What Do You Mean I Can't Renew?

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In the excitement of investigating and eventually opening a new franchise business, it is not unusual for a prospective franchisee to "look past" many of the terms and conditions contained in the franchise agreement. It is mostly those prospective franchise buyers who obtain counsel to explain and lead them through the minefield of the FDD, who can reasonably be "sensitized" to the duties, conditions and obligations in their agreement.

In particular, it has been the experience of the authors that until fully advised by counsel, franchise buyers are generally unaware that the franchise agreement contains specific conditions for renewal. In fact, many are surprised (if not shocked) to learn that the right to operate "their business" is not perpetual, but is only for a designated period of time that will expire without renewal unless the franchisee complies with specific conditions identified in the franchise agreement, including payment of a renewal fee. The range of such conditions is only limited by the imagination of

the franchisor's drafting counsel, as well as the nature of the franchise system.

Execution of a New Agreement

One renewal term that is prevalent in most franchise agreements is the requirement that the franchisee sign what is generally defined as "the then current franchise agreement." While this definition would seem to be self-explanatory, there have been cases brought seeking clarification. The consensus seems to be, however, that "then current" means the franchise agreement used by the franchisor at the time of renewal, not at the time the franchisee first signed the franchise agreement. *G.I. McDougal, Inc. v. Mail Boxes Etc., Inc.*, No. B226112, 2012 WL 90083, at *8 (Cal. App. 2d, Jan. 12, 2012). Thus, it is imperative that counsel explain to its franchisee client that even if they pay renewal fees, refurbish their site and meet all other stated renewal terms, they will be required to sign a new franchise agreement that may, in fact, be on very different terms and conditions. This concept is foreign to many buyers who contrast their agreements to real estate leases, which are often extended by options permitting the original terms and condition to continue (albeit with certain changes such as rent or other costs).

I Have to Pay Another Fee?

Another common renewal term is payment of a renewal fee. Even though it is required to be stated in Item 6 of the FDD (and most

certainly will be in the renewal terms in the franchise agreement), franchisees are often surprised to discover that an additional fee must be paid to "renew" their franchise rights. As a matter of contract law, franchisors certainly have the right to charge a renewal fee (generally either a fixed amount or a percentage of the "then current" franchise fee). The amount and extent of fees vary greatly depending upon corporate culture - some companies view it as another revenue source, others see it as necessary to cover legal and administrative costs that can result, and yet others may charge no fees whatsoever. In most cases, it is the experience of the authors that the amount charged by franchisors for a renewal fee is generally a small percentage of the original fee, revenue from which is used to cover administrative expenses incurred with respect to addressing questions or issues in the new FDD.

Is "Good Cause" Enough to Refuse Renewal?

However, it cannot always be assumed that the franchise agreement renewal provisions are enforceable as written. Eighteen states have statutes or regulations imposing some degree of limitation on a franchisor's refusal to renew a franchise. While these statutes exist, franchisees should not expect the protection granted by them to be limitless. Most of these regulations are liberal in nature, requiring only that the franchisor demonstrate that it has "good cause" for its decision not to renew. "Good cause" is defined differently under different statues, but frequently encompasses franchisee's failure to comply with a term

or terms of the franchise agreement or franchisee's failure to execute the then existing franchise agreement. *See G.I. McDougal* at *10. Many state laws expressly state that franchisors may require franchisees to agree to then existing policies, practices and standards established by the franchisors, as a condition to renewal of the franchise (e.g., Arkansas, Hawaii, Indiana, Iowa, Nebraska and New Jersey). Yet, in many states, just having "good cause" is not enough to preclude renewal rights. For example, some states require written notice be given within a defined time period (e.g., Arkansas, California, Connecticut, Illinois, Iowa, Maryland, Minnesota, Mississippi, Missouri and Washington). Other states have some form of purchase or compensation requirement if the franchisee cannot operate a similar business (e.g., Connecticut, Hawaii, Maryland, Michigan, Illinois and Washington). One state has an advance notice requirement and additionally a requirement that the franchisee should have been given the opportunity to operate the franchise over a sufficient period of time to recover its fair market value as a going concern (Minnesota). Wisconsin requires that any substantial change in the competitive circumstances of a franchise agreement cannot be done without good cause.

A summary of state laws affecting renewal are as follows:

Arkansas – It is a violation of the Arkansas Franchise Practices Act if a franchisor does not renew a franchise agreement except where the failure to renew is for good cause or in accordance with the current policies, practices and standards established by the

franchisor, which in their establishment, operation, or application are not arbitrary or capricious. Ark. Code Ann. § 4-72-204(a)(2) (LexisNexis 2013).

California – Franchisor may not fail to renew unless 180-day prior written notice is provided, and at least one other specified condition is met, one of them being that franchisor and franchisee fail to agree to changes or additions to terms and conditions of the franchise agreement, if such changes or additions would result in renewal of the franchise agreement on substantially the same terms and conditions on which the franchisor is then customarily granting renewal franchises. Cal. Corp. Code § 20025 (2013).

Connecticut – It is a violation of the statute if a franchisor does not renew a franchise except for good cause. The franchisor may elect not to renew a franchise which involves the lease by the franchisor to the franchisee of real property under certain specified circumstances (and upon 6 months' written notice). Conn. Gen. Stat. § 42-133f (2013).

Delaware – It is a violation of the statute if the franchisor fails to renew a franchise without good cause or in bad faith. If there is a lease by the franchisor, renewal terms of the lease have to be reasonable. Del. Code tit. 6, § 2552 (2013).

Hawaii – It is a violation of the statute for a franchisor not to renew a franchise except for good cause or in accordance with current terms and standards established by the franchisor. Haw. Rev. Stat. § 482E-6(H) (2013).

Illinois – It is a violation of the statute not to renew a franchise agreement without compensating the franchisee if the franchisee is barred from continuing to conduct substantially the same business under another trademark or trade name, or the franchisee has not been sent notice of the franchisor's intent not to renew the franchise at least 6 months prior to the expiration date or any extension thereof of the franchise. 815 Ill. Comp. Stat. § 705/20 (2013).

Indiana – A franchise agreement cannot provide that the agreement is not renewable without good cause or in bad faith, provided that it can provide that the agreement is non-renewable or that it is renewable only if the franchisee meets certain conditions. Ind. Code § 23-2-2.7-1(8) (2013.)

Iowa – It is a violation of the statute for a franchisor to refuse to renew a franchise unless 6 months' prior notice is provided and there is good cause. As a condition of renewal, a franchise agreement may require that the franchisee meet the then current requirements for franchises and execute a new franchise agreement. Iowa Code § 523H.8 (2013).

Maryland – A grantor of a franchise has to notify its distributor at least 60 days before non-renewal of a distributor agreement. The requirement to provide prior notice and the repurchase obligations do not apply to a termination of a distributorship at the natural expiration of the specified term of a written contract

that does not contemplate renewal options exercisable by either party. Md. Code Ann., Com. Law § 11-1303 (LexisNexis 2013).

Michigan – Provisions in the franchise agreement that allow a franchisor not to renew without fairly compensating the franchisee by repurchase, etc. are unenforceable (this provision only applies if the term of the franchise is less than 5 years, and the franchisee is prohibited from continuing substantially the same business under another trademark). Any provision that allows the franchisor to refuse to renew on terms generally available to other franchisees is also prohibited. Mich. Comp Laws § 445.1527 (2013).

Minnesota – A franchisor is prohibited from failing to renew a franchise agreement unless the failure to renew is for good cause, the franchisee is given 180 days prior written notice, and the franchisee has been given the opportunity to operate the franchise over a sufficient period of time to recover its fair market value as a going concern. Minn. Stat. § 80C.14 (2013).

Mississippi – A franchisor may not fail to renew a franchise agreement without notifying the franchisee of such intention in writing at least 90 days in advance of the failure to renew, except under certain specified circumstances where such advance notice need not be provided (for instance, insolvency of the franchisee). Miss. Code Ann. § 75-24-53 (2013).

Missouri – A franchisor may not fail to renew a franchise agreement without notifying the franchisee at least ninety 90 days

in advance of the failure to renew, except under certain specified circumstances where such advance notice need not be provided (for instance, insolvency of the franchisee). Mo. Rev. Stat. § 407.405 (2013).

Nebraska – It is a violation of the statute to fail to renew a franchise agreement without giving written notice of such failure to renew at least 60 days before such failure to renew, except under certain specified circumstances where such advance notice need not be provided. Although the statute also provides that it will be a violation to fail to renew a franchise without good cause, it also states that this shall not prohibit a franchisor from providing that the franchise is not renewable or that the franchise is only renewable if the franchisee meets certain reasonable conditions. Neb. Rev. Stat. § 87-404 (2013).

New Jersey – It is a violation of the statute to fail to renew a franchise without giving written notice setting forth all the reasons for such non-renewal at least 60 days in advance of such non-renewal, except under certain specified circumstances where such advance notice need not be provided. Although the statute also provides that it will be a violation to fail to renew a franchise without good cause, it also states that good cause for failing to renew a franchise shall be limited to failure by the franchisee to substantially comply with requirements imposed on it by the franchise and other agreements ancillary or collateral thereto. N.J. Rev. Stat. § 56:10-5 (2013).

Virginia – It shall be unlawful for a franchisor to cancel a franchise without reasonable cause or to use undue influence to induce a franchisee to surrender any right given to it by any provision contained in the franchise. Va. Code Ann. § 13.1-564 (LexisNexis 2013).

Washington – It is an unfair or deceptive act or practice, and a violation of the statute to refuse to renew a franchise without fairly compensating the franchisee for the fair market value, at the time of expiration of the franchise, provided that compensation need not be made to a franchisee for goodwill if one year's notice of non-renewal is provided and the franchisor agrees in writing not to enforce any non-competition covenants in its favor. Wash. Rev. Code § 19.100.180 (2013).

Wisconsin – No grantor may fail to renew or substantially change the competitive circumstances of a dealership agreement without good cause. The burden of proving good cause is on the grantor. Wis. Stat. § 135.03 (2013).

Thus, except for those states regulating "substantial change," franchisors are legally free to materially change the terms of the franchise relationship upon expiration of the initial term if such terms are substantially similar to that being offered to other franchisees at the time of renewal. The efficacy of doing so can be debated on both sides. Franchisees often argue that failure to renew on the same terms and conditions leaves them susceptible to having the franchisor change material terms of the expiring

agreement, such as decreasing or changing the protected territory or charging large renewal fees, as an excuse to make more money. The primary remedy for the franchisee is to argue that such actions demonstrate a lack of good faith, or argue discrimination if such terms are not the same for other franchisees. For example, in Wisconsin, a franchisee may be able to argue that the terms of the new franchise agreement "substantially change the competitive circumstances" without good cause. Still, it's a tough position to win. In *Bresler's 33 Flavors Franchising Corp. v. Wokosin*, 591 F. Supp. 1533 (E.D. Wis. 1984), the court held that an ice cream franchisor's imposition, upon renewal, of a new standard agreement on a franchisee, requiring substantial additional investment and an increased franchise fee, did not substantially change the franchisee's competitive circumstances in violation of the Wisconsin Fair Dealership Law since such a claim did not take into account the potential for additional sales and passing on of additional costs to customers. This case illustrates that a franchisor may very well have valid business reasons for not only making changes, but potentially overhauling a franchise system after 10 or 20 years, the result of which may require new terms, conditions and expenditures that otherwise could not be accomplished. While there may be substantial changes, it could also be argued that they were being made in "good faith" for the benefit of the entire franchise system as whole.

In truth, while many of the states that regulate the franchise relationship impose upon franchisors some level of protection for a franchisee desiring to renew, the standards of "good faith,"

“notice” and “good cause” are fairly easy for franchisors to meet, essentially eroding the very intent of the state regulations. It is important that franchise counsel fully explain to the client that being licensed to operate a “business format,” is not the same as simply leasing a real estate site, which aside from rental costs dictated by the market, are typically not subject to change. Clients must be advised that the licensed rights are only for a specified term and that renewal is contingent upon satisfying conditions stated in the agreement, subject to state statute protections that may or may not be helpful. It still may not be “fair,” but the franchisee at least has all available information upon which to base its decision. The bottom line is that franchisees must clearly understand that renewal rights are not absolute, and, most importantly, what is being renewed is not the form of agreement they originally signed, but the right to continue operating the franchised business. This right may in fact look (and cost) substantially different than what it did when the initial franchise agreement was signed many years before.