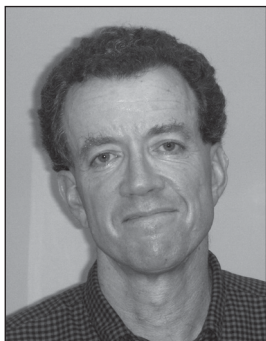


The Franchisor's Control over the Transfer of a Franchise

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The franchisee's ability to transfer or assign its franchise rights to a third party is a crucial element of the relationship between franchisors and franchisees because it is one of the franchisor's primary tools in controlling the franchisee. For franchisees, the transfer/assignment right enables them to sell their business and retire, or pass their business on to the next generation. Most franchisors want as much control over the transfer process as possible while most franchisees want to convey their rights as freely as possible.



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The franchisor's permitted degree of control over transfer involves a complex web of statutory law and judicial decisions. The first part of this article examines the standards that courts apply in interpreting franchise agreements that affect a franchisor's ability to control a franchisee's assignment or transfer. The second part discusses state statutes that govern a franchisor's ability to grant or withhold consent to a proposed assignment or transfer.

Franchise Agreements

This article refers to a franchisee's intent to transfer its franchise. Generally speaking, franchise agreements define *transfer* to include any sale, assignment, or pledge of the franchisee's right to own, control, and operate the franchise. A franchisee could transfer its interest by assigning the franchise agreement, by conveying the franchisee entity or its assets, or by transferring the right to control the franchised business.

Franchise agreements typically fall within one of four categories concerning consent to a transfer:

1. Agreements that require the franchisor to act reasonably or not act unreasonably
2. Agreements that prohibit the franchisor from acting arbitrarily
3. Agreements that give the franchisor unlimited or sole discretion
4. Agreements that are silent about what standard applies

The following section examines the relevant case law in these categories. It also explores franchisees' attempts to use the implied covenant of good faith and fair dealing to compel

the franchisor's consent, an argument that franchisees have advanced, usually unsuccessfully, in disputes involving all of the above categories.

Reasonability Standard

Reasonability is the most common restriction on a franchisor's ability to grant or withhold consent. Many franchise agreements allow a franchisor to grant or withhold consent if it acts reasonably, or conversely, if it does not act unreasonably. Generally, in considering reasonability, courts have evaluated franchisors' denial of transfer requests under an objective standard focused on whether there is a reasonable concern about the viability of the franchise after the proposed transfer. Courts have held that a franchisor's withholding of consent without a strong and legitimate business interest behind it is unreasonable.¹

The parties to a franchise agreement can agree in advance about what is reasonable, and courts will enforce the criteria established in the agreement. However, the imposition of too many requirements may ultimately tip the scales toward a finding that the franchisor unreasonably withheld consent. In *Richter v. Dairy Queen of Southern Arizona*,² plaintiffs wished to sell their business, but the franchisor would not agree to the transfer. The franchise agreement provided that the

license hereunder may not be transferred, assigned or alienated in whole or in part without the written consent of the Company [Dairy Queen of Southern Arizona], which consent shall not be withheld unreasonably, but Company may insist that any proposed assignee be a person, in Company's judgment, qualified to provide active supervision over the operation of said 'Dairy Queen' store in said territory in compliance with Licensee's obligations thereof hereunder.³

The franchisor refused to consent, contending that sales volume at the franchisees' three other Dairy Queens had decreased since the franchisees bought them, the franchisees had been late in remitting royalty payments, the franchisees were in arrears on their account with their supplier, the franchisees' ownership of other Dairy Queens would impair management of a new store, and the franchisor's relationship with the transferring franchisees was already strained.

The franchisees responded that the decrease in business was regional and not specific to the franchisees; the defaults in royalty payments were minimal; there was no arrearage with the supplier; the new franchisee could easily manage the store, a task that took the current franchisee no more than an hour a day; and the strained business relationship would not affect the assignment, especially because the proposed transferee was approved by the franchisor's president.

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The parties and the court treated the transfer provision as requiring reasonability, even though it contained both a reasonableness standard (in that consent could not be arbitrarily or unreasonably withheld) and a unilateral right to withhold consent if the franchisor determined that the assignee could not actively supervise the store. Applying Arizona law, the court held that the franchisor unreasonably withheld consent because the franchisor's complaints about the transferor's conduct had no bearing on any reasonable analysis of the transferees' likelihood of future success. The proposed transferees were reputable and experienced businesspeople with a good record of meeting their obligations, and there should have been no reasonable concern about their viability as franchisees.

In *Culligan Soft Water Service of Inglewood, Inc. v. Culligan International Co.*,⁴ the parties' agreement required the franchisor to consent if "in the reasonable determination of [franchisor], the proposed transferee was financially qualified, had no conflicting interest and possesses personal qualifications and business competence, skill and integrity necessary for performing as a dealer."⁵ The court noted that although the agreement gave the franchisor some discretion in making its decision, the remaining language of the provision listed specifications that defined reasonability. The court thus held it unreasonable for the franchisor to refuse to approve a transfer to a franchisee meeting those specifications.

Courts consider it reasonable for a franchisor to require certain conditions, including the execution of a release, as a prerequisite to approval of an assignment.⁶ In *Schott Enterprises, Inc. v. Pepsico, Inc.*,⁷ the franchise agreement prohibited any sale, transfer or disposition of the franchise without the written consent of Pepsico. Pepsico conditioned its consent on Schott's dismissal of a lawsuit against Pepsico, execution of a mutual release, and the purchaser's agreement to conditions similar to those in the existing franchise. Schott agreed to those conditions and the transfer was made, but Schott subsequently claimed duress and tried to rescind the release. The district court found no wrongful or offensive conduct and held the release requirements reasonable. The Sixth Circuit affirmed, finding that Schott was not induced by duress to sign the mutual release. Moreover, because Schott had retained legal counsel, he had alternatives that he could have exercised. A franchisor has a legitimate business interest in ensuring that it will not be subject to claims by a former franchisee while permitting the continuation of the franchise by a new franchisee.

The Fourth Circuit examined similar franchise agreements in *Brock v. Entre Computer Centers, Inc.*⁸ Those agreements prohibited the franchisor from unreasonably withholding its consent, subject to certain conditions, including that the transferor agreed to execute a general release of any and all claims against the franchisor and its officers. The franchisor had enforced that condition and refused to consent to the transfers unless the franchisee signed a release. The parties exchanged executed releases, but the franchisee then challenged the effectiveness of its release. The court ruled that the franchise agreement imposed a duty upon the franchisor to "not act unreasonably in withholding its consent to a transfer," but that such duty was "subject to the conditions" set out in the agreement and agreed to by

the parties, which included the franchisee's execution of the release.⁹ The court further held that the franchisor's consent to transfer was adequate consideration for the releases.

Courts also recognize other reasonable conditions to an assignment. For instance, the franchisor may require the continued operation of the franchise as a condition for consenting to an assignment. In *Mason County Drugs, Inc. v. Medicap Pharmacies, Inc.*,¹⁰ a federal court applying Illinois law analyzed a franchise agreement that conditioned an assignment on the prior written permission of the franchisor, permission that the franchisor could not withhold if the franchisee had satisfied the conditions and requirements of the franchise agreement. Those conditions included that the transferee be of good moral character and reputation and have a good credit rating, financial capabilities, and competent business qualifications acceptable to the franchisor. The agreement also required the transferee to sign a new franchise agreement in the form then being used by the franchisor and required the transferee's shareholders and partners to guaranty payment and performance. The franchisor did not consent because the franchisee's sale contract with the proposed transferee did not provide for the transfer of the franchise agreement or the continued operation of a franchised business. The court held those elements as reasonable grounds for the franchisor to withhold its consent. A franchisor always has a legitimate business interest in the continuation of its franchised business.

Courts consistently hold that a transferor's past failures to comply with an existing franchise agreement is reasonable ground to withhold consent to a transfer. In *Bishay v. Foreign Motors Inc.*,¹¹ a Massachusetts court held that the franchisor reasonably rejected an assignment based upon the transferor's prior infringement of the franchisor's trademark rights. Although the court disposed of the lawsuit under the Massachusetts Regulation of Business Practices Between Motor Vehicle Manufacturers, Distributors and Dealers Act,¹² the court, in its dicta, addressed the franchisee's breach of contract and implied covenant of good faith and fair dealing claims. The court held that the franchisee's trademark infringement provided the franchisor a "reasonable, legitimate, and justified" basis to deny the transfer and that the franchisor had acted in good faith. The franchisor would not be able to sustain its system without vigorous enforcement of its rights with respect to its agreements and its intellectual property.

In sum, courts have endorsed a variety of reasonable grounds for disapproving a proposed transfer, focusing on how the transfer will affect the viability of the franchise:

1. Transferee's lack of business experience¹³
2. Possible dilution of sales because the transferee sells a competitor's product¹⁴
3. Transferee's unrealistic sales predictions, failure to account for capital improvements, insufficient working capital, and debt load¹⁵
4. Transferee's conditioning its purchase on an application to relocate the franchise¹⁶
5. Transferee's unacceptable character¹⁷
6. Transferee's inadequate training to operate the franchise¹⁸
7. Transferee's inadequate financial and management experience to operate the franchise¹⁹

8. Transferee's failure to provide required and necessary financial information concerning a major investor²⁰
9. Transferee's poor sales record with its current franchise²¹
10. Transferee's default of a franchise agreement with its current franchisor²²

Overall, courts have interpreted reasonability requirements not in terms of the franchisor's subjective fairness but under an objective analysis of the franchisor's business reasons for disapproving a requested transfer or assignment. The courts' focus has been on whether the reason given for disapproval or the conditions imposed upon the consent are reasonably related to the likely viability of the franchise after transfer. As franchisors add conditions to the grant of consent, or base disapproval on grounds that are not legitimate business concerns, the likelihood that the court will reject that disapproval increases.

Arbitrary Denial of Consent

As an alternative to a reasonability standard, some franchise agreements require that consent may not be arbitrarily withheld. The court considered such an agreement in *Perez v. McDonald's Corp.*²³ McDonald's refused to consent to a sale of the franchise, citing the purchaser's failure to complete the McDonald's franchise applicant training program, which was mandatory for all prospective franchisees. The California court held that withholding consent on these grounds was not arbitrary primarily because McDonald's had established that refusing to admit untrained applicants was a legitimate business concern.

In *Zuckerman v. McDonald's Corp.*,²⁴ plaintiffs were owners of five franchises and brought the action against McDonald's to recover losses allegedly incurred due to the franchisor's arbitrary withholding of assignment approval. The license agreement stated that "licensee shall not sell, transfer or assign this license to any person or persons without licensor's prior written consent. Such consent shall not be arbitrarily withheld."²⁵ The license agreement specified eight criteria for the franchisor to evaluate whether to grant its consent, which included work experience and aptitude, financial background, character, ability to personally devote full time and best efforts in managing the restaurant, residence in the locality of the restaurant, equity interest in the restaurant, conflicting interests, and "such other criteria and conditions as Licensor shall then apply in the case of an application for new License to operate a McDonald's restaurant."²⁶ The license agreement did not define the term *arbitrarily withheld*.²⁷

McDonald's required, as a condition of sale, that the purchase price be reduced by the amount of a required reinvestment in the facility. The federal court applied Illinois law and held that as a matter of law, McDonald's actions were not arbitrary or capricious. The court noted that the condition of reinvestment was not arbitrary, but reflected considerations openly contemplated by the parties when they entered into their agreements, and those

considerations were grounded in the franchisor's concerns about the continued viability of its franchise. The agreement clearly required reinvestment of funds to modernize the restaurant and make it competitive in the marketplace.

In cases evaluating a standard of arbitrarily withholding consent, courts will apply a similar standard to the cases discussing reasonability: a franchisor does not act arbitrarily if it bases its decision on a rational business analysis of the effect of the proposed transfer.

Unlimited or Sole Discretion

Many cases concern franchise agreements that permit unlimited, sole, or arbitrary discretion. A federal district court in Michigan held that a clause in a distributorship agreement providing that the distributor could not assign the agreement without the manufacturer's consent gave the manufacturer unlimited authority to withhold its consent, because the parties had agreed as much.²⁸ That court opined that if the parties did not impose any reasonability or other requirements upon themselves in their agreement, then none was required.

In *Gans v. Miller Brewing Company*,²⁹ a Florida court made a ruling based upon the Florida statute governing beer distributorships, which prohibits unreasonably withholding consent in the sale of a distributorship. The court noted that as a matter of broader contractual interpretation,

Florida law does not tolerate contract impairment and will give credence to the contractual bargain. If the contract permits a party to withhold consent arbitrarily, then Florida will honor those rights, except as limited by statute. Based on those dicta, a Florida court would only apply a requirement of reasonability where the parties have specifically agreed to it.

In *Burger King Corp v. H&H Restaurants, LLC*,³⁰ the franchise agreement provided that the franchisee could not transfer the franchise without Burger King's prior written consent. The franchise agreement further provided that Burger King could condition its consent upon the transferee's satisfaction of Burger King's business standards and requirements, that determination to be made in Burger King's "sole judgment." Burger King disapproved of the proposed transfer, citing the transferee's inadequate financial resources and failure to satisfy Burger King's financial, character, managerial, and ownership criteria. Although the court record indicates that the prospective transferee operated seven Burger King franchises in a manner that was inconsistent with Burger King's operational standards and procedures, the court held that fact irrelevant because "the decision of whether to approve a sale was left to Burger King's 'sole judgment' under the franchise agreement."³¹ Thus, the court reasoned, the decision was not arbitrary, and the franchisor did not unreasonably withhold its consent.³²

In *Stephenson v. Allstate*,³³ an agency agreement provided that any transfer required agency approval and that the insurance company would give or withhold its approval in the company's

Many cases concern franchise agreements that permit unlimited, sole, or arbitrary discretion.

exclusive judgment. The federal court applying Michigan law held that the contract granted an unlimited right, and exercising such a right cannot, as a matter of law, constitute a wrongful act.

Generally speaking, courts will honor the parties' agreement to permit the franchisor to exercise its sole discretion or judgment.

Undefined Standard of Consent

Of course, there are agreements that offer no standard or guidance as to what standard a franchisor should or may apply when asked to approve a transfer. In *Knox Crow v. Mobil Oil Corp.*,³⁴ the agreement did not provide for reasonability or establish any other standard governing the franchisor's consent to a sale. In this sale of a gasoline franchise, the federal district court in California held that without a defined standard of consent, the franchisor was contractually permitted to withhold consent without regard to the transferee's qualifications.

However, in Colorado, the Tenth Circuit held that an agreement that requires a franchisor's consent without defining standards for that consent does not give the franchisor the absolute right to disapprove transfer. To withhold consent arbitrarily or unreasonably, the franchisor must have specifically bargained for that right.³⁵

As this disparity indicates, some jurisdictions provide that reasonability will not be imposed where the contract does not specify it, while other jurisdictions do not permit arbitrary consent unless it is specifically provided for. An agreement that is silent on that standard creates the risk that a court will either allow an arbitrary denial or will require a nonarbitrary reason to deny an assignment. This creates inherent risks for both parties, and it would be inadvisable to leave an agreement silent on this point.

Implied Covenant of Good Faith

Where contractual provisions do not impose an enforceable standard of reasonability or fairness, or where the contract permits unlimited or arbitrary discretion, frustrated franchisees/assignors frequently invoke an implied covenant of good faith to require a franchisor to give fair consideration to an application for an assignment. Courts have given little relief to franchisees under this theory.

As noted above, if the agreement specifically permits arbitrary action or does not require reasonability, courts typically will enforce that agreement. Generally speaking, courts will not apply the implied covenant of good faith and fair dealing where the contract specifically permits or requires the parties to act in a particular manner.

The Eighth Circuit discussed an implied covenant of good faith in *Taylor Equipment, Inc. v. John Deere Co.*,³⁶ a dealer case based on South Dakota law. Although it was a manufacturer/dealer case, the court analyzed the matter under standards analogous to a franchisor/franchisee relationship. The dealer contract provided that the dealer could not assign its dealership without prior consent; the court interpreted that provision as allowing an absolute right to disapprove or approve. The court examined the implied covenant of good faith and held that the intention of the covenant is to honor the parties' justified expectations. The assignor in this case would have no justified

expectation that John Deere would surrender its absolute right to approve or disapprove an assignee. John Deere could be liable if it dishonestly withheld approval but not if its disapproval was simply unreasonable.

Similarly, in *Walner v. Baskin Robbins Ice Cream Co.*,³⁷ the federal court applying Texas law held that a party may exercise a right to disapprove a transfer without regard to goodwill or motive if neither is required contractually.

In North Carolina, it has been clearly settled that neither courts nor parties may invoke an implied covenant of good faith or fair dealing where the parties have contracted to the contrary. In the case of *Keating v. Baskin Robbins USA, Co.*,³⁸ the franchise agreement permitted Baskin Robbins to withhold consent to a transfer of a franchisee's interest "arbitrarily and for any reason whatsoever or may condition any consent in their sole discretion."³⁹

In that particular case, the potential purchaser was denied approval based upon his inability to speak fluent English, though the franchisor had never permitted the purchaser to take the English proficiency test that the franchisor used to evaluate new franchisees. The court noted that the franchisor rejected the proposed franchisee over the telephone before interviewing him and before giving him an opportunity to take the English language test, and the court acknowledged the apparent unfairness of that process. However, the court found that there was nothing in the agreement that required the franchisor to administer a proficiency exam before denying approval. The franchise agreement specifically stated that Baskin Robbins' denial of a proposed franchisee could be based on any reason whatsoever. Accordingly, Baskin Robbins' conduct did not constitute a breach of contract.

The franchisee went further and raised a cause of action for breach of an implied covenant of good faith and fair dealing. The court agreed that, in general, if matters are left to a party's discretion, that party must exercise that discretion reasonably and must not act in bad faith. However, the court reasoned that while that doctrine may be implied in all contract provisions, it becomes irrelevant where the contract is drawn to leave a decision to the "uncontrolled discretion" of one of the parties.⁴⁰ In such a case, the parties have contracted to allow one of them the unconditional right to act so that an implied promise to deal fairly is not applicable or relevant. The court specifically wrote that it was not aware of any reported case in which a court has held that the covenant of good faith may be applied so as to prohibit a party from doing that which it is expressly permitted to do by agreement.⁴¹

The Eleventh Circuit considered the implied covenant of good faith and fair dealing in *Ford v. Ford Motor Co.*⁴² The court applied Florida law in interpreting a dealership agreement that permitted the manufacturer to use its "best judgment" in consenting to a transfer.⁴³ There, the dealer's agreement with the transferee required the manufacturer's consent to the relocation of the dealership, but the manufacturer disapproved of the relocation and withheld its consent to the transfer. Under Florida law, the covenant of good faith and fair dealing prevents a party from capriciously exercising its judgment or discretion "so as to thwart the contracting parties' reasonable expectations."⁴⁴

The discretion granted by contract will always be honored, but it must be exercised in a manner contemplated by the agreement. The implied covenant of good faith can be violated if no reasonable party could have reached the same discretionary decision because the contract is presumed to be grounded in reason. The dealer had bargained with the manufacturer for the right to sell cars at that specific location. The court reasoned that the manufacturer's exercise of its "best judgment" to forbid relocation and transfer of the dealership, although not in the dealer's best interests, did not contravene the dealer's reasonable expectations concerning the agreement and was based upon a legitimate business concern. As such, the court determined that the franchisor acted in good faith, since the disapproval was reasonably ground in a concern about the continued operation of the dealership, specifically, the location of the dealership. There can be no breach of a covenant of good faith and fair dealing where the parties have agreed to be governed by the franchisor's best judgment and the facts bear out that best judgment was exercised.

In *Bevilacqua v. Ford Motor Co.*,⁴⁵ the franchise agreement simply provided that the sale of the franchise was conditioned upon Ford's approval of the proposed transferee. The New York court held that the implied covenant of good faith would not prevent Ford from arbitrarily withholding consent, since the agreement did not require Ford to act reasonably. However, New York's Vehicle and Traffic Law § 463(2)(f) provides that a manufacturer cannot unreasonably withhold consent and must articulate specific reasons for withholding consent. But for that industry-specific statute, the court stated that it would have held that the agreement allowed Ford to withhold consent for any reason.

To summarize, the implied covenant of good faith and fair dealing will not be applied to require a higher standard of good faith where the parties have specified the standards by which parties must abide, whether that is unlimited discretion, best judgment, or reasonable practice. The parties will be bound by whatever standard they have agreed to.

Another means of keeping some control over the assignment process is the right of first refusal. This contractual provision permits the franchisor to buy back the franchise in lieu of permitting a sale to go through. By their nature, right of first refusal agreements require a franchisor to acquire its franchise at a price being offered by a third party, which may not always be desirable for the franchisor. This provision is not as useful as an unlimited or even reasonable power to grant or withhold consent, as it requires the franchisor to take the franchise back in order to prevent an undesirable assignment.

Franchise Agreements--Summary

A franchise agreement that requires reasonability will require a franchisor to advance legitimate and specific concerns, grounded in a real-world analysis of the operations of the business, in order to deny consent to a transfer. It is lawful for a franchisor to attach reasonable conditions to its consent to an assignment, such as mutual releases or specific compliance with the franchise agreement.

However, if the franchise agreement permits sole, unlimited, or arbitrary discretion, the franchisor is relatively free to decline

consent for any reason or no reason. In cases where the agreement is silent, courts divide on how to interpret the parties' contractual intent by refusing to require a reasonability standard where one is not stated or by refusing to permit an arbitrary standard where one is not specifically allowed. If a standard is provided, courts will not thwart a franchisor's denial with the implied covenant of good faith and fair dealing, as that covenant will not insert a reasonability standard where the parties have specifically agreed otherwise.

If parties have specifically agreed to any standard of conduct, whether reasonable, arbitrary, or unlimited, courts will enforce that standard in most instances. If the agreement requires reasonable consideration of transfer requests or if the franchisor may not arbitrarily withhold consent, courts will support the franchisor's decision if it is grounded in a rational analysis of the transfer's effect on the franchised business.

State Regulation

All fifty states have some laws affecting franchisee transfer rights in certain industries (many of them motor vehicle franchising laws), and many states have laws of more general application as well.

Forty-six states have statutory procedures that limit the restrictions a franchisor may impose on the sale, transfer, or assignment of a franchise in the motor vehicle industry specifically.⁴⁶ Thirty states regulate franchise transfers in the beer, wine, or liquor industries.⁴⁷ Franchise transfers in other specific industries are regulated in certain states, including heavy equipment (Virginia), petroleum or motor fuels franchises (California, Maine, and New York), service stations (District of Columbia), agricultural equipment manufacturers (Georgia and Texas), insurance (Illinois), watercraft and outboard motor manufacturers (Michigan), and trailer dealers (Virginia).

These regulations prohibit franchisors from unreasonably withholding consent to the transfer of a franchise in the specific industry regulated. Some states require that the franchisor set forth a material reason for denying consent to the transfer (Arkansas, Nebraska, New Jersey, South Dakota, and Texas).

Some state statutes set out specific reasons why consent may be withheld (California, Florida, Hawaii, New Hampshire, and New York). For instance, in an evaluation of the reasonability standard imposed by the Florida Automobile Dealer Law § 320-643, the court in *Bayview Buick-GMC Truck Inc. v. General Motors Corp.*⁴⁸ considered a manufacturer's refusal to accept a proposed transferee who was of good moral character and had clearly met the written, reasonable, and applied standards and qualifications and business experience required by the manufacturer. The court deemed that refusal to be unreasonable. Because the prospective transferee was already a General Motors dealer, its qualifications were presumptively acceptable. The Florida Automobile Dealer Law provides that notwithstanding the terms of a dealer agreement, a manufacturer cannot prohibit a motor vehicle dealer from transferring the agreement unless the manufacturer can prove that the proposed transferee is a person who is not of good moral character or who does not meet the manufacturer's standards relating to financial qualifications or business experience. Because General

Motors failed to set forth material reasons for the unacceptability of the transferee, the court held that its disapproval of the prospective transferee was unreasonable.

The following twenty states have statutes of general applicability relating to the franchisor-franchisee relationship: Arkansas, California, Connecticut, Delaware, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, South Dakota, Virginia, Washington and Wisconsin.

Of these, statutory provisions in nine states specifically address the issue of the transfer of the franchise: Arkansas, California, Hawaii, Indiana, Iowa, Michigan, Minnesota, Nebraska, and New Jersey. There are similarities among certain states within this group, but there does not appear to be a developing national trend in terms of a uniform approach to the statutory regulation of franchise transfers.

Hawaii and Michigan

Among the nine states that regulate franchise transfer by statute, Hawaii⁴⁹ and Michigan⁵⁰ have enacted statutes deeming it an unfair or deceptive act to refuse to permit a transfer of a franchise without good cause. Both statutes identify four instances in which a franchisor may withhold consent for good cause, indicating that good cause shall include, but is not limited to, the following four situations: (1) the proposed transferee fails to meet the franchisor's then current reasonable standards and qualifications; (2) the fact that the proposed transferee is a competitor of the franchisor; (3) the unwillingness of the proposed transferee to comply with all lawful obligations; and (4) the franchisee, the proposed transferee, or both fail to pay all sums due to the franchisor or fail to cure any default under the franchise agreement existing at the time of the proposed transfer. Thus, the statutory language provided for in both Hawaii and Michigan may permit a franchisor to draft the franchise agreement in such a way as to create other good faith reasons for withholding consent to proposed transfers.

Hawaii incorporates the concept of good faith into its Franchise Investment Law.⁵¹ In particular, Hawaii requires that the franchisor act in good faith when considering a request by a franchisee to assign or transfer its franchise.

Under the Michigan Franchise Investment Law, a franchisor may refuse to permit a proposed transfer for good cause, which is defined to include a franchisee's failure to cure any default existing at the time of the proposed transfer. As an example, the court in *Franchise Management Unlimited v. America's Favorite Chicken*⁵² ruled that a franchisee's refusal to provide a release of its claims against the franchisor was good cause for the franchisor's refusal to approve a proposed transfer. The franchise agreement in that case expressly stated that the franchisee would be in default if it failed to comply with the requirements imposed by the franchise agreement, one stipulated that the franchisee provide a release of all claims against the franchisor at the time of

the proposed transfer. Thus, the franchisee's refusal to execute that release constituted a default under the franchise agreement, providing the franchisor with sufficient good cause to deny the proposed transfer.

California and Indiana

The California Franchise Relations Act⁵³ and the Indiana Deceptive Franchise Practices Act⁵⁴ prohibit franchisors from preventing a surviving spouse, heir, or the estate of the franchisee or a major shareholder of the franchisee from participating in the ownership of the franchise for a reasonable period after the death of the franchisee or major shareholder of the franchisee, provided that the surviving spouse, heir, or estate satisfies all of the franchisor's then current standards and qualifications. California further prohibits franchisors from preventing the surviving spouse, heirs or estate from selling, transferring or assigning the franchise to a person who satisfies the franchisor's then current standards and qualifications.

Iowa and Minnesota

The Iowa Franchise Act⁵⁵ and the Minnesota Franchise Act⁵⁶ provide that if a proposed transferee satisfies the franchisor's then current standards and qualifications, the franchisee may

transfer the franchise. Alternatively, if the proposed transferee does not satisfy the franchisor's then current standards and qualifications, the franchisor may only withhold consent to the transfer if the franchisor's denial is not "arbitrary or capricious." The Iowa statute expressly per-

mits a franchisor to condition its consent to a transfer on any of: (i) the proposed transferee's completion of the franchisor's reasonable training program; (ii) payment of a transfer fee to the franchisor for reimbursement of the franchisor's reasonable and actual expenses attributable to the transfer; (iii) a requirement that the franchisee pay or make provisions to pay the franchisor or any of its affiliates any amount due to the franchisor or any of its affiliates at the time of the transfer; and (iv) the compliance of the terms of the transfer with the franchisor's then current financial requirements for its franchisees.

Arkansas, Nebraska, and New Jersey

Arkansas, Nebraska, and New Jersey have also developed systems addressing transfers. Initially, the franchisee has the burden to notify the franchisor of any proposed transfer, sale, or assignment, and must provide the franchisor with pertinent information about the transfer, such as the transferee's name, address, and financial ability or business experience. Failure to provide notice of intent to transfer is a violation of the Arkansas Franchise Practices Act,⁵⁷ the Nebraska Franchise Practices Act,⁵⁸ and the New Jersey Franchise Practices Act.⁵⁹

Once the franchisor has received notice of the proposed transfer, the burden shifts from the franchisee to the franchisor. The franchisor must approve the transfer or provide the franchisee

All fifty states have some laws affecting franchisee transfer rights in certain industries.

with a material reason for the unacceptability of the proposed transfer based on the character, financial ability, or business experience of the proposed transferee.

Where a franchisor has failed to comply with the regulations of the New Jersey Franchise Practices Act, specific performance is an available remedy. In *VW Credit, Inc. v. Coast Automotive Group, Ltd.*,⁶⁰ Volkswagen and Audi refused to consent to a proposed transfer without providing material reasons for the unacceptability of the proposed transferee. In doing so, those manufacturers failed to meet their burden to present credible reasons for their respective denials of consent to the transfer. The New Jersey court noted that the legislature's intent is to allow a transfer in the absence of a valid reason for denial, so the court granted specific performance and enjoined the manufacturers from preventing the transfer. According to the court's interpretation of the New Jersey Franchise Practices Act, where "a franchisor unreasonably withholds consent to a transfer, the franchise transfers to the proposed transferee by operation of law."⁶¹

State Statutes in Brief

Any one of these statutory provisions, if applicable to a franchise, would control over contractual provisions that are contrary to or inconsistent with the legislative intent expressed in these laws. When drafting a franchise agreement in any of these nine states, or evaluating a franchise agreement where the choice of law is based in one of these states, the drafter should review the relevant state statute to assess the rights of the parties, and should structure the language accordingly: (1) in Hawaii and Michigan, specifically define what constitutes good cause for the franchisor to decline to consent; (2) in California and Indiana, specifically define the standards and qualifications that apply to a transfer necessitated by the death of the franchisee; (3) in Arkansas, Nebraska, and New Jersey, specifically define as broadly as possible the specific material reasons that a franchisor may give as grounds for finding a proposed franchisee to be unacceptable; and (4) in Iowa and Minnesota, specifically define the franchisor's standards and qualifications as they would apply to a transferee franchisee. In Iowa, the drafter should go even further and specifically condition approval on all of the stated criteria: (1) completion of the training program, (2) payment of a transfer fee; (3) payment of all past due amounts; and (4) compliance with all financial requirements.

Practice Perspective

The first step in creating or interpreting a franchise agreement in any jurisdiction is to examine the statutory landscape to determine what requirements or restrictions may be imposed by existing laws. Beyond these considerations, a franchisor will ideally reserve for itself an absolute unqualified right to grant or withhold consent to an assignment; specifically permitting itself to reach that determination in its sole discretion, for any reason or no reason, without regard to a standard of reasonability. The franchisee should be specifically required to acknowledge this right, in a warranty clause, in effect waiving any independent imposition of a reasonability standard. If the process of negotiation or other intervening factors require the use of a reasonable standard of judgment in the assignment

provision, then the franchisor should carefully enumerate the factors that would be considered reasonable, including specific financial and character criteria.

On the other hand, a franchisee will seek to have a standard of reasonability imposed and to define that standard in as broad a manner as possible. If a franchisee's rights are defined by an agreement that requires reasonability, the franchisee's right to transfer should prevail if it has abided by the franchise agreement and it provides a commercially viable assignee. If the agreement is silent on the franchisor's standard of conduct or permits an arbitrary denial, the franchisee will have little redress if the franchisor declines to consent; even if the implied covenant of good faith would otherwise prevail.

Endnotes

1. Town & Country Ford, Bus. Franchise Guide ¶ 8660 (N.D. Ga. 1985).
2. 643 P.2d 508 (Ariz. Ct. App. 1982).
3. *Id.* at 509.
4. 288 N.W.2d 213 (Minn., 1979).
5. *Id.* at 217.
6. *Am. Favorite Chicken Co. v. Suryoutomo*, 889 F. Supp. 916 (E.D. La. 1995).
7. 520 F.2d 1298 (6th Cir. 1975).
8. 933 F.2d 1253 (4th Cir. 1991).
9. *Id.* at 1256.
10. No. 05 C 1115, 2006 WL 328255 (N.D. Ill. Feb. 8, 2006).
11. 616 N.E.2d 96 (Mass. 1993).
12. MASS. GEN. LAWS ANN. ch. 93B.
13. *Amoco Oil Co. v. Luehrs*, 465 A.2d 1192 (Md. Ct. Spec. App. 1983); *Portaluppi v. Shell Oil Co.*, 684 F.Supp. 900 (E.D. Va. 1988), *aff'd*, 869 F.2d 245 (4th Cir. 1989); *Sun Refining v. Brooks-Maupin Car Ctrs.*, Bus. Franchise Guide (CCH) ¶ 9325 (E.D. Mich. 1988); *Town & Country Ford, Bus. Franchise Guide* ¶ 8660 (N.D. Ga. 1985).
14. *Brittain v. Stroh Brewery, Bus. Franchise Guide (CCH)* ¶ 10,199 (4th Cir. 1993).
15. *Town & Country Ford, Bus. Franchise Guide* ¶ 8660 (N.D. Ga. 1985); *Walner v. Baskin Robbins, Bus. Franchise Guide (CCH)* ¶ 7723 (N.D. Tex. 1981).
16. *Ernie Haire Ford v. Ford Motor Co.*, 260 F.3d 1285 (11th Cir. 2001).
17. *Burger King Corp. v. H&H Rests., LLC*, No. 99-2855, 2001 WL 1850888 (S.D. Fla. Nov. 30, 2001).
18. *Perez v. McDonald's Corp.*, 60 F. Supp. 2d 1030 (E.D. Cal. 1998).
19. *Burger King*, 2001 WL 1850888.
20. *Holt Motors Inc. v. Gen. Motors Corp.*, No. 87-3953, 1988 WL 109857 (6th Cir. Oct. 19, 1988).
21. *In re Pioneer Ford Sales*, 729 F.2d 27 (1st Cir. 1984).
22. *Dunkin Donuts Inc. v. Sharif, Inc.*, 177 Fed. App'x 809 (10th Cir. 2006).
23. 60 F. Supp. 2d 1030 (E.D. Cal. 1998).
24. 35 F. Supp. 2d 135 (D. Mass. 1999).
25. *Id.* at 138.
26. *Id.*
27. *Id.*
28. *James v. Whirlpool Corp.*, 806 F. Supp. 835 (E.D. Mo. 1992).
29. 560 So. 2d 281 (Fla. Dist. Ct. App. 1990).