos, devices, forms, and other trade dress and items associated with the franchised system), and cancel advertising and social media accounts using trademarked logos, etc. These are critical requirements to protect the brand and the goodwill associated with the trademarks and system. Indeed, the trademarks and the system are the most valuable assets of many franchised systems, and the franchisor and other franchisees depend on the goodwill associated with those things. For this reason, a former franchisee should not be permitted to continue to operate using and displaying the trademark, trade dress, system and trade secrets. Further, to protect the system and trade secrets and avoid customer confusion, franchise agreements almost always include a covenant not to compete that prevents the franchisee and its principals from operating a competing business at the location of the former franchised business or an area near to it.[131]

Acting quickly to enforce these post-termination obligations and restrictions is critical. As noted above, the termination notice should have included the post-termination requirements and the franchisor should be following up to ensure and demand compliance. If the franchisee does not act quickly to comply and/or continues to operate and/or continues to display or use the trademarks, trade dress, system and trade secrets, swift action is often required. We discuss below the escalation of options to address this situation, but note that if injunctive relief through courts is required, delay in pursuing it can be a factor the court will consider.[132]

A. Non-Judicial Enforcement

1. Self-Help Remedies for Franchisors

[131]Non-compete covenants are under assault in several states and federally. The thrust of the assault is on preventing or limiting enforcement of these clauses in the employment context, but most states have interpreted the law and statutes addressing non-compete covenants as also applying to franchise agreements, especially in the context of preventing a former owner or manager of franchised location from working in a competing business. While beyond the scope of this paper, it is critical that a franchisor seeking to enforce a post-termination non-compete covenant carefully review the applicable law(s) (and practitioners drafting franchise agreements to be aware of applicable laws in writing non-compete clauses).

[132]See, e.g. *Stone Strong, LLC v. Stone Strong of Texas, LLC*, No. 21-CV-3130, 2021 WL 4710449 at *7 (D. Neb. Oct. 8, 2021) (denying franchisor's motion for preliminary injunction on the bases that the franchisor did not show irreparable harm because it waited 10 months to enforce its rights and that was "a long time to tolerate putatively irreparable harm.").

Many franchise agreements allow the franchisor to take certain actions on the franchisee's behalf with respect to de-identifying the location of the former franchised unit. For example, agreements often give franchisors the right to de-identify the former franchised premise, at the franchisee's expense, without committing trespass or some other tort (and many franchisors require that the lease between the franchisee and landlord include such rights in the form of a lease rider specified by the franchisor). Franchisors, however, may decide not to invoke such self-help rights, like when the former franchised location is not geographically convenient for any of the franchisor's personnel. Moreover, absent permission from the property owner, self-help is fraught with legal risk.[133] And the franchisor may never collect its expenses— especially if the former franchisee already owed the franchisor money.

Where self-help is unavailable or impractical, the franchisor may turn to other avenues for enforcing the termination of the franchise agreement.

2. Mediation

Before or instead of resolving a dispute before the courts, parties may engage in in one or more forms of alternate dispute resolution ("ADR"). Mediation is one type of ADR where an impartial third party attempts to help parties negotiate a mutually-agreeable solution. It can be an efficient and cost-effective way of reaching resolution. Other benefits include control of the process, confidentiality, and speed to resolution.

Some franchise agreements require mediation as a first step to resolving any dispute. The clauses typically mandate the parties submit certain (or all)[134] disputes to nonbinding mediation upon the request of either party. Nonbinding means that the parties must merely engage in the mediation—often expressly in good faith—before proceeding to litigation.

Although mediation is controlled by the parties, the proceedings generally follow a similar format. After being selected by the parties, the mediator solicits input from both parties regarding legal and factual issues in the dispute—usually via written submission and follow-up joint or *ex parte* phone calls with the parties' counsel. Next, the actual mediation session occurs, during which the mediator may begin by joining the parties together and requesting opening statements from counsel. If the mediator thinks that opening statements would not be productive—perhaps because both parties are highly sophisticated or too emotionally involved—the mediator may start with each party in its own room. The mediator then shuttles between rooms, discussing strengths and

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[133] If the franchisor holds the site of the franchisee's business through a lease or sublease, self-help might be easier, as the franchisor has the right of access. But even in these circumstances the franchisor will incur expenses in removing the vestiges of the terminated franchisee.

[134]As noted above, if a former franchisee is refusing to de-identify the location and/or operating while using and displaying the trademark, trade dress, system and trade secrets, it may be necessary to skip or delay mediation (or pursue arbitration) and first seek an injunction to require compliance with the post termination obligations. Many franchise agreements carve out claims for injunctive relief from the scope of claims covered by the mediation (and arbitration clauses).

weaknesses of each party's claims and defenses and pushing each party to agree to some sort of compromise that makes business sense for both. Various organizations offer mediation services, such as the National Conflict Resolution Center, American Arbitration Association, CPR Institute, and state and local ADR organizations.

If one party refuses to engage in contractually-mandated mediation, courts often compel that party to participate.[135] Since most jurisdictions do not have mediation-specific acts, courts extend the scope of arbitration laws to include mediation clauses— grouping arbitration and mediation under the general rubric of ADR.[136] The rationale for this extension is that both arbitration and mediation evidence the parties' desire to pursue an alternative to litigation.[137]

A handful of courts, however, have distinguished mediation from arbitration and refused to compel the former. In *Lynn v. Gen. Elec. Co.*, the court applied a two-step test to address this very issue.[138] The first step examined how closely the proposed mediation process resembled classic arbitration, and the second step analyzed whether treating the procedures the same furthered Congressional intent.[139] In refusing to compel mediation, the court's decision hinged on the fact that arbitration is binding while mediation is not, and that there was no evidence suggesting Congress intended to include mediation in the Federal Arbitration Act.[140]

3. Arbitration

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[135] *Brave Optical, Inc. v. Luxottica of Am., Inc.*, No. 1:23-cv-793, 2024 U.S. Dist. LEXIS 112552, at *13 (S.D. Ohio June 26, 2024) (concluding that the plaintiffs were required to mediate before filing their lawsuit as the relevant agreement were clear and staying the "case until the parties have completed the contractually required mediation").

[136] The Federal Arbitration Act, 9 U.S.C. §§ 1-15 governs the enforcement of arbitration agreements. *See infra* Section VII.A.3; *see*, *e.g.*, *Wolsey, Ltd. v. Foodmaker, Inc.*, 144 F.3d 1205 (9th Cir. 1998) (finding a mediation provision enforceable, and that the lower court should have granted the motion to compel arbitration under the FAA).

[137] *See CB Richard Ellis, Inc. v. Am. Envtl. Waste Mgmt.*, No. 98-CV-4183(JG), 1998 WL 903495, at *2 (E.D.N.Y. 1998) (noting that "[b]ecause the mediation clause in the case at bar manifests the parties' intent to provide an alternative method to 'settle' controversies arising under the parties' [sic] agreement, this mediation clause fits within the Act's definition of arbitration.") (citing 9 U.S.C. § 2); see also *Nurse Next Door Home Healthcare Servs. USA, Inc. v. Sipp*, No. C24-884 MJP, 2024 U.S. Dist. LEXIS 147830 (W.D. Wash. Aug. 19, 2024) (granting a motion to compel arbitration despite argument that failing "to mediate prevents issuance of an order compelling arbitration" as the failure to mediate must be addressed before the arbitrator).

[138] No. 03-2662-GTV-DJW, 2005 WL 701270, at *5 (D. Kan. Jan. 20, 2005).

[139] *Id.*

[140] *Id.* at *6.

Arbitration is another common form of ADR. It involves submitting a dispute to a private arbitrator or a panel of arbitrators who hear the parties' dispute and issue an award that the parties often agree in advance to be bound by.

Arbitration can offer various advantages over litigation. Like mediation, arbitration may provide for a more rapid resolution of disputes and the ability to select decision makers with relevant experience. Arbitration proceedings are also private and can be subject to confidentiality. Arbitration proceedings also tend to be more procedurally relaxed than litigation.[141] Historically, arbitration was faster and less expensive and while arbitrations tend today to take longer and have more expenses (e.g. discovery) than decades ago, it can still be faster and less expensive than court cases, and the parties are free to provide limits to discovery and other procedural terms to streamline the process. Another advantage is that clauses that may not be enforced under state law in a court proceeding will be enforced in arbitration because the FAA preempts state law and provides that the terms of the parties' agreement must be enforced as written. This means that clauses like class action waivers and venue in the state of the franchisor, even for franchise agreements in states with relationship laws that do not enforce venue, are enforced in arbitrations.

There are some disadvantages. Due to the limited scope of judicial review, arbitration awards are generally unappealable or unsuccessfully appealed.[142] Also, there is a perception by many attorneys that dispositive motions, which can end a legal proceeding at an early stage, are difficult to obtain in arbitration. Critics also complain about the perceived tendency by some arbitrators to issue compromise awards and never rule fully in favor of either party.

Despite these concerns, many franchise agreements require arbitration for some or all disputes arising under them or relating to the franchise relationships.[143] As noted above, many arbitration provisions in franchise agreements exclude claims seeking equitable relief, like injunctions. Often claims relating to the franchisor's intellectual property and right to enforce restrictive covenants are also excluded.

One of the reasons that arbitration is so prevalent is that the parties' agreement to arbitrate is heavily protected by state and federal laws. The Federal Arbitration Act ("FAA") strongly favors enforcement of arbitration clauses in commercial contracts.[144] This

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[141] *See*, *e.g.*, American Arbitration Association Commercial Arbitration Rules, R-35(a) ("Conformity to legal rules of evidence shall not be necessary.").

[142] *C&C Commc'ns, LLC v. T-Mobile USA, Inc.*, No. 86334-7-I, 2025 Wash. App. LEXIS 26 (Wa. Ct. App. Jan. 13, 2025) (affirming the lower court's confirmation of arbitration award for attorneys' fees and costs as C&C failed to meet the heavy burden to demonstrate that the arbitrator exceed his authority).

[143] A detailed discussion of arbitration proceedings is beyond the scope of this paper. For more on this topic, see Bethany L. Appleby, Richard L. Rosen and David L. Steinberg, *Inside a Franchise Arbitration*, ABA 31st Annual Forum on Franchising (October 2008).

[144] The FAA specifically provides that "[a] written provision in...a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction...shall

law allows a party subject to a contract with an arbitration clause to petition a federal court to stay any litigation and to compel arbitration.[145]

Many franchise agreements designate an arbitration administrator, like the American Arbitration Association ("AAA") and JAMS (formerly Judicial Arbitration and Mediation Services). To initiate a proceeding, either party must file a "Demand for Arbitration," which is similar to filing a complaint in court.[146] The responding party has a period to file an answer or counterclaims. Under most administrator rules, the failure to file an answer is deemed a denial of all claims by that party—which is a significant difference from most court rules. Next, the administrator leads the arbitration selection process, which is either governed by the parties' express agreement or the administrator's rules. The arbitrator then sets the duration and scope of discovery, any other pre-hearing deadlines, and the final hearing deadline. After the final hearing occurs, the arbitrator issues an award.

An award is merely a piece of paper until a court turns it into a judgment. The FAA provides that if a party applies to the proper court for an order confirming an arbitration award, the court "must grant such an order unless the award is vacated, modified, or corrected as prescribed in Sections 10 and 11 of the [FAA]."[147] These sections set forth certain technical grounds for modifying or correcting an award as well as egregious grounds for vacating an award, such as when the award is procured by corruption, fraud, or undue means.[148]

In 2008 the Supreme Court held in *Hall Street Associates, LLC v. Mattel, Inc.*, that Section 10 and 11 of the FAA are the exclusive grounds for vacating, modifying, or correcting an arbitration award, and cannot be supplemented by contract.[149] This ruling created uncertainty regarding the viability of a judicially-created standard for vacating arbitration awards that involved a "manifest disregard of the law."[150] Federal circuit courts

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by valid, irrevocable, and enforceable, save upon grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2; *See also, Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

[145] *See, e.g.*, *High Country Dealerships, Inc. v. Polaris Sales, Inc.*, No. 1:18-CV-00078-MR-DLH, 2018 WL 3620494, at *2-3 (W.D.N.C. July 30, 2018) (court compelled arbitration under the FAA after dealer agreement was terminated where there was: (i) a dispute between the parties, (ii) a written agreement that contained an arbitration provision purportedly covering the dispute, (iii) a transaction related to interstate or foreign commerce, and (iv) failure, neglect or refusal of one party to arbitrate the dispute).

[146] *See*, *e.g.*, www.adr.org.

[147] 9 U.S.C. § 9.

[148] 9 U.S.C. §§ 10-11.

[149] 552 U.S. 576, 584 (2008).

[150] In dicta in the 1953 case of *Wilko v. Swan*, the Supreme Court mentioned "manifest disregard" while discussing the power to vacate arbitration awards, spawning a significant body of case law that treated manifest disregard as a separate judicially-created basis to vacate arbitration awards. 346 U.S. 427 (1953);

remain split regarding whether manifest disregard of the law is still a viable ground on which to overturn an arbitration award.[151] Although the precise standard for overturning an arbitration award may vary, courts routinely confirm arbitration awards absent unusual events during the arbitration process.[152]

B. Judicial Enforcement

1. Injunctive Relief

To enforce a termination and compliance with the franchise agreement's post termination covenants, franchisors often seek preliminary and permanent injunctive relief from the courts. Although relatively routine in the franchising context, injunctions are generally considered an extraordinary and drastic remedy that are closely scrutinized by the courts.[153]

To obtain an injunction, the moving party generally must demonstrate (i) a likelihood of success on the merits, (ii) that it will be irreparably harmed if the injunction is denied, (iii) that the harm to it if the injunction is denied is greater than the harm to the non-moving party if the injunction is granted, and (iv) that the public interest favors issuance of the injunction.[154] Courts vary in how these factors are applied and weighed, such as whether a movant must establish each element with equal weight or the court will employ a sliding scale approach where the greater the irreparable harm the less showing of likelihood of success is needed.

Often the two most important factors are the franchisor's likelihood of success on the merits and ability to demonstrate irreparable harm. If franchisors cannot show, for example, that the agreement was properly terminated and that the franchisee is continuing to operate without authorization, then the inquiry ends there. If, however, termination is proper and the former franchisee continues to use the franchisor's marks, then the franchisor has likely met its burden for showing likely success on the merits. As

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See, e.g., Daesang Corp. v. NutraSweet Co., 85 N.Y.S.3d 6, 16 (N.Y. App. Div. 2018) (discussing *Wilko* and how the limited doctrine of "manifest disregard" gives extreme deference to arbitrators).

[151] *Warfield v. Icon Advisers, Inc*, 26 F.4th 666, 670 (4th Cir. 2022) ("Since *Hall St. Associates*, the question of whether the manifest disregard theory survives has caused an entrenched circuit split" and citing *Bangor Gas Co., LLC v. H.Q. Energy Servs. (U.S.) Inc.*, 695 F.3d 181, 187 n.3 (1st Cir. 2012) as collecting cases).

[152] See *Weiss v. Sallie Mae, Inc.*, 939 F.3d 105, 109 (2d Cir. 2019) ("A litigant seeking to vacate an arbitration award based on alleged manifest disregard of the law bears a heavy burden, as awards are vacated on grounds of manifest disregard only in those exceedingly rare instances where some egregious impropriety on the part of the arbitrator is apparent," and the arbitration award will be upheld "so long as 'the arbitrator has provided even a barely colorable justification for his or her interpretation of the contract.") (citations omitted).

[153] *Mazurek v. Armstrong*, 520 U.S. 968, 972 (1997).

[154] *See*, *e.g.*, *Winter v. Natural Res. Def. Council*, 555 U.S. 7 (2008) (stating the elements under federal law). Most states' law follows very similar elements to obtain injunctive relief.

one leading commentator explained: "[I]f, as a matter of contract law, a service mark or a trademark license has ended, the licensee has no right to continue use of the licensed mark. Any such use is without the trademark owner's consent and constitutes infringement."[155] If a former franchisee is operating a competing business in violation of the post termination non-compete clause, the burden to prove irreparable harm is not presumed, and courts will scrutinize whether the franchisor can prove that it will be irreparably harmed by the continued breach pending trial on the merits.

Indeed, this is the second important requirement --demonstrating irreparable harm. Irreparable harm is a harm that cannot be remedied by a subsequent award of monetary damages.[156] Courts historically had been willing to presume that trademark infringement constitutes irreparable harm as a matter of law, although in recent years, some courts and circuits questioned the continued viability of this presumption.[157] [158] Even if irreparable harm is not presumed, franchisors might establish it by showing that the franchisee's

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[155] J. Thomas McCarthy, TRADEMARKS AND UNFAIR COMPETITION § 25:31 (4th ed. 2011). *See Baskin-Robbins Franchising LLC v. Pena*, No. 19-cv-06657-JSC, 2020 WL 2616576, at *8 (N.D. Cal. May 7, 2020), report and recommendation adopted, No. 19-cv-06657-LHK, 2020 WL 2614851 (N.D. Cal. May 22, 2020) (Franchisees "have used and continue to use the [franchisor's] marks following termination of the Franchise Agreement.... Such continued unauthorized use as a holdover franchisee is dispositive of the trademark infringement issue.").

[156] *Kahala Franchising, LLC v. Real Faith, LLC*, No. 21-cv-08114, 2022 WL 1605377 (C.D. Cal. May 20, 2022) (denying franchisor's motion to enjoin continued operations by terminated franchisee on the basis that the franchisor did not establish irreparable harm when the former franchisee's operations were successful and not substandard); *GNC Franchising, LLC v. Masson*, No. CIV.A. 05-1613, 2005 WL 3434076, at *3 (W.D. Pa. Dec. 13, 2005) (denying franchisor's request for preliminary injunction, finding that any harm suffered could be remediated by monetary damages and therefore was not irreparable).

[157] *See*, *e.g.*, *Pappan Enterprises, Inc. v. Hardee's Food Sys., Inc.*, 143 F.3d 800, 805 (3d Cir. 1998) ("once the likelihood of confusion caused by trademark infringement has been established, the inescapable conclusion is that there was also irreparable injury."); *S&R Corp. v. Jiffy Lube Int'l, Inc.*, 968 F.2d 371, 378 (3d Cir. 1992) ("[b]ecause we have concluded that [the franchisor] is likely to prove at trial that [the franchisee] is infringing its trademark, we find that [the franchisor] has *a fortiori* alleged irreparable injury.").

[158] Irreparable harm was traditionally presumed to flow from a finding of infringement until the United States Supreme Court rejected the automatic issuance of an injunction upon proof of infringement in a patent case. *eBay Inc. v. MercExchange, LLC* (2006) 547 U.S. 388, 393-94 (eBay). *Compare Ferring Pharmaceuticals, Inc. v. Watson Pharmaceuticals, Inc.* 765 F.3d 205, 214 (3d Cir. 2014) (holding, "although eBay in particular arose in the patent context, its rationale is equally applicable in other contexts, including cases arising under the Lanham Act") *with* J. Thomas McCarthy, McCarthy on Trademarks and Unfair Competition § 30:47.70 (5th ed. 2017) ("the presumption of irreparable injury traditionally followed in trademark preliminary injunction cases is in [no] way inconsistent with the letter or the spirit of the Supreme Court's eBay decision"). *And see* Ridi Holland LLC v. N. Holland Sylvania Rd. Ctr., LLC, No. 3:23-cv-02334-JGC, 2024 U.S. Dist. LEXIS 143412 (N.D. Ohio Aug. 13, 2024) (finding the owners of the trademarks were not entitled to a presumption of irreparable harm under the Lanham Act); *Herb Reed Enterprises, LLC v. Florida Entertainment Management, Inc.*, 736 F.3d 1239, 1250-51 (9th Cir. 2013) (rejecting presumption in trademark case); *North American Med. Corp. v. Axiom Worldwide, Inc.*, 522 F.3d 1211, 1228-29 (11th Cir. 2008) (suggesting, without deciding, presumption may no longer be applicable in trademark cases); *Swarovski Aktiengesellschaft v. Bldg. No. 19*, 704 F.3d 44, 54 (1st Cir. 2013) (same). *See also* Scott McIntosh and Jonathan Labukas, *To Presume Or Not to Presume, Irreparable Injury in Trademark Disputes Involving Franchises Following eBay and Winter*, 36 Franchise Law Journal, No. 1, Summer 2016.

unauthorized use of trademarks causes a loss of control over the franchisor's reputation.[159]

The Lanham Act was amended in 2020 to include a statutory rebuttable presumption of irreparable injury when there is a violation of the Lanham Act: "A plaintiff seeking any such injunction shall be entitled to a rebuttable presumption of irreparable harm upon a finding of a violation identified in this subsection in the case of a motion for a permanent injunction or upon a finding of likelihood of success on the merits for a violation identified in this subsection in the case of a motion for a preliminary injunction or temporary restraining order."[160] The statutory presumption applies after its enactment on December 27, 2020.

But if the former franchisee is not continuing to use trademarks or trade dress, the franchisor still may seek to prevent violations of other post-termination clauses through injunctive relief. Without the Lanham Act, the franchisor must prove irreparable harm.[161]

In challenging the franchisor's request for injunctive relief relating to a termination or seeking its own injunctive relief to prevent the termination, the franchisee may emphasize the irreparable harm that it and/or customer(s) will suffer from enforcement of the termination of the franchise agreement. Courts will balance these harms as contemplated in the third prong of the test. With holdover franchisees, courts often find

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[159] *See* J. Thomas McCarthy, TRADEMARKS AND UNFAIR COMPETITION § 30:47 (4th ed. 2011) (there is irreparable harm because the owner "will probably lose control of its reputation because this reputation rests upon the quality of defendant's activities as a result of a likelihood of confusion of purchasers. Such a likelihood of damage to reputation is by its nature 'irreparable.'"). Courts also have recognized that a franchisee's continued unauthorized operation constitutes irreparable harm because it inhibits the franchisor's ability to secure a legitimate franchisee in the same territory. See *ABP Holdings, Inc. v. Rainbow International, LLC,* no. 10-21-00122-CV, 2021 WL 5920276 (Tex. Ct. App. Dec. 15, 2021) (affirming injunction enforcing non-compete covenant against terminated franchisee on basis that franchisor established irreparable harm at the hearing); *Core Progression Franchise LLC v. O'Hare*, No. 21-1151, 2022 WL 1741836 (10th Cir. May 31, 2021).

[160] 15 U.S.C. § 1116(a). The amendment restored the presumption created via case law traditionally used in trademark preliminary injunction cases and nullified those decisions by courts adopting *eBay*.

[161] *JTH Tax LLC v. Agnant*, No. 22-CV-2385, 2022 WL 1556656 (E.D.N.Y. May 17, 2022) (holding that franchisor did not establish irreparable harm in part because the former franchisee was not operating under the franchisor's trademarks, and the franchisor had locked the former franchisee out of the system so it no longer could access the franchisor's proprietary and confidential information). But compare, *JTH Tax LLC v. Gause*, No. 21-CV-00543, 2021 WL 50855347 (W.D.N.C. Nov. 1, 2021) (granting franchisor's motion to enjoin former franchisee from operating a competing business and finding threatened use of confidential information satisfied irreparable harm), *JTH Tax LLC v. Gilbert*, No. 22-cv-625, 2022 WL 1619594 (M.D. Fla May 12 2022) (granting franchisor's motion to enjoin former franchisee from operating a competing business and finding franchisor established irreparable harm even though former franchisee had removed the signs and began operating under different trademarks; the court found that the former franchisee's continued operations of a competing business would constitute irreparable harm to the franchisor in part due to lost good will and inability refranchise in the market), and *JTH Tax LLC v. Kukla*, No. 22-cv-01543, 2022 WL 1651074 (E.D. N.Y. Apr. 26, 2022) (same).

the harms are self-inflicted and not cognizable, such that a franchisor would not be precluded from enforcing its rights.[162]

The final factor considers the public interest. A franchisor might argue that the public has an interest in the enforcement of valid contracts to avoid confusion about a formerly-authorized unit.[163]

The same factors must be met to obtain injunctions to enforce other common provisions in connection with franchisee termination, such as noncompetition covenants. The law in this area, however, varies widely compared to claims related to trademark infringement.

In addition to a franchisor seeking injunctive relief to enforce the termination and the post-termination obligations, sometimes franchisees seek to enjoin the termination. For example, in *Northwest Bakery Distributors, Inc. v. George Weston Bakeries Distribution, Inc.*,[164] a distributor brought an action against the manufacturer to enjoin the termination of the distribution agreement. The manufacturer tried to terminate the agreement because, among other reasons, a subcontractor of the distributor engaged in dishonest conduct by stealing merchandise. However, the court enjoined the termination and found that the distributor was likely to succeed on the merits as (i) the manufacturer failed to show that the distributor was actually involved in the dishonest conduct and did not affect the distributor's ability to perform and (ii) the other alleged violations did not amount to a "chronic failure to of performance" giving rise to good cause to terminate.

Similarly, in *E2W, LLC v. Kidzania Operations, S.a.r.l.*,[165] the court enjoined a franchisor's attempted termination on the basis that the franchisee showed a reasonable likelihood of success on its waiver and estoppel claims given the franchisor's conduct and

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[162] *See Pappan Enterprises, Inc. v. Hardee's Food Sys., Inc.*, 143 F.3d 800, 805 (3d Cir. 1998) (awarding preliminary injunction to franchisor where any difficulties faced by the franchisee "were brought on by its own conduct in continuing to use the [] marks despite the termination of the franchise agreements"); *Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.*, 970 F.2d 273, 277 (7th Cir. 1992) (awarding preliminary injunction to franchisor where franchisees "have only themselves to blame" and franchisees' "dubious showing" is balanced against "the real though unquantified harm to the [franchisor] of being forced to continue doing business with [such] a franchisee"); *S&R Corp.*, 968 F.2d at 379 (affirming preliminary injunction where former franchisee "brought much of the difficulties of which he complains upon himself"); *Huang v. Holiday Inns, Inc.*, 594 F.Supp. 352, 356 (C.D. Cal. 1984) ("a franchisor is not precluded from exercising its right to terminate a franchise in a reasonable, good faith manner merely because the franchisee will suffer great hardship as a result of the termination.").

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

[164] No. 04 C 8233, 2005 U.S. Dist. LEXIS 385 (N.D. Ill. Jan. 6, 2005)

[165] No. 1:20CV02866 (S.D.N.Y., April 9, 2020).

statements. The franchisee owned the rights to development of franchised educational amusement parks in malls in the United States and owed past due fees to the franchisor. The franchisor sent a notice of termination when, after COVID-19 shutdowns ceased negotiations for financing and the franchise therefore appeared unable to pay past due fees. The franchisee sought injunctive relief preventing the termination pending an arbitration on the basis that COVID-19 shutdowns constituted a force majeure and that the franchisor by its conduct waived the right to immediately terminate for non-payment. The court agreed, finding the franchisee showed a reasonable likelihood of success on its waiver defenses and enjoined the termination[166].

2. Damages

The franchise agreement often defines the types of damages that may be available to the franchisor following breach or termination of the franchise agreement. For example, many franchise agreements contain liquidated damages provisions. These provisions entitle a franchisor to recover a certain amount from the franchisee following termination of the franchise agreement based on a formula – *e.g.*, 100% of the royalty fees paid during a specific period. Courts scrutinize these provisions to assess their reasonableness before enforcing them.[167]

Even absent a liquidated damages provision, a franchisor may recover lost future royalties.[168] Recovery of such damages is not certain and varies by jurisdiction. In *Postal Instant Press, Inc. v. Sealy*, a California Court held that a franchisor that terminated its franchisee for failure to pay royalties was not entitled to recover lost future royalties.[169]The court reasoned that the franchisor's decision to terminate—not the franchisee's breach—was the proximate cause of the franchisor's loss of the future royalty stream.[170] The court further reasoned that recovery of such amounts would be unconscionable.[171] Some courts

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[166] But see, *Omaha Interlock, Inc. v. Alcohol Detection Systems Technology, LLC*, No. 21CV8, 2021 4305722 (D. Neb. Sept. 21, 2021) (denying franchisee's motion to enjoin alleged termination of agreement on the basis that franchisee did not establish that money damages could not provide adequate remedy).

[167] *See*, *e.g.*, Dennis R. LaFiura and David S. Sager, *Liquidated Damages Provisions and the Case for Routine Enforcement*, 20(4) Franchise L.J. 175 (Spring 2001); Restatement of Contracts (Second) 356(1) (1981) ("Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.").

[168] A full discussion of the recoverability of lost future royalties is beyond the scope of this paper. For additional discussion, see Joseph Schumacher and Kimberly Toomey, *Recovering Lost Future Royalties in a Franchise Termination Case*, 20(3) Franchise L.J. 116 (Winter 2001).

[169] Cal. Rptr. 2d 365 (Ct. App. 1996).

[170] *Id.*

[171] *Id.*

have followed *Sealy's* reasoning[172], while others have rejected it. In 2011, the Fourth Circuit weighed in on this issue in *Meineke Car Care Centers, Inc. v. RLB Holdings, LLC*, which involved a franchisee that had closed its four units prior to the end of the franchise term.[173] Following the unauthorized closure, the franchisor terminated the franchisee and filed suit for prospective royalties and advertising fund contributions.[174] The court ultimately determined that the franchisee's abandonment, rather than the subsequent termination by the franchisor, was the proximate cause of the franchisor's lost profits such that the franchisor was not barred from recovering future damages.[175] And after *Sealy*, another court in California upheld a liquidated damages clause and allowed the franchisor to recover lost future royalties.[176]

Franchisors may also be entitled to statutory damages in connection with terminations. In the case of a "holdover franchisee," or a franchisee that continues to operate using the franchised system following termination of the franchise agreement, the Lanham Act—which governs federal trademark infringement and counterfeiting claims—authorizes recovery of any actual damages proximately caused by infringement of a registered trademark.[177] Critically, the Lanham Act allows for treble damages if the infringement was willful.[178]

A franchisor may also recover damages against holdover franchisees under the counterfeiting provisions of the Lanham Act. The counterfeiting provisions state that, in cases of willful counterfeiting, the court shall enter judgment for treble profits or damages, whichever amount is greater, together with reasonable attorneys' fees, unless there are

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[172] See *United Consumers Club, Inc. v. Bledsoe*, 441 F. Supp. 2d 967, 987 (N.D. Ind. 2006); *Kissinger, Inc. v. Singh*, 304 F.Supp.2d 944, 949-50 (W.D. Mich. 2003); *Burger King Corporation v. Hinton, Inc.,* 203 F.Supp.2d 1357, 1366 (S.D. Fla. 2002); *I Can't Believe It's Yogurt v. Gunn*, 1997 WL 599391, at *23-24 (D. Colo. Apr. 15, 1997).

[173] 423 F. App'x 274, 2011 WL1422900 (4th Cir. 2011).

[174] *Id.* at 278.

[175] *Id.* at 289; *See also Golden Corral Franchising Systems, Inc. v. Scism,* No. 18-12879, 2021 WL 4490233 (D.N.J. Oct. 1, 2021) (rejecting former franchisee's assertion that lost future royalties are not recoverable when franchisor terminates franchise agreement on the basis that franchisee had abandoned the franchise); *but see, Medicine Shoppe Int'l, Inc. v. TLC Pharmacy, Inc., et al.*, Bus. Franchise Guide (CCH) ¶ 14,416 (E.D. Mo. 2010) (no recovery of future license fees following termination of a license agreement where the license agreement did not expressly provide that the licensee's obligation to pay license fees survives termination).

[176] *Radisson Hotel Intern. Inc. v. Majestic Towers*, 488 F. Supp. 2d 953 (C.D. Cal. 2007).

[177] 15 U.S.C. § 1114; Unregistered trademarks can be protected under Section 43(a) of the Trademark Act, 15 § U.S.C. 1125.

[178] *See*, *e.g.*, *U.S. Structures, Inc. v. J.P. Structures, Inc.*, 130 F.3d 1185 (6th Cir. 1997) (awarding franchisor past profits and trebled profits).

some extenuating circumstances.[179] Counterfeiting remedies are of significant economic value to franchisors, particularly because these judgments may not be dischargeable in bankruptcy.

[179] 15 U.S.C. § 1117(b). As an alternative to these damages, § 35(c) of the Act, 15 U.S.C. § 1117(c), offers an option of statutory damages ranging between $500 and $100,000 per counterfeit mark per type of goods/services sold, or if the court finds that the use of the counterfeit mark was willful, up to $1,000,000 per counterfeit mark per type of good/services sold.

STATE FRANCHISE NOTICE REQUIREMENTS

(Consult local, state, and federal laws for current status and to ensure compliance with other applicable regulations and requirements; Please note the governing agreements must be complied with as well in relation to the notice requirements and cure periods).

STATE	CITATION (only if applicable to notice/cure period)	TYPE OF BREACH/NOTICE	MINIMUM CURE/NOTICE PERIOD
Alabama	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Alaska	No generally applicable franchise relationship or disclosure statute. (However, Alaska Stat. § 45.45.700, *et seq*. applies to distributorships but does not have a notice requirement.)	N/A	The required notice and cure period under the agreement
Arizona	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Arkansas	Ark. Code § 4-72-204 (Arkansas Franchise Practices Act)	All defaults and terminations (except as stated below)	90 days notice prior to termination date with 30 days to cure
		Failure to Pay	10 days notice, then immediate termination allowed if franchisee fails to pay
		Abandonment	No notice required
		Bankruptcy	No notice required
		Loss of Location/Premises of the Center	No notice required
		Conviction of an offense punishable by imprisonment in excess of 1 year and substantially related to the business conduct pursuant to the franchise	No notice required
		Any conduct "which substantially impairs the franchisor's trademark or trade name"	No notice required
		Nonrenewal (except for any reason above)	90 days notice prior to termination date with 30 days to cure
		Notices of Termination or Nonrenewal for Repeated Defaults	If the franchisee rectifies the repeated deficiencies within 10 days, the notice is void.
California	Cal. Bus. & Prof. Code §§ 20000, et al. (California Franchise Relations Act)	All defaults and terminations for good cause (except as included below)	60 days notice to terminate and a reasonable opportunity to cure, which shall not be less than 60 days or more than 75 days
		Abandonment	Immediate notice of termination allowed if failed to operate for 5 consecutive days as required
		Bankruptcy (specific requirements in the Act)	Immediate notice of termination allowed
		Conduct "which reflects materially and unfavorably upon the operation and reputation of the franchise business or system"	Immediate notice of termination allowed
		Failure to comply with any federal, state, or local law or regulation	10 days notice of noncompliance, then immediate termination is allowed if franchisee fails to comply in that time period
		Imminent danger to public health or safety	Immediate notice of termination allowed upon reasonable determination by frnachisor that continued operation will result in such danger
		Mutual termination in writing	Immediate notice of termination allowed
		Subsequent Default - if "franchisee, after curing any failure in accordance with Section 20020 engages in the same noncompliance whether or not such noncompliance is corrected after notice"	Immediate notice of termination allowed
		Repeated Defaults - if "franchisee repeatedly fails to comply with one or more requirements of the franchise, whether or not corrected after notice"	Immediate notice of termination allowed

STATE FRANCHISE NOTICE REQUIREMENTS

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STATE	CITATION (only if applicable to notice/cure period)	TYPE OF BREACH/NOTICE	MINIMUM CURE/NOTICE PERIOD
California (continued)	Cal. Bus. & Prof. Code §§ 20000, et al. (California Franchise Relations Act)	Failure to Pay	5 days notice of overdue fees, then immediate termination is allowed if franchisee fails to comply in that time period
		Loss of Location/Premises of the Center (specific requirements in the Act)	Immediate notice of termination allowed
		Convicted of a Felony	Immediate notice of termination allowed
		Nonrenewal (specific requirements in the Act)	180 days notice of intention not to renew
Colorado	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Connecticut	Conn. Gen. Stat. § 42-133f	All defaults and terminations for good cause (except as included below)	60 days notice in advance of termination
		Abandonment	30 days notice in advance of termination
		Conviction of an offense punishable by imprisonment in excess of 1 year and substantially related to the business conduct pursuant to the franchise	Notice may be given at any time after the conviction effective upon delivery
		Nonrenewal (specific requirements in the Act)	6 months notice of intention not to renew if the franchisor leases property to the franchisee; otherwise 60 days notice in advance of intent not to renew is sufficient
Delaware	Del. Code tit. 6, § 2555 (This section only applies to distributorships. For non-distributorship franchise systems, all notice requirements and cure periods are governed by the agreement itself.)	For distributorships only, all defaults and terminations for good cause	90 days notice for termination or election not to renew
	No generally applicable franchise relationship or disclosure statute for non-distributorship franchise systems.	For non-distributorship franchises, no related statute applies.	The required notice and cure period under the agreement.
District of Columbia	No generally applicable franchise relationship or disclosure statute. (Prior Act Repealed)	N/A	The required notice and cure period under the agreement.
Florida	No generally applicable franchise relationship statute.	N/A	The required notice and cure period under the agreement.
Georgia	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement.
Hawaii	Haw. Rev. Stat. § 482E-6	All defaults and terminations for good cause	Written notice and a reasonable period of time to cure is required; otherwise what is in FTA will suffice
Idaho	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement.
Illinois	815 Ill. Comp. Stat. 705/19 (Illinois Franchise Disclosure Act of 1987)	All defaults and terminations for good cause	Reasonable opportunity to cure that does not need to exceed 30 days
		Abandonment	Notice and opportunity to cure not required.
		If franchisee "makes an assignment for the benefit of creditors or a similar disposition of the assets of the franchise business"	Notice and opportunity to cure not required.
		Felony conviction or other crime impairing franchisor's goodwill	Notice and opportunity to cure not required.
		Repeated failure to comply with FTA	Notice and opportunity to cure not required.
		Nonrenewal	Notice of intent not to renew 6 months prior to expiration date or any extension thereof
Indiana	Ind. Code § 23-2-2.7-3 (Indiana Deceptive Franchise Practices Act)	Any termination or election not to renew	90 days, unless otherwise provided in the agreement

STATE FRANCHISE NOTICE REQUIREMENTS

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STATE	CITATION (only if applicable to notice/cure period)	TYPE OF BREACH/NOTICE	MINIMUM CURE/NOTICE PERIOD
Iowa	Iowa Code §§ 523H.7, 523H.8	All defaults and terminations for good cause (except as included below)	Notice and reasonable cure period of at least 30 days to 90 days
		Failure to Pay	30 day notice and opportunity to cure
		Abandonment	No notice and opportunity to cure required if failed to operate for 5 consecutive days as required
		Bankruptcy or if all or substantial part of the assets of the franchise "are assigned to or for the benefit of any creditor"	No notice and opportunity to cure required.
		Felony conviction or other crime materially affecting the "operation, maintenance, or goodwill of the franchise in the relevant market"	No notice and opportunity to cure required.
		Mutual termination in writing	No notice and opportunity to cure required.
		Material misrepresentation by franchisee relating to acquisition, ownership, or operation of the franchise	No notice and opportunity to cure required.
		Subsequent Defaults - after 3 prior material breaches within a 12 month period for which franchisee had notice and opportunity to cure	No notice and opportunity to cure required so long as the "action is not arbitrary and capricious".
		Imminent danger to public health or safety	No notice and opportunity to cure required.
		Seizure of premises of franchise by governement authority or official	No notice and opportunity to cure required.
		Nonrenewal (specific requirements in the statute)	Notice of intent not to renew 6 months prior to expiration date or any extension thereof
Kansas	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Kentucky	No generally applicable franchise relationship or disclosure statutes.	N/A	The required notice and cure period under the agreement
Louisiana	No generally applicable franchise relationship or disclosure statute. (However, La. Rev. Stat. § 23:921 governs restraints on franchisor and franchisee competition).	N/A	The required notice and cure period under the agreement
Maine	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Maryland	No generally applicable franchise relationship or disclosure statute for non-distributorship franchise systems. (However, Md. Code, Com. Law § 11-1303 governs distributorships that are not otherwise regulated under the Maryland Franchise Registration and Disclosure Law.)	N/A	The required notice and cure period under the agreement
Massachusetts	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Michigan	Mich. Comp. Laws § 445.1527 (the Michigan Franchise Investment Law)	All defaults and terminations for good cause (except as included below) (specific notice requirements in the Act)	Notice and reasonable cure period, which does not need to exceed 30 days

STATE FRANCHISE NOTICE REQUIREMENTS *(Consult local, state, and federal laws for current status and to ensure compliance with other applicable regulations and requirements; Please note the governing agreements must be complied with as well in relation to the notice requirements and cure periods).*			
STATE	**CITATION (only if applicable to notice/cure period)**	**TYPE OF BREACH/NOTICE**	**MINIMUM CURE/NOTICE PERIOD**
Minnesota	Minn. Stat. § 80C.14	All defaults and terminations for good cause (except as included below); good cause means failure to "substantially comply with the material and reasonable franchise requirements"	90 days notice of termination with 60 days opportunity to cure
		Voluntary Abandonment	Immediate notice of termination is allowed and effective upon receipt.
		Conviction of an "offense directly related to the business conduct pursuant to the franchise"	Immediate notice of termination is allowed and effective upon receipt.
		Failure to cure a default that "materially imparirs the good will associated with" the franchisor and its marks after written notice to cure of at least 24 hours in advance	Immediate notice of termination is allowed and effective upon receipt, after failing to cure after a 24 hour advance notice
		Nonrenewal (without good cause under the reasons stated above)	180 days notice of intention not to renew from expiration of the franchise
Mississippi	Miss. Code § 75-24-53	All defaults and terminations (except as included below)	90 days notice in advance of termination or nonrenewal
		Abandonment	No notice period required.
		Bankruptcy or insolvency	No notice period required.
		Criminal Misconduct	No notice period required.
		Fraud	No notice period required.
		Giving of a no account or insufficient funds check	No notice period required.
		Nonrenewal	90 days notice in advance of termination or nonrenewal
Missouri	Mo. Stat. § 407.405	All defaults and terminations (except as included below)	90 days notice in advance of termination or nonrenewal
		Abandonment	No notice period required.
		Bankruptcy or insolvency	No notice period required.
		Criminal Misconduct	No notice period required.
		Fraud	No notice period required.
		Giving of a no account or insufficient funds check	No notice period required.
		Nonrenewal	90 days notice in advance of termination or nonrenewal
Montana	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Nebraska	Neb. Rev. Stat. § 87-404 (the Nebraska Franchise Practices Act)	All defaults and terminations for good cause (except as included below)	60 days notice in advance of termination or nonrenewal
		Voluntary Abandonment	15 days notice in advance of of termination
		Conviction of an "indictable offense directly related to the business conduct pursuant to the franchise"	Immediate notice of termination is allowed and effective upon receipt.
		Insolvency (the institution of bankruptcy or receivership)	Immediate notice of termination is allowed and effective upon receipt.
		Failure to pay or "failure to account for the proceeds of a sale of goods"	Immediate notice of termination is allowed and effective upon receipt.
		"Falsification of records or reports required by the franchisor"	Immediate notice of termination is allowed and effective upon receipt.
		Imminent danger to public health or safety	Immediate notice of termination is allowed and effective upon receipt.
		Loss of location/premises of the franchise	Immediate notice of termination is allowed and effective upon receipt.
		Nonrenewal	60 days notice in advance of termination or nonrenewal
Nevada	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
New Hampshire	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement

STATE FRANCHISE NOTICE REQUIREMENTS

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STATE	CITATION (only if applicable to notice/cure period)	TYPE OF BREACH/NOTICE	MINIMUM CURE/NOTICE PERIOD
New Jersey	N.J. Stat. § 56:10-5 (the New Jersey Franchise Practices Act)	All defaults and terminations for good cause (except as included below)	60 days notice in advance of termination or nonrenewal
		Voluntary Abandonment	15 days notice in advance of of termination
		Conviction of an "indictable offense directly related to the business conduct pursuant to the franchise"	Immediate notice of termination is allowed and effective upon receipt after conviction
New Mexico	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
New York	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
North Carolina	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
North Dakota	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Ohio	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Oklahoma	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Oregon	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Pennsylvania	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Rhode Island	6 R.I. Gen. Laws § 6-50-4 (the Rhode Island Fair Dealership Act)	All defaults and terminations for good cause (except as included below)	60 days notice in advance of termination or nonrenewal, with 30 days to cure ("provided that a dealer has a right to cure three(3) tmes in any twelve-month (12) period during" the agreement)
		Failure to Pay	Written notice of default with 10 days to cure (with the right to cure 3 times in 12 months)
		Voluntary Abandonment	Immediate notice of termination is allowed and effective upon receipt.
		Conviction of a felony "related to the business conducted pursuant to the dealership"	Immediate notice of termination is allowed and effective upon receipt.
		Conduct that will "materially impair the goodwill" of the franchisor's marks	Immediate notice of termination is allowed and effective upon receipt.
		Material misrepresentation made to the franchisor relating to the dealership	Immediate notice of termination is allowed and effective upon receipt.
		Attempting to transfer without authorization	Immediate notice of termination is allowed and effective upon receipt.
		Bankruptcy or assignment for the benefit of creditors	Immediate notice of termination is allowed and effective upon receipt.
		"Violation of any law, regulation, or standard relating to public health or safety" after written notice and opportunity to cure at least 24 hours in advance	Immediate notice of termination is allowed and effective upon receipt, after failing to cure after a 24 hour advance notice
South Carolina	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
South Dakota	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Tennessee	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Texas	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Utah	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement
Vermont	No generally applicable franchise relationship or disclosure statute.	N/A	The required notice and cure period under the agreement

<table>
<tr><th colspan="4">STATE FRANCHISE NOTICE REQUIREMENTS
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<tr><th>STATE</th><th>CITATION
(only if applicable to notice/cure period)</th><th>TYPE OF BREACH/NOTICE</th><th>MINIMUM CURE/NOTICE PERIOD</th></tr>
<tr><td>Virginia</td><td>Va. Code § 13.1-564 (the Virginia Retail Franchising Act).</td><td>All defaults and terminations must be for "reasonable cause"</td><td>30 days or the required notice/cure period under the agreement</td></tr>
<tr><td rowspan="6">Washington</td><td rowspan="6">Wash. Rev. Code § 19.100.180 (the Washington Franchise Investment Protection Act)</td><td>All defaults and terminations for good cause (except as included below)</td><td>Notice and reasonable opportunity to cure, which does not need to exceed 30 days (if it cannot be cured wihtin 30 days, then the termination can occur if franchisee fails to "initiate within thirty days substantial and continuing action to cure such default")</td></tr>
<tr><td>Repeated Defaults - 3 "willful and material breaches of the same term of the franchise agreement" within a 12 month period</td><td>Immediate notice of termination is allowed and effective upon receipt, upon a subsequent default if the franchisee was given notice and opportunity to cure for the first 3 defaults</td></tr>
<tr><td>Voluntary Abandonment</td><td>Immediate notice of termination is allowed and effective upon receipt.</td></tr>
<tr><td>Bankruptcy/Insolvency or makes an assignment for the benefit of creditors</td><td>Immediate notice of termination is allowed and effective upon receipt.</td></tr>
<tr><td>Conviction or a plea of guilty/no contest to a "charge violating any law relating to the franchise business"</td><td>Immediate notice of termination is allowed and effective upon receipt.</td></tr>
<tr><td>Nonrenewal</td><td>1 years notice of nonrenewal and franchisor agrees in writing not to enforce the non-compete; otherwise the franchisor is required to fairly compensate th franchsee for the FMV of the franchisee's in good will (regardless franchisor is required to compensate the franchisee for the FMV of inventory, supplies, equipment, and furnishing purchased from the franchisor)</td></tr>
<tr><td>West Virginia</td><td>No generally applicable franchise relationship or disclosure statute.</td><td>N/A</td><td>The required notice and cure period under the agreement</td></tr>
<tr><td rowspan="4">Wisconsin</td><td rowspan="4">Wis. Stat. § 135.04 (the Wisconsin Fair Dealership Law)</td><td>All defaults and terminations for good cause (except as included below)</td><td>90 days notice of termination with 60 days opportunity to cure</td></tr>
<tr><td>Failure to Pay</td><td>Written notice of default required with 10 days opportunity to cure from the delivery of the notice</td></tr>
<tr><td>Bankruptcy/Insolvency or makes an assignment for the benefit of creditors</td><td>Immediate notice of termination is allowed and effective upon receipt.</td></tr>
<tr><td>Nonrenewal for good cause</td><td>90 days notice of termination with 60 days opportunity to cure</td></tr>
<tr><td>Wyoming</td><td>No generally applicable franchise relationship or disclosure statute.</td><td>N/A</td><td>The required notice and cure period under the agreement</td></tr>
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