THE FAITHLESS FRANCHISOR: RETHINKING GOOD FAITH IN FRANCHISING

Robert W. Emerson

INTRODUCTION: GOOD FAITH, A PROBLEMATIC RULING, THE COVENANT, AND A ROADMAP ............................................... 412
I. INSUFFICIENCY OF CONTRACT DAMAGES ........................................... 417
II. SPECIAL CONSUMER OR BUSINESS RELATIONSHIPS ..................... 423
III. FRANCHISE PARTIES ON THEIR BEST BEHAVIOR ............................. 424
IV. LEGAL REALISM .............................................................................. 428
   A. Establishing a Special Relationship .............................................. 430
   B. Rare and Exceptional Cases of Special Relationships in a Tortious Breach ........................................................................... 433
   C. An Unorthodox Explanation of Franchisee Dependence ............... 437
   D. Franchisees in Atypical Commercial Settings ............................... 439
V. EXPANDING THE GOOD FAITH AND FAIR DEALING CLAIM .......... 443
VI. FRANCHISOR PROTECTION ............................................................. 452
   A. Free-Riding and Franchisee Protection Overall .............................. 452
   B. Protections Abroad ....................................................................... 461
      i. Good Faith .................................................................................. 462
      ii. Fair Dealing ............................................................................... 468
CONCLUSION .......................................................................................... 472

ABSTRACT

The rapid expansion of franchising requires that the courts, and the law in general, adapt to new circumstances, including the franchise parties’ rightful expectations. Franchisees and franchisors may not act in the spirit of the contract, and the traditional approach under contract damages law often fails to remedy that situation. For example, how can a franchisee or franchisor recover in the event of actions that are not prohibited by the

* J.D., Harvard Law School. Huber Hurst Prof., Univ. of Florida. Email: robert.emerson@warrington.ufl.edu
contract, but that nevertheless run counter to a party’s natural (and probable) expectations? These and other issues are addressed in the context of a “Fairness in Franchising” rule.

Currently, remedies for disgruntled parties to franchise agreements are limited to those available for the breach of an express contract provision, and they certainly do not allow for an award of punitive damages. However, legal remedies for bad faith in franchising agreements already exist. For example, at common law, tort damages may be awarded in a cause of action for “bad faith.” The allowance of a tort cause of action for bad faith could deter wrongful acts by parties inducing franchise purchases, by would-be fraudsters (whether franchisors or franchisees) throughout the course of a franchise relationship, and otherwise by free-riding franchisees or through the opportunistic behaviors on the part of franchisors after an agreement has been executed. A standard test for franchising good faith and fair dealing will leave courts better able to not simply deal with bad acts, but also to encourage the franchise parties’ appropriate and mutually beneficial actions while they are reaching and then implementing their contracts.

Key Words/Phrases: Franchisors, Franchisees, Franchising, Contracts, Good Faith, Fair Dealing, Special Relationships, Dependence, Business Judgment Rule, Free-Riding, Contract Damages, Tortious Breach, Commercial Settings, Legal Realism, Franchisee Protections

INTRODUCTION: GOOD FAITH, A PROBLEMATIC RULING, THE COVENANT, AND A ROADMAP

Across the United States, courts do, in practice, consider whether to apply “good faith”\(^1\) to franchising. We see this when courts decide for or against claims that the franchisor should be held liable for breach of the implied covenant of good faith and fair dealing.\(^2\) In Canada, too, one sees

---


2. See Seth William Goren, Looking for Law in All the Wrong Places: Problems in Applying the Implied Covenant of Good Faith Performance, 37 U. S.F. L. REV. 257, 258–60(2003) (arguing courts have made general pronouncements on the subject but have reversed their own decisions because good faith has multiple definitions); Howard Hunter, The Implied Obligation of Good Faith, in THE FUTURE OF THE LAW OF CONTRACT 6, 13 (Michael Furmston eds., 2020) (citing Whited v. WestRock Servs., No. 3:17-CV-01341, Inc. 2018 WL 3416704 (M.D. Tenn. 2018), and concluding that “[m]ost American courts seem to be in agreement . . . that the implied obligation of good faith does not create any new rights for the parties but simply protects the reasonable expectations that each party has about the benefits to be derived
the same approach, and the search for and possible application of a good faith covenant can be found worldwide. The covenant is frequently limited—in effect, avoided—because courts cannot simply insert a “good faith” provision into a contract. Nonetheless, while the implied covenant of

from the agreement”).

3. Brad Hanna & Mitch Koczerginski, Canada, in INTERNATIONAL FRANCHISING CAN/1, CAN/5 (Dennis Campbell eds., 2d ed. 2018) (referring to Ontario’s franchise legislation which imposes a duty of fair dealing on both franchisors and franchisees). Similar provisions are included in Canada’s other provinces as well. Franchises Act, R.S.N.B. 2014, c 111, section 3(1) (Can.); Franchises Act, R.S.P.E.I. 1988, c F-14.1, section 3(1); Franchises Act, C.C.S.M 2012, c F-156, section 3(2); and S.B.C. Act 2015, c 35, section 3(1). Curiously, however, New Brunswick is the only Canadian province not to impose a duty of fair dealing. Richard R. Woznenilek, Canada, in INTERNATIONAL AGENCY AND DISTRIBUTION LAW CDN/1, CDN/47 (Dennis Campbell eds., 2d ed. 2018). Although there is no uniform franchise legislation in Canada, the statutes in each of the provinces are substantially similar. Hanna & Koczerginski, Canada, in INTERNATIONAL FRANCHISING, at CAN/1.

4. Good faith is applied to franchise contracts and the franchise relationship arising therefrom, in the two main legal traditions, the common law and the Civil Law.

[I]n civil law jurisdictions, the duty to act in good faith appears to imply a positive obligation to take affirmative steps to, inter alia, support franchisees throughout the franchise relationship and be responsive to threats faced by the franchise brand against competition. On the other hand, the common law duty of honest performance, which originates from a general organizing principle of good faith, seems to call for a negative obligation for franchisees to refrain from acting in a capricious manner towards franchisees. Perhaps more importantly, while the distinction between the application of the principle of good faith in these diverging legal traditions may not always be described as simply, it is generally accepted that the notion of good faith in civil law would impose more significant expectations and obligations on a franchisor, and likely sooner, than would similar concepts under common law.


5. Goren, supra note 2, at 281.

6. Era Aviation Inc. v. Seekins, 973 P.2d 1137, 1141 (Alaska 1999) (“[T]he covenant is implied to effectuate, not to alter, the reasonable expectations of the parties. . . .”) (emphasis added); Hickcox-Huffan v. US Airways, Inc., 855 F.3d 1057, 1066 (9th Cir. 2017) (noting that the covenant is to aid in the interpretation of a contract); Kropinak v. ARA Health Services, 33 P.3d 679, 682 (N.M. Ct. App. 2001) (declining to apply an implied covenant to
good faith and fair dealing “cannot replace the express provisions of a franchise agreement, [it certainly] may shed light on the parties’ intentions when there is no express provision.”

In effect, the covenant “may serve as the best method to measure contract performance in franchising.”

Some courts have declined to infer a good faith and fair dealing requirement into franchise agreements. For example, in the recent decision of *Pizza Inn, Inc. v. Clairday*, the U.S. Court of Appeals for the Fifth Circuit reaffirmed the idea of strict compliance to the terms within a franchise-related option contract. The Court stated that, under Texas law, a franchise developer cannot invoke equitable intervention as a means to evade the plain terms of the agreement when the franchise developer attempted to exercise a renewal option. The franchisee had a twenty-year agreement with the franchisor for a Pizza Inn franchise. At the end of the twenty years, the franchisee had the option to renew for two five-year terms if the franchisee notified the franchisor of the franchisee’s intent to renew at least six months before the current term expired. When the first renewal term expired, the franchisor refused to grant the franchisee a second renewal because the franchisee had been two months late in notifying the franchisor of his intent to renew. Generally, in Texas, courts require strict compliance with option contracts.

The franchisee tried to argue for equitable intervention to allow the franchisee to exercise the option to renew. Equitable intervention is an exception to strict compliance, which is allowed when (1) the delay is slight, (2) the optioner’s loss is small, and (3) failure to “grant relief would result in such hardship... as to make it unconscionable to enforce literally the implied covenant of good faith and fair dealing to override express provisions addressed in a written contract).


8. *Id.* at 648–49. *See* Carmen D. Caruso, *Franchising’s Enlightened Compromise: The Implied Covenant of Good Faith and Fair Dealing*, 26 Franchise L.J. 207, 207 (2007) (“It remains impossible to define the parties’ mutual rights and responsibilities so precisely that every future question is decided in advance, when the agreement is signed”. Therefore, the implied covenant of good faith and fair dealing is, for resolving franchising contract controversies, “an unhappy but enlightened compromise” better than “everything else that has been, or could be, tried.” *Id.*).


10. *Id.* at 1066–67.

11. *Id.* at 1066 & 1069.

12. *Id.* at 1066.

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.* at 1065–66.
condition precedent.” Equitable intervention, however, has only been applied to lease agreements in the past. The franchisee had argued that not allowing him to renew his option contract would be a hardship because (1) the franchisee would partially forfeit the $1,250,000 initial investment to become an area developer, (2) there would be a forfeiture of future profits, and (3) the franchise location would close. The court found that the reasons given by the franchisee did not meet the hardship prong because they did not lead to a forfeiture. The court reasoned that when the option expired the franchisee had received everything he had bargained for, that future profits were not an unconscionable hardship except for extreme cases, and that the franchise store closure was not an unconscionable hardship.

The decision in Pizza Inn, Inc. v. Clairday overlooks the nature of the franchise relationship and focuses exclusively on unconscionability as a reason to not apply strict compliance. However, why must equity be bound by (i.e., limited to) unconscionability? One could argue that, in applying the doctrine of unconscionability to the facts, a court should still account for the magnitude of harm and whether the parties acted in good faith. The renewal option in this case was not a naked option but was inextricably linked to the underlying franchise development agreement. Additionally, it is clear that the two agreements in Pizza Inn, Inc. v. Clairday (the development agreement and the renewal agreement/provision) should have been read together. Then, the court could have easily concluded that the developer suffered a forfeiture: the developer paid his initial $1,250,000 fee, which could be seen as including the discounted future value of the renewal options. If the optionee had paid this amount over time, not upfront as a fixed fee, would paying a much smaller amount — e.g., $200,000 one year before the expiration — have sufficed? Apparently, this was not an issue for the court, with its narrow view of matters involving franchising; the court’s turning toward good faith could have been a move towards justice. We will now consider this concept further, as we examine the covenant of good faith and fair dealing.

The covenant itself is the expectation that the parties will adhere to “community standards of decency, fairness or reasonableness” and refrain

---

18. Pizza Inn, Inc., 979 F.3d at 1067 & 1067 n.2.
19. Id. at 1068.
20. Id. at 1069.
21. Id.
22. The court also fails to recognize, for example, the potential answers to derive from concepts, provisions, or principles in the Uniform Commercial Code or the Second Restatement of Contracts.
from interfering with the contractual rights of the other party or parties. Put another way, the covenant prohibits actions that destroy, injure, or limit a party’s right or ability to receive the expected benefits of the contract. As


24. See In re Magna Cum Latte, Inc., Bankruptcy No. 07-31814, 2007 WL 4412143, at *3, 4 (Bankr. S.D. Tex. 2007) (noting, “[i]f a contract gives a party discretion to act, rather than expressly allowing or disallowing action, the implied contract applies,” and thereby holding that the franchisor of coffeehouse franchises breached the implied covenant of good faith and fair dealing owed to franchisee Magna Cum Latte; further stating that breach of the covenant requires more than mere negligent or mistaken conduct. . . . [I]t requires ‘a failure or refusal to discharge contractual responsibilities, prompted not by an honest mistake, bad judgment or negligence but rather by a conscious and deliberate act, which unfairly frustrates the agreed common purposes and disappoints the reasonable expectations of the other party thereby depriving that party of the benefits of the agreement’ (citations omitted)); Interim Health Care of N. Illinois, Inc. v. Interim Health Care, Inc., 225 F.3d 876, 884 (7th Cir. 2000) (overturning the trial court’s summary judgment for the defendant franchisor, and noting that the covenant of good faith and fair dealing requires the franchisor, “[w]hen . . . vested with contractual discretion, [to] exercise that discretion reasonably and with proper motive, and may not do so arbitrarily, capriciously or in a manner inconsistent with the reasonable expectations of the parties”).

Although the approach of common law courts to the duty of good faith in franchise agreements has been inconsistent at times, the content of the duty of good faith in the franchise context may be summarised as follows:

• the franchisor must exercise its powers under the franchise agreement in good faith and with due regard to the interests of the franchisee;

• the franchisor must observe standards of ‘honesty, fairness and reasonableness’ and take into account the interests of its franchisees;

• the parties must not act in such a way that ‘eviscerates or defeats the objectives of the agreement’ or ‘destroys the rights of the franchisee to enjoy the fruits of the contract’;

• neither party must substantially reduce the benefit of the bargain for the other, or cause significant harm to the other, in a manner contrary to the original intention and expectation of the parties; and

• where the franchisor is given discretion under the franchise agreement, it must be exercised reasonably and with proper justification, and may not be done subjectively, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.

Floriani, Carnevale & Nakhoul, supra note 4, at 6–7.

The duty of good faith and fair dealing may be positive - requiring that “parties honestly and reasonably carry out their contractual obligations.” Days Inn Worldwide, Inc. v. Sai Baba, Inc. 300 F. Supp. 2d 583, 590 (S.D. Ohio 2004). Or it may be negative - forbidding parties to take any action that would “destroy[] or injur[e] the right of the other party to receive the
business deals unfold, uncertainty and complexity may reign, leaving any application of a broad-minded “Golden Rule” for franchise parties\textsuperscript{25} extremely difficult as doing so requires the determination of community standards for a specific set of facts. Business lawsuits, for example, raise questions as to what “decency”\textsuperscript{26} is and at what point the parties are interfering with each other’s contractual rights. Thus, the term “good faith” has no precise meaning because it is subject to court interpretation on a case-by-case basis.\textsuperscript{27}

Still, while the subject, good faith, may seem ephemeral, there are a number of principles and improvements that can be pursued. The Article first considers the covenant of good faith and fair dealing and how a party harmed by the covenant’s breach may need more than simply contract damages, which are insufficient to cover all the harms incurred. The following section, Part II of the Article, reviews special consumer or business relationships and the covenant, while Part III looks to franchising and the available damages for a breach of the covenant, usually just contract-related awards. The following Parts, IV and V, deal with special relationships, tortious breach, franchisee dependence, the unusual commercial settings for franchisees, and the potential for expanding the reach of good faith and fair dealing claims. The Article then proceeds to major concerns such as fighting franchisee free-riding while also working to facilitate franchisee protections. It concludes with information about comparable franchisee protections abroad that may serve to model improvements in the U.S. law on good faith in franchising. Standards for good faith and fair dealing, with both prohibitions and perhaps safe harbors, may enable courts to foster appropriate conduct and deter franchisor opportunism.

I. \textbf{INSUFFICIENCY OF CONTRACT DAMAGES}

In the event of a breach of the covenant of good faith and fair

\textsuperscript{25} In effect, franchisor X and franchisee Y would be expected to do for the other party (X’s franchisee or Y’s franchisor, respectively) as X or Y would have its contracting party (X’s franchisee or Y’s franchisor) do in return.


dealing, the non-breaching party should receive contract damages.\textsuperscript{28} The purpose of damages is to assist the non-breaching party in recovering any financial losses or injuries that the party suffered because of the breach.\textsuperscript{29} The non-breaching party is normally entitled to (1) compensatory or liquidated damages, or (2) specific performance.\textsuperscript{30}

In the franchise context, an award of contract-related damages may be insufficient. In California, for instance, the amount of damages for a breach of the implied covenant in the employment context is limited to actual damages caused by the breach.\textsuperscript{31} Specific examples include the value of the loss of compensation and the benefits and financial damage that may result from a franchisee’s or a franchisor’s breach.\textsuperscript{32} More generally, it is the total loss in value, any incidental or consequential damages, and any cost or loss that the non-breaching party avoided by not having to perform.\textsuperscript{33}

Franchisees typically face severe challenges trying to prove damages that are “certain.” For example, in the event of a territorial encroachment\textsuperscript{34} how could a franchisee demonstrate that a loss of revenue stemmed specifically from the actions of its franchisor? Indeed, a franchise’s failure can result from cultural changes, population differences, or the existence of competition.\textsuperscript{35} To show lost revenue, franchisees ordinarily

\begin{itemize}
\item \textsuperscript{28} \textit{Restatement (Second) of Contracts} § 205 (Am. L. Inst. 1981).
\item \textsuperscript{30} Emerson, supra note 29, at 167–72; see also Bigda v. Fischbach Corp., 898 F. Supp. 1004, 1011 (S.D.N.Y. 1995) (finding that the non-breaching party, the plaintiff, elected not to seek liquidated damages).
\item \textsuperscript{31} Judicial Council of California Civil Jury Instructions (2020) No. 2423.
\item \textsuperscript{32} Id.
\item \textsuperscript{34} See generally Robert W. Emerson, \textit{Franchise Encroachment}, 47 Am. Bus. L.J. 191 (2010) (reviewing one of the most significant issues in franchising, franchisors’ encroachment upon existing franchisees’ markets, such as by granting new franchises or building franchisor-owned units near those existing franchises, or perhaps through direct competition with franchisees by, for example, direct sales online; recommending a series of actions to rectify encroachment problems, and concluding that franchisees be accorded some protections comparable to that of employees if they are not given any market/territorial protection).
must provide business records or expert testimony establishing a “reasonably accurate” amount. 36 However, when a franchisee has yet to operate for a sufficient length of time, providing enough evidence to create a reasonable estimate of revenue losses may not be possible. Additionally, franchisees often cannot assert a quantifiable experience value to their franchise.

One issue, in particular, is the valuation of any goodwill the franchisee may have generated. 37 Goodwill is the loyalty and reputation that a business has developed and which goes to the benefit of the franchise name and, more generally, the franchisor. 38 There are no set ways to calculate goodwill, 39 and the franchisor normally retains ownership of any goodwill

36. Blythe v. Bell, No. 11 CVS 933, 2013 WL 440709, at *5 (Super. Ct. N.C. 2013) (stating that corporations are allowed to recover lost profits due to a defendant’s wrongful conduct as long as they can be proven with reasonable certainty); Safeco Ins. Co. of America v. S & T Bank, No. 07-01086, 2010 WL 786257, at *10 (W.D. Pa. 2010) (requiring “reasonably accurate evidence” to support the damages claim when using the Total Cost Method); Spirit Airlines, Inc. v. Northwest Airlines, Inc., 431 F.3d 917, 945 (6th Cir. 2005) (using a reasonably accurate standard for experts); Cell, Inc. v. Ranson Investors, 427 S.E.2d 447, 448 (W. Va. 1992) (allowing the recovering of lost revenues where they are shown to be reasonably accurate).

37. Goodwill is the intangible asset that includes a company’s reputation, local impact, and other factors. It is used to evaluate the company. Goodwill, BLACK’S LAW DICTIONARY (10th ed. 2014). See Clemense Ehoff, Jr. & Marvin L. Bouillon, Accounting for Goodwill: Still Crazy After All These Years, 20 J. ACCOUNTING, ETHICS & PUB. POLICY 411, 413-414 (2019) (stating that “goodwill is the result of earnings or the expectation of them, and its value fluctuates as earnings expectations vary. Changes in the value of goodwill cannot be associated with the revenue of any period nor can they be assigned to a period on a rational systematic basis”) (citing G.R. CATLETT & N.O. OLSON, N. O., ACCOUNTING FOR GOODWILL 85 (Accounting Research Study 10) (1968)); DONALD E. KIESO, JERRY J. WEYGANDT & TERRY D. WARFIELD, INTERMEDIATE ACCOUNTING, ch. 12, p. 11-12 (17th ed. 2019) (concluding, "[g]oodwill is measured as the excess of the cost of the purchase over the fair value of the identifiable net assets (assets less liabilities) purchased"; when defining purchased goodwill, stating, "goodwill is recorded only when an entire business is purchased. [The difference between] the fair value of the net tangible and identifiable intangible assets with the purchase price of the acquired business . . . is considered goodwill[,] the excess cost over fair value of the identifiable net assets acquired."); KIESO, WEYGANDT & WARFIELD, supra, at ch. 12, p. 10 (declaring, “[c]onceptually, goodwill represents the future economic benefits arising from the other assets acquired in a business combination that are not individually identified and separately recognized”); C. WILLIAM THOMAS, WENDY M. TIETZ & WALTER T. HARRISON JR., FINANCIAL ACCOUNTING 823 (7th ed. 2019) (stating that goodwill is "[t]he excess cost of an acquired company over the sum of the market values of its net assets (assets minus liabilities)").


through the franchise agreement itself. This poses an interesting question: If the franchisor breaches the franchise agreement, is the franchisee’s claim to any generated goodwill thereby strengthened?

The foreseeability requirement, insofar as it restricts the award of compensatory or consequential damages, may also present a high barrier for the injured franchisee to overcome. In this instance, the franchisee is required to show that the franchisor could have foreseen that the damages would occur because of the breach. Generally, predicting a breach of contract is difficult, even if one could foresee and thereby calculate the damages that would follow such a breach.

Lastly, the franchisee must mitigate any damages that arise after a breach has occurred. This could create an obstacle because of franchise agreement terms. A franchisor may require that the franchisee return property or dispose of the property in a certain way. Additionally, there are certain investments that a franchisee makes for the purpose of a franchise agreement that the franchisee cannot use in any other context. Each of these hypothetical requirements may reduce the franchisee’s ability to recoup its investment.

Other forms of damages, such as liquidated damages or specific

---


41. See Kerry L. Bundy & Robert M. Einhorn, Franchise Relationship Laws, in FUNDAMENTALS OF FRANCHISING 183, 216 (Rupert M. Barkoff et al. eds., 4th ed. 2015) (stating various state laws in which a franchiser may be found liable for damages of goodwill to the franchisee).

42. Compensatory damages, BLACK’S LAW DICTIONARY (10TH ed. 2014) (Compensatory damages are “[d]amages sufficient in amount to indemnify the injured person for the loss suffered”).

43. Id. (defining consequential damages as “[l]osses that do not flow directly and immediately from an injurious act but that result indirectly from the act”).

44. JOSEPH M. PERILLO, CONTRACTS 519 (Hornbook Series, 7th ed. 2014).

45. Id.

46. Emerson, supra note 7, at 693 app. § C(9)(c) (review of 100 franchise contracts in 1993 and in 2013 showed that in 78% and 81%, respectively, terminated franchisees were required to return to the franchisor all trademarked supplies, signs, stationery, forms, and other materials; id. at 694 app. § C(9)(d) (finding that 55% of surveyed franchise contracts provided that all franchise concepts become the franchisor’s exclusive property, dramatically up from just 3% in 1993).

47. Contracting parties may specify in their agreement a specific amount due to the nonbreaching party if the other party breaches. These are known as stipulated damages or, more commonly, liquidated damages. See Liquidated damages, BLACK’S LAW DICTIONARY.
performance, are equally unlikely to be fruitful for an injured franchisee.\footnote{48} This is because franchisees have notoriously inferior bargaining power\footnote{49} and will not likely be able to convince a franchisor to add a provision that provides for liquidated damages in the event the franchisor breaches its obligations.\footnote{50} Indeed, the franchisor may simply dictate the terms of the franchise agreement.\footnote{51} This pro-franchisor power disparity emanates from law upholding franchisors’ contractual rights and from industry practice (a franchisor’s knowledge of the franchisee’s business)\footnote{52} as well as the franchisee’s dependent state, along with economic and educational imbalances.\footnote{53} Many franchisees do not even have legal counsel advising them about contract terms perhaps available to them, let alone negotiating on their behalf.\footnote{54}

The current judicial approach—supportive of franchisor-dictated

\footnote{48}{The threshold to receive specific performance is high because courts tend to prefer monetary damages instead of forcing the defendant to perform a certain action. Some of the common reasons courts put forth for this preference are the high cost of monitoring a defendant and the desire to avoid involuntary servitude. Emerson, supra note 29, at 172; see also Robert L. Ebe, David L. Steinberg & Brett R. Waxdeck, Radisson And The Potential Demise Of The Sealy-Barnes-Hinton Rule, 27 FRANCHISE L.J. 3, 5–7 (2007) (discussing the negative effect liquidated damages can impose on the franchisee).}


\footnote{50}{But see Appleby & Meaney, supra note 33, at 13 (providing a discussion of liquidation clauses in franchise agreements). Some franchise agreements provide for liquidation damages for lost royalties owed to the franchisor if the franchisee breaches the franchise agreement. Appleby & Meaney, supra note 33.}

\footnote{51}{Jiri Jaeger & Frederik Born, Franchisees as Consumers, 5 FRANCHISE L. REV. 101, 101 (2018).}

\footnote{52}{See Robert W. Emerson, Fortune Favors the Franchisor: Survey and Analysis of the Franchisee’s Decision Whether to Hire Counsel, 51 SAN DIEGO L. REV. 709, 719 (2014) (restating the comments of franchise attorneys, reporting on a survey of franchise lawyers, and otherwise noting that studies show that franchisees visit their family lawyer or a friend for counsel instead of obtaining advice from an attorney skilled in franchise matters).}
terms (even, for example, liquidated damages that only apply in favor of the franchisor)—only exacerbates the imbalance in bargaining power. On the other hand, since there are mechanisms for calculating a liquidated amount for a breach, franchisees should also be able to take advantage of a damages calculation method in order to determine their rightful award if the franchisor breaches the franchise agreement. With possible contract awards being insufficient for a harmed franchisee, the courts should provide a more expansive set of remedies.

A philosophical precept of robust, mutually reinforcing duties can be the basis for protecting franchisees and, in turn, strengthening the franchise relationship. Promoting system-wide uniformity nurtures sales. Franchisees are willing to pay for a franchisor’s market brand that brings to the franchisee customers who would otherwise not come to a non-brand business offering the same or similar fare. Franchisors charge for that brand, in terms of fees and royalties, while maintaining sufficient controls to maintain strong trademarks and to prevent franchisee free-riding.

55. See supra note 50 and accompanying text.

56. In a related area, there are proposals to calculate franchise royalties more efficiently and fairly. Robert W. Emerson & Charlie C. Carrington, Devising a Royalty Structure that Fairly Compensates a Franchisee for Its Contribution to Franchise Goodwill, 14 VA. L. & BUS. REV. 279, 289–95 (2020).


58. Uniformity typically goes to the heat of franchise viability. Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962), aff’d, 332 F.2d 505 (2d Cir. 1964) (“It is this uniformity of product and control of its quality and distribution which causes the public to turn to franchise stores for the product.”); DLA PIPER U.S. LLC, EXPANDING A BUSINESS BY FRANCHISING 162 (2007).

59. W. MICHAEL GARNER, FRANCHISE & DISTRIBUTION LAW AND PRACTICE § 1:3 (2019); Thomas J. Chinonis, Implied Covenant of Good Faith: A Two-Way Street in Franchising, 11 DEPAUL BUS. L.J. 229, 238 (1998) (“Even inexperienced franchisees benefit from the franchisor’s support and economic advantage that results from operating an established system.”); Emerson, supra note 38, at 353 (referring to the concept as “good will”).

60. See Uri Benoliel, The Expectation of Continuity Effect and Franchise Termination Laws: A Behavioral Perspective, 46 AM. BUS. L.J. 139, 144 (2009) (“Individual franchisees have an incentive to cut costs and supply low-quality products and services because they do not bear the full cost of any resulting deterioration in the trademark’s value.”); Tyler Jones, Keeping the Entire Pie and the Dog Fed: Why the Modern Instrumentality Test Fails to Reflect the Realities of the Franchisor-Franchisee Relationship, 36 FRANCHISE L.J. 341, 341 (2016) (arguing the control franchisors have is only to protect their brand or intellectual property).
II. SPECIAL CONSUMER OR BUSINESS RELATIONSHIPS

The implied covenant of good faith and fair dealing implicitly requires all involved parties to behave in such a way that every party may fully benefit from the terms of an agreement.\(^61\) In more elaborate language, one American court ruled that “a party vested with contractual discretion must exercise that discretion reasonably and with proper motive, and may not do so arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.”\(^62\) The requirement is imposed either by statute\(^63\) or by common law.\(^64\) Any action contrary to this requirement is traditionally viewed as a breach of an implied contract.\(^65\) While some judges have taken the stance that the implied covenant cannot be used to insert contract terms which could have been obtained through negotiation,\(^66\) and courts certainly have demonstrated great reluctance to let the implied covenant somehow supersede contractual provisions,\(^67\) that reluctance should not be overemphasized.\(^68\) Despite its opposition, the implied covenant of good faith and fair dealing can be invaluable to protecting the

---

63. ARIZ. REV. STAT. ANN. § 44-1566 (2018); COLO. REV. STAT. § 4-1-304 (2018); FLA. STAT. § 671.203 (2018); IOWA CODE ANN. § 554.1304 (West 2018); MASS. GEN. LAWS ch. 106, §1-304 (2018); MONT. CODE ANN. § 28-1-211 (2018); OR. REV. STAT. ANN. § 650.245 (2018).

Because reasonable expectations arise not only from express terms, but also from implied terms and the context in which the contract is made, limitations on good faith that give excessive deference to express terms are incorrect. The obligation of good faith rests on reasonable expectations that can create duties that go beyond those specified in the express terms of the contract, including duties that limit a party’s ability to exercise rights apparently created by the express terms. Even a narrow view of the content of the good faith obligation . . . recognizes this possibility.

franchisee from an arbitrary, callous, or even spiteful franchisor.\(^{69}\)

Enforcing laws to ensure good faith and fair dealings of franchisors is crucial to the health of a franchisee. It is not prohibited for franchisors to deal in ways that best suit their business, but they are held to a certain standard—that is, to exhibit candor and engage in good faith when negotiating with franchisees.\(^{70}\) Franchisors in the United States should understand that misrepresenting pertinent information in pre-contractual negotiations and even lack of certain details required by disclosures deserve serious consequences and will not be tolerated in franchise dealings.\(^{71}\) Honesty from a franchisor will not only build trust between itself and its franchisee but also likely facilitate the advancement of mutual interests.

### III. Franchise Parties on Their Best Behavior

In the context of franchising, for courts to apply a meaningful, although limited, covenant of good faith and fair dealing may be impractical.\(^{72}\) In contract law generally and franchise agreements particularly, states have employed multiple approaches to enforce implied covenants:\(^{73}\) typically, the franchisor is still obliged to perform in good faith despite a contract clause reserving sole discretion to the franchisor.\(^{74}\) Florida,

---

69. The Ontario Superior Court of Justice has held that in determining whether a franchisor has acted in good faith, the relevant test is to look to the franchisor’s conduct as a whole in the context of the franchise agreement. Hanna & Koczerginski, *supra* note 3, at CAN/7 (citing Fairview Donut Inc. v. The TDL Group Corp., aff’d 2012 ONSC 1252, leave to appeal refused 2012 ONCA 867).


74. Dady, *supra* note 73, at 7–8; see Northwest, Inc. v. Ginsberg, 572 U.S. 273, 286 n.2 (2014) (invoking Minnesota law and suggesting that the law of many states—Alabama, Alaska, Arizona, Connecticut, Minnesota, Missouri, New York, and Wyoming—as well as
for example, recognizes the implied covenant of good faith and fair dealing. The covenant “is intended to protect the reasonable expectations of the contracting parties in light of their express agreement.” Good faith performance is important to uphold a franchisor’s legal obligation and encourage its future business, but a few states have allowed franchisors the “sole discretion” to negate what was presumed to be a franchisor’s implied covenant of good faith and fair dealing. Indeed, any use of discretion “should be consistent with the overall purpose of the agreement and not arbitrary, capricious or unduly surprising.”

The implied covenant of good faith and fair dealing is intended to protect the reasonable expectations of the contracting parties in light of their express agreement. Good faith performance is important to uphold a franchisor’s legal obligation and encourage its future business, but a few states have allowed franchisors the “sole discretion” to negate what was presumed to be a franchisor’s implied covenant of good faith and fair dealing. Indeed, any use of discretion “should be consistent with the overall purpose of the agreement and not arbitrary, capricious or unduly surprising.”


76. Id. at 445 (internal punctuation omitted).


78. Hunter, supra note 2, at 2.16 (citing, as an example, Lath v BMS Cat, No. 16-cv-534-LM, 2018 WL 1835966 (D. N. H. 2018)). This does run counter to the great latitude given for a franchisor’s “discretion” in overseeing the franchise system, as specified in the franchise agreements and disclosed in the Franchise Disclosure Documents (FDDs). The author’s review of 500 FDDs from the year 2020—covering all industries (including lodging, restaurants, services, education, exercise, and other fields), all regions, and close to one-sixth of all extant U.S. franchise systems—found that the vast majority of them (462) had clauses
Compensation in these disputes is normally limited to contract-related damages.\textsuperscript{79} However, there are some instances where contract damages for breach of implied covenants are insufficient.\textsuperscript{80} In these cases, franchisors may decide to litigate because there is no risk of accruing additional—in this case, punitive—damages.\textsuperscript{81} If the franchisor is able to exert unlimited discretion without any repercussions, the franchisee is at a disadvantage before the agreement even begins.\textsuperscript{82} This imbalance often occurs when franchisors execute the franchise agreement. For instance, if the franchise is nationally known and possesses a variety of franchisees, ranging from sophisticated to novice, the franchisor may fail to enforce the agreement equally among the franchisees.\textsuperscript{83}

To counter the stark “sole discretion”\textsuperscript{84} franchisor defense, a franchisee would use the numerous cases, including those outside of franchise litigation, in which there are narrow interpretations of this defense. Consider \textit{Miller v. HCP Trumpet Investments, LLC}.

\textsuperscript{85} The plaintiff, Christopher Miller, asserted that the defendant trustee board of a limited liability company (Trumpet), co-founded by Miller, violated the implied covenant of good faith and fair dealing.\textsuperscript{86} Miller contended that the board had to conduct a \textit{Revlon}-type or “open-market” sale process before selling the LLC under the specifically acknowledging the franchisor’s right to exercise broad discretion and that this alone would not breach an implied covenant of good faith and fair dealing.


\textsuperscript{80} J. Kokolakis Contracting Corp. v. Evolution Piping Corp., 988 N.Y.S.2d 788, 793–94 (N.Y. Sup. Ct. 2014) (stating that claims seeking damages for breach of covenant of good faith and fair dealing could not also be brought with claim for breach of contract).

\textsuperscript{81} Note that in the event of frivolous litigation, the attorney may be subject to punishment. \textsc{Model Rules of Pro. Conduct} r. 3.1(AM. BAR. ASS’n 1983). So, while not a direct risk to the corporation, the attorney may have some objections against a frivolous action.

\textsuperscript{82} It is arguable that the franchisee is aware and accepts the disadvantage. After all, the franchise process involves discussions and plenty of disclosures.

\textsuperscript{83} Stephanie Russ & Laura Kupish, \textit{It’s My Franchise Agreement, I’ll Enforce it However I Want to – Maybe You Will, Maybe You Won’t}, 37 \textsc{Franchise L.J.} 589, 589 (2018). \textit{But see id.} (stating that inconsistent enforcement can lead to discrimination claims).

\textsuperscript{84} The Canadian approach to absolute discretion provides respite to the franchisee. The franchisor must act reasonably in exercising its discretion honestly and in good faith. Discretion must be exercised with a proper motive and not arbitrarily or capriciously. See Sally L. Dahlstrom et al., \textit{W-7 The Evolution of Litigating Good Faith and Fair Dealing Claims}, Am. Bar Ass’n 43rd Annual Forum on Franchising 12 (October 2020).


\textsuperscript{86} \textit{Id.} at 1–2.
The franchise agreement does not lay out everything that is to occur during the franchise relationship. Franchisors and franchisees have expectations that may not be expressed in the written franchise agreement—expectations encompassed within an implied covenant of good faith and fair dealing. Franchisees can have expectations about their relationship with their franchisors and expect certain things from their franchisors because of the special relationship that is the franchisee-franchisor relationship.

When dealing with the implied covenant, the structural benefits that arise from the franchisee-franchisor relationship may warrant a more in-depth view of the expectations the franchisee has in the relationship. Benefits in the form of knowledge, experience, research, and reputation provide the base of the relationship, and monthly royalty payments make it last for the duration of the contract. Operational guidance in the form of research and training bolsters the contractual relationship and places an onus on the franchisor to provide assistance to its franchisee. These structural benefits are enforced by contract but also come with franchisee expectations.

87. Id. at 2 (citing Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986)). In its order denying Miller’s appeal, the court did not refute Miller’s claim on the law but simply held that Miller had “. . . not attempt[ed] to advance targeted claims of that type below or before us.” Id. at 3 (emphasis added).

88. Id. at 3-4.

89. Indeed, even the absence of a contractual prohibition on particular acts or omissions does not mean that one carrying out such acts or failing to act (omissions) necessarily falls short of evidence of bad faith. An act or omission may still be problematic—implicitly wrong while not expressly forbidden.


91. For the franchisee, benefits arise out of a higher chance of success than in a sole proprietorship; shorter time to open; the selling power of a known brand; and the use of an established business model. See Eddy Goldberg, The Benefits of the Franchise Model, FRANCHISING.COM https://www.franchising.com/guides/benefits_of_the_franchise_model.html [https://perma.cc/6XD6-JQX3] (last visited Jan. 30, 2022).

92. Notably, the success of a franchise system relies on a proven concept, the franchisor’s support and assistance, favorable market conditions, and a reputable brand developed by the franchisor. See Craig Tractenberg et al., The Franchisor’s Duty to Police the Franchise System, 36 FRANCHISE L.J. 87, 87 (2016).
for cooperation and support from the parent. It is not in either the franchisee’s or franchisor’s interest to slack on agreed contractual terms—especially given the special relationship that is formed which can give rise to a claim based on violation of the implied covenant of good faith and fair dealing.  

IV. LEGAL REALISM

Similar to some employment and insurance contracts, what if it were possible for franchisees to recover tort damages? It would allow a party to escape statutory caps that may result in insufficient recovery. Franchisees should be able to recover if they are able to establish a special relationship or demonstrate that they have no other recourse in the marketplace. It would circumvent discretion-related defenses and allow courts to uphold the purpose of the franchise agreement: a mutually beneficial and perhaps long-lasting relationship. This is a trend, referred to as the “legal realist” approach, that has developed in California.

In Bolter v. Superior Court, the California Court of Appeals held that an arbitration clause within a franchise agreement was procedurally unconscionable because the franchisor had superior bargaining power, and the clause required the franchisee to arbitrate in Salt Lake City instead of California. The court used the legal realist doctrine of unconscionability to invalidate the franchise agreement’s arbitration clause as an unfair market practice. This case is a prime example of legal realist judicial techniques.
used to further populist goals and correct economic and market power imbalances in franchising.  

Constructive discharge occurs when an employee discharges herself because of an employer’s treatment of the employee. In the United States, courts look towards the events that occurred around the time that the employee decided to discharge herself. In France, for comparison, judges are not bound by the current classification of the employment relationship—such as employer-employee or franchisee-franchisor—when determining if there is an employment issue and how to classify the relationship, so a franchise arrangement can be reclassified as an employment contract to receive treatment under the constructive termination doctrine. In the United States, this idea is not prominent.

Currently, there are no federal laws and only a few state laws that protect franchisees from retaliatory behavior from their franchisors. The prospects for future legislation in this area is dim. The best hope that franchisees have for protection from retaliatory behavior from franchisors is from the legal community, courts, and regulators. In line with the information of a special relationship—in the independent contractor context—even if the relationship is not characterized as employee-employer, there still may be relief for an independent contractor in the case of retaliatory discharge.

In Washington state, federal and state employment discrimination statutes apply to not only employees but also non-employees such as those in an independent contractor-principal relationship. In Currier v. Northland Services, Inc., the Washington state Court of Appeals held that the status of the worker does not matter, and an independent contractor is also able to bring a claim for retaliatory discharge under the Washington Against Discrimination Act. Currier shows that employers cannot escape liability for employment discriminatory conduct because of the status of the employee as an independent contractor.

---

99. Id. at 253.
102. Id. at 190.
104. Id.
106. Id.
Currier is not a franchising case, but its takeaway can be applied to franchises. Sometimes franchisors terminate the franchise agreement in retaliation for the franchisee exercising its rights. Where both employment and independent contractor relationships receive the protection of anti-discrimination and retaliatory dismissal laws, the same approach should apply to franchisor-franchisee relationships. This could be especially helpful if a law or a court holding determines that a franchisee is an independent contractor because the independent contractor relationship would not absolve the franchisor of its contractual duties or the implied covenant of good faith and fair dealing in the termination context. Practically, when a claim for wrongful dismissal can be successfully mounted against a business party, be it an employer or the hirer of an independent contractor, the fact that there may be a franchise relationship between the terminator and the terminated party should not absolve the parties from their contractual duties, including the implied covenant of good faith and fair dealing.

Occasionally, a court will observe that a franchisor-franchisee relationship has the attributes of a consumer relationship, with the franchisee (the consumer) subject to a contract of adhesion. The franchise agreements are fraught with bargaining inequality between the franchisor and franchisee, resulting in terms that reflect gross bargaining disparity. While it is a minority view that the franchisee is a consumer, several states enforce such claims under unfair trade practices statutes (Little FTC Acts) under which the franchisee has been found to be the consumer.

A. Establishing a Special Relationship

To establish the presence of a special relationship (or, perhaps, the absence of any other franchisee recourse), it is important to distinguish franchisees from employees. Normally, franchisees are more aligned with independent contractor status. This is a vital distinction that usually

---


109. See Postal Instant Press, Inc. v. Sealy, 51 Cal. Rptr. 2d 365, 373 (Ct. App. 1996) (stating that franchise agreements are “... usually form contracts the franchisor prepared and offered to franchisees on a take-or-leave-it basis”).

110. See Emerson, supra note 108, at 38.
eliminates the vicarious liability of the franchisor.\textsuperscript{111} Indeed, states frequently have created an exception to the implied covenant in the employment context.\textsuperscript{112} Franchisees face further trouble because as independent contractors, they do not receive better treatment with respect to a good faith or fair dealing requirement.\textsuperscript{113} In fact, some jurisdictions bar tort recovery under the implied covenant and require plaintiffs to recover under retaliatory discharge.\textsuperscript{114}

The assertion of a claim for tortious breach of the implied covenant of good faith and fair dealings is rarely successful. One example of the many failures is \textit{Ennes v. H&R Block E. Tax Services}.\textsuperscript{115} There, the franchisee had worked with the franchisor for thirty years before the relationship ceased.\textsuperscript{116} The court noted that though in effect the fair dealing requirement is present in every contract, a tort claim is applicable only when a party violates its duty to act in good faith.\textsuperscript{117} The court further narrowed the tort claim by requiring a “special relationship” between the two parties.\textsuperscript{118} Despite the longstanding relationship and the fact that the “franchisor controls the sole means of [the franchisee’s] livelihood,” the court declined to grant tort damages to the franchisee.\textsuperscript{119} The court reasoned that to make such an award would unduly extend what constitutes a breach of the covenant of good faith and fair

\begin{itemize}
  \item \textsuperscript{111} Leela Baskaran, \textit{Malaysia, in International Franchising} MAY/34 (Dennis Campbell 2d ed., 2018).
  \item \textsuperscript{112} Northwest, Inc. v. Ginsberg, 572 U.S. 273, 287 (2014) (citing policy reasons for the employment exception).
  \item \textsuperscript{113} Kropinak v. ARA Health Servs, Inc., 33 P.3d 679, 682 (N.M. Ct. App. 2001). \textit{But see} Dynamex Operations West, Inc. v. Superior Court of Los Angeles, 416 P.3d 1, 11 (2018) (holding that a person is considered an employee unless (A) . . . the worker is free from the control and direction of the [hiring entity] in connection with the performance of the work, both under the contract for the performance of [the] work and in fact; and (B) . . . the worker performs work that is outside the usual course of the hiring entity’s business; and (C) . . . the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed. . . .}
  In effect, the potential that franchisees may not be considered independent remains strong, both on the facts in all states and on the law in the leading “pro-consumer” jurisdiction, California.
  \item \textsuperscript{114} Kropinak, 33 P.3d at 682. Certainly, constructive discharge, due to onerous franchisor requirements upon its franchisee or unmet obligations of the franchisor, may be an alternative remedy for mistreated franchisees. \textit{See} Emerson, \textit{supra} note 101.
  \item \textsuperscript{116} \textit{Id.} at *2.
  \item \textsuperscript{117} \textit{Id.} at *7 (noting that not all contracts breached in bad faith can find recovery in tort).
  \item \textsuperscript{118} \textit{Id.}
  \item \textsuperscript{119} \textit{Id.} at *10 (allowing the plaintiffs to recover solely contract damages).
\end{itemize}
In denying to extend these “special relationships” to the context of a franchisor-franchisee relationship, the court opined “the most notable, but not exclusive, example [of such a special relationship] are contracts between insurers and insureds, where distinct elements are present, such as: unequal bargaining power, vulnerability, and trust among the parties; nonprofit motivations for contracting (e.g., peace of mind, security); and inadequacy of standard contract damages.”

There are, of course, logical deficiencies in such reasoning: the court’s contrast of franchise relationships from the insurer-insured relationship reveals many similarities between the two. Like the insurer-insured relationship, the franchisor-franchisee relationship includes the “distinct elements” of unequal bargaining power, with the franchisor offering a “take it or leave it” franchise contract; vulnerability, as in Ennes where the franchisee depended on the franchisor for his livelihood; trust among the parties, especially in a long-standing franchise relationship; and the inadequacy of standard contract damages, as such damages are typically inadequate to make wronged parties whole and carry no threat of deterrence. While it may be frustrating to franchisees, the denial of tort-related damages does serve a purpose. Awarding tort damages requires courts to balance two rightful interests: wronged franchisees deserving of compensation and franchisors protecting their trademarks.

By raising the prospects of a pro-franchisee damages award, a court awarding significant damages would encourage franchisors to act preemptively and minimize the impact of an unfavorable judgment. Potential actions—to protect themselves from both liabilities and pay for any awards—would include raising franchisee fees and restricting franchisee actions. In turn, franchisees would not be interested in paying higher fees and royalties to accommodate another franchisee’s recovery of extra damages.

120. Id. at *12.
121. Id. at *3.
122. RESTATMENT (SECOND) OF TORTS § 901 (AM. L. INST. 1979).
124. John Verhey et al., Basics Track: Franchise Litigation, International Franchise 18 (2017), available at https://www.franchise.org/sites/default/files/BasicsTrack_FranchiseLitigation.pdf [https://perma.cc/3PFT-UUBP] (recognizing that franchisees are likely to have different litigation end goals depending on their franchising future). Indeed, even when franchisees may recognize the usefulness of acting collectively and supporting one another, that recognition is unlikely to produce any action that over turns any strongly pro-franchisor power imbalance. See Robert W. Emerson, Franchising and the Collective Rights of Franchisees, 43 VAND. L. REV. 1503, 1556-1566 (1990) (arguing for the need for state right of association laws and federal antitrust law reforms bolstering the franchisees’ right to act collectively); Robert W. Emerson & Uri Benoliel, Can Franchisee Associations Serve as a
Franchises are popular because, among other things, they facilitate individual ownership and operation of their own business. The imposition of further restrictions would make that dream harder to achieve. Still, the courts’ typical position—even when franchisee mistreatment is plain—is to invoke precedent upholding the parties’ freedom to contract and focus on pro-franchisor contractual limitations. This often excludes any serious examination of whether and how the supposed precedent should apply.  

B. Rare and Exceptional Cases of Special Relationships in a Tortious Breach

Ennes noted that a tort damages award is appropriate only for “rare and exceptional cases” and gave only the example of the insurer-insured relationship, leaving open the possibility of including other relationships by stating that the insurer-insured relationship was not the exclusive “special relationship” that would necessitate the availability of tort damages for breaches of the covenant of good faith and fair dealing. The court further required more than the possibility that a franchisor could take unfair advantage of a franchisee. This stance falls in line with traditional jurisprudence. Courts are only interested in dealing with injuries-in-fact,


126. In an insurance contract there are two duties that are imposed involving good faith. Cheah You Sum, The Quagmire of Utmost Good Faith in Insurance Law, in THE FUTURE OF THE LAW OF CONTRACT 4.13 (Michael Furmston ed., 2020). The first duty is for “[T]he proposer not to misrepresent any matter relating to the risk [of the] insured. . . .” Id. The second duty is for “[T]he proposer not to conceal facts which are material to the risk. . . .” Id. These two duties are placed on the proposer because the proposer is in the best position to know of the potential risks, and the insurer relies on the proposer for full disclosure. Id.
127. See infra notes 210-213 and accompanying para. in text (while discussing good faith and fair dealing, outlining basic similarities between insurance relationships and franchise relationships).
129. Id.
ones that are concrete and particularized, and this begs the question of what is “rare and exceptional.” There is an argument to be made that a franchisor-franchisee relationship is a form of “insurance” in that a franchise pays—in the form of royalty fees and premiums—to run the business, receive guidance from the franchisor, and to use the franchisor’s trademarks. This argument might establish a special relationship, or a special type of “insured” relationship, for a tort claim. This could make franchisees’ claims actionable, because an independent tort claim based on a breach of the implied covenant of good faith and fair dealing can be brought in court if there is a special relationship between the parties.

One potential factor is franchisee inexperience. The franchise relationship in Ennes lasted for thirty years, and over time the franchisee likely became less dependent on his franchisor. An unsophisticated, comparatively new, and inexperienced franchisee presents a much stronger reason for courts to consider awarding tort damages. This is due to the reliance that inexperienced franchisees place upon the franchisor for business guidance: many franchise agreements require the franchisee to participate in ongoing training and routine compliance monitoring. This illustrates the trust inherent in a “special relationship,” which would necessitate awards in tort for breaches of the implied covenant of good faith and fair dealing.

The concept of protecting unsophisticated parties, including franchisees, is longstanding. For example, unsophisticated franchisees often have more leeway to disregard, in effect, the impact of merger clauses. In contrast, consider Cornerstone Square Associates, Ltd. v Bi-

132. Ennes, 2002 U.S. Dist. LEXIS 419, at *12 (“The Court finds no trend in the law towards [allowing tort damages], nor any compelling reason to initiate one.”) (emphasis added).
133. The sophistication of the parties and unequal bargaining power may lead courts to look beyond the strict language of the contract and take a more nuanced contextual understanding of the franchise agreement. In the weighing of contractual terms, the balance may lead towards a more holistic view due to the nature of the franchisor and franchisee. Howard Hunter, The Implied Obligation of Good Faith, in The Future of the Law of Contract 2.13 (Michael Furmston ed., 2020).
135. Id. at 496. For a discussion of the parol evidence rule’s usage against franchisees and proposals to reform the rule to reflect franchising business realities and meet franchisee’s reasonable expectations, see Robert W. Emerson, Franchising and the Parol Evidence Rule,
Lo, LLC. In Cornerstone Square Associates, Ltd., the tenant gave the landlord timely notice of its intent not to renew the lease at the end of the 20-year lease. The lease had stated that tenants of the shopping center would share in costs of common-area maintenance, and payment would be twelve equal installments. The landlord decided to repave the parking lot six days before the tenant’s lease was to expire. This was a large cost that had not been included in the estimates for the year. The tenant objected to paying for the repaving because the tenant would not be using the parking lot after the lease expired. The Court ruled for the landlord because the contract stated that maintenance costs were allocated proportionally at the time the costs were incurred. This may seem extreme, especially when you consider that the tenant’s portion was around $89,000, but in this case, both parties were sophisticated and substantial business entities who were not without market power and knowledge.

While retention of an attorney may help the franchisee understand its situation and thereby presumably avoid the “unsophisticated” label, it is common for prospective franchisees not to employ or even try to have an initial consultation with attorneys. Some potential franchisees have

---

137. Id. at *2.
138. Id. at *1.
139. Id. at *2.
140. Id.
141. Id.
142. Id. at *8.
143. Id. at *2.
144. Courts have considered in what situation a franchisee’s reliance is reasonable. They cited to Schlumberger and noted that the negotiations were arm’s length, the parties were represented by “highly competent and able legal counsel[,] . . .” and the parties themselves were knowledgeable and sophisticated. Carousel’s Creamery, L.L.C. v. Marble Slab Creamery, Inc., 134 S.W.3d 385, 393–94 (1st Ct. App. Tex. 2004). The court noted that franchisees in Carousel were not “sophisticated” because they did not retain counsel and there was no evidence of an arm’s length transaction. Id. The court later concluded that there was no dispute that the franchisee lacked representation and the record evidenced that the franchisees were not sophisticated.
turned to cheaper, online legal advice services such as Legal Zoom.\textsuperscript{146} A survey undertaken for this article demonstrates the concerns people have when looking to hire a franchise attorney, including factors other than money. Specifically, respondents, as prospective entrepreneurs, believed that the more experienced attorneys would already be representing the franchisor.\textsuperscript{147}

A second survey for this article asked franchisor attorneys whether the franchisee was represented by counsel.\textsuperscript{148} The surveyed attorneys stated that roughly 26\% of the franchisees were represented.\textsuperscript{149} It is unclear how many unrepresented franchisees speak to legal advisors on occasion, but the number clearly is much smaller than it should be.

The Federal Trade Commission also recognizes the need to distinguish the different levels of franchisee’s experience.\textsuperscript{150} For example, the level of disclosures the franchisor must provide to the franchisee varies depending on the franchisee’s level of experience. As discussed above, there are plenty of factors and considerations that courts apply to protect the inexperienced.\textsuperscript{151} With support from a variety of regulations and case law,\textsuperscript{152} the sophistication of a franchisee should be a vital consideration when determining the existence of a special relationship. Also, differentiating legal experience from business experience should be used to analyze the sophistication of the franchisee.\textsuperscript{153}

Outside of the franchise context, it is also difficult to find these special relationships. An example of these special relationships may be

\begin{flushleft}
\textsuperscript{146} Robert W. Emerson, \textit{Transparency in Franchising}, 2021 \textit{COLUM. BUS. L. REV.} 172, 219-223 (2021) (discussing how potential franchisees sometimes opt for franchise law advice and related guidance from online services, particularly LegalZoom, including the charges for these services as well as the problems with and litigation against LegalZoom and other online providers of documents and legal assistance).

\textsuperscript{147} The reason might be the franchisor’s presumed ability to pay more. It could be that the franchisor is believed to simply have the experience and contacts to hire the very best lawyers.

\textsuperscript{148} Emerson, \textit{supra} note 54.

\textsuperscript{149} \textit{Id}.


\textsuperscript{151} Medicap Pharmacies, Inc. v. Roach, 2008 WL 11337474, at *1 (Iowa 2008) (considering whether the franchisee voluntarily and knowingly waived the right to a jury trial).


\textsuperscript{153} David Gurnick & Sam Wolf, \textit{Unconscionability in Franchising}, 38 \textit{FRANCHISE L.J.} 81, 100 (2018).
\end{flushleft}
government actors protected by a public duty doctrine.\textsuperscript{154} This doctrine limits a government actor’s duty to respond to situations where a special relationship is present between an individual and the actor, not to the public at large.\textsuperscript{155} This standard is in place because the government has a general duty to protect its citizens. However, to avoid undue dependence on such protection, courts require a special relationship, stemming from “induce[d] detrimental reliance,” to trigger a duty of care.\textsuperscript{156} This approach is very fact-specific, with no bright-line rule.\textsuperscript{157} However, the presence of a special relationship—as a legal conclusion—tends to depend upon whether there has been dependence among the parties, unilaterally or bilaterally.\textsuperscript{158}

\textit{C. An Unorthodox Explanation of Franchisee Dependence}

A franchise can serve as a unique relationship between each franchisee. For example, a franchisee may seek special provisions or notify the franchisor of special conditions that set it apart from other franchisees. The franchise agreement creates this form of privity.\textsuperscript{159} In the franchise agreement, the franchisor provides express assurances. The franchise agreement can discuss the term, area of protection, opening of the franchise, orientation and training, guidance, and more.\textsuperscript{160} Some assurances expressly or implicitly provided in the franchise agreement create a franchisee’s justifiable reliance on the franchisor.\textsuperscript{161} The agreement provides the royalty schedules, indemnification, contract interpretation, arbitration requirements,

\begin{itemize}
\item \textsuperscript{154} Cope v. Utah Valley State Coll., 290 P.3d 314, 318 (Utah Ct. App. 2012).
\item \textsuperscript{155} Id.
\item \textsuperscript{156} Id. at 319.
\item \textsuperscript{157} Wilson v. Valley Mental Health, 969 P.2d 416, 419 (Utah 1998).
\item \textsuperscript{159} Privity is defined as “the connection or relationship between two parties, each having a legally recognized interest in the same subject matter[.] . . .” \textit{Privity}, BLACK’S LAW DICTIONARY (10th ed. 2014). This relationship can be created through contract and allows the parties to sue each other and precludes a third party from doing so. \textit{Id.}
\item \textsuperscript{161} \textsc{Michael W. Garner}, \textsc{Franchise Deskbook Selected State Laws, Commentary and Annotations} (2001).
\end{itemize}
and more. These provisions seem to imply the existence of a “special relationship” subject to higher expectations of reliance on the franchise agreement. In fact, between half and two-thirds of all franchisees come from positions of dependent employment.

Consider a scenario where the franchisee sought specific assurances regarding territorial exclusivity. Due to the franchisee’s inexperience and unfamiliarity with common law doctrines such as parol evidence, the franchisee does not concern himself or herself with the fact that there are no provisions in the franchise agreement regarding exclusivity. Instead, the franchisee relies on the franchisor’s word. In this hypothetical, there is no fraudulent misrepresentation if the franchisor could have believed there would be no issue with encroachment. From another perspective, it may be almost impossible for the franchisee to prove any fraudulent behavior — any intentional misrepresentation — on the part of the franchisor. Moreover, could the franchisee establish his justifiable dependence on the franchisor?

Applying such law-based but practical concerns to the franchise context, courts should acknowledge the special relationship when the franchisor exerts a large amount of control over the franchisee. For example, this should occur when the franchisor issues a specific directive to the franchisee with regards to employment choices or another area normally under the banner of “day to day operations.” This level of control normally exposes a franchisor to liability to third parties if the franchisee harms the third party. It also creates a “special relationship” between the franchisor and franchisee through agency law because of the franchisors frequent control over its franchisees. This special relationship concept should be

164. See Emerson, supra note 135 (on the parol evidence rule in franchising disputes); see also Emerson, supra note 34 (on encroachment claims brought by franchisees against their franchisors).
166. Cope, 290 P.3d at 320.
167. PAUL M. COLTOFF, 65 C.J.S. NEGLIGENCE, Vicarious Liability § 150 (2019) (recognizing that a relationship between two parties is the foundation of vicarious liability). By contrast, for tort claims, Germany does not recognize a supervisory obligation of the franchisor over the franchisee and does not consider the franchisee to be a vicarious agent of the franchisor. Stefan Bretthauer, Germany, in INTERNATIONAL FRANCHISING GER/31
transferable to “good faith and fair dealing” claims and allow franchisees to obtain tort damages when relevant.

D. Franchisees in Atypical Commercial Settings

The possibility of recovery is also limited to “special relationships” not covered under the banner of an ordinary commercial setting. These ordinary commercial settings typically involve two businesses contracting for goods, property, or services. This limited group tends to prohibit franchisees from using this claim to recover from franchisors they believe have acted in bad faith. However, it is arguable that franchises are not in an ordinary commercial setting, despite the support of this classification found in current case law. While franchises are relatively common in the modern economy, the method of their creation is not as simple as the start of other businesses or business relationships.

A franchise agreement can be considered a special type of business contract. In *Postal Instant Press, Inc. v. Sue Sealy*, the court noted that while franchises fall under the realm of commercial contracts, they share...
many of the same attributes as consumer contracts. Specifically, there is an economic inequality between the franchisee and the franchisor that mirrors a consumer-producer relationship. Franchisees are often small business owners operating their first business. This results in an unequal distribution of both a steady inflow of money and profitable opportunities for franchisees. While states may enact legislation to protect the small business owner, creating a tort cause of action outside the scope of the franchise agreement will allow further protection.

Some state legislation tries to protect franchisees by treating them as if they were regular small businesses. For example, in California, courts construe the legislative intent of the statutory provision providing protection to small business owners as also protecting those who have entered into a franchise relationship. In Thueson v. U-Haul Int’l, Inc., the franchisee received the protections afforded to other small business owners when U-Haul terminated the dealership. U-Haul prevailed for different reasons, but the law clearly covered small businesses that owned franchises, as opposed to only covering completely separate, non-franchised, or networked small businesses. The franchise relationship deserves this protection because it often involves an unsophisticated and highly dependent party. The relationship is unusual, if not unique, due to a combination of a franchisee

174. Id. at 373.
175. Id.
176. See id.; see also Coraud LLC v. Kidville Franchise Company, LLC, 121 F. Supp. 3d 387, 391 (S.D.N.Y. 2015) (stating the franchisees had planned but did not have experience running a small business).
179. Thueson, 144 Cal. App. 4th at 676.
180. Id. at 664.
likely being unsophisticated and extremely dependent on the franchisor to provide intellectual property and guidance. The guidance involves methods of operation, trade secrets, advertisement, and development techniques. Such a reliance on the franchisor’s word further distinguishes a franchise relationship from the ordinary commercial setting. The recognition of this lack of sophistication occurs in realms beyond franchise law. It was even the motivation for various regulations, such as the FTC-mandated disclosures, which emerged from the FTC’s Franchise Rule.

Another sign of the distinct nature of franchising is the recent controversy over whether to classify franchise relationships as independent contracts or employment. Some states, most prominently California, have adopted tests which should lead regulators and courts to find that many franchises constitute employment. This is because these commercial arrangements have the trappings of independent contracting between two business entities but their hallmark is, in reality, an employee-like franchisee dependency.

The California Supreme Court went against its previous ruling and adopted an ABC test to determine that a supposed independent contractor

181. Some franchisors advocate for an exception for sophisticated franchisees. With that argument, it must be assumed that a majority of the cases involve an unsophisticated franchisee. See Paul Steinberg & Gerald Lecastre, Beguiling Heresy: Regulating the Franchise Relationship, 109 PENV. St. L. REV. 105, 108 (2004) (discussing the franchisee relationships); see also Emerson, supra note 54 (reporting on a 2014 survey of franchise lawyers, and otherwise noting that studies show that prospective franchisees tend to take a foolish, inexperienced approach to reviewing and negotiating a proposed franchise agreement, including the failure to obtain legal counsel).

182. See John E. Clarkin & Peter J. Rosa, Entrepreneurial Teams Within Franchise Firms, 23 INT’L SMALL BUS. J. 303, 305 (2005) (“[F]ranchisees play little or no role in the creation or innovation process of the business. They operate within what appears to be a mechanistic organization, centered on cost effective production.”) (citation omitted).

183. See id. (stating that Illinois recognized that franchisors attempt to “induce” unsophisticated parties into signing agreements).


The test presumes all workers are classified as employees unless the company can demonstrate all three ABC factors are met: 1. The worker is free from the control and direction of the hirer in connection with performing the work, 2. The worker performs work outside of the usual course of the hiring entity’s business,
may in fact be an employee. The decision, in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles*, left many questions unanswered, an outcome particularly vexing for some California businesses, including franchisors and franchisees. The state legislature moved to make the *Dynamex* decision statutory law, with some push from worker advocates and labor unions. The new law goes beyond the *Dynamex* decision by protecting even more people as employees than were covered under *Dynamex*. In effect, California maintained its lead, and influence, in expanding worker protections to those previously viewed as distinct, typically unprotected independent hires. The state initially became one of the first to codify the ABC test into law, and a few years later, effective January 1, 2020, the California legislature enacted “AB-5,” which expands the scope of *Dynamex Operations* even further.

[186. See *Dynamex Operations*, supra note 113 (discussing the *Dynamex* case and the “ABC” test for determining employment status as opposed to independent contractor status).


189. Id.

190. Id.

191. Proponents of protecting independent contractors focus on higher-minimum wages and employer-provided insurance benefits, however, overlook the fact that a franchisee may be operating as a third party. There are times in which the franchisee is the employer and other times where the franchisee is dependent on the franchisor. This may call for a quasi-independent contractor status for the franchisee, affording protections in the proper contexts when necessary. For a discussion on quasi-independent employees, see Mitchell H. Rubenstein, *Employees, Employers, and Quasi-Employers: An Analysis of Employees and Employers Who Operate in the Borderland Between an Employer and Employee Relationship*, 14 U. PA. J. BUS. L. 605, 606 (2012).

192. Andrew G. Malik, *Worker Classification and the Gig-Economy*, 69 RUTGERS U.L. REV. 1729, 1744 (2017). In *Dynamex*, the California Supreme Court set forth a new, stringent, three-factor test that is used in determining proper worker classification for purposes of California’s wage order rules. 416 P.3d 1 (Cal. 2018). With analysis rooted in the ABC test, the court held that the burden of proof is on the hirer, who is compelled to meet a very high bar because the worker is presumed to be an employee for California wage order purposes unless all three of the ABC factors exist. *Id.*


194. The California legislature codified the common law ABC test in AB-5 (CA A.B. No. 5 (2019), where workers are now considered to be employees who are “suffer[ed] or permit[ted] to work” under wage orders unless the employer is able to establish the three
conflict over “independent” status and employment continues, now even via plebiscites. 195

V. EXPANDING THE GOOD FAITH AND FAIR DEALING CLAIM

Franchisee dependency is further emphasized because the franchisee’s actions are restricted until the franchisor gives approval. For example, a group of franchisees sued Dunkin’ Donuts for failing to respond to a fall in the Dunkin’ Donuts market share in Quebec, Canada. 196 The franchisees worried that the franchisor would not revitalize the brand and
strategy to compete against rising businesses, such as the large and growing Tim Hortons restaurant chain headquartered in Toronto. The franchisees were, in effect, trapped; they tried to adapt without having garnered franchisor approval, and that could have been in violation of their franchise agreements. Instead of focusing on what the franchisees had a right to do, the opinion was about what the franchisees had a right to expect from the franchisor. The franchisor did not take into account the market developments: as a result, the franchisor was not innovating and passing on the innovation to the franchisees. The loss of market share incurred by the franchisees violated the essence of the franchise relational contract. The franchisees had a right to ongoing savoir-faire, but were denied such innovation. In effect, the decision permitted franchisees to take matters into their own hands.

While the situation occurred outside the United States’ borders, it reveals a predicament that U.S.-based franchisees also may encounter. The French concept of “savoir faire[,]” or know-how, was an element in the court’s decision in the Dunkin’ Donuts case, but this is not a commonly considered concept by U.S. courts, so it is possible that an American court would have held differently. In the Dunkin’ Donuts case, the Quebec Superior Court held that Dunkin’ was liable to its Quebec franchisees for breach of contract and allowed the franchisees to terminate their leases because the franchisor had failed to protect its franchisees’ market share by maintaining the strength of the Dunkin’ brand in Quebec in the face of the “Tim Hortons onslaught.”

The French courts do not have a set definition of savoir-faire but

---

197. Id.
199. Id.
200. See Bertico Inc. v. Dunkin’ Brands Can. Ltd., 2012 CanLII 2809 (Can. Que. Super. Ct.), aff’d sub nom. Dunkin’ Brands Can. Ltd. v. Bertico Inc., 2015 CanLII 624 (Can. Que. Ct. App.). Instead of focusing on what the franchisees had a right to do, the opinion in effect was about what the franchisees had a right to expect from the franchisor. In Bertico, the franchisor was not taking account of market developments and was therefore not innovating and passing on the innovation to the franchisees; this violated the essence of the franchise relational contract. The franchisees had a right to this ongoing savoir-faire. One can conclude that Bertico implicitly gave permission for ignored, unaidered franchisees to take matters into their own hands (e.g., foregoing the payment of royalties, suing the franchisee for damages, leaving the franchise network).
draw from the EC Regulation on vertical agreements, the Association Française de Normalisation (AFNOR) norm, and the reflections of scholars. For something to be know-how it must have the characteristic of secrecy, substantially, experimentation and identification. There are many courts in different countries that recognize the idea of savoir-faire and have incorporated the idea into their jurisprudence. Franchisees are dependent on franchisors’ know-how, but, in the United States, franchisors are not required to transfer their know-how to their franchisees. France, on the other hand, requires the transfer of know-how in order for the franchisor’s rights to occur.

The amount of know-how a franchisor is willing to share with...
potential franchisees, to attract them, varies from company to company. A study of 100 franchises showed that 67% of the franchises polled had all training costs at franchisee’s expense and 94% would willingly continue to provide consulting services, after training is completed, for a fee.

Notice the similarities between the insurer-insured and franchisor-franchisee relationships. The insured is entirely dependent on the insurer performing its end of the bargain when there is a need for coverage. In the event the insurer fails to perform in good faith, the insured has little recourse other than through the insurer. The insured cannot seek other insurance companies for protection and an honoring of the policy. This plight is analogous to what is found in the franchising context. If the franchise agreement is not honored by the franchisor, the franchisee is not likely to be able to apply any of the equipment, inventory, or trade secrets to any other franchise. For example, a former McDonalds franchisee may not be able to use anything from his former franchise if he or she becomes a Burger King franchisee. Indeed, the ex-franchisee is typically barred for some time from any significant form of competition against the former franchisor. These non-compete clauses are common in franchise agreements of other countries as well and aim to protect the knowledge and goodwill of franchisors. These clauses often apply throughout the entire duration of the franchise agreement, not exclusively after the agreement has been terminated.

208. Emerson, supra note 149, at 606.
209. Emerson, supra note 7, at 691–92.
210. Franchise agreements may be stuffed with confidentiality agreements, non-compete agreements, and other restrictive covenants that legally prevent the franchisee from moving forward in the market. The skills and training taught to the franchisee could be applied outside of that specific franchise, but the franchisee may have to change its location and industry or wait until the restrictions expire. See William M. Corrigan, Jr. & Michael B. Kass, Non-Compete Agreements and Unfair Competition – An Updated Overview, 62 J. Mo. B. 81, 85 (2006) (noting that non-compete agreements must be reasonable in duration and geographical area).
211. See Matthew Ellman, Specificity Revisited: The Role of Cross-Investments, 22 J. L., Econ., & Org. 234, 251 (2006); see also Jeff Fabian, Know Before You Go – Non-Compete Provisions in Franchise Agreements, Franchise Help, https://www.franchisehelp.com/franchise-resource-center/know-before-you-go-non-compete-provisions-in-franchise-agreements/ (last visited Jan. 30, 2022) (“[N]on-compete provisions state that the franchisee will not, during the term of the franchise agreement and for a reasonable period thereafter (typically two or three years), own or be involved in any ‘competitive business.’”).
212. See Elias Neocleous & Ramona Livera, Cyprus, in INT’L FRANCHISING CY/14 (Dennis Campbell eds., 2d ed. 2018) (emphasizing that non-competes in franchise agreements are prevalent in other countries as well).
213. See Anca Irena Tudorie & Miha Romeo Nicolescu, Romania, in INT’L AGENCY AND DISTRIBUTION L. ROM/30 (Dennis Campbell eds., 2d ed. 2018) (discussing the timeline that
Another reason to expand the good faith and fair dealing claim is to allow franchisees to act in the event the contract is not yet created or has expired. Franchising is an expanding business model and, therefore, the cases of franchisor opportunism are growing in frequency. Almost all cases of franchisee abuse occur after the contract is signed – a time period that is likely to be outside the scope of any franchise negotiations. Since the abuse often lies outside of the terms of the agreement or the duration thereof, the franchisee may have to rely on tort law to seek recourse.

One example that requires the expansion of the implied covenant is when the franchisor opens a franchise near another franchisee. This “encroachment” issue is prevalent in the franchise context and is often considered the “number one problem” for franchisees. Unless the contract provides a regional clause, the franchisee cannot rely on the terms of the contract to protect himself or herself. Additionally, a novice or inexperienced franchisee may not even be aware that a franchisor has the authority to take such action. This exposes a major policy concern that the expansion of the covenant of good faith and fair dealing will address.

Consider encroachment. There are numerous examples, such as that of Steven Scheck, who entered a franchise agreement with Burger King. Scheck believed he had been wronged when the franchisor approved a franchise opening roughly two miles away from his franchise. Similarly, Joseph Davis, the franchise applicant that was approved by Burger King, was told prior to signing the franchise agreement, that the only other franchise “on the board” was located far enough to have no effect on his franchises.

---

214. Steinberg & Lecastre, supra note 181, at 106.
215. Id.
216. See Thomas A. Diamond & Howard Foss, Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated, 47 HASTINGS L. J. 585, 586 (1996) (discussing good faith dealings and franchisee recourse to franchisors); see also Robert Zarco & Morgan Ben-David, Cycle City, LTD v. Harley-Davidson Motor Company: Can Statutory Law or the Implied Covenant of Good Faith and Fair Dealing Override Express Provisions of Contract, 36 FRANCHISE L. J. 47, 49 (2015) (“In franchising, the implied covenant of good faith and fair dealing is invoked in a multitude of situations, including, but not limited to, encroachment, transfers, use of advertising funds, and issues relating to termination and renewal.”) (footnotes omitted).
217. Emerson, supra note 34, at 193.
219. Id. at 545.
220. Davis v. McDonald’s Corp., 44 F. Supp. 2d 1251, 1254 (N.D. Fla. 1998). Davis relied on the fact that in six years, McDonald’s had built only one restaurant in that area. Id.
A third example involves Zuri Barnes, who claimed that he was completely unaware that the franchisor’s policy was to build “restaurants ‘wherever [it felt] there [was] a potential customer base to support the viability of all parties concerned.’”221 The cases involving Scheck and Barnes are not unique occurrences, and these types of lawsuits can send shockwaves through the franchise industry.222 However, both Davis and Barnes were experienced franchisees, and it is unclear why they assumed regional exclusivity would come with their franchise agreements.223

Regardless of their own reasons, it is often quite reasonable for franchisees to believe that they will have some exclusivity or other protections involving costs, markets, or the like. A franchisee is told of this tried-and-true system for operating a business,224 and the franchisee is aware that franchisees reputedly have a higher success rate than people who open small, completely independent businesses without the benefit of a franchise network and usually sans the franchisee’s trademark protection and other advantages, including regional, national or even international recognition.225

McDonald’s did provide in its Franchise Offering Circular that a franchise agreement does not inherently grant exclusivity in a region. Id. Unfortunately for Davis, four new restaurants were placed in the area. Id. One of Davis’s locations had a sales decline of around fortyfive percent. Id.

221. Barnes v. Burger King Corp., 932 F. Supp. 1420, 1423 (S.D. Fla. 1996). When Barnes originally signed the document, he believed that Burger King had a “2-mile policy” with respect to encroachment. It is interesting to note that Scheck had believed that the two-mile protection was violated. See Scheck, supra note 218, at 545 (“Plaintiff has stated that he suffered compensable damages caused by Burger King’s decision to sanction the . . . Burger King franchise two miles away from Scheck’s franchise . . .”).


223. One of the issues in dispute for Barnes’s lawsuit was that the franchisor intentionally failed to inform Barnes that the “2-mile policy” he believed was in effect was in fact false. See Barnes, supra note 221, at 1423 (“[T]here is some dispute as to whether the [franchisor’s sales and service manager] was specifically instructed not to [correct] Barnes.”).

224. Franchisees are expected to operate within a community – i.e., a system overseeing a network of franchisees and, typically, company units. See Emerson, supra note 38, at 355 (stating that franchisees depend on customer goodwill towards a franchise network as a whole and that franchisees generate goodwill to the benefit of the franchise network); see also Rick Grossman, Why You Should Buy a Franchise Instead of Starting Your Own, ENTREPRENEUR (Dec. 9, 2016), https://www.entrepreneur.com/article/286212 [https://perma.cc/GH5F-AGAC] (stating that franchisees share the benefits of the efforts of each other and the franchisor under the franchise system).

225. ARJUN KAKKAR, SMALL BUSINESS MANAGEMENT: CONCEPTS & TECHNIQUES FOR IMPROVING DECISIONS 73 (2009). The beliefs exist, even if they are baseless. See also Common Mistakes Hindering You to Make Your Franchise Successful, ENTREPRENEUR INDIA (July 9, 2018), https://www.entrepreneur.com/article/316418 [https://perma.cc/V7TW-GK7
Is it a senseless leap of faith for a franchisee to think that his or her franchisor would not authorize a direct competitor within a mile of its location? From the perspective of a consumer, both locations offer the same quality; so, why should one travel farther to one franchise location rather than the other? In these situations, owning one’s own business can quickly turn into a nightmare scenario of being trapped in a failing business.

Encroachment is not the only realm in which a franchisee may argue that there was a breach of the good faith and fair dealing covenant. There are a variety of operational claims involving “failure to provide training and support,” misuse of advertising funds, and poor-pricing claims. Also, a franchisor can breach the duty of good faith and fair dealing by failing to cooperate in the franchisee’s performance, doing something that injures the franchisee in his or her right to receive the benefits of the franchise agreement, acting contrary to the spirit of the franchise agreement, performing a task incorrectly on purpose, and many more.

The court in Wojcik v. InterArch, Inc. held that a franchisor could be held liable for breaching the covenant of good faith and fair dealing if the franchisor gives itself broad discretion over the franchisor’s performance and

---

226. See id. See Kazi v. KFC US LLC, Civil Action No 19-cv-03300-RBJ (D. Colo. May. 17, 2021) (also 2021 WL 1978754) (denying summary judgment on the plaintiff franchisee’s one surviving claim against the franchisor, one for breach of the covenant of good faith and fair dealing in how franchisor KFC administered its program for calculating the impact on the plaintiff if KFC opened another allegedly encroaching franchise; it is not merely second-guessing KFC’s business judgment if evidence suggests not just that the KFC impact study was flawed, but that KFC acted in bad faith because it knew the study was flawed and nonetheless accepted it without conducting any meaningful further analysis).


228. See Wojcik v. InterArch, Inc., No. 13-cv-1332, 2013 U.S. Dist. LEXIS 157853 (N.D. Ill. Nov. 4, 2013) (discussing a case in which a franchisor was found guilty of breaching its duty of good faith and fair dealings).
does not exercise good faith in the discretion. In Pennsylvania, the covenant of good faith and fair dealing is not implied in every contract as it is in the UCC. Judge Pratter dismissed the franchisee’s claim for breach of implied covenant in Azmi Takiedine v. 7-Eleven, Inc. because the franchisee had continued to operate his franchise.

In the United States, franchisors can be held accountable for a particular abuse of their power or more general wrongs. For the former, the U.S. District Court of Connecticut provided a good example by holding that a franchisor undermined its franchisees’ operations by selling products through supermarkets. As to more general “infractions,” almost any failure to provide the typical goods or services can be the basis for a claim against the franchisor. The franchisor’s training, support, and overall expertise, which are to be provided initially and on an ongoing basis to the franchisee, constitute one of the most important features of franchising, going to the heart of franchise economic viability as a going concern. The viability of a franchise system relies notably upon a proven concept; the franchisor’s support and assistance; favorable market conditions; constant innovation; and, finally, a reputable brand. The non-exclusive right to use these

---

231. Id.


234. See Tractenberg, supra note 232. Pennsylvania law says that a franchisor has a duty of good faith and “commercial reasonableness when terminating a franchise for reasons not explicit in the agreement.” Id. While the Pennsylvania Supreme Court has inferred a covenant of good faith and fair dealing outside of franchise termination disputes, the district courts have followed the explicit limitation to apply this covenant to only termination disputes. Id.


237. See Steinberg & Lecastre, supra note 181, at 131 & 131 n.119 (quoting a Great Earth Vitamin Stores “We Are Family” advertisement that states, “As one of our Franchisees, you’ll feel like a valued member of a family . . . entrepreneurs who receive the personal attention, training, and support they need to succeed.”); Craig Tractenberg et al., The Franchisor’s Duty to Police the Franchise System, 36 FRANCHISE L.J. 87, 87 (2016) (stating, The viability of a franchise system relies notably upon a proven concept; the franchisor’s support and assistance; favorable market conditions; constant innovation; and, finally, a reputable brand. The non-exclusive right to use these
Covenant of good faith and fair dealing has similarly found that franchisors breached the covenant by not providing such support, even where the support was not contractually guaranteed. 238

Consider further that the franchisee is already extremely limited by his bargaining power and knowledge. As noted above, normally the franchisee is provided with a “take-it-or-leave-it” agreement and is unable to negotiate regional protection. 239 In another scenario, the franchisee may not be aware such a problem exists. Many franchisees fail to hire, from the outset (or maybe even at all), the independent legal counsel they truly need before seriously contemplating and entering into a franchise agreement. 240 Some individuals seek online help from websites such as “Legal Zoom” without even considering the possibility that the franchisor might place a competing franchise in close proximity. Thus, if the franchise agreement does not, for whatever reason, have a clause addressing the issue, a franchisee must rely on an award outside of the realm of contract law.

Another example of uncontracted terms is an implied term to take reasonable measures to help support the brand and the franchisees relying on it. 241 The implied duty of ongoing support is recognized domestically and internationally, 242 but what is expected is rather vague. There are some

---

238. See Gladys Glickman, Franchising: Legal, Business and Tax Considerations of Modern Franchising, § 3.03[4] (2018) (concluding, “A franchisor will typically be in breach of the franchise agreement if the franchisor fails to train and supervise the franchisee”); also noting that a franchisor’s furnishing of “adequate training and assistance to its franchise can aid the franchisor [give it the justification needed] in terminating a noncompliant franchisee.” Changes create the need for ongoing training so that the franchise system can adapt to a changing marketplace. “Franchisors should also consider the need for field support to supervise and provide additional training to franchisees.”); see, e.g., 2 W. Michael Garner, Franchise & Distribution Law and Practice § 8:29 (2019) (discussing a case where “the franchisor did not have a contractual obligation to provide any training, marketing, or other materials to the franchisee” and the court ruled that an implied covenant could be breached even though the breach was not of an expressed contractual provision).

239. By contrast, franchisor-franchisee negotiations are common, at least generally, in other countries, such as Israel. There, negotiating terms “is the norm, not the exception.” Peggy Sharon & Inbal Natan-Zehavi, Israel, in Int’l Franchising ISR/1, ISR/2 (Dennis Campbell eds., 2d ed. 2018).

240. Emerson, supra note 54.

241. See supra note 200 and accompanying text (discussing the Dunkin’ Donuts case in Quebec (Bertico) and savoir-faire.

instances in which the franchisor may include a provision regarding ongoing support. However, when there is no discussion of the term, the implied covenant may be vital to assisting a wronged franchisee.

The final reason to divert from the original rule and allow for tort-based franchisee claims is to discourage franchisors from breaching the covenant of good faith and fair dealing. In the event the franchisor does breach the covenant or take actions similar thereto, the franchisee is limited in damages despite any willful or malicious actions the franchisor may have taken. To go outside the box of contract-based claims and encourage individuals to engage in franchise relationships by lowering the risk of “bad faith,” an expansive notion of good faith and fair dealing should be adopted.

VI. FRANCHISOR PROTECTION

A. Free-Riding and Franchisee Protection Overall

Some protections are granted to franchisees in specific industries, but overall the franchisee occupies a dangerous position. With respect to franchisors, the allowance of tort damages can be used as a weapon against free riding. Franchisees engaged in free riding can be viewed as breaching

243. See e.g., Burger King Corporation v. E-Z Eating 8th Corp., No. 07-20181-CIV-COKE/BROWN, 2008 WL 11330709 at *2 (S.D. Fla. Mar. 31, 2008) (discussing a franchisors duty to provide continuous support); Allegra Network LLC v. Alpha Omega Print & Imaging, Inc., No. 12-10346 2012 WL 12930591 at *2 (E.D. Mich. Dec. 19, 2012) (noting that the franchisor had a duty to provide “continuing consultation service and ongoing support on all facets of operating a Center, including such topics as business operation, marketing, management, technical, pricing, sales and advertising and promotional materials and programs.”).

244. This might serve as a counterweight to the highly restrictive parameters for “good faith and fair dealing” so often set forth in the franchise agreements and disclosed in the Franchise Disclosure Documents (FDDs). The author’s review of 500 FDDs from the year 2020 – covering all industries (including lodging, restaurants, services, education, exercise, and other fields), all regions, and close to one-sixth of all extant U.S. franchise systems – found that over half of them – 270 – had clauses specifically stating that the franchisee waived any claims for a breach of the implied covenant of good faith and fair dealing, that the express (quite pro-franchisor) terms of the franchise agreement negated any possible contrary terms under an implied covenant of good faith and fair dealing, or that no covenant will imply any rights or duties inconsistent with a fair construction of the agreement’s provisions.

245. See N.J. STAT. ANN. § 56:10-18 (2018) (prohibiting a franchisor from granting, relocating, reopening or reactivating a franchise . . . if it will be injurious to another franchise).

246. See Emerson, supra note 54, at 714 (describing the need for franchisee protection laws as well as the difference in bargaining power).
the “covenant of good faith and fair dealing.” A franchisee might free ride by lowering its cost and the quality of its goods or services. Franchisors can admonish against this behavior by threatening to bring tort damages. Tort damages, however, must be weighed against the appearance of immediate economic benefit to the franchisees who are free riding. A franchisee may decide to free ride because free-riding can allow it to keep charging the same prices as the other franchisees while lowering the quality of its products or services. The free-riding franchisee makes a quick and

247. Franchising law and practice often concerns issues such as the prevention of free-riding franchisees and the overall incentivizing of productivity among all franchise units. See Girl Scouts of Manitou Council, Inc. v. Girl Scouts of U.S. of America, Inc., 646 F.3d 983, 988 (7th Cir. 2011) (noting the disincentivizing nature of free riding); Gillian K. Hadfield, Problematic Relations: Franchising and the Law of Incomplete Contracts, STAN. L. REV. 927, 949-950 (1990); see also David J. Kaufman et al., A Franchisor Is Not the Employer of Its Franchisees or Their Employees, 34 FRANCHISE L. J. 439, 447 (recognizing the franchisor’s goal of maximizing productivity and profitability); see Adi Ayal & Uri Benoliel, Revitalizing the Case for Good Cause Statutes: The Role of Review Sites, 19 STAN. J.L. BUS. & FIN. 331, 339 (2014) (discussing and proposing different legal methods by which franchisors combat the threat of free-riding franchisees); see also Emerson, supra note 38, at 354-355 (discussing the issue posed by free-riders to the franchise system).

248. Emerson, supra note 38.

249. See generally, Stojan Arnerstal & Anders Fernlund, The Outer and Inner Dimensions of Protecting Franchising Concepts, 14 INT’L J. FRANCHISING L. 3, 6 (2016) (pointing out that free-riding may not only trigger breach of contract claims, but also other remedies, including trademark law and tort). The Seventh Circuit poses an interesting standard for tort claims, encompassing the free-riding issue. The Court imposes a “bad motive” standard, where discretionary decisions that happen to result in economic disadvantage are of no legal significance without the requisite intention. Original Great American Chocolate Chip Cookie CO. v. River Valley Cookies, Ltd., 970 F.2d 273, 280 (7th Cir. 1992).

250. See e.g., S.M. Amdae, Rational Choice Theory, Britannica, https://www.britannica.com/topic/rational-choice-theory [https://perma.cc/ZU8C-ZFDS] (last visited Jan. 30, 2022) (stating that rational choice theory is the assumption that people will act in a way “that is most in line with their personal preferences”); SooCheong Jang & Kwangmin Park, A sustainable franchisor-franchisee relationship model: Toward the franchise win-win theory, 76 INT’L J. HOSP. MGMT. 13, 21–22 (Jan. 2019) (noting that additional, empirical studies would be needed to test for free-riding, but concluding that franchisees “are willing to continue their current franchise business only when they are satisfied with a franchisor’s fairness, autonomy, formalization, and support”); see also Adi Ayal & Uri Benoliel, Good-Cause Statutes Revisited: An Empirical Assessment, 90 IND. L. J. 1178, 1183-1184 (2015) (stating, the franchisee’s incentive to free ride derives from two central cumulative factors: On one hand, the individual franchisee fully internalizes the benefits of her free riding. On the other hand, the individual franchisee incurs only part of the reputational costs suffered by the franchise brand name due to her free-riding behavior

further concluding,

Since franchisees use a common brand as a trademark, a reduction in quality by
large profit, but causes long-term damage to the goodwill of the overarching franchise. Enforcement of any proscription against free-riding may be limited to tort damages for breaching the “covenant of good faith and fair dealing” – in effect, reversing, with a damages award, a bad-faith termination by the franchisor.

Generally, free-riding by one franchisee weakens the potential power of the franchise group as a whole. In the long haul, this causes non-free-riders to experience a decrease in value and loss of profits. Franchisors may try to prevent free-riding by charging high fees upfront and regulating decision making.

---

251. “[T]he individual franchisee incurs only part of the reputational costs suffered by the franchise brand name due to her free-riding behavior.” Ayal & Benoliel, supra note 250, at 1183.

252. See Ayal & Benoliel, supra note 250, at 1183 (“[T]he individual franchisee incurs only part of the reputational costs suffered by the franchise brand name due to her free-riding behavior.”); see also Implied Covenant of Good Faith and Fair Dealing, BUS. FRANCHISE GUIDE P. 1250 (2018) (noting that some courts require franchisors to act in good faith in exercising their termination and nonrenewal rights); see also Ayal & Benoliel, supra note 250, at 1179 (stating seventeen states have a statutory requirement that there be good faith, on the part of the franchisor, as a condition for the termination of the franchise relationship).

253. Emerson, supra note 34, at 276–77; see also L. Stewart, Free Riding Problem in Franchising (Dec. 2, 2008), https://lesstewart.wordpress.com/2008/12/02/free-riding-problem-in-franchising/ [https://perma.cc/75AJ-TRK7] (“The free rider problem manifests itself in two principal ways within franchising. One, franchisees can free ride . . . by taking the benefits of being within the system but not paying the price . . . Two, franchisees can cheat by ripping off their peers; other franchisees within an independent franchisee association”).

254. Emerson, supra note 38, at 355; see also J. Chappelow, Free Rider Problem, INVESTOPEDIA (Jul. 25, 2019), https://www.investopedia.com/terms/f/free_rider_problem.asp. [https://perma.cc/C2NL-WMEJ] (“To the free rider, there is little incentive to contribute to a collective resource since they can enjoy its benefits even if they don’t. As a consequence, the producer of the resource cannot be sufficiently compensated [and] the shared resource must be subsidized in some other way.”). “If a franchisee withholds effort and successfully free rides on the franchisor’s brand name, this may reflect poorly on perceived brand quality and lead to poor organizational performance.” Roland E. Kidwell et al., Antecedents and Effects of Free Riding in the Franchisor-Franchisee Relationship, 22 J. BUS. VENTURING 522, 525 (2007).

255. Doug Berry, Using the Franchise Agreement to Discourage Free-Riding (Jul. 7, 2014), https://www.lexblog.com/2014/07/07/using-the-franchise-agreement-to-discourage-free-riding/ [https://perma.cc/J653-JV76] (discussing potential methods for franchisors to discourage free riding: termination of contracts for “shirking” franchisees, providing rebates for compliance, and levying fines for noncompliance); see also What is the Concept of Free-Riding in Franchising and Why Does it Occur?, THE FRANCHISE INSTITUTE (Sept. 6, 2017
potential franchisees that follow the standards. Instead of taking preventative measures, franchisors can rely on the tort-enhanced implied covenant of good faith and fair dealing.

The question then becomes: When would a court find a breach of the implied covenant? One approach is to consider what behavior lacks good faith, based on an objective, case-by-case analysis. Referred to as the “excluder approach,” some common actions are “evasion of the spirit of the bargain, lack of diligence . . . abuse of power to determine compliance, and interference or failure to cooperate in the other party’s performance.” The list is not exhaustive; it allows courts enough flexibility to consider the specific circumstances such as the franchisee or franchisor’s sophistication and reliance.

In a case-by-case approach, courts could also examine whether the franchisee has “recourse in the marketplace” or some other way to mitigate damages. A downside to this approach is that the boundaries of good faith are very ambiguous, which prevents a plaintiff or defendant from knowing what may trigger an “evasion of the spirit of the bargain.” However, a court may rely on guidance from insurance-related litigation, where a key public interest favoring tort recovery is to deter bad faith handling of insurance claims.

If courts intend to utilize the recourse factor, the focus should be on the “economic dilemma” that a wronged franchisee or franchisor may face.

12:01 AM), https://thefranchiseinstitute.com.au/concept-of-free-riding-in-franchising-and-why-it-occurs [https://perma.cc/BFT7-7CU4] (indicating that some franchisors incorporate provisions for forfeiture of the franchisee’s initial investment in order to exclude the underperformer out of the network); see also Ayal & Benoliel, supra note 250, at 1187 (arguing that a conventional law and economics analysis shows that the best way to reduce franchisee free-riding is for the franchisor to have the ability to terminate a franchise relationship at will without having to prove that there is good cause for termination).

256. Diamond & Foss, supra note 216, at 591.

257. Emily M.S. Houh, The Doctrine of Good Faith in Contract Law: A (Nearly) Empty Vessel?, Utah L. Rev. 1, 3 (2005) (“Robert Summers’s excluder-analysis approach explicitly concerns itself with fairness, justice, and community standards, [and] it has been and continues to be employed positively and normatively by the courts to conform the conduct of contracting parties to an economically ideal, efficient contracting world.”).

258. Diamond & Foss, supra note 216, at 590.

259. Id. One may argue that “good cause” for termination, through court analysis over time, has actually become a clearer standard in terms of actual, collective judicial holdings. Emerson, supra note 27.


This factor would be more helpful in a franchisee claim because a franchisor naturally has more recourse than a franchisee has. The franchisor can revoke the intellectual property licenses and move on to the next franchisee; a franchisee lacks that same luxury. Additionally, it is dangerous to end the analysis at that point because the dilemma (the lack of any real recourse) must have worse financial effects than the more usual breach. Without deterring intervention, a faithless franchisor might have the opportunity to lie, cheat, scheme, and defraud without any possibility of repercussion in excess of where the franchisor would have been if not for the unethical practices: in effect, it allows franchisors to get away with what they can and pay after the fact for what they cannot. An award of tort damages, on the other hand, would markedly change the risk calculus for a franchisor considering such practices.

The reasonable expectations of the parties is another approach that policymakers may undertake. Just as important, it strikes a fair balance between two parties with different levels of bargaining power. California courts have considered this approach in the insurance context because of the power disparity between the two parties. Generally, the insured party signs what may be considered a contract of adhesion that automatically gives the insurer more power than the insured. However, if the insured has legal sophistication or a closer level of bargaining power to the franchisor’s, the protection is not needed as much. A sophisticated or comparable franchisee will have a reasonable expectation that is closely aligned with, or at least cognizant of, the goals and behavior of the franchisor. Rightful franchisee expectations could be for successfully owning and operating the franchised business; earning a reasonable, hopefully optimal, return on that

262. Frakes, supra note 260, at 519.
263. E.g., courts and legislatures.
266. Id.
268. See AIU Ins. Co. v. Superior Court, 799 P.2d 1253, 1265 (Cal. 1990) (discussing when protections are needed in bargaining power).
269. See id. (“It follows . . . that where the policyholder does not suffer from lack of legal sophistication or a relative lack of bargaining power . . . we need not go so far in protecting the insured from ambiguous or highly technical drafting.”).
franchise investment; and buying into a prosperous system or brand.\textsuperscript{270} Franchisors should be expected to meet such expectations, if reasonable and not violative of any express contractual obligations.\textsuperscript{271} They may do so out of their own sense of fairness (of good faith and fair dealing)\textsuperscript{272} and because that is in keeping with not just the franchisee’s needs, but also the long-term interests of the franchised system as a whole.\textsuperscript{273}

The next issue to consider is the actual award of punitive damages. Punitive damages themselves are treated as a last resort when compensatory damages will not suffice.\textsuperscript{274} Normally, franchise litigation falls under the auspices of contract law, which typically does not award punitive damages. However, sometimes egregious actions in franchise law may result in a breach of the implied covenant of good faith and fair dealing. Furthermore, the shocking conduct may be sufficient to carry the award of punitive damages.

One “guidepost” the Supreme Court considered when awarding punitive damages is how reprehensible the defendant’s conduct was (hereinafter, the “reprehensibility analysis”).\textsuperscript{275} Within that analysis, the Supreme Court mentioned three factors that are relevant in the franchisee’s situation. The first factor is whether the target of the defendant’s conduct was financially vulnerable.\textsuperscript{276} The second factor measures whether the defendant’s conduct involved repeated actions or isolated action.\textsuperscript{277} Lastly, courts should examine whether the plaintiff’s harm was the result of malice, trickery, or deceit.\textsuperscript{278}

\textsuperscript{270} See Levine v. McDonald’s Corp., Bus. Franchise Guide para. 7890 (CCH), 1982 WL 1019145 (noting the franchisor conducted “extensive market analysis” when selecting a franchise location); DLA PIPER, EXPANDING A BUSINESS BY FRANCHISING 128 (2007) (stating a traffic flow analysis is used to determine site locations). Franchising is often about branding. Supra notes 59-60 and accompanying text.

\textsuperscript{271} Lagarias & Kushell, supra note 170, at 9.


\textsuperscript{273} See e.g., In re GNC Franchising, Inc., 22 S.W.3d 929 (Mem.), 931 n.15 (Tex. 2000) (recognizing the long-term nature of franchise agreements); DLA PIPER US LLC, EXPANDING A BUSINESS BY FRANCHISING 106 (2007) (discussing the importance of trust and cooperation in a franchise relationship).


\textsuperscript{275} See id. at 420 (referring to this guidepost as “the most important indicium of the reasonableness of a punitive damages award”).

\textsuperscript{276} Id. at 419.

\textsuperscript{277} Id.

\textsuperscript{278} Diane G.P. Flannery and Jason T. Burnette, One Size Doesn’t Fit All: Analyzing Punitive Damages Reprehensibility, 53 No. 12 DRI For Def. 31 (June 1, 2011), https://www
The franchisee may be financially vulnerable during the beginning of the franchise relationship. However, the franchisee is undoubtedly bound financially to the franchisor throughout the duration of and perhaps beyond the franchise agreement. Franchisees rely on franchisors to provide business guidance and other assistance, such as the furnishing of training materials or goods. It is this provision that makes franchising so appealing to some would-be “entrepreneurs” who want to own and run a business, but also want a network, a valuable trademark, and advice — some institutional “handholding.” The strength of the franchise and the franchisor is a major determinant of the franchisee’s success. Therefore, the franchisee is financially vulnerable to the actions of the franchisor. Indeed, any actions that are outside the covenant of good faith and fair dealings can have a negative impact on either party.  

Consider a situation in which the franchisor refuses to renew the franchise agreement and thereby affects a financially vulnerable franchisee. For some franchises, a franchisee will need to invest somewhere in the range of $300,000 to $600,000. With that being just the initial investment, the franchisee is also obligated to pay royalties and, perhaps, to order from specific manufacturers and vendors at the franchisor’s discretion. This may result in the franchisee paying a higher price than what it would

---

279. Laws regarding the breach of the good faith covenant are not specific to the United States. Article 7 of Peru’s Antitrust Law outlines circumstances under which a financially dominant party has abused its position. María del Carmen Alvarado, Peru, in INTERNATIONAL FRANCHISING PER/1, PER/11 (Dennis Campbell eds., 2d ed. 2018).

280. Suing a franchisor for failure to renew without cause is a common occurrence. Franchisees are often frustrated when they are forced to terminate their businesses without a valid reason from the franchisor. For an example, see McDonald’s Corp. v. Markim, Inc., 306 N.W.2d 158 (Neb. 1981) (stating the franchisees operated the franchise 196 to 1980).

pay from an alternative source.\textsuperscript{282} After these multiple payments, the franchisee is no doubt duty bound and economically exposed to the franchisor. The franchisee may not see profit to make back that initial investment until two or three years after the business develops.\textsuperscript{283}

All of these considerations tie a franchisee to its franchisor and demonstrate the financial vulnerability that a court considers. A reprehensibility analysis\textsuperscript{284} may also be undertaken against a backdrop of franchise ethics. Codes of ethics, such as those from the International Franchise Association and the British Franchise Association,\textsuperscript{285} have, \textit{inter alia}, the purpose of providing a baseline for handling franchise disputes.\textsuperscript{286}

When a franchisor has its own personally tailored franchise code of ethics, a court may use those ethical guidelines to set the boundaries of good faith and fair dealing. In the pursuit of fairness, while interpreting the ethics codes, a court should recognize the franchisee’s vulnerabilities,\textsuperscript{287} examine the traditional behavior between parties, and, if possible, determine the industry norms. Note, however, that franchise relationships can be unique, so the court should be wary when considering how a franchisor interacts with a variety of franchisees.\textsuperscript{288}

Whether the franchisor repeats its conduct against the same plaintiff-franchisee is the second consideration.\textsuperscript{289} In other words, even if a franchisor committed the same breach of good faith against multiple, unrelated franchisees, the courts would restrict their focus to the conduct that was against that specific plaintiff. However, if a group of franchisees banded together, courts would be allowed to consider the repetition of actions across

\begin{itemize}
\item \textsuperscript{283} Ellis Davidson, \textit{The Average Time to Reach Profitability in a Start Up Company}, \textsc{Chron} (July 24, 2017), https://smallbusiness.chron.com/average-time-reach-profitability-start-up-company-2318.html [https://perma.cc/9P84-W2SX].
\item \textsuperscript{284} Supra notes 275–278 and accompanying text.
\item \textsuperscript{285} Ethical Franchising, \textsc{Franchise Direct} (Sept. 26, 2013), https://www.franchisedirect.com/information/introductiontofranchising/ethicalfranchising/7/84/ [https://perma.cc/6EG7-KWXJ].
\item \textsuperscript{286} Id.
\item \textsuperscript{287} Sandquist v. Lebo Automotive, Inc., 376 P.3d 506, 514 (Cal. 2016) (citing \textsc{Restatement (Second) of Contracts} § 206 cmt. a (Am. Law Inst. 1977)).
\item \textsuperscript{288} Indeed, industry norms also can be complicated because of the wide variety of franchise concepts.
\end{itemize}
various franchise agreements, assuming that all franchisees are in business with the same franchisor. Furthermore, the financial benefit of “combining” the franchisees’ contentions would increase the odds of a franchisor’s being held accountable for its bad faith actions.

Collaboration by plaintiffs might be blocked by nondisclosure agreements prohibiting the discussion of trade secrets, proprietary information, or information that the franchisor deems to be confidential. This is an extremely broad umbrella, and the list may not be exhaustive, depending on the terms of the franchise agreement. As franchisees lack equal footing with the franchisor, the possibility of limiting this term is small. The disparity in bargaining power may allow the franchisor to prohibit discussions of franchising prices or other franchise-related information. Such a prohibition would make investigating a breach of good faith and fair dealing even more difficult and costly for the franchisees.

Lastly, the court must examine the subjective intent of the alleged wrongdoer. Has the franchisor or franchisee acted in the spirit of the franchise agreement? This should not be a cursory examination. To find a lack of malicious intent does not, alone, mean that the party acted in good faith. As noted in Harlow v. Fitzgerald, “inquiry into subjective motivation . . . may entail broad-ranging discovery. . . .” With the burden of proof riding on the shoulders of the franchisee, any saved costs from grouping with other franchisees would simply be categorized anew for the intent investigation. The presence of nondisclosure agreements once again could pose challenges for discovering a franchisor’s wrongful, or at least

290. Id. at 420 (“Any proper adjudication of conduct that occurred outside Utah to other persons would require their inclusion. . . .”). Farooqui, supra note 282.
291. This, of course, assumes that a collective franchisee action is procedurally viable.
292. See Hamden v. Total Car Franchising Corp., 548 Fed. Appx. 842, 844 (4th Cir. 2013) (providing an example of a nondisclosure in the franchise context). A nondisclosure can remain in effect even after the franchise agreement is terminated. Id. at 851.
293. The Uniform Trade Secrets Act states that a trade secret is information, including a formula, pattern, compilation, program, etc. that derives independent economic value, actual or potential, from not being generally known to others who could obtain economic value from learning the information and the holder of the trade secret is making some sort of effort to keep the information secret. UNIF. TRADE SECRETS ACT § 1 (4) (1985); see also 88 Ohio Jur. 3d Trade Secrets § 6 (ed. 2018) (including within trade secrets any scientific or technical information, design, process, procedure, formula, pattern, compilation, program, device, method, technique, plans, financial information, lists of names, or phone numbers).
296. See id. at 817 (discussing the investigation of intent in the qualified immunity context).
lacking in good faith, intent.

Fraudulent nondisclosure can exist in a number of different ways, like when a franchisor does not disclose a fact that he or she is aware that the other party does not know, the fact could not be discovered by ordinary investigation, or the other party could not be reasonably expected to discover the fact, and if the other party had known the nondisclosed fact he or she would not have entered into the agreement.\textsuperscript{297}

\textit{B. Protections Abroad}

Throughout the world, suits may be brought challenging the nondisclosure or inaccurate disclosure of relevant information. In Europe, for example, a franchisee may have a claim of action against a franchisor for damages from, or other remedies for, franchisor nondisclosure or incomplete disclosure.\textsuperscript{298} Some nations may adopt a high barrier to franchisee actions, such as that found in Taiwan’s Principle for Handling Cases Relating to Article 25 of the Fair Trade Law.\textsuperscript{299} Taiwan requires disclosure by franchisors, but further provides that a franchisee’s claim based on nondisclosure must prove “intentional malfeasance or nonfeasance.”\textsuperscript{300}

In April 2020, Saudi Arabia’s new franchise law took effect.\textsuperscript{301} The language of the new law is ambiguous when dealing with disclosure and registration violations.\textsuperscript{302} The law appears to offer two options to the franchisee in the case of a breach, either terminate or demand compensation.

\begin{itemize}
  \item \textsuperscript{297} \textit{W. Michael Garner, Franchise & Distribution Law Practice} § 9:11. Omissions, at 45 (2019).
  \item \textsuperscript{298} Karsten Metzlaff & Mark Abell, \textit{European Union}, in \textit{Fundamentals of Franchising Europe} 1, 42 (Robert A Lauer & John Pratt eds., 2017). In Sweden, nondisclosure does not mean a franchisee is entitled to damages or to invalidate the agreement, but the franchisee is entitled to specific performance. Anders Fernlund & Anders Thylin, \textit{Sweden}, in \textit{International Franchise Sales Law} 457, 472 (Andrew P. Loewinger & Michael K. Lindsey eds., 2nd ed. 2015).
  \item \textsuperscript{299} The Principle, published by Taiwan’s Fair Trade Commission, focus on harm to the public interest and – unlike Taiwan’s Civil Code, which focuses on harm to private interests – the Fair Trade Law demands that there be “harmful effects to the [franchise] market order.” Wellington Liu, I-Chen Wu & David Lu, \textit{Taiwan}, in \textit{International Franchise Sales Law}, \textit{supra} note 298, at 475, 497.
  \item \textsuperscript{300} Wellington Liu, I-Chen Wu & David Lu, \textit{Taiwan}, in \textit{International Franchise Sales Law}, \textit{supra} note 298, at 475, 497.
  \item \textsuperscript{302} \textit{Id.}
\end{itemize}
If there is a violation of the registration and disclosure provisions then Article 19 requires franchisors to compensate the franchisee for losses suffered because of the violation, but Article 19 prohibits the franchisee from terminating the franchise relationship. On the other hand, Article 17 allows a franchisee to terminate the franchise relationship if there is a material breach of the registration and disclosure obligation, but Article 17 does not allow for a franchisee to receive compensation for the breach.

Finally, potential punitive damages may also motivate the franchisor to exhibit its best behavior. Franchisors are able to purchase insurance protecting against “defense costs and settlement.” However, only about 20% of franchisors carry franchise-litigation insurance.

i. Good Faith

Globally, many jurisdictions have taken approaches influenced by German and French interpretations of the duty of good faith on both parties. Saudi Arabia’s new law requires the franchisor to act in good faith, and this law applies to pre-existing agreements. Canada, for example, in addition to disclosure requirements placed on the franchisor, imposes on each party to the agreement a duty of good faith in dealing in performance and enforcement of the agreement. The remedy for a breach of the duty of fair dealing is the right to bring an action for damages. The case of Katotikidis v. Mr. Submarine Ltd. provides an example of bad faith in the context of the special relationship that is formed between franchisor and franchisee. The franchisor abandoned the franchisee when it was experiencing operation

303. Id.
304. Id.
308. Hanna & Koczerginski, supra note 3, at CAN/5.
309. Id.
difficulties and violated a legal obligation to assist the franchisee. The court awarded punitive damages because the franchisor violated the duties of good faith and fair dealing and “betrayed the trust that symbolizes the relationship between a franchisor and a franchisee.” Further, in Canada, an entire agreement clause does not preclude a review to determine whether the parties have complied with the expectation of honesty in performance.

Denmark has a similar approach, in which the parties in the franchise relationship are held to standards of “good practice” and concerns the initial stages of the franchise, the ongoing relationship, and the minimum terms of the franchise agreement. There are also obligations on the franchisor that they must have operated the business concept with at least one pilot store for a reasonable time before establishing the franchise system. Training the franchisee is required and continued commercial technical assistance given throughout the relationship. Taking from the French, Danish law also acknowledges that know-how is an important element of a business and encompasses the information and technology required for the franchisee to complete business or certain processes.

The English approach is unique in that there are no specific safeguards for franchisees that are not generally available to all persons entering commercial contracts. There is no general duty to act in good faith in contracts, but in Yam Send Pte, Ltd. v. Int’l Trade Corp., Ltd., the court acknowledged that while the duty of good faith is not implied in every commercial contract, elements may be implied in contracts involving long-term relationships between the parties who have made a substantial commitment. While this was not a franchise case, the court indicated that franchise agreements are “relational contracts” and that franchisors will have to provide all relevant information to their franchisees, whether asked for it

311. Hanna & Koczerginski, supra note 3, at CAN/6.
312. Id.
314. Lasse Sondergaard Christensen & Soren Hogh Thomsen, Denmark, in International Franchising DEN/27 (Dennis Campbell eds., 2nd ed. 2019).
315. Id.
316. Id.
317. Id. at DEN/18.
320. Pratt & Pratt, supra note 318, at ENG/27.
Further, if a franchisor has the power to make unilateral decisions, they must exercise that power honestly and in good faith for which the power was conferred. A franchisee, however, may have the remedy of the tort of negligence, if the court finds that the franchisor owed a duty of care to the prospective franchisee. Franchisors are likely to owe a prospective franchisee a duty of care when giving estimates of potential profits or turnover rates that may affect the franchisee. Inaccurate information may lead to the tort of negligent misstatement.

Courts are divided on the issue of implying good faith into contracts. The law does not impose an implied duty of good faith in commercial contracts, but the Code of Ethics requires the franchisee and the franchisor “to exercise fairness in their dealings with each other and to resolve complaints, grievances, and disputes with good faith.” The Carewatch Care Services Ltd. v. Focus Caring Services Ltd. court dismissed a franchisee’s argument that there was an implied good faith requirement in the franchise agreement and held that the franchise agreement was detailed about the franchise relationship making it unnecessary to imply any additional terms into it. Other cases have gone the other way, though. In Sheikh Tahnoon Bin Saeed Bin Shakhoot Al Nehayan, the court held that parties to an oral joint venture agreement had to act in good faith towards the other party. Also, in Bates v. Post Office, the court held that all “relational” contracts should apply a duty of good faith towards the parties. This case featured guidance on what a “relational” contract is; indeed, under the guidance provided, a franchise agreement is included as a “relational”
contract.329

Israel has an approach to good faith that is modeled greatly after the U.S. and Europe. The duty of good faith is imposed both in the negotiations for a franchise agreement and in the performance of the respective obligations of the parties.330 Due to the precarious nature of the franchise relationship and the unique risks that a franchisee faces, Israel’s Franchise Code of Ethics imposes mandatory disclosures of relevant information essential to enable investors to make informed decisions about franchise offerings.331 The franchisor has a similar “know-how” requirement as seen in other countries, obligating them to provide the franchisee with business guidance and financial guidance.332

Italy imposes requirements on the franchisor akin to those seen in France. The franchisor is bound to confer on the franchisee the know-how and confidential knowledge that comes from the franchisor’s own experience.333 A general description of know-how should be sufficient at the preliminary negotiation stage, and further details given in an operations manual.334 There are remedies outside of the contract if the franchisor is incorrect or false information was given to the prospective franchisee during negotiations.335 Another nation, Portugal, takes franchisee protections a step further, as there is no specific law applicable to franchise agreements, and applies general statutory regimes to impose the principle of good faith in franchise agreements.336

Franchisors have fought to replace good faith and fair dealing with a franchising Business Judgment Rule (“BJR”)337 protecting the party making decisions in the interest of the business entity (i.e., the franchisor acting for the franchise network). BJR could provide clarity and lessen litigation.338

329. *Id.*


331. *Id.* at ISR/10.

332. *Id.* at ISR/11.


334. *Id.*

335. *Id.* at ITA/8.


338. *Id.* For a discussion of corporate governance issues in the franchise context, see Norman D. Bishara & Cindy A. Schipani, *A Corporate Governance Perspective on the
the corporate context, the law only requires that a party “acted on an informed basis, in good faith, and in honest belief that the action taken was in the best interests of the company.”339 There is no requirement to act in the best interest of the contract, which is required by the good faith and fair dealing covenant. In fact, allowing a personally interested decision may undermine the duty of care.340

BJR is not limited to the corporate context and the relationship between boards of directors and shareholders. For example, it can reach partnerships formed under the Revised Uniform Partnership Act.341 Additionally, if applied in franchising cases, the fact-intensive nature of the rule would allow courts to perform, as in corporate BJR, a balancing test.342

The umbrella of duty of care and loyalty is wide. Shifting BJR to the franchise context, the franchisor would substitute for the director and the franchise system for the corporation.343 BJR could allow the franchisor to protect its interests and sustain the franchise.344 Perhaps, the cynic may opine, the rule gives franchisors the ability to act in bad faith as long as the action can be hidden under the guise of BJR. Doubtless the franchisor may have legitimate reasons to take an action, but that decision may harm either a single franchisee or a more substantial number of franchisees.345 Generally, BJR could protect these decisions made by a franchisor and lead to a presumption that decisions were not made with abusive discretion.346 What about the franchisees? Do franchisees have a benefit or at least a way to

---

339. In re Walt Disney Co. Derivative Litigation, 906 A.2d 27, 52 (Del. 2006); see Lenois v. Lawal, No. 11963–VCMR, 2017 WL 5289611, at *10 (Ch. Ch., Del. Super. Nov. 7, 2017) (noting the business judgment rule does not require perfection or consideration of every conceivable alternative); see also Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971) (requiring only a “rational business purpose” to protect a board member from liability).


343. Calderas & Murray, supra note 337, at 8.

344. Schnell & Gardner, supra note 340, at 167.

345. Id.

346. Calderas & Murray, supra note 337, at 9. But see Carvel Corp. v. Diversified Mgmt. Grp., Inc., 930 F.2d 228, 231–32 (2d Cir. 1991) (holding that just because a franchisor-distributor, Carvel, had “considerable discretion” in, among other matters, overseeing the system’s advertising, store locations, and wholesale sales, “did not relieve Carvel of its duty to act in good faith”).
overcome BJR?

Since BJR is merely a presumption, such as in corporate law, the presumption can be shifted. In the franchise context, shifting the presumption could occur when a franchisor makes a decision in bad faith or breaches a fiduciary duty. Some franchises have started to put BJR into the franchise agreement. Franchisees may find an argument when trying to prevent BJR from replacing the standard of good faith and fair dealing. BJR may be harder to apply in the franchise context because, if a franchisor makes a decision out of self-interest, which is quite common, then the rule cannot be applied. Decisions to switch brands, expand products, or re-locate may be self-interested decisions made by the franchisor without any clear benefit to the franchisee. All of these actions could lead to BJR being insurmountable. While inconvenient, such decisions may not necessarily be “bad faith, fraud, illegality, or gross overreaching.” So, a good faith and fair dealing standard may still stand in part because franchisors must act in good faith, no matter what standard is used.

Admittedly, courts may be reluctant to apply BJR, which originates out of fiduciary duties, to franchisees. Many courts review the franchisor’s decisions by applying the good faith and fair dealing standard. In Stone v. Ritter, the Delaware Supreme Court stated, “to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty.” This breaks the chain between the covenant of good faith and fair dealing leading into a fiduciary duty and allows the application of BJR. In the franchise context, it has long been the standard that franchisors are not fiduciaries.

347. Henderson Square Condominium Ass’n v. LAB Townhomes, LLC, 46 N.E.3d 706, 727 (Ill. 2015).
352. Schnell & Gardner, supra note 340, at 180.
354. Id. at 370.
in franchise agreements and disclosed in the Franchise Disclosure Documents (FDDs).  

However, the adoption of BJR could have some positive aspects as it would prevent ill-willed franchisees from taking action against a franchisor for simply acting to preserve the franchise network as a whole. If a franchisor takes advantage of such a provision and places it in the franchise agreement, the implied covenant will be blocked out.

ii. Fair Dealing

In many jurisdictions around the world, franchise legislation has been enacted to impose a general obligation of fair dealing on performance and enforcement of franchise agreements. In Canada, the legislation sets out franchise disclosure laws that require fair dealings. To fulfill the duty of fair dealing, a franchisor must perform its contractual duties, and enforce the franchise agreement, all the while taking the franchisees’ interest into account. Before making a system-wide change, a franchisor needs to consider the entire franchise network’s interest, not only the individual franchisee’s interest, and the franchisor should conduct a “meaningful consultation” with the franchisees. According to the Canadian common law courts, a franchisor breaches the duty of fair dealing by unduly withholding information with the intent to make the franchisee not exercise the franchisee’s right to renew. Also, the duty of fair dealing is breached when a franchisor unreasonably or abusively exercises its termination rights. Case law has provided guidance on the duty of fair dealing, but the


356. The author’s review of 500 FDDs from the year 2020 – covering all industries (including lodging, restaurants, services, education, exercise, and other fields), all regions, and close to one-sixth of all extant U.S. franchise systems – found that a large number of them – 325 – had clauses specifically declaring that the franchisor is not a fiduciary for the franchisee.

357. Schnell & Gardner, supra note 340, at 173 (“If a franchisee doesn’t like the franchisor’s decision . . . or the decision has any disparate impact on the franchisee’s business, the franchisee can claim a violation of the implied covenant of good faith and fair dealing.”).

358. Floriani et al., supra note 4, at 8.

359. Id.

360. Id. See supra Part V. (discussing the law, politics, and case law of systemic change within a franchise network; discussing, Emerson, supra note 198, and outlining how the concept of savoir-faire should be incorporated into the notion of franchisor good faith toward its franchisees).

361. Floriani et al., supra note 4, at 8-9.

362. Id. at 9.
law around this area is not set in stone.\textsuperscript{363} This duty does not override unequivocal contract terms, so the duty of fair dealing might be mitigated by franchise agreement provisions.\textsuperscript{364}

The French approach to the implied duty of good faith and fair dealing is a bit different than what is practiced in the United States.\textsuperscript{365} Specifically, in France, franchisor development schedules and business plans that do not live up to their “promise” can be grounds for liability.\textsuperscript{366} Because of the potential liability for franchisors and this special “expectation” claim, business plans should be avoided and left to the franchisee’s sole responsibility.\textsuperscript{367} The franchisor in France must be careful about ratios which are used to draft the franchisee’s business plan. These ratios are handed out to franchisees, and – “if the franchisor validates or even just keeps silent about the resulting business plans” - then its liability is “practically certain.”\textsuperscript{368} This liability arises in a business and legal setting where franchisees’ and franchisors’ mutual duties of good faith are intended to reduce the franchise parties’ risks and thereby “preserv[e] the interest the franchisees have in franchising.”\textsuperscript{369}

The principle of good faith and fair dealing has not always been uniformly used in France, but recently, has been applied not only to the performance of the contract but also to pre-contractual negotiations and during the post-termination phase.\textsuperscript{370} In October 2016, French Civil Code was amended to include article 1.1.4, which states that “[a]ll contracts must be negotiated, created and performed in good faith. This obligation is a matter of public order.”\textsuperscript{371} The obligation of good faith can never be

\textsuperscript{363} Id.

\textsuperscript{364} Id.

\textsuperscript{365} Although different jurisdictions have various interpretations of the duty of good faith, the French and German good faith standards have inspired many jurisdictions around the world, including Belgium, Austria, Poland, and Spain. See Francesca R. Turitto et al., \textit{Anatomy of a Franchise Dispute: Lessons for Transactional Lawyers Drafting Franchising Agreements}, 14 INT’L J. FRANCHISING L. 3, 19 (2016) (discussing the difference between the implied obligation of good faith in France and the U.S.).

\textsuperscript{366} Id. at 5.

\textsuperscript{367} Id.

\textsuperscript{368} Id. at 6 (citing a Court of Appeal of Paris holding in 2015).

\textsuperscript{369} Id. at 16.

\textsuperscript{370} Id. at 18. In order for pre-contractual bad faith to be actionable, other tort requirements must be fulfilled: the damage must have been caused by the bad act, the damage must be certain, and it must be yet uncompensated. This is based in the obligation to repair damage caused by one’s act or failure to act. See Nadia E. Nedzel, \textit{A Comparative Study of Good Faith, Fair Dealing, and Precontractual Liability}, 12 TULANE EUR. & CIV. L. FORUM 97, 115 (1998) (discussing the obligation of good faith).

\textsuperscript{371} John Pratt, \textit{Common Law and Civil Law on Franchising Issues}, LEXOLOGY 7 (May
In line with the know-how requirements of savoir-faire, franchisors are required—from formation to the termination of the contract—to support the franchisee with commercial and technical assistance. Furthermore, a party that has acted in bad faith cannot require the performance of the other party.

Australia is a federal common law jurisdiction, comparable to the United States, in which principles followed by the courts of one state may be different than principles followed in another state. Generally, Australian franchises must comply with the Franchising Code and are subject to numerous legal requirements and require careful drafting of franchise agreements. The Franchising Code’s purpose is to assist franchisees in making informed decisions before entering into a franchise agreement and to provide a framework for a workable relationship between the parties. Civil penalties will be imposed for breaches of the Franchising Code, including lack of proper documents disclosed to prospective franchisees, not complying with the obligation to act in good faith, not updating financial disclosure documents, proper notice with respect to term arrangements, and copies of all material documents. The New South Wales Court of Appeal held, “the concept of good faith had to be accepted on the basis that it represented the current ‘expected standard.’” Exercise of discretion should be consistent with the overall purpose of the agreement and not contrary to the nature of the agreement.

When determining whether there was a breach of the duty of good faith, courts may consider whether the party acted honestly and not arbitrarily and whether the party cooperated to achieve the purpose of the agreement. Importantly, this does not prevent a party from acting in its legit commercial interests and does not require a franchisor to extend an agreement at the end of its term. The Franchising Code is stringent with requirements and the duties for both parties, including marketing requirements, financial
information disclosures, leasing information, transfer restrictions, circumstances for termination, and dealing with former franchisees.\textsuperscript{381}

Common law jurisdictions, including Australia, Canada, and the United States, to one extent or another, have embraced a notion of good faith as an implied obligation in contracts—even though there is variation in the details and application.\textsuperscript{382} Civil law countries, such as France and Germany, may have a more uniform approach to applying good faith obligations, as the duties are codified and expected by the parties in each transaction.

On June 30, 2020, the Dutch Senate enacted a national Franchise Act, the first of its kind in the Netherlands.\textsuperscript{383} The Franchise Act became effective on January 1, 2021 and it regulates the sales of franchises while imposing a “good behavior” standard for franchisors and franchisees, requiring reasonableness in actions depending on the type of industry and the size of the franchise chain.\textsuperscript{384} There are specific provisions regarding prior consent and goodwill that franchisors opposed as restricting business and stifling innovation.\textsuperscript{385} These provisions are mandatory, and a franchise agreement cannot deviate from the requirements established in the Franchise Act, regardless of the law governing the franchise arrangement.\textsuperscript{386}

The aim of the Dutch Franchise Act is to provide more balance in the franchisor-franchisee relationship by offering statutory protections to the franchisee. The parties should behave toward each other as a “good franchisor” and a “good franchisee.”\textsuperscript{387} The Act’s opponents questioned whether such statutory protection is needed, as both the franchisor and the franchisee already had to behave in accordance with Civil Law principles of reasonableness and fairness.\textsuperscript{388} It is unclear how this will affect existing franchise relationships and how franchisors will react to this very pro-franchisee law, but it is a significant step toward codifying the implied duty of good faith and fair dealing inherent in all contracts.

\textsuperscript{381} Id. at AUS/7–AUS/12.
\textsuperscript{382} Howard Hunter, \textit{The Implied Obligation of Good Faith, in The Future of the Law of Contract} 2.46 (Michael Furmston eds., 2020).
\textsuperscript{383} Benjamin B. Reed & Antonia Scholz, \textit{Annual Franchise and Distribution Law Developments} 2020, American Bar Association, 1, 329 (Sept. 15, 2020).
\textsuperscript{384} Id.
\textsuperscript{385} Id. at 330.
\textsuperscript{386} Id. at 331.
\textsuperscript{388} Id.
CONCLUSION

Overall, most rules for franchising—statutes, regulations, and case law—tend to be franchisor-friendly.389 Franchisors can take risks without the fear that, ordinarily, courts will second-guess the decision and impose liability or sanctions for the franchisors’ actions.390

Given this predisposition in favor of the franchisor’s contract, as the franchisor intended it, the courts, regulators, or legislators could, and probably should, impose a duty of “faithfulness to an agreed common purpose and consistency with the justified expectations of the other party.”391 This or a similar covenant of good faith and fair dealing is an underutilized method of recovery for franchisees. The hesitance is only reinforced by the courts’ hesitance to breach precedent and the difficulty of outlining the boundaries of what constitutes good faith.392 Courts are hesitant to rewrite contracts. Franchise agreements are not signed overnight and, regardless of the potential franchisee’s sophistication, a franchisee does have an opportunity to review the terms and accept, negotiate for changes, or even simply toss the draft agreement in the trash. The argument thus goes, should a franchisor be bound to presumably fairer (to franchisees) contract terms simply to make up for franchisees’ mistakes, and often, at least at the outset, franchisees’ lack of due diligence when buying a franchise.393

Expansion of franchising requires the law, and the judges, to adapt to circumstances, to the age of disruption. While using the “blue pencil” may not necessarily be the answer, some sort of judicial quill should be used.394 Franchisees and franchisors may not act in the spirit of the contract, and the traditional contract damages may not be sufficient to remedy the

389. See Emerson & Benoliel, supra note 124, at 105 (noting that all federal-level franchisee protection laws have been rejected and only a small number of states enacted general franchisee protection laws). By contrast, France’s laws are more franchisee-friendly. See Emerson, supra note 101, at 202 (noting that the United States lacks most of the “pro-franchisee aspects that French law possesses, such as savoir-faire, territorial protections, goodwill, and indemnity”; in turn, lacking the contractual and judicial protections of French franchisees, American franchisees must contend with “pro-franchisor written agreements dominating the [U.S.] franchising arena”).
390. Selman, supra note 67, at 112.
393. See ENTREPRENEUR, supra note 226 (arguing that the imposition of the good faith and fair dealing covenant is inappropriate).
394. See supra notes 210 & 213 and accompanying notes (discussing that judges should adapt to expansion of franchising).
situation. For example, how can a franchisee or franchisor recover in the
event of actions that are not prohibited by the contract, but nevertheless harm
either side of the agreement?

To move the franchise law toward more franchisee protections
aligns with some regulatory trends. This would also not be the first time in
which policy overruled freedom of contract. Consider the freedom of
“master over employee” that was once held in the highest esteem.395 Courts
and legislatures have determined that it is not an absolute right, and courts
do have the ability to take policy considerations into account when dealing
with contract enforcement.396

In the modern era, protection of franchisees is likely to take a back
seat to other issues. The last major economic substantive due process
intervention occurred during a nationwide low point when the courts
believed that protection of the overworked employee was a major policy
concern. In contrast, franchising has been a rapidly growing sector of the
economy and franchisees generally have a higher likelihood of success than
their non-franchised counterparts.397 In comparison, business franchises
were rightly considered prone to danger—a wild, often lawless place until
the 1970s, when California and other states enacted franchising legislation.398

In the current legal environment, the optimal approach would

Skrupa, 372 U.S. 726 (1963) (discussing that the master over employee was held in high
esteem).

396. West Coast Hotel Co. v. Parrish, 300 U.S. 379, 392 (1937). Note, it is unlikely for
this change to occur at the federal level. When Lochner v. New York was decided, it signaled
a rapid decline in federal intervention in the economy. This was known as the Lochner Era.
See Barry Cushman, Teaching the Lochner Era, 62 ST. LOUIS U. L.J. 537 (2018) (noting that
as the Great Depression took its toll, the Supreme Court was more willing to intervene and
this demonstrated a growth employment protection. However, in modern day, the Supreme
Court has changed again and it is believed that another Lochner Era is quickly approaching);
see also Mark Joseph Stern, A New Lochner Era, SLATE (June 29, 2018, 4:01 PM), https://slate.

397. Franchise Business Success Rate vs Non-Franchise Business, ACG RESOURCES,
se-business/ [https://perma.cc/U3M2-9PEH]

Franchise businesses typically have a higher growth rate and more stability, but
there is less freedom and control in how the franchisee runs the business. The
opposite is true of non-franchise businesses, whereby they are more risky [sic]
typically a lower growth rate) but they give the business owner more freedom
and control in how the business runs.

398. See Giles & Barkoff, supra note 242, at 165 (noting the misrepresentations that
plagued franchisees).
include court adoption of a stronger, expanded implied covenant of good faith and fair dealing. It invokes an already-existing legal doctrine that can be applied to the franchise world with little disruption. It allows parties to be protected from issues not specifically covered in the contract. Franchisees and franchisors can take comfort in knowing that, if they are blindsided, they can recover. By adopting a standard test for franchising good faith and fair dealing, courts may be better able to delineate the boundaries of appropriate conduct and provide a stronger deterrent to bad faith behavior.