



PENDING FRANCHISE



WHAT FRANCHISORS
AND FRANCHISEES
NEED TO KNOW

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LEGISLATION

Franchisors and franchisees alike should be aware of pending legislation in several states, which, if enacted, could cause dramatic industry changes.

Legislators are recognizing the unequal bargaining power between franchisors and franchisees, and many are now attempting to ‘even the playing field’ between the parties by codifying increased protections for franchisees into state law.

The idea is nothing new. Franchisees have been attempting to increase their bargaining power in franchise relationships for years. In 2011, the Coalition of Franchisee Associations released a “Universal Franchisee Bill of Rights,” which identified ‘basic terms of fairness’ the Coalition determined should be included in all franchise agreements. These included, among other things: The right to freely associate with other franchisees; a right to rely on a franchisor’s good faith, fairness and exercise of due care; a right to renew a franchise agreement under reasonable terms; a right to fair sourcing of goods and services; a right to fairness in the dispute

resolution process; and a right that restricts a franchisor’s ability to terminate the relationship without a required showing of good cause.

In states like Massachusetts, Maine and Pennsylvania, pending legislation seeks to incorporate some of the rights franchisee groups have identified as integral to the success of the franchise industry. If the pending legislation passes and successfully accomplishes its objectives, other states may seek to follow suit. The proposed Massachusetts Fair Franchise Act cites the “profound imbalance of contractual power in favor of the franchisor” as one of several reasons the law should be passed. The Act addresses the common franchisee grievance of unfair competition and seeks to limit a franchisor’s ability to terminate a franchise agreement without good cause. The Act also seeks to significantly limit the amount of liquidated damages franchisors can recover from franchisees and would impose a duty on franchisors to deal fairly and in good faith when exercising discretion.

In Maine, pending legislation known as “An Act to Enact the Maine Small Business Protection Act” was proposed in 2013. Similar to Massachusetts, the Maine Act would restrict the circumstances under which franchisors can terminate franchise agreements, would require franchisors

to compensate franchisees if they permit unfair encroachment, and would limit the ability of franchisors to enforce post-term covenants against competition.

In Pennsylvania, legislators recognize that franchisors who “simply [act] in compliance with the terms of [a] franchise contract with a franchisee [are] not necessarily dealing with [franchisees] fairly and in good faith.” Pending legislation there seeks to restrict a franchisor’s ability to limit sources of equipment and goods – regardless of whether or not those goods are branded with the franchisor’s trademark – and would prohibit franchisors from selling new franchises in “unreasonable proximity” to an existing franchisee. The Pennsylvania Act would also limit the scope of non-competition provisions, an important aspect of the franchise relationship for franchisors and franchisees alike.

A common grievance among franchisees in various franchise systems is that franchisors do not consult with franchisees nor seek their input with regard to marketing, advertising, product development or other business management decisions. This is not particularly surprising, as franchise agreements do not typically require franchisors to do so. A statutory requirement that requires franchisors to act in good faith, or which precludes a franchisor from unreasonably terminating a franchise agreement, could go a long way in providing some measure of comfort to franchisees who are frequently required to sign a franchise agreement on a “take it or leave it” basis. On the other hand, a franchisor’s abilities to terminate franchisees for material defaults of their



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Julie Lusthaus



Mackenzie Dimitri

contractual obligations and to enforce non-competition provisions protect not only the franchisor, but existing franchisees as well, and are essential to the success of the system.

Regardless of how these statutes will impact the franchise relationship, if passed they will likely result in increased litigation as both parties seek judicial clarification of ambiguous standards and terms set forth therein. The Pennsylvania Act, for example, imposes an obligation on franchisors to provide initial training and continuing commercial or technical assistance throughout the entire term of the franchise agreement. If the bill passes, the frequency, nature, and quality of the

training provided by franchisors could be the subject of extensive litigation, as the terms are highly subjective. Other provisions, which require franchisors to act in “good faith” or require franchisors to prove “good cause” for terminating a franchise agreement, are also likely to end up as fodder for the courts.

Ultimately, it remains to be seen what effect passage of these various statutes would have on franchising. One thing, however, is undisputed - both franchisors and franchisees should continue to monitor the pending legislation, and should consult with legal counsel before entering into franchise agreements, seeking to enforce contractual obligations or seeking to

terminate the franchise relationship.

Attorney Julie Lusthaus is a partner in the firm of Einbinder & Dunn, LLP. She focuses her practice in the area of franchise law, serving as counsel to both franchisors as well as franchisees. She can be reached by phone at 212-391-9500 or 914-705-5417 and via email at jcl@edlawfirm.com.

Mackenzie Dimitri is an associate attorney practicing franchise law and related litigation on behalf of franchisors and franchisees at Einbinder & Dunn, LLP in New York City.

For more information:

Website: www.ed-lawfirm.com/