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**FUNDAMENTALS 201:
TRANSFERS AND ASSIGNMENTS IN FRANCHISING**

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FUNDAMENTALS 201: TRANSFERS AND ASSIGNMENTS IN FRANCHISING

I. INTRODUCTION

Before a franchise is purchased, both the franchisor and the franchisee conduct a thorough investigation of one another and make an informed choice to engage in what is expected to be a mutually beneficial long term relationship. That expectation is typically supported by an agreement providing for a life span of at least five years and often substantially more than that if renewal or extension options are exercised. Then life happens: for one reason or another the franchisee must or wishes to transfer ownership of the franchised business in one way or another, perhaps by selling an interest in an entity franchisee, by transferring to children who will take over operation of the business, by capitalizing on the value of the franchised business by selling at a profit, to make a life change of one sort or another, including due to death or disability. Whatever the cause, the franchisor is faced with the prospect of a change that may affect operation of the franchised business in any one or more ways and the franchisee is faced with the disposition of what may be its most valuable asset.

This paper discusses the issues created by transfers and assignments and the methods of addressing the tension between the franchisor's desire to ensure that it will continue to do business with people who fit its panoply of qualifications and the franchisee's need or desire to make a change. Beginning with an explication of the legal framework, the paper explores the many variables involved in a change in ownership of the franchised business. Those variables include the many possible reasons for a change that must be addressed in the franchise agreement, the many ways to address the franchisee's ability to transfer or assign an interest in the franchised business, and the ways courts have addressed the transfer and assignment provisions of franchise agreements. In that context, the paper discusses claims based on the implied covenant of good faith and fair dealing, as well as the interests not only of the franchisor and the franchisee but also third parties like landlords and lenders. Finally, the paper includes sample provisions that can be a starting point for drafting appropriate provisions of the franchise agreement or other documents.

II. THE LEGAL FRAMEWORK

A. Disclosure and Registration in the Transfer Context

1. FTC Rule

It is an unfair or deceptive act or practice in violation of Section 5 of the Federal Trade Commission Act for any franchisor to fail to furnish a *prospective franchisee* with a copy of the franchisor's current franchise disclosure document ("FDD") at least fourteen calendar days before the prospective franchisee signs a binding agreement with, or makes any payment to,

* Mr. Beyer wishes to thank Cheryl S. Lucente (an associate at Quarles & Brady LLP, Tampa, Florida) for her contributions to this paper.

the franchisor (or its affiliate) related to the proposed franchise sale.¹ A franchisor must comply with the disclosure requirements of the FTC Rule² in connection with the "offer" or "sale" of a franchise (unless the transaction is exempt).³ But the FTC Rule defines "sale of a franchise" to expressly exclude the transfer of a franchise by an existing franchisee, as long as the franchisor has not had "significant involvement" with the prospective franchisee.⁴

The franchisor's approval or disapproval of a proposed transfer, without more, does not constitute "significant involvement" triggering a disclosure obligation.⁵ But if the franchisor provides financial performance information to a prospective franchisee, then the franchisor will be deemed to have played a more significant role in the franchise sales process and would need to disclose the prospective transferee with a copy of the franchisor's current FDD.⁶ The franchisor should also provide disclosure to the prospective transferee if he or she will be required to sign the franchisor's "then-current" form of franchise agreement as a condition of the transfer, especially if the new franchise agreement contains terms that are materially different from the existing franchise agreement.⁷

Since "prospective franchisee" is defined as "any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship,"⁸ a disclosure obligation could be triggered if the franchisor "approaches" or "is approached by" a proposed transferee to discuss the franchise. Thus, a franchisor who refers prospective franchisees to an existing franchisee for a resale should furnish the prospective transferee with a copy of the franchisor's current FDD. Similarly, a franchisor that participates in sales discussions with a prospective transferee to facilitate the transfer or sale of a franchise has "significant involvement" requiring the franchisor to disclose the transfer prospect with the FDD.

In sum, the determination as to whether the FTC Rule's disclosure requirements apply to a franchise transfer will depend on the extent of the franchisor's involvement with, and control over, the transfer or assignment process.

Excerpts from the FTC Rule addressing franchise transfers, and from FTC Interpretations, are attached as Appendix A.

¹ 16 C.F.R. § 436.2(a) (2007).

² *Id.* § 436.

³ *Id.* § 436.2(a).

⁴ *Id.* § 436.1(t).

⁵ *Id.*

⁶ FED. TRADE COMM'N, FRANCHISE RULE COMPLIANCE GUIDE 18 (2008), <http://www.business.ftc.gov/documents/bus70-franchise-rule-compliance-guide> [hereinafter FTC COMPLIANCE GUIDE]. However, if a franchisor wishes to disclose only the operating results of a specific outlet being offered for sale, that information is not required to be included as "financial performance information" in the Item 19 disclosure of the FDD. 16 C.F.R. § 436.5(s)(4).

⁷ Note, however, that there may be statutory prohibitions on requiring the transferee to sign the then-current form of franchise agreement. See, e.g., IOWA CODE ANN. § 523H.5(4) (2014) (prohibiting a franchisor from requiring the franchisee or the transferee to enter into a new or different franchise agreement as a condition of the transfer).

⁸ 16 C.F.R. § 436.1(r).

2. Transfer Disclosures in the FDD

While a transferee of a franchised business may or may not be a prospective franchisee requiring delivery of a FDD, the FDD nevertheless must contain certain information relating to franchise transfers generally. For example, Item 6 requires disclosure of other fees that are payable to the franchisor or its affiliates during the term of the franchise.⁹ If the franchisor charges a fee relating to transfer (i.e., a “transfer fee”),¹⁰ then the franchisor must disclose:

- (a) the type and amount of the fee;¹¹
- (b) the due date and any explanatory remarks to elaborate on the information. The franchisor must disclose whether they are payable only to the franchisor, imposed and collected by the franchisor, whether they are refundable and under what circumstances, and whether the fees are uniformly imposed.¹²

Item 9 requires a cross-reference to the franchise agreement and the FDD item for franchisee obligations, including on transfers.¹³ This disclosure is part of a table of franchisee obligations designed to enable prospective franchisees to find more detailed information about them.

Likewise, Item 17 requires a cross-reference to, and summary of, the section in the franchise agreement or other agreements relating to the franchise relationship, including transfers. The transfer cross-references are separated into 5 categories:

- (1) assignment by franchisor;
- (2) definition of transfer;
- (3) franchisor’s approval;
- (4) conditions for franchisor’s approval; and
- (5) any franchisor right of first refusal.¹⁴

Certain financial information provided in the context of a transfer may be excluded from financial performance representation disclosures in Item 19.¹⁵ Thus, if a franchisee is offering its outlet for sale, a franchisor may disclose to a prospective purchaser of that outlet the actual operating results for that specific unit without having to comply with the other conditions for

⁹ *Id.* § 436.5(f).

¹⁰ *Id.* § 436.5(f)(1) (specifically referencing transfers as a type of fee).

¹¹ *Id.* § 436.5(f)(2).

¹² *Id.* § 436.5(f)(4)(i)-(v).

¹³ *Id.* § 436.5(i) (listed as Obligation t. on the Item 9 Table).

¹⁴ *Id.* § 436.5(q)(3)(j)-(n).

¹⁵ *Id.* § 436.5(s)(4).

disclosures of financial performance representations in Item 19.¹⁶ While this information usually is provided by the selling franchisee itself, sometimes a franchisor can facilitate the sale by providing information in its possession relating to that specific unit.

The exception applies only to actual operating results and does not include proformas or projections. Finally, the financial information for that outlet must be provided only to prospective purchasers of that outlet. Thus, franchisors should be sure to be satisfied that the information is only furnished to someone who has expressed a bona fide interest in acquiring that specific franchised outlet.

FDD Item 20 requires disclosure of various system-wide statistical outlet information.¹⁷ In particular, Table No. 2 requires disclosure of the number of transfers in each state during the immediately preceding 3 fiscal years.¹⁸ For purposes of the Item 20 tables, the FTC defined the term “transfer” as “the acquisition of a controlling interest in a franchised outlet, during its term, by a person other than the franchisor or an affiliate. It covers private sales of an outlet by the existing franchisee-owner to a new franchisee-owner and the sale of a controlling interest in the ownership of a franchise.”¹⁹

The FTC created a separate table for transfers because a transfer does not change the total number of outlets in operation in the system, and to distinguish them from other changes in ownership that may occur in reacquisitions by a franchisor, or other terminations.²⁰ However, franchisors should provide in footnotes that multiple transactions may have occurred.²¹ Therefore, if a franchisor had a company-owned outlet at the beginning of the year, sold it to a franchisee who later transferred it, and then the franchise was terminated, the transfer would be shown in Table No. 2 of Item 20, and the termination would be shown in Table No. 3 with a footnote explaining the transactions. Furthermore, Table No. 4 dealing with the status of company-owned outlets would also describe the series of transactions showing the outlet opening the year as company-owned, and then being sold to a franchisee.²²

Franchisees who have transferred their franchised businesses must be disclosed as former franchisees in Item 20.²³ This information includes name, city and state, and current business telephone number. If the business telephone number is not known, then the last known home telephone number.

Franchisors that acquire franchised units from franchisees, and later offer them for sale to new prospects, must also retain and disclose additional information.²⁴ If a franchisor is selling

¹⁶ *Id.*

¹⁷ *Id.* § 436.5(t).

¹⁸ *Id.* § 436.5(t)(2)(i).

¹⁹ FTC COMPLIANCE GUIDE, *supra* note 6, at 96.

²⁰ *Id.* at 98.

²¹ *Id.* at 100.

²² *Id.* at 100-101.

²³ 16 C.F.R. § 436.5(t)(5).

²⁴ *Id.* § 436.5(t)(6).

previously owned franchised outlets now under its control, it must disclose information relating to the last 5 fiscal years of ownership history. The information can be provided in the text of the FDD or as an addendum or supplement to a previously furnished disclosure document.²⁵ The franchisor must disclose:

- (1) The name, city and state, current business telephone number or last known home telephone number of each previous owner of the outlet in the last 5 years;
- (2) The time period when each previous owner controlled the outlet;
- (3) The reason for the change in ownership (i.e., voluntary transfer, non-renewal, etc.); and
- (4) The time period when the franchisor retained control over the outlet.²⁶

3. **State Laws**

The franchisor may also be obligated to comply with state franchise registration and disclosure statutes in connection with its consent to a proposed transfer. All states with franchise registration and disclosure statutes exempt from their disclosure and/or registration requirements a transfer by a franchisee for his or her own account.²⁷ This means the transfer cannot be effected "by or through" the franchisor.

Many of these statutes expressly provide that mere approval or disapproval of the proposed transferee will not obligate the franchisor to comply with registration and disclosure requirements.²⁸ Illinois, Oregon, Rhode Island, Virginia, Washington, and Wisconsin expressly allow the franchisor to impose a reasonable transfer fee without implicating any registration or disclosure obligations.²⁹ Under both the Illinois and Rhode Island statutes, the franchisor may also require the transferee to execute a new franchise agreement on terms that are not materially different from the existing franchise agreement.³⁰ The Hawaii statute provides for "the issuance of a new franchise agreement" in connection with the transfer, with no express

²⁵ *Id.* § 436.5(t)(6)(i)-(iv).

²⁶ *Id.* § 436.5(t)(6)(i)-(iv).

²⁷ A transfer by a franchisee for his or her own account is exempt from both registration and disclosure in the following states: California, Hawaii, Illinois, Indiana, Michigan, New York, Oregon, and South Dakota. The transfer will be exempt from registration, but not from disclosure, in these states: Maryland, Minnesota, North Dakota (modified disclosure), Rhode Island, Virginia, Washington, and Wisconsin. See *infra* Appendix B for a list of the states and applicable statutory and regulatory exemptions from disclosure and registration requirements for franchise transfers.

²⁸ See CAL. CORP. CODE § 31102 (2014); 815 ILL. COMP. STAT. § 705/7 (2014); IND. CODE § 23-2-2.7-4 (2014); MD. CODE ANN., BUS. REG. § 14-214(c)(2) (West 2014); MINN. STAT. § 80C.03 (2014); N.Y. GEN. BUS. LAW § 684(5) (2014); N.D. CENT. CODE § 51-19-04(2) (2014); OR. ADMIN. R. § 441-325-0030(4)(a) (2014); R.I. GEN. LAWS § 19-28.1-6(b) (2014); S.D. CODIFIED LAWS § 37-5b-1(28) (2014); 21 VA. ADMIN. CODE § 5-110-75(1) (2014); WASH. REV. CODE § 19.100.030(1) (2014); WIS. STAT. § 553.23 (2014).

²⁹ 815 ILL. COMP. STAT. § 705/7; OR. ADMIN. R. § 441-325-0030(4)(a); R.I. GEN. LAWS § 19-28.1-6(b); VA. ADMIN. CODE § 5-110-75(1); WASH. REV. CODE § 19.100.030(1); WIS. STAT. § 553.23.

³⁰ 815 ILL. COMP. STAT. § 705/7; R.I. GEN. LAWS § 19-28.1-6(b).

limitation regarding materially different terms.³¹ As a matter of best practices, however, the franchisor should always make disclosure to a prospective transferee if he or she will be required to sign a new franchise agreement as a condition of the transfer.

Similar to the FTC Rule, the degree of the franchisor's involvement in the transfer process determines whether the disclosure and/or registration obligations will be triggered under these state statutes. In *Interstate Automatic Transmission Co. v. Harvey*, a franchisor of automobile transmission repair shops acted as the broker for a franchisee selling his existing franchise location to a new franchisee.³² The franchisor prepared all of the legal documents related to the franchise transfer and received a \$2,500 fee for its services.³³ It also had the right under the franchise agreement to approve or disapprove the transfer.³⁴ When the franchisor later filed suit against the new franchisee for unpaid royalties, the franchisee claimed that the franchise sale was illegal because it never received a disclosure document.³⁵ The court, focusing on the franchisor's degree of control over the transfer process, found the franchisor liable for the disclosure violation and granted the franchisee rescission.³⁶

It is important to note that some of the states with franchise registration and disclosure laws limit the number of exempt franchise sales. For example, Hawaii, Michigan, New York, and Oregon require the franchise transfer to be an "isolated sale."³⁷ Minnesota limits the exemption to no more than one sale by the transferring franchisee during any consecutive 12-month period.³⁸

Excerpts of the state laws addressing disclosure and registration on franchise transfers are attached as Appendix B.

B. The Impact of Franchise Relationship Laws

1. The Laws

Ten states have franchise relationship laws that deal directly with franchise transfers and impose restrictions on the franchisor's right to approve or disapprove a transfer request.³⁹ These state statutes supersede the contractual transfer provisions in the franchise agreement and regulate the circumstances under which the franchisor may reject or withhold its consent to

³¹ HAW. REV. STAT. § 482E-4(a)(7) (2014).

³² *Interstate Automatic Transmission Co. v. Harvey*, 350 N.W.2d 907, 908 (Mich. Ct. App. 1984).

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at 909.

³⁷ HAW. REV. STAT. § 482E-4(a)(7) (2014); MICH. COMP. LAWS. § 445.1506(1)(f) (2014); N.Y. GEN. BUS. LAW. § 684(5)(a) (2014); OR. ADMIN. R. § 441-325-0030(4)(c) (2014); WASH. REV. CODE § 19.100.030(1) (2014).

³⁸ MINN. STAT. § 80C.03 (2014).

³⁹ See ARK. CODE ANN. § 4-72-205(b)-(c) (2014); CAL. BUS. & PROF. CODE § 20027 (West 2013); HAW. REV. STAT. § 482E-6(2)(I); IND. CODE § 23- 2-2.7-2(3) (2014); IOWA CODE § 523H.5 (2014); MICH. COMP. LAWS § 445.1527(g); MINN. STAT. § 80C.14(5) (2014); NEB. REV. STAT. § 87-405 (2014); N.J. REV. STAT. § 56:10-6 (2014); WASH. REV. CODE §§ 19.100.030(1), 19.100.180(1), 2(h).

a proposed transfer. Some of these statutes require the franchisor to act reasonably or in good faith in denying or rejecting a proposed transfer.⁴⁰ Others require good cause or a legitimate business reason in order to withhold consent to a proposed transfer,⁴¹ and some set forth specific circumstances that constitute "good cause" for purposes of rejecting or disapproving a franchise transfer.⁴²

A handful of the state relationship statutes require the franchisor to specify in writing the material reasons for withholding its consent to a proposed transfer. For example, Arkansas, Nebraska and New Jersey require the franchisor to set forth the material reasons relating to the "character, financial ability or business experience" of the proposed transferee.⁴³ However, the requirement for the franchisor to articulate the material reason or reasons for withholding its consent to the transfer is typically conditioned upon the franchisor receiving advance written notice of the proposed transfer from the franchisee.⁴⁴

Finally, several states permit the franchisor to condition its consent on the satisfaction of certain conditions, such as compliance with the franchisor's then-current standards for new franchisees, the completion of the franchisor's training program, the payment of a reasonable transfer fee and any sums owing to the franchisor or its affiliates, and/or the proposed transferee's agreement to comply with all lawful requirements of the franchise.⁴⁵

The state relationship laws dealing directly with transfers are summarized below and are reproduced in Appendix C for restrictions on franchisors and Appendix D for obligations on franchisees.

a. **Arkansas**

The Arkansas statute contains transfer restrictions applicable to both the franchisor and the franchisee. The franchisee must notify the franchisor in writing of his/her intent to transfer, assign or sell any interest in the franchise, including the proposed transferee's name, address, financial qualifications, and business experience during the previous 5 years. The franchisor then has 60 days to either approve the transfer or advise the franchisee in writing that the proposed transferee is unacceptable. If the franchisor does not approve the transfer, its response notice must state a material reason relating to the "character, financial ability, or business experience" of the proposed transferee. The franchisor will be deemed to have given approval if it does not respond within 60 days after receiving the franchisee's notice of the proposed transfer. The statute further provides that a transfer, assignment or sale is invalid if

⁴⁰ See HAW. REV. STAT. § 482E-6(1); IOWA CODE § 523H.5; MINN. STAT. § 80C.14(5); WASH. REV. CODE §§ 19.100.180(1), 2(h).

⁴¹ See HAW. REV. STAT. § 482E-6(2)(l); IOWA CODE § 523H.5; MICH. COMP. LAWS § 445.1527(g).

⁴² See, e.g., HAW. REV. STAT. § 482E-6(1); MICH. COMP. LAWS § 445.1527(g). These lists are not exhaustive, and there may be other valid reasons for the franchisor to reject or disapprove a proposed transfer.

⁴³ ARK. CODE § 4-72-205(b)(1); NEB. REV. STAT. § 87-405; N.J. REV. STAT. § 56:10-6.

⁴⁴ ARK. CODE § 4-72-205(a); NEB. REV. STAT. § 87-405; N.J. REV. STAT. § 56:10-6.

⁴⁵ See e.g., ARK. CODE § 4-72-205(c); CAL. BUS. & PROF. CODE § 20027 (West 2013); HAW. REV. STAT. § 482E-6(2)(l); IOWA CODE § 523H.5(3)(a); MICH. COMP. LAWS § 445.1527(g).

the transferee fails to agree in writing to comply with all of the requirements of the franchise then in effect.⁴⁶

b. **California**

The thrust of the California law is on succession after death of a franchisee or its principal owner. California's statute prohibits a franchisor from denying the surviving spouse, heirs, or estate of a deceased franchisee (or its majority shareholder) the opportunity to participate in the ownership of the franchise for a reasonable period of time following the death of the franchisee. However, the survivor must either (a) satisfy the franchisor's then-current standards for new franchisees or (b) sell, transfer, or assign the franchise to a person who satisfies those standards. The statute also clarifies that franchisors may exercise a contractual right of first refusal to purchase a franchise after receipt of a bona fide offer from a third party purchaser.⁴⁷

c. **Hawaii**

Under the Hawaii statute, a franchisor may not refuse to permit a franchise transfer without "good cause." Good cause for disapproval exists if the proposed transferee fails to satisfy the franchisor's reasonable qualifications or standards for new franchisees; the proposed transferee (or its affiliate) is a competitor of the franchisor; the proposed transferee will not agree in writing to comply with all lawful obligations imposed by the franchise or refuses to sign the then-current form of franchise agreement; or the transferor or the proposed transferee fails to pay any sums owing to the franchisor or to cure any existing defaults under the franchise agreement or any other agreements with the franchisor. There may be other good cause reasons for refusing to approve a transfer, in addition to those listed in the statute. The franchisor has 30 days from its receipt of notice of the proposed transfer to approve or disapprove such transfer, in writing. The franchisor's failure to respond within such 30-day period will be deemed approval of the proposed transfer.⁴⁸ Hawaii's statute also requires the franchisor and the franchisee to "deal with each other in good faith."⁴⁹

d. **Indiana**

The Indiana statute is similar to, but not as comprehensive as, the California statute. Indiana prohibits a franchisor from denying a deceased franchisee's surviving spouse, heirs, or estate the opportunity to participate in the ownership of the franchise for a reasonable period of time after the franchisee's death, as long as the surviving spouse, heirs, or estate, as applicable, maintains all standards and obligations of the franchise.⁵⁰

e. **Iowa**

Iowa's statute is by far the most detailed and restrictive transfer statute. It allows the existing franchisee to transfer the franchise to a proposed transferee that satisfies "the

⁴⁶ ARK. CODE § 4-72-205(a)-(c).

⁴⁷ CAL. BUS. & PROF. CODE § 20027.

⁴⁸ HAW. REV. STAT. § 482E-6(2)(l).

⁴⁹ *Id.* § 482E-6(1).

⁵⁰ IND. CODE § 23-2-2.7-2(3) (2014).

reasonable current qualifications of the franchisor for new franchisees."⁵¹ The statute defines "reasonable current qualifications" as "a qualification based upon a legitimate business reason."⁵² Even if the proposed transferee fails to meet the franchisor's reasonable qualifications, the franchisor may not arbitrarily or capriciously withhold approval of the transfer.⁵³

The Iowa statute does allow the franchisor to impose the following transfer conditions: (a) the proposed transferee's completion of a reasonable training program; (b) the payment of a reasonable transfer fee to reimburse the franchisor for its "reasonable and actual expenses directly related to the transfer"; (c) the payment of (or agreement to pay) any sums owed to the franchisor or its affiliate; and/or (d) the financial terms of the transfer complying with the franchisor's then-current financial requirements for franchisees.⁵⁴ However, the franchisor is prohibited from imposing any of the following conditions: (a) a requirement that the transferee enter into a new or different franchise agreement as a condition of the transfer;⁵⁵ (b) a requirement that the existing franchisee undertake new obligations, or relinquish any rights, unrelated to the franchise being transferred,⁵⁶ or (c) a requirement that the existing franchisee sign a release of claims that is broader than a similar release of claims by the franchisor.⁵⁷ In addition, the statute prohibits the franchisor from discriminating against a proposed transferee based on his or her race, color, national origin, religion, sex, or disability.⁵⁸

A proposed transfer is deemed approved 60 days after the franchisor receives the franchisee's transfer request, unless within that time, the franchisor disapproves by written notice specifying the reasons for the disapproval.⁵⁹

Iowa's statute also enumerates certain events that *do not* constitute a transfer requiring the franchisor's consent.⁶⁰ The following occurrences will not be deemed a "transfer" and cannot, therefore, result in the imposition of any penalties under the franchise agreement or the exercise of any right of first refusal granted to the franchisor under the franchise agreement:

- A transfer to the franchisee's spouse, heir, or partner active in the management of the franchise upon the death or disability of the franchisee, unless the successor fails to meet the franchisor's then-current reasonable qualifications for new franchisees within one year of

⁵¹ IOWA CODE § 523H.5(1) (2014). See also *id.* § 537A.10(5)(a) for further explanation.

⁵² *Id.* § 523H.5(1).

⁵³ *Id.*

⁵⁴ *Id.* §§ 523H.5(3), 537A.10(5)(c).

⁵⁵ *Id.* § 523H.5(4).

⁵⁶ *Id.* § 523H.5(9).

⁵⁷ *Id.*

⁵⁸ *Id.* §§ 523H.5(10), 537A.10(5)(f).

⁵⁹ *Id.* §§ 523H.5(7), 537A.10(5)(e).

⁶⁰ *Id.* §§ 523H.5(12), 537A.10(5)(g)-(j).

the franchisee's death or disability, provided that the enforcement of such qualifications is not arbitrary or capricious.⁶¹

- A transfer from a sole proprietorship to a controlled business entity, in which case the franchisor may require a personal guaranty by the franchisee of all obligations under the franchise agreement.⁶²
- A transfer among the existing owners, as long as the transferee meets the franchisor's reasonable current qualifications for franchisees and the franchisor receives 60 days' prior written notice of the transfer. If less than 50% of the franchise would be owned by individuals who meet the franchisor's reasonable current qualifications, then the franchisor may refuse to approve the transfer, provided such disapproval is not arbitrary or capricious.⁶³
- A transfer of less than a controlling interest to the franchisee's spouse or child, as long as individuals that satisfy the franchisor's reasonable current qualifications continue to own more than 50% of the franchise. If less than 50% of the franchise would be held by persons who satisfy the franchisor's reasonable current qualifications, the franchisor may reject the proposed transfer, as long as the rejection is not arbitrary or capricious⁶⁴.
- A transfer of less than a controlling interest in the franchise of an employee stock ownership plan or employee incentive plan, as long as 50% or more of the ownership interests continue to be held by persons who satisfy the franchisor's reasonable current qualifications. If less than 50% of the franchise would be held by persons who satisfy the franchisor's reasonable current qualifications, the franchisor may refuse to authorize the proposed transfer, as long as the disapproval is not arbitrary or capricious.⁶⁵
- A grant or retention of a security interest in the franchised business, the business assets, or an ownership interest, if the security agreement requires the secured party to give the franchisor notice of any intent to foreclose on the collateral and provides the franchisor a reasonable opportunity to cure the franchisee's default.⁶⁶

Iowa's statute imposes a duty of good faith in both the performance and the enforcement of the franchise agreement. For purposes of the statute, "good faith" means "honesty in fact

⁶¹ *Id.* §§ 523H.5(12)(a), 537A.10(5)(h).

⁶² *Id.* §§ 523H.5(12)(b), 537A.10(5)(i).

⁶³ *Id.* §§ 523H.5(12)(c), 537A.10(5)(j).

⁶⁴ *Id.* §§ 523H.5(12)(d), 537A.10(5)(g).

⁶⁵ *Id.* §§ 523H.5(12)(e), 537A.10(5)(b).

⁶⁶ *Id.* § 523H.5(12)(f).

and the observance of reasonable commercial standards of fair dealing in the trade."⁶⁷ Accordingly, a franchisor must act in good faith when considering a franchisee's transfer request.

f. **Michigan**

Michigan provides that a franchisor cannot refuse to permit a transfer without good cause. For purposes of the statute, "good cause" includes, but is not limited to: (a) the proposed transferee's failure to meet the franchisor's then-current reasonable qualifications or standards; (b) the proposed transferee is a competitor of the franchisor; (c) the proposed transferee refuses to agree to comply with all lawful obligations; or (d) the existing franchisee or proposed transferee fail to pay sums owing to the franchisor or to cure any existing default under the franchise agreement.⁶⁸

g. **Minnesota**

Under the Minnesota statute, it is an "unfair and inequitable" practice for a franchisor to unreasonably withhold consent to a transfer if the proposed transferee meets the franchisor's then-current qualifications and standards for new franchisees.⁶⁹

h. **Nebraska**

Nebraska requires the franchisee to provide written notice, via certified mail, to the franchisor of any proposed transfer or assignment. The notice must include the proposed transferee's name, address, financial qualifications, and business experience during the past 5 years. The franchisor must respond within 60 days with either written approval or disapproval of the transfer and, if disapproved, specifying material reasons relating to the "character, financial ability or business experience" of the proposed transferee. If the franchisor fails to reply within the 60 day period, its approval is deemed granted. The statute also requires the transferee to agree in writing to comply with all requirements of the franchise then in effect.⁷⁰

i. **New Jersey**

The transfer restrictions contained in the New Jersey statute are identical to Nebraska.⁷¹ Like the Nebraska statute, it places restrictions on both the franchisor and the franchisee.

j. **Washington**

Washington's statute requires the franchisor to exercise its approval or disapproval of a transfer "in a reasonable manner."⁷² The statute also imposes an obligation of good faith on the

⁶⁷ *Id.* §§ 523H.10, 537A.10(11).

⁶⁸ MICH. COMP. LAWS § 445.1527(g) (2014).

⁶⁹ MINN. STAT. § 80C.14(5) (2014).

⁷⁰ NEB. REV. STAT. § 87-405 (2014).

⁷¹ N.J. REV. STAT. § 56:10-6 (2014).

⁷² WASH. REV. CODE § 19.100.030 (2014).

parties and prohibits the franchisor from imposing transfer conditions that are not "reasonable and necessary."⁷³

The Director of the Securities Division of the Washington Department of Financial Institutions issued 2 Interpretive Statements (the "Statements") addressing the franchisor's obligation of good faith and the prohibition from imposing unreasonable transfer conditions.⁷⁴ The Statements address transfers in the context of whether they are voluntary or involuntary. The Statements view a transfer resulting from a franchisee death to be an involuntary transfer⁷⁵ and issued Interpretive Statement FIS-3 ("FIS-3").⁷⁶ In FIS-3, the Washington regulators interpret the termination of a franchise upon death of a franchisee as violating the good faith requirements unless the franchise relies upon the unique talents of the franchisee.⁷⁷ Thus, FIS-3 expresses the Washington regulators belief that a franchisee's death is not an express ground for good cause under the Washington statute.⁷⁸

In Interpretive Statement FIS-2 ("FIS-2"), the Washington regulators compare other types of involuntary transfers and transfers on death, stating that they should be treated similarly.⁷⁹ With respect to voluntary transfers, FIS-2 states that it is unreasonable for a franchisor to withhold consent to a transfer if the transferee meets the franchisor's criteria for buying a new franchise. FIS-2 expressly authorizes requiring the transferee to sign the then-current franchise agreement but purports to limit the amount of transfer fees only to compensate the franchisor for expenses directly incurred as a result of the transfer.⁸⁰ Furthermore, FIS-2 authorizes the requirement of a release as a condition of transfer as long as it does not include a release of claims under the Washington Franchise Investment Protection Act.⁸¹

2. Industry-Specific Statutes

Franchisors and legal counsel should also be aware of industry specific statutes and regulations that may impose restrictions on the transfer, sale or assignment of franchises or dealerships in certain industries. All U.S. states have at least one industry-specific statute on their books. These statutes are most commonly found in the motor vehicle industry, but the following industries may also be governed by transfer restrictions imposed under industry-specific statutes in certain states:

- Beer, wine or liquor

⁷³ *Id.* §§ 19.100.180(1), 2(h).

⁷⁴ Bus. Franchise Guide (CCH) ¶¶ 5470.76, 5470.77.

⁷⁵ *Id.* ¶ 5470.76.

⁷⁶ *Id.* ¶ 5470.77.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.* ¶ 5470.76.

⁸⁰ *Id.*

⁸¹ *Id.*

- Heavy equipment
- Petroleum or motor fuels
- Service stations
- Agricultural equipment
- Insurance
- Recreational vehicles (motorcycles, powersport vehicles, all-terrain vehicles, vessels, watercraft and outboard motors, marine products, mobile homes)

Many of these industry-specific statutes limit a franchisor's or dealer's ability to impose transfer restrictions. Although the statutes vary from industry to industry, they generally prohibit a franchisor from unreasonably withholding consent to transfer.⁸²

3. **Some Significant Judicial Interpretations**

Despite strict statutory language prohibiting franchisors from unreasonably withholding consent to a proposed transfer or rejecting a transfer without good cause, franchisee attempts to enforce these state statutes have generally been unsuccessful. Courts will consider a franchisor's good faith and reasonableness when reviewing a franchisor's decision to withhold consent or disapprove a proposed transfer.⁸³ If the franchisor has a legitimate business reason for refusing a transfer, the courts will typically uphold the franchisor's decision.⁸⁴ If, however, the transfer decision lacks a good faith business justification, the franchisor's decision may be overturned, even in cases where the franchise agreement purports to provide the franchisor with unfettered discretion.⁸⁵

a. **Good Faith and Good Cause**

If the terms of the contract do not impose an enforceable standard of reasonability or fairness, disappointed franchisees will often invoke the implied covenant of good faith and fair dealing against franchisors withholding consent to a transfer.⁸⁶ Generally speaking, the implied covenant of good faith and fair dealing will not override the express terms of the contract or operate to impose a higher standard of conduct than what the parties have specifically agreed to. This is true even where the franchise agreement grants the franchisor unlimited discretion or

⁸² See e.g., CAL. BUS. & PROF. CODE §§ 22902(h), 22903(c)(1) (West 2013) (equipment); COLO. REV. STAT. § 12-6-120 (2013) (motor vehicles); FLA. STAT. § 686.413(3)(h) (2013) (outdoor power equipment); IDAHO CODE ANN. § 28-24-103(8) (2014) (farm equipment); ME. REV. STAT. ANN. tit. 10 § 1434(3)(H) (recreational vehicles); MD. CODE ANN., TRANSP. § 15-211(d) (West 2014) (motor vehicles); MISS. CODE ANN. § 67-7-13 (2013) (wine and beer); N.H. REV. STAT. ANN. § 357-C:3 (2013) (motor vehicles); N.C. GEN. STAT. § 18B-1206 (2013) (wine); OR. REV. STAT. § 646A.310 (2013) (farm equipment); TEX. ALCO. BEV. CODE ANN. § 102.76 (West 2013) (alcoholic beverages).

⁸³ Joel D. Siegel & Glenn J. Plattner, *Saying No: Franchisor Exposure for Franchisee Transfer Restrictions*, 16 FRANCHISE L.J. 131, 133 (1997).

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ Terrence M. Dunn, *Franchisor's Control over the Transfer of a Franchise*, 27 FRANCHISE L.J. 233, 236 (2008).

the right to arbitrarily withhold its consent. However, state relationship statutes may impose a reasonableness standard or require good cause to refuse a transfer, which will supersede the terms of the franchise agreement but may not lead to a different result.

The Michigan relationship law's requirement of good cause for a refusal to consent to a change of ownership was the basis for a challenge to the requirement that the transferring franchisee sign a general release in favor of the franchisor as a condition to approval of a change in ownership in *Franchise Management Unlimited v. America's Favorite Chicken*. In that case, the transfer provisions of the franchise agreement entitled the franchisor to require a general release of any and all claims against the franchisor as a condition of approving a sale of the franchise.⁸⁷ The franchisee was a multi-unit operator and had previously filed a lawsuit against the franchisor for unfair trade practices and other claims relating to the franchisor's acquisition of a competitive franchise chain.⁸⁸ Those claims were pending in the United States District Court in Louisiana at the time of the transfer request.⁸⁹ The franchisee refused to sign the general release, which would have required the franchisee to dismiss its pending claims against the franchisor.⁹⁰ The franchisor, in turn, refused to approve the transfer without the release.⁹¹ The franchisee filed suit seeking a declaratory judgment that its failure to execute a release was not "good cause" for refusal to approve a transfer under the Michigan Franchise Investment Law ("MFIL").⁹²

The trial court agreed with the plaintiff franchisee, holding the general release invalid.⁹³ However, the court of appeals reversed, noting that, while the terms of the franchise agreement prohibited the franchisor from unreasonably withholding consent to a transfer, the agreement further provided that the franchisee must execute a general release, in form satisfactory to the franchisor, prior to the transfer.⁹⁴ The MFIL renders void and unenforceable any provision in a contract that permits a franchisor to refuse a proposed transfer of a franchise without good cause.⁹⁵ The statute provides four examples of "good cause," which includes "[t]he failure of the franchisee or proposed transferee to pay any sums owing to the franchisor or to cure any default in the franchise agreement existing at the time of the proposed transfer."⁹⁶ The court held that the franchisee's refusal to sign the contractually agreed-upon general release constituted a default under the terms of the franchise agreement, satisfying the "good cause" requirement under the MFIL.⁹⁷

⁸⁷ *Franchise Mgmt. Unlimited v. America's Favorite Chicken*, 561 N.W.2d 123, 242 (Mich. Ct. App. 1997).

⁸⁸ *Id.* at 241.

⁸⁹ *Id.*

⁹⁰ *Id.* at 242.

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.* at 243.

⁹⁴ *Id.* at 243-244.

⁹⁵ *Id.* at 244.

⁹⁶ *Id.* at 244-245 (emphasis in original).

⁹⁷ *Id.* at 245-246.

Even assuming, arguendo, that franchisee's failure to provide the release did not constitute "good cause" under the four specific examples set forth in the MFIL, those examples are not exhaustive.⁹⁸ "The good cause requirement centers on commercial reasonability," and the court found it commercially reasonable for the franchisor to require all claims to be resolved before approving a transfer of the franchise.⁹⁹ The requirement of a release is discussed in Section IV of this paper.

In *Perez v. McDonald's Corp.*, a franchisee seeking to sell its McDonald's restaurant submitted four prospective purchasers to the franchisor for approval.¹⁰⁰ The franchisor rejected all four purchasers on the basis that each had failed to complete McDonald's franchisee applicant training program, which was mandatory for all prospective franchisees.¹⁰¹ Although the plaintiff franchisee did not dispute McDonald's right to require prospective transferees to satisfy McDonald's current requirements for new franchisees, including the completion of the applicant training program, it argued that McDonald's arbitrarily limited access to the training program and failed to disclose in its FDD the severity of the limited access and the fact that the plaintiff would therefore not be able to sell its franchise on the open market.¹⁰²

The franchise agreement, however, was silent as to the requirements for admission into the applicant training program, i.e., it did not impose any obligation on McDonald's to admit prospective purchasers into the program or limit in any way McDonald's right to decide which applicants would be admitted into the program.¹⁰³ Because there was no applicable provision in the franchise agreement, the franchisee was unable to rely on the implied covenant of good faith and fair dealing.¹⁰⁴ "Although every contract implies good faith and fair dealing between the parties to it, the covenant is not an independent source of duties for the parties to a contract."¹⁰⁵

In *Taylor Equipment, Inc. v. John Deere Co.*, a dealer case based on South Dakota law, the terms of the parties' dealer agreement prohibited the dealer from assigning its dealership without John Deere's prior written consent.¹⁰⁶ When John Deere withheld its consent to an assignment based on the proposed transferee's inadequate equity capital, the proposed sale fell through.¹⁰⁷ The dealer was later able to sell its dealership assets to an approved buyer, but on

⁹⁸ *Id.* at 246.

⁹⁹ *Id.* at 247-248. The court noted that the release only covered non-MFIL claims, which was appropriate because the MFIL prohibits any requirement that a franchisee assent to a release, assignment, novation, waiver or estoppel that deprives the franchisee of any rights or protections provided under the MFIL. *Id.* at 248.

¹⁰⁰ *Perez v. McDonald's Corp.*, 60 F. Supp.2d 1030, 1032 (E.D. Cal. 1998).

¹⁰¹ *Id.*

¹⁰² *Id.* at 1033.

¹⁰³ *Id.* at 1035.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Taylor Equip., Inc. v. John Deere Co.*, 98 F.3d 1028, 1030 (8th Cir. 1996).

¹⁰⁷ *Id.*

much less favorable terms.¹⁰⁸ As a result, the dealer brought suit against John Deere for breach of the implied covenant of good faith and fair dealing, which is implied into every contract under South Dakota law.¹⁰⁹ The court interpreted the dealer agreement as granting John Deere an absolute right to approve or disapprove the proposed transferee.¹¹⁰ The purpose of the implied covenant of good faith is "to honor the parties' justified expectations," but the dealer did not have a justified expectation that John Deere would agree to surrender its absolute right to approve or disapprove the dealer's successor.¹¹¹ The court made it clear that the implied covenant could not be applied to limit a clear contractual provision. "Though every contract includes the implied covenant, it does not affect every contract term. The covenant is 'a method to fill gaps' in a contract. It has 'nothing to do with the enforcement of terms actually negotiated' and therefore cannot 'block use of terms that actually appear in the contract.'"¹¹²

In *Keating v. Baskin Robbins USA, Co.*, the franchise agreement allowed Baskin Robbins to withhold its consent to a transfer of the franchisee's interest in the franchise agreement "arbitrarily and for any reason whatsoever" or to "condition any consent in [its] sole discretion."¹¹³ It was undisputed that Baskin Robbins withheld its approval of the proposed transferee due to his inability to speak fluent English, despite the fact that the prospect intended to purchase the business for his American college educated son to operate.¹¹⁴ The prospective purchaser was denied on the telephone without being given the opportunity to take an English language proficiency test, which the evidence showed Baskin Robbins used in its application process.¹¹⁵ The court found that Baskin Robbins did not breach the franchise agreement, since there was no provision in the contract that required the franchisor to administer a proficiency test before denying approval of the transfer.¹¹⁶ The court then turned to the separate issue of whether Baskin Robbins breached the implied covenant of good faith and fair dealing, which requires a party vested with discretion under the contract to exercise that discretion reasonably and not in bad faith.¹¹⁷ The court concluded that the implied covenant of good faith and fair dealing cannot override the express terms of the agreement.¹¹⁸ Because the franchise agreement gave Baskin Robbins the right to withhold consent to a transfer "arbitrarily and for

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* at 1031.

¹¹⁰ *Id.* at 1033.

¹¹¹ *Id.*

¹¹² *Id.* at 1032 (citing *Cont'l Bank, N.A. v. Everett*, 964 F.2d 701, 705 (7th Cir. 1992), cert denied, 506 U.S. 1035 (1992)).

¹¹³ *Keating v. Baskin Robbins USA, Co.*, No. 5:99-CV-148-BR(3), 2001 WL 407017, *9 (E.D.N.C. Mar. 27, 2001).

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.* at *10.

any reason whatsoever," the implied covenant of good faith was held to have no relevance to the case.¹¹⁹

However, where the implied covenant of good faith is applied to a contract term, the franchisor must show a legitimate business reason for refusing a proposed transfer. In *V.W. Credit, Inc. v. Coast Automotive Group, Ltd.*,¹²⁰ the franchisor disapproved a transfer request based on alleged deficiencies in the transfer application and concerns about the character of the transferee's majority member.¹²¹ If a proposed transferee is unacceptable, the New Jersey Franchise Practices Act requires the franchisor to notify the franchisee in a writing "setting forth material reasons relating to the character, financial ability or business experience of the proposed transferee."¹²² The trial court found that the defendant did not act in good faith when it withheld approval of the transferee's application.¹²³ On appeal, the court made it clear that New Jersey's relationship statute has been interpreted as imposing a reasonableness requirement on the franchisor's decision to approve or disapprove a transfer, which requires the franchisor's decision to be "supported by substantial evidence showing that the proposed franchisee is materially deficient."¹²⁴ The appellate court reviewed the franchisor's alleged bases for disapproving the transferee and found that the franchisor failed to meet this burden and, hence, unreasonably withheld its consent to transfer, in violation of the statute.¹²⁵ The court further held that specific performance was available to the franchisee to compel the transfer since the franchisor acted unreasonably in withholding its consent.¹²⁶

Franchisors have also been found to act in good faith when they deny a transfer due to a transferee's failure to satisfy the franchisor's qualifications, including relevant business experience.¹²⁷

As the above cases demonstrate, in the absence of a relationship statute to the contrary, courts are reluctant to award relief to franchisees based on an implied covenant of good faith and fair dealing where the express terms of the parties' contract require or permit the parties to act in a particular manner.

¹¹⁹ *Id.*

¹²⁰ *VW Credit, Inc. v. Coast Auto. Group, Ltd.*, 346 N.J. Super. 326 (App. Div. 2002).

¹²¹ *Id.* at 332.

¹²² *Id.* at 337.

¹²³ *Id.* at 333.

¹²⁴ *Id.* at 337-338.

¹²⁵ *Id.* at 338.

¹²⁶ *Id.* at 330.

¹²⁷ See, e.g., *Sun Refining & Mktg Co. v. Brooks-Maupin Car Ctrs, Inc.*, Bus. Franchise Guide (CCH) ¶ 9325 (E.D. Mich. 1998) (upholding franchisor's transfer refusal based on transferee's lack of business experience in the service station industry, where the franchise agreement allowed the franchisor to refuse an assignment for "reasonable and objective business practices and standards.").

b. **Reasonableness**

Reasonability is perhaps the most common restriction imposed on a franchisor's ability to grant or withhold approval, both from a statutory and contract perspective. Many franchise agreements provide that the franchisor must act in a reasonable manner or, conversely, may not act unreasonably. Reasonableness is typically found to exist where a franchisor has a legitimate business reason to deny a proposed franchise transfer.¹²⁸

In *Burger King Corporation v. H & H Restaurants*, the franchisee proposed to sell its 29 Burger King restaurants to another Burger King franchisee.¹²⁹ Burger King disapproved the transfer on grounds that some of the proposed transferee's existing restaurants were not operating in compliance with Burger King's standards. The transferring franchisee claimed that Burger King's disapproval was arbitrary and also a pretext for its true motivation of forcing a sale of the restaurants to certain pre-approved purchasers at a substantially reduced price.¹³⁰ The transfer provision of the franchise agreement provided that Burger King would not unreasonably withhold its consent to a proposed transfer.¹³¹ However, the agreement also allowed Burger King to condition its consent on the satisfaction of enumerated conditions, including a requirement that the proposed transferee satisfy, in Burger King's "sole judgment," Burger King's financial, character, managerial, and ownership criteria.¹³² The transferring franchisee argued that Burger King breached the franchise agreement by unreasonably withholding its approval of the transfer.¹³³ But the court agreed with Burger King and held that the agreement gave Burger King "sole judgment" in determining whether the intended transferee satisfied its business standards and requirements.¹³⁴ Because the decision to disapprove the transfer was based on reasons specifically left to Burger King's sole discretion under the franchise agreement, the decision was not arbitrary, and Burger King's consent was therefore not unreasonably withheld in violation of the franchise agreement.¹³⁵

A franchisor will be deemed to have acted *reasonably* in withholding consent to a proposed transfer where the franchisee is in default of his or her contract or the agreement is subject to termination. In *Dunkin' Donuts Inc. v. Sharif, Inc.*,¹³⁶ the franchise agreement was terminated when the franchisee ceased making payments to the franchisor under the franchise agreement and a related promissory note.¹³⁷ Nonetheless, the franchisee continued to operate the store as a Dunkin' Donuts shop following termination of the franchise agreement.¹³⁸ Dunkin'

¹²⁸ Siegel & Plattner, *supra* note 83, at 133.

¹²⁹ *Burger King Co. v. H&H Rests*, No. 99-2855, 2001 WL 1850888, *4 (S.D. Fla. Nov. 30, 2001).

¹³⁰ *Id.*

¹³¹ *Id.* at *5.

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.* at *6.

¹³⁶ *Dunkin' Donuts Inc. v. Sharif, Inc.*, 177 Fed. Appx. 809 (10th Cir. 2006).

¹³⁷ *Id.* at 810.

¹³⁸ *Id.*

Donuts subsequently commenced an action against the franchisee seeking both injunctive and monetary relief for breach of contract, trademark infringement, and unfair competition related to the franchisee's continued operation of the store as a Dunkin' Donuts shop.¹³⁹

The franchisee counterclaimed, arguing that Dunkin' Donuts violated a duty of good faith and fair dealing, and also breached the franchise agreement in bad faith, by withholding its approval of a proposed buyer for the franchise.¹⁴⁰ According to the franchisee, the sale would have allowed it to satisfy the monetary obligations owed to Dunkin' Donuts and also make a profit on the sale.¹⁴¹ Under the franchise agreement, the franchisee could not transfer its interest in the franchise without Dunkin' Donuts' prior written consent, which would not be unreasonably withheld as long as the proposed transferee had "a good credit rating and business qualifications reasonably acceptable to Dunkin' Donuts."¹⁴² The proposed purchaser was another Dunkin' Donuts franchisee but was in default under his existing franchise agreement based on the failure to report weekly gross sales and pay fees owed to Dunkin' Donuts.¹⁴³ Under these circumstances, "no reasonable jury could conclude that Dunkin' Donuts violated the Franchise Agreement by unreasonably withholding its consent" to the proposed sale.¹⁴⁴

In cases that involve the arbitrary withholding of consent to transfer, courts will apply a similar standard to cases that involve a reasonableness standard.¹⁴⁵ The franchisor does not act arbitrarily if it has a rational business reason for disapproving the proposed transfer.¹⁴⁶ For example, in *Zuckerman v. McDonald's Corp.*,¹⁴⁷ the court held that the transfer requirements imposed by the franchisor were not arbitrary or capricious. The franchise agreement contained a lengthy assignment provision, which prohibited the franchisee from transferring any interest in the franchise without McDonald's prior written consent.¹⁴⁸ It further provided that McDonald's would not arbitrarily withhold consent to a proposed transfer.¹⁴⁹

When the franchisee sold the franchise, it discounted the price by the amount of the "required investment" that the purchaser would be required to make in order to bring the restaurant into compliance with McDonalds' then-current image and standards for new

¹³⁹ *Id.*

¹⁴⁰ *Id.* at 811.

¹⁴¹ *Id.*

¹⁴² *Id.* at 811-812.

¹⁴³ *Id.* at 813.

¹⁴⁴ *Id.* at 814.

¹⁴⁵ Dunn, *supra* note 86, at 235.

¹⁴⁶ *Id.*

¹⁴⁷ *Zuckerman v. McDonald's Corp.*, 35 F. Supp.2d 135 (D. Mass. 1999).

¹⁴⁸ *Id.* at 137-138.

¹⁴⁹ *Id.*

restaurants.¹⁵⁰ The franchisee claimed, however, that the purchaser was never required to make the "required investment" and thus acquired the franchise at a bargain price, to the franchisee's detriment.¹⁵¹ The disgruntled franchisee alleged that McDonalds arbitrarily withheld consent to the proposed assignment (until the franchisee reduced the purchase price), thus violating the implied covenant of good faith and fair dealing.¹⁵²

In rejecting this argument, the court explained that the implied covenant of good faith and fair dealing applies only where the contract terms are ambiguous.¹⁵³ In this case, although the term "arbitrarily withheld" was not defined, the contract contained detailed assignment provisions that listed the specific criteria to be used in determining whether to consent to an assignment.¹⁵⁴ The factors included "financial background, equity interest in the restaurant and 'such other criteria and conditions as [McDonalds] shall then apply in the case of an application for [a new franchisee] to operate a McDonald's restaurant.'"¹⁵⁵ However, even assuming the contract terms were ambiguous, the court found that the condition to update the restaurant "reflected considerations openly contemplated by the parties" and was therefore not arbitrary or capricious.¹⁵⁶

It is important to note that, even if the franchisor acts unreasonably or with pretext, its motive will generally be deemed irrelevant if the franchise agreement expressly allows the franchisor the absolute right to deny or reject a franchise transfer.¹⁵⁷

c. **Tort Liability**

Because of the franchisor-friendly nature of the good faith and reasonableness requirements, it is not uncommon for franchisees and transferees to bring tortious interference claims in an attempt to obtain favorable results in franchise transfer disputes. Generally, to bring a successful tortious interference claim, one must prove that (1) a business relationship existed between the transferee and the franchisee; (2) the franchisor had knowledge of the business relationship; (3) the franchisor's intentional and unjustified interference with the relationship caused the transfer to fail; and (4) the failed transfer resulted in damages.¹⁵⁸

¹⁵⁰ *Id.* at 140.

¹⁵¹ *Id.*

¹⁵² *Id.* at 143.

¹⁵³ *Id.* at 144.

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ See *Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.*, 970 F.2d 273, 280 (7th Cir. 1992) (Contract law "does not provide remedies for spiteful conduct or refuse enforcement of contractual provisions invoked out of personal nastiness."); *Walner v. Baskin Robbins Ice Cream Co.*, 514 F. Supp. 1028 (holding that a franchisor may exercise a right to disapprove a transfer without regard to motive or goodwill if neither is required by the terms of the contract).

¹⁵⁸ *KMS Rest. Corp. v. Wendy's Int'l, Inc.*, 361 F.3d 1321, 1325 (11th Cir. 2004).

For example, in *KMS Restaurant Corp. v. Wendy's International, Inc.*, a franchisor rejected a franchisee's proposed transfer, and the transferee alleged that the franchisor tortiously interfered with its purchase of the franchise.¹⁵⁹ The transferee argued that the franchisor intentionally and unjustifiably interfered, destabilizing its corporate structure, and then used a "lack of stability" as reason to deny the transfer.¹⁶⁰ The court found that a franchisor's use of improper methods could support a tortious inference claim even if the franchisor did not act solely out of malice.¹⁶¹

Despite the favorable holding in *KMS*, tortious interference claims have not been very successful. When a franchisor is a "necessary party," courts have dismissed tortious interference claims.¹⁶² For example, in *J.K.P. Foods, Inc., v. McDonald's Corp.*, a franchisee alleged that its franchisor tortiously interfered with its contract to transfer the franchise by increasing the reinvestment costs associated with the transfer.¹⁶³ However, under the franchise agreement, any transfer was subject to the franchisor's approval.¹⁶⁴ As a result, the court found that the franchisor was not liable.¹⁶⁵ Because any transfer was subject to the franchisor's approval, the franchisor was a necessary party to the contract, and a party to a contract cannot be held liable for interference.¹⁶⁶

Similarly, in *Home Repair Inc. v. Paul W. Davis Systems*, the franchisee asserted that the franchisor acted with malice and tortiously interfered with its business expectancy to transfer the franchise.¹⁶⁷ The court found, however, that, under the franchise agreement, the franchisee needed the franchisor's consent for any transfer.¹⁶⁸ Therefore, the franchisor was a party to the prospective business expectancy.¹⁶⁹ As a matter of law, the franchisor could not be liable for tortious interference, regardless of the franchisee's claim of malice, because the franchisor was the source of the franchisee's business expectancy.¹⁷⁰

On the same note, in *Cook v. Little Caesar Enterprises, Inc.*, a franchisee alleged tortious interference with contractual and advantageous relationships when a franchisor

¹⁵⁹ *Id.* at 1323.

¹⁶⁰ *Id.* at 1325.

¹⁶¹ *Id.* at 1328.

¹⁶² Craig Tractenberg, *Assignment, Termination, and Renewal*, in *COLLATERAL ISSUES IN FRANCHISING: BEYOND REGISTRATION AND DISCLOSURE* 296, 306-307 (Kenneth R. Costello ed., 2014).

¹⁶³ *J.K.P. Foods, Inc., v. McDonald's Corp.*, 420 F. Supp 2d 966, 968 (E.D. Ark. 2006).

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* at 969.

¹⁶⁶ *Id.*

¹⁶⁷ *Home Repair Inc. v. Paul W. Davis Sys.*, Bus. Franchise Guide (CCH) ¶ 11,515 (N.D. Ill. 1998).

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

withheld its consent to a proposed transfer.¹⁷¹ Once again, the franchise agreement provided the franchisor with the right to disapprove of any transfer.¹⁷² Like many other courts, the court in *Cook* held that a tortious interference claim cannot be successful when the defendant is a party to the contract or business relationship.¹⁷³ Furthermore, the franchisor is a party to the contract or business relationship if it maintains discretion to disapprove of a transaction.¹⁷⁴ Thus, because the agreement provided the franchisor with the right to reject any transfer, the court in *Cook* granted the franchisor's motion to dismiss; the franchisor was a party to the business relationship.¹⁷⁵

A federal court in Florida came to the same conclusion in *Hall v. Burger King Corp.* when a franchisee brought a tortious interference lawsuit against its franchisor.¹⁷⁶ The franchisee alleged that the franchisor tortiously interfered when the franchisor rejected a potential transferee and dissuaded another transferee from buying the franchise.¹⁷⁷ The court, however, dismissed the franchisee's claim because, under the franchise agreement, the franchisor maintained the contractual right to approve of any transfer.¹⁷⁸ The court stated that this right made the franchisor a party to any transfer, contract, or business relationship that the franchisee could have with any potential transferee.¹⁷⁹ Thus, as a matter of law, the franchisor could not tortiously interfere with the franchisee's attempt to transfer.¹⁸⁰

Likewise, in *Pasqualetti v. Kia Motors America, Inc.*, a franchisee claimed that a franchisor interfered with several business relationships when the franchisor denied the franchisee's transfer application.¹⁸¹ Consistent with the majority of courts, the court found that there could be no tortious interference claim because the franchise agreement required the franchisee's approval for any transfer.¹⁸² Consequently, too, the franchisor was the source of the franchise opportunity being sought.¹⁸³ Therefore, the franchisor was a party to the

¹⁷¹ *Cook v. Little Caesar Enters., Inc.*, 972 F. Supp. 400, 414 (E.D. Mich. 1997).

¹⁷² *Id.* at 416.

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Id.* at 417.

¹⁷⁶ *Hall v. Burger King Corp.*, 912 F. Supp. 1509, 1515 (S.D. Fla. 1995).

¹⁷⁷ *Id.* at 1529-29.

¹⁷⁸ *Id.*

¹⁷⁹ *Id.* at 1538.

¹⁸⁰ *Id.*

¹⁸¹ *Pasqualetti v. Kia Motors Am., Inc.*, 663 F. Supp. 2d 586, 602 (N.D. Ohio 2009).

¹⁸² *Id.*

¹⁸³ *Id.*

contract.¹⁸⁴ The court reasoned that, as a matter of policy, franchisors should not fear tort liability for choosing to not contract with a transferee.¹⁸⁵

Tortious interference claims have also been dismissed where a franchisor exercises a contractual right.¹⁸⁶ In *Tacoma Auto Mall, Inc. v. Nissan North America, Inc.*, a franchisee claimed that a franchisor tortiously interfered with a business relationship when the franchisor refused to consent to a proposed sale of the franchise.¹⁸⁷ However, the franchise agreement expressly provided that any transfer was subject to the franchisor's approval.¹⁸⁸ Thus, the court held that the franchisee's interference claim failed as a matter of law because merely exercising one's legal rights in good faith cannot constitute tortious interference.¹⁸⁹

Similarly, in *Hunt Enterprises, Inc. v. John Deere Industrial Equipment Co.*, a franchisee requested assistance in selling the franchise when the franchisor threatened franchise termination for poor sales performance.¹⁹⁰ The franchisor agreed to assist in the process but maintained that any transfer was subject to the franchisor's approval.¹⁹¹ A transferee expressed interest in the franchise, but the franchisor disapproved of the transfer because the transferee operated a similar business which sold a competitor's product.¹⁹²

After an 8-year business relationship and continued poor performance, but before the franchisee could transfer the franchise, the franchisor terminated the franchise agreement.¹⁹³ The franchisee responded by bringing a lawsuit for tortious interference with a business opportunity.¹⁹⁴ The court, however, dismissed the claim, reasoning that the franchisor simply exercised a right that it bargained for and made part of the franchise agreement.¹⁹⁵ Thus, there could be no tortious interference.¹⁹⁶

Maryland courts have gone even further and have rejected tortious interference claims, holding that a franchisor does not have a duty to act reasonably.¹⁹⁷ In *Enfield Equip. Co. v.*

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ Tractenberg, *supra* note 162, at 308.

¹⁸⁷ *Tacoma Auto Mall, Inc. v. Nissan N. Am., Inc.*, Bus. Franchise Guide (CCH) ¶ 14,867 (Wash. Ct. App. 2012).

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Hunt Enters, Inc. v. John Deere Indus. Equip. Co.*, Bus. Franchise Guide (CCH) ¶ 11,479 (6th Cir. 1998).

¹⁹¹ *Id.*

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ *Id.*

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ Tractenberg, *supra* note 162, at 308-09.

John Deere Co., a franchisee sought approval of several different transferees, as required by the franchise agreement, but the franchisor would only agree to one specific transferee.¹⁹⁸ When the franchisee submitted the transfer agreement with the agreed upon transferee, the franchisor rejected it and required the parties to negotiate a new agreement.¹⁹⁹ The franchisee subsequently brought a tortious interference with prospective advantage action against the franchisor, alleging that the franchisor caused the franchisee to reach a less favorable deal.²⁰⁰ The court in *Enfield*, however, dismissed the action, recognizing that Maryland has long accepted that, in the commercial world, businesses will act at the expense of others to pursue their own interests, and that, in itself, is not tortious interference.²⁰¹ Thus, by withholding consent, even if unreasonably so, the franchisor was simply acting in its own interest.²⁰² Without improper or wrongful conduct, the franchisor's actions could not amount to tortious interference.²⁰³

Likewise, in *R.A., Inc. v. Anheuser-Busch, Inc.*, a transferee sued a franchisor for tortious interference of prospective contracts when the franchisor backed out of the transfer agreement.²⁰⁴ This agreement, like many others, provided that the franchisor had to approve any transfers.²⁰⁵ The court dismissed the claim, reasoning that the law "clearly" requires the franchisor's conduct to be improper before any liability for tortious interference will attach.²⁰⁶ Because, as a matter of law, the franchisor's conduct did not amount to improper or wrongful conduct, it could not interfere with prospective contractual relations.²⁰⁷

Courts have also rejected tortious interference claims when a franchisee attempts to transfer or sell a franchise to a competitor.²⁰⁸ For example, in *Brittain v. The Stroh Brewery*, a franchisor rejected an initial transferee but later accepted a subsequent transferee.²⁰⁹ The franchisee then sued the franchisor for refusing to approve the first transferee because that deal was more lucrative for the franchisee.²¹⁰ However, the court found that the franchisor had reasonable grounds to reject the first transferee because that transferee sold the competitor's product and expressed an antagonistic and uncooperative attitude.²¹¹ Accordingly, the court

¹⁹⁸ *Enfield Equip. Co. v. John Deere Co.*, 64 F. Supp. 2d 483, 484 (D. Md. 1999).

¹⁹⁹ *Id.* at 485.

²⁰⁰ *Id.*

²⁰¹ *Id.* at 487.

²⁰² *Id.*

²⁰³ *Id.*

²⁰⁴ *R.A., Inc. v. Anheuser-Busch, Inc.*, Bus. Franchise Guide (CCH) ¶ 10,820 (D. Minn. 1995).

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ *Id.*

²⁰⁸ Tractenberg, *supra* note 162, at 308-09.

²⁰⁹ *Brittain v. The Stroh Brewery*, Bus. Franchise Guide (CCH) ¶ 10,199 (4th Cir. 1993).

²¹⁰ *Id.*

²¹¹ *Id.*

held that the franchisor's refusal to give consent was neither unreasonable nor taken in bad faith.²¹² Thus, the court dismissed the tortious interference claim.²¹³

Similarly, in *Bishay v. Foreign Motors, Inc.*, the franchise agreement provided that the franchisor had the right to approve all transferees but could not do so unreasonably.²¹⁴ A transferee sued the franchisor when the franchisor refused to approve of a transfer, alleging that the franchisor unreasonably withheld consent.²¹⁵ The court found that the franchisor's rejection of the transferee was reasonable considering the transferee's history of repeatedly violating the franchisor's trademark and the transferee's operation of a satellite businesses, which could be confused with the franchise.²¹⁶ Thus, it dismissed the franchisee's claim.²¹⁷

On the other hand, in *Woody v. General Motors Corp.*, the court found that a franchisor's refusal to accept a transfer was a potential breach of contract because it was arbitrary.²¹⁸ In *Woody*, a franchisor refused two transfer proposals, so the franchisee brought suit for tortious interference with contract, alleging that the franchisor's refusal to give consent was arbitrary.²¹⁹ The court found merit in the argument because the franchise agreement provided that the franchisor would "consider" a transferee and would "not arbitrarily refuse to agree" to a transfer proposal.²²⁰ Accordingly, the court vacated the lower court's summary judgment in favor of the franchisor and remanded to determine whether the actions were arbitrary.²²¹

The vast majority of frustrated franchisees and prospective transferees will find themselves faced with the reality that challenges to franchisor disapprovals of transfers on tortious interference grounds will generally fail.

III. DRAFTING PRACTICES AND PROVISIONS IN THE FRANCHISE AGREEMENT

Appendix E contains a set of Franchise Agreement assignment, transfer, and right of first refusal provisions that elucidate the discussion in this Section of the paper. Those provisions can be a starting point for drafting, but the provisions are drafted to give the franchisor the broadest control for the reasons discussed in this Section.

²¹² *Id.*

²¹³ *Id.*

²¹⁴ *Bishay v. Foreign Motors, Inc.*, 616 N.E.2d 96, 98 (Mass. 1993).

²¹⁵ *Id.* at 100.

²¹⁶ *Id.* at 99.

²¹⁷ *Id.* at 103.

²¹⁸ *Woody v. Gen. Motors Corp.*, Bus. Franchise Guide (CCH) ¶ 10,336 (4th Cir. 1993).

²¹⁹ *Id.*

²²⁰ *Id.*

²²¹ *Id.*

A. The Elements of Change of Ownership Definitions

As the title of this paper suggests, the principal terms to be defined in the franchise agreement are transfer and assignment. These definitions are frequently combined into a clause addressing what can be generally referred to as changes in ownership of the franchised business and its component elements.

The change in ownership section of the franchise agreement should begin by addressing a fundamental premise of the franchise relationship from the franchisor's viewpoint: the franchise has been granted based upon the qualifications, experience, economic resources, capability, attitude, and even personality of the named franchisee or its owners and presumes a commitment to a relationship that will endure for the full term of the franchise agreement. That is also the basis for much of the tension between the interests of the franchisor and those of the franchisee. That tension and the circumstances of many proposed changes in ownership also require addressing differing attitudes about who owns the value the franchisee builds in the business and therefore who controls its disposition.

Hence the need for flexibility in the change of ownership provisions to address the necessary balance between the franchisor's desire to pick and choose its franchisees and protect the particular franchised business and the franchise system in general juxtaposed against the franchisee's need or desire to change ownership of the franchised business because of changed relationships or circumstances, problems with the operation or profitability of the franchised business, or the desire of the franchisee or one or more of its owners to capitalize on the value of the franchised business.

While protecting the franchisor's interest in preserving the relationship it chose to create, the breadth of these clauses can create conflict in the relationship between franchisor and franchisee. To avoid that result, the change of ownership provisions must allow the franchisor to respond to particular circumstances while maintaining consistency in its treatment of franchisees.

The change of ownership provisions are typically drafted very broadly to accomplish the franchisor's goal of controlling any change whatsoever in the ownership of the franchisee or the assets of the franchised business. Those provisions address a plethora of events, occurrences, or actions that may result in someone other than those initially involved in ownership of the franchise becoming involved in its ownership.

To accomplish that, the change in ownership provisions must address:

(i) who is the franchisee: an individual, spouses or domestic partners, or a de facto or formal entity;

(ii) what might be transferred: the interest of the individual owner of the franchised business or an interest in an entity that is the owner of the franchised business, one or more of the tangible or intangible assets of the franchised business, the franchise agreement itself, or all of those;

(iii) to whom the interest or asset may be transferred, which will be determined by (iv) below; and

(iv) how a change in ownership might occur: as a direct result of a voluntary occurrence like a sale, as a result of an uncontrollable occurrence like divorce, death, or insolvency, or as an indirect result of a voluntary occurrence like a pledge of an interest in the franchised business or its assets that results in foreclosure.

1. **Who Is the Franchisee**

The broadest of clauses will include as changes of ownership the transfer of any portion of the interest held by a franchisee that is an individual or any interest whatsoever in an entity franchisee. A franchisor may feel it is necessary to restrict the transfer of any interest whatsoever in an entity franchisee because business relationships can be very dynamic and those dynamics can be affected by the composition of, and relationships between, the individuals who own the entity. More common with entity franchisees is the use of a definition that addresses control, most commonly the change in ownership of 50% or more. But a more cautious approach is to refer to any change that results in a change in control of the franchisee. Similarly, the cumulative effect of changes in ownership must be addressed in order to provide for the possibility that a series of transfers by one or more individual owners of a franchisee entity in the aggregate results in a change in control. These provisions are all aimed at the goal of assuring that individuals or entity owners selected by the franchisor are compatible with one another and remain in charge of the management and operation of the franchised business.

A corollary of this line of reasoning is a prohibition on transfer of interests to a publicly held company or an investment entity that is not closely held. A franchisor may reason that it is necessary to prohibit the diffuse ownership that results from ownership by a public or investment entity because responsibility for operation of the franchised business is then more diffuse and indirect, resting in shareholders, members, or a diverse group of investors. This line of reasoning may be difficult to follow as franchise systems rely more frequently on subfranchisors or area developers, where more capital and a broad management structure are common.

At the other end of the spectrum a franchisor must consider how it addresses ownership by a family trust. This is an essential consideration both where the family trust is the owner of the interests in an entity franchisee and where individual franchisees or franchisees who are spouses or domestic partners wish to place ownership of what amounts to a family business and may be a significant family asset into an estate planning vehicle. During the lifetime of the trustor who is the operator the franchisor selected, ownership by the family trust may not be an issue. But the change of ownership clause must address what happens upon the death of the trustor/trustee who is the active operator of the franchised business. Common ways to address this issue are to give the franchisor or its nominee the right to purchase the franchised business upon the death of the operator, to give the decedent franchisee or franchisee entity owner's heirs or successors a period of time to sell the franchised business to a purchaser who can qualify and provide for the franchisor to place a manager in the franchised business until the sale is completed, or to permit the heirs or successors to take over the franchised business if they qualify and complete training.

2. **What Might Be Transferred**

A typical provision addressing changes in ownership will include changes: by assignment of an interest in the franchise agreement, including transfers by one or more individual owners to an entity; in ownership of any of the tangible or intangible assets of the franchised business; by transfer of shares of stock, units of membership interest, the interest of a general or limited partner; or change in the trustees or beneficiaries of a trust that is the

franchisee. Whether entity transfer issues arise can be controlled in part by choices made at the outset of the franchise relationship, for example a policy of not permitting ownership by public entities.

A fundamental element of a change of ownership clause will ordinarily be a prohibition on transfer of less than all of the elements of the franchised business: the franchise agreement, the owned tangible assets (it being assumed that the intangible assets belong to the franchisor), the lease or ownership of the premises where a bricks and mortar franchised business is located, equipment leases, inventory, accounts receivable of a franchised business that carries accounts, transferrable governmental licenses and permits, and perhaps contracts with employees and independent contractors. To avoid inadvertent piecemeal transfers, the franchisor also has an interest in prohibiting pledging individual assets to secure financings other than purchase money financings of fixtures and equipment. The ramifications of this consideration for financing of franchised businesses are beyond the scope of this paper, but the two needs must be reconciled and coordinated.

3. **Transfer: “Let Me Count the Ways”**

There are numerous ways and reasons to transfer a franchise. Many of the methods are addressed in the franchise agreement transfer definition.

The most common method is the transfer of the franchise agreement itself by assignment as part of a sale of substantially all of the assets of the franchised business. This process normally takes the form of a formal assignment and assumption.²²²

Franchise transfers are also frequently accomplished by changing the entity owner or the persons who control the entity owner. For example, individuals often transfer the franchise agreement to a corporation or limited liability company to operate the business. Again, this is frequently done by an assignment and assumption form. For a franchise that is already owned by a business entity, the transfer often is accomplished indirectly by a sale of the ownership interests of the entity. This can be accomplished by a sale of the business entity’s stock, limited liability company membership interests, partnership interests, etc. In this case, from a technical legal standpoint, there may have been no transfer or assignment of the franchise agreement itself, but a deemed transfer by operation of the defined term of the franchise agreement. Nevertheless, the franchisor will require some form of documentation to evidence the transaction and to give its consent.²²³ With today’s flexibility in creating, structuring and organizing business entities, it is critical for the franchisor to determine how control over the franchised business will be exercised. For example, it is common for management control to differ from majority equity ownership of limited liability companies. Franchisors should delve into the background of the operating agreements, shareholders agreements or partnership agreements governing the business entity to determine appropriate control. Simply requiring majority ownership may not be enough and a change in less than majority ownership interest in the business entity may effectively change all management control.

Similar to transfers of underlying ownership interest from one owner to another, a franchise transfer can also occur simply by a corporate franchisee selling newly issued stock to third parties. In this manner effective control can be transferred even though the existing

²²² See *infra* Appendix F, Form 2 for forms of consent.

²²³ See *infra* Appendix F.

owners have not transferred any of their ownership interests. Again, from a technical legal basis, no assignment of the franchise agreement may have occurred but since effective control of the business entity franchisee has taken place, the franchisor will want to confirm the organizational structure to determine the proper parties are still responsible for fulfilling the franchise agreement obligations.

Franchise transfers also can occur involuntarily. The death of a franchisee or its principal owner may both result in a defined transfer or a defacto one. While a franchisor still has an interest in making sure that its brand is protected, its management of the transfer process under these circumstances is likely to be more circumspect than for a franchisee wanting to transfer voluntarily. Furthermore, franchisees in financial difficulty may face involuntary franchise transfers due to collateral foreclosure or other collection efforts by lenders. Franchisors will still want to be sure that operational control of the franchised business is in the hands of an experienced operator, and not a passive lender or heir who may be remote from the business.

Franchisees that have experienced injuries may want to transfer due to disability to ensure that the business can be operated by active operators. Transfers in this context can be done in virtually the same way as for transfers to third parties generally. Franchisors often assist in this process due to the common goal of having their franchisees be successful operators.

Finally, franchisees are often engaged in sophisticated estate planning and asset protection strategies. When they do so, they will want to transfer either assets or ownership interests to trusts and related vehicles. Franchisors will want to examine the trust and other governing documents to ensure that their interests remain protected, ultimate control remains with the franchisee of record, and that sufficient financial resources are readily available (and not remote or judgment proof) to back up the obligations in the franchise agreement.

The franchisor's evaluation of a proposed transfer may differ significantly depending on the reason for the transaction. Many franchisors have franchise resale programs, both to assist franchisees in their exit strategies and to facilitate franchise ownership with successful operators.²²⁴ Furthermore, franchisors often utilize the transfer process to serve as a work-out solution to avoid a franchisee's entire loss of business due to a franchise termination.²²⁵ The transfer process can also be utilized as a way to help resolve franchise disputes. A franchisor's assistance in resale may enable a franchisee to recover its investment and eliminate the franchisee's need for redress for an alleged violation or breach.

B. Why One Size May Not Fit All: The Need for Flexibility and Consistency

The variety of circumstances that may lead to a change of ownership, ranging from death of an individual franchisee or entity owner to the owner's desire to capitalize on the value of the franchised business, with a range of possibilities in between that include both choices made by the franchisee, mutual desire of the franchisee and franchisor for a change of ownership, and events the franchisee cannot control, make it imperative that the franchisor be able to adapt its change of ownership policy to the circumstances so it can choose to do what it determines is best for the franchise system in any particular circumstance. At the same time,

²²⁴ For further discussion on franchise resale programs, see Brian B. Schnell and Sarah J. Yatchak, *Let's Make a Deal: Developing a Successful Franchise Resale Program*, 27 FRANCHISE L.J. 215 (2008).

²²⁵ See Tractenburg, *supra* note 162, at 373.

the franchisor must create predictability and equality of treatment for franchisees both to preserve order and stability in the franchise system and protect itself against claims of discrimination. For these reasons, selection of an appropriate standard is the foundation of a successful approach to changes of ownership.

Recognizing the need for flexibility, some franchisors provide in the franchise agreement that some of the conditions to the franchisor's consent apply only to changes of ownership under certain circumstances or that involve a certain level of change. For example, it is not uncommon for a threshold standard to be an event that results in a change of management of the franchisee or a change of more than 50% of the ownership of the franchisee or a change sufficient to change voting control of an entity franchisee.

C. Some Common Standards

1. Complete Discretion

A franchisor cannot be assured of having the right to prohibit a transfer of which it does not approve unless the franchise agreement clearly and expressly gives the franchisor the right to grant or withhold permission for the transfer in its complete, absolute, unqualified, and even arbitrary discretion.²²⁶ However, as noted in Section II, some state statutes prohibit such broad grants of the right to withhold consent to a change in ownership.²²⁷ Most notably, the Iowa statute²²⁸ prohibits a franchisor from imposing any conditions on a franchisee's transfer of the franchise agreement.

In addition to statutory restrictions in the states that have them, as discussed in Section II and described in Appendix B, a franchisee objecting to the franchisor's refusal to consent to a proposed change of ownership who might otherwise be thwarted by a clause that grants the franchisor complete discretion will assert that other legal principles limit a franchisor's ability to withhold consent even under a clause that provides for absolute discretion. Most often, the basis for the franchisee's objection is the implied covenant of good faith and fair dealing. The results of the claims turn on whether a court views the covenant as an absolute prohibition on unfettered and even arbitrary decision making by the franchisor or a standard that applies only if the franchise agreement does not give the franchisor an unfettered right to refuse consent.²²⁹

The prevailing rule is that the covenant of good faith and fair dealing applies not to override the terms of the parties' agreement (in these cases, the franchise agreement) and therefore does not prohibit a franchisor from arbitrarily refusing consent to a transfer if the language of the franchise agreement expressly gives the franchisor that right.²³⁰ *Keating v.*

²²⁶ Adolph Coors Co. v. Rodriguez, 780 S.W.2d 447, 480 (Tex. App. 1989).

²²⁷ See *supra* Part II.B for discussion of state relationship laws; e.g. HAW. REV. STAT. § 482E-6 (2014).

²²⁸ IOWA CODE § 523H.5.1 (2014).

²²⁹ See Burger King Co. v. H&H Rests, LLC, No. 99-2855, 2001 WL 1850888 (S.D. Fla. Nov. 30, 2001) (there is no independent duty of good faith and fair dealing).

²³⁰ E.g., C. Pappas Co. v. E & J Gallo Winery, Bus. Franchise Guide ¶ 8378 (Cal. Dist. Ct. May 23, 1985) (citing Walnut Creek Pipe Distrib., Inc. v. Gates Rubber Co., 228 Cal. App. 2d 810, 815 (Cal. Ct. App. 1964)) ("It is not enough to say that without the proposed implied covenant, the contract would be improvident or unwise or would operate unjustly. Parties have the right to make such agreements. The law refuses to read into contracts anything by way of implication except upon grounds of obvious necessity."). See *Larese v. Creamland Dairies, Inc.*, 767 F.2d

Baskin-Robbins USA Co.,²³¹ discussed above, is a striking example of the cases that find the covenant of good faith and fair dealing cannot limit the express terms of the franchise agreement because the facts of the case presented ample opportunity for the court to find the franchisor acted unfairly.²³² As noted in the discussion above, in *Keating* the franchisor had expressly reserved the right to act arbitrarily.²³³ The franchisor then summarily refused to consider an assignment to the proposed transferee.²³⁴ Although it noted that the covenant of good faith and fair dealing is particularly important when a party to a contract is given complete discretion, the North Carolina court said the covenant would apply only if the franchisee could show that the franchisor “acted dishonestly, outside of commercial practices, with improper motive, in an unreasonable manner that was arbitrary, capricious or inconsistent with the reasonable expectations of the parties.”²³⁵ Quoting with approval from *Carma Developers (California) Inc. v. Marathon Development California, Inc.*,²³⁶ the court concluded:

It is universally recognized the scope of conduct prohibited by the covenant of good faith is circumscribed by the purposes and express terms of the contract.... “The general rule [regarding the covenant of good faith] is plainly subject to the exception that the parties may, by express provisions of the contract, grant the right to engage in the very acts and conduct which would otherwise have been forbidden by an implied covenant of good faith and fair dealing.... [I]f defendants were given the right to do what they did by the express provisions of the contract there can be no breach.”²³⁷

Another often-cited example of the limits courts have imposed on use of the implied covenant of good faith and fair dealing is *Taylor Equipment, Inc. v. John Deere Co.*,²³⁸ discussed above. That case demonstrates that once the court determines that the franchisor’s rejection of a proposed transferee is supported by specific language in the franchise (or in this case, dealer) agreement, the implied covenant of good faith and fair dealing generally cannot support a franchisee’s attack on the franchisor’s exercise of its right to refuse consent to a change in ownership.²³⁹ The only factor that tempers the result in *Taylor* is that the court

716, 717-718 (10th Cir. 1985) (stating in dictum that the franchisor could have refused consent to a transfer without cause if a “freely negotiated” provision in the franchise agreement permitted it because that provision was not unconscionable, despite a finding that the franchisor/franchisee relationship requires that the parties deal with one another in good faith and a commercially reasonable manner).

²³¹ *Keating v. Baskin-Robbins USA, Co.*, No. 5:99-CV-148-BR(3), 2001 WL 407017 (E.D.N.C. Mar. 27, 2001). See *supra* notes 113-119 and accompanying text.

²³² See *Keating*, 2001 WL 407017, at *10.

²³³ *Id.* at *9.

²³⁴ *Id.*

²³⁵ *Id.* (citing *In re Sizzler Rest. Int’l, Inc.*, 225 B.R. 466, 473 (Bankr. C. D. Cal 1998)).

²³⁶ *Carma Developers (Cal.), Inc. v. Marathon Dev. Cal., Inc.*, 826 P.2d 710 (Cal. 1992).

²³⁷ *Keating*, 2001 WL 407017, *10 (citing *Carma*, 826 P.2d at 727-728).

²³⁸ *Taylor Equip., Inc. v. John Deere Co.*, 98 F.3d 1028 (8th Cir.). See *supra* notes 106-112 and accompanying text.

²³⁹ See *id.*

interpreted the dealer agreement to give John Deere an unfettered right to refuse consent.²⁴⁰ But even that fact cannot provide any real comfort to a franchisee seeking redress for a refusal to consent in the context of a franchise or dealer agreement provision that does not give the franchisor or dealer such broad authority.

The number of court decisions that reject claims based on the covenant of good faith and fair dealing in favor of language of the franchise agreement granting broad or total discretion to the franchisor—as well as the cases discussed in the next subsection of this paper that find a franchisor that is prohibited from unreasonably withholding consent but given broad authority to decide whether a proposed transferee is suitable—may signal to franchisors that the change of ownership clause can and should give the franchisor very broad rights and particularly the right to act arbitrarily.

2. **Not Unreasonably Withhold**

A commonly used standard requires that the franchisor not unreasonably (or arbitrarily) withhold its consent to a change in ownership. This standard limits the franchisor's unfettered discretion and requires that there be at least some rational, or perhaps even a commercially reasonable, basis for any denial of consent to a transfer. This provision is frequently accompanied by a listing of factors the franchisor may consider and often permits the franchisor to determine in its own discretion whether those factors have been met. (The franchisee might like the clause to require that the franchisor's permission also not be unreasonably delayed or conditioned, but those requirements are not ordinarily found in franchise agreement change of ownership provisions.)

Perez v. McDonald's Corp., described in detail above, demonstrates both the benefit to the franchisor of enumerating many bases on which consent may be withheld and how those factors can impact a court's decision about what constitutes a reasonable basis for withholding consent.²⁴¹ In *Perez*, the franchise agreement prohibited the franchisee from denying consent arbitrarily.²⁴² The franchisor refused to consent to four proposed assignees because none of them had taken the pre-approval training the franchisor required—because the franchisor would not permit them to take that training.²⁴³ The court found that the refusal to grant consent to any of the transfers was not arbitrary because the franchise agreement permitted the franchisor to require completion of the pre-approval training course.²⁴⁴ The court also found the franchisor's refusal to permit the proposed transferees to take the required training was not arbitrary and did not violate the covenant of good faith and fair dealing because nothing in the franchise agreement required the franchisor to permit the applicants to take the training.²⁴⁵ This reasoning gives the franchisor a great deal of leeway in blocking transfers.

²⁴⁰ *Id.* at 1032.

²⁴¹ See *Perez v. McDonald's Corp.*, Bus. Franchise Guide ¶ 11538 (Cal. Dist. Ct. Nov. 18, 1998).

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ *Id.*

²⁴⁵ *Id.*

As the cases described in Section II demonstrate, a franchisor will also be deemed to have acted reasonably in withholding consent to a proposed transfer when the franchisee is in default under the franchise agreement, particularly when the default has reached the stage where the franchise agreement is subject to termination or has been terminated. The fact that the transferring franchisee is in default under the franchise agreement is alone enough to support the franchisor's refusal of approval even where the standard set forth in the franchise agreement is that the franchisor will not unreasonably withhold consent is clear from the court's discussion in *Dunkin' Donuts Inc. v. Sharif, Inc.* discussed above.²⁴⁶ Courts have also found the fact that the proposed transferee has defaulted in performance under an agreement with the franchisor to be a valid basis for withholding consent where the standard provided in the franchise agreement is that the franchisor will not withhold consent unreasonably.²⁴⁷

That the contract standard requiring that the franchisor not arbitrarily withhold consent is functionally the same as the contract standard requiring that the franchisor not unreasonably withhold consent is demonstrated by the discussion in *Zuckerman v. McDonald's Corp.*²⁴⁸ When McDonald's refused consent to an assignment unless the price was discounted by the cost of certain work on the franchise location that the franchisee alleged the transferee was not required to perform, the imposition of that requirement was found not to violate McDonald's obligation not to arbitrarily deny consent to a transfer.²⁴⁹

*Richter v. Dairy Queen of Southern Arizona, Inc.*²⁵⁰ demonstrates that a franchisor is well advised to elucidate what is meant by "not unreasonably withhold", words that may not have as plain a meaning as the franchisor might assume. In *Richter* the franchise agreement prohibited the franchisor from unreasonably withholding consent but also said that the franchisor "may insist that any proposed assignee be a person, in Company's judgment, qualified to provide active supervision over the operation."²⁵¹ The proposed transferee was an existing Dairy Queen multi-unit franchisee who was experiencing declining sales and had defaulted in royalty payments for its other franchise locations, resulting in a default under all its franchise agreements by application of cross-default provision.²⁵² Despite the presence of these objective factors supporting a denial and the added fact that the franchisor testified that addition of another unit would not be beneficial to the transferee's operations, the Arizona appellate court found that the franchisor's objections were not sufficient in the face of what it found to be contradictory provisions in the franchise agreement that it ultimately read to require that the franchisor's consent not be unreasonably withheld.²⁵³

The conundrum a drafter faces is evident when the result in *Richter* is compared to the result in cases like *Perez v. McDonald's*. *Perez* also highlights the need for the franchisee to

²⁴⁶ *Dunkin' Donuts Inc. v. Sharif, Inc.*, Bus. Franchise Guide ¶ 13337 (10th Cir. May 2, 2006).

²⁴⁷ See, e.g., *Burger King Co. v. H&H Rests, LLC*, No. 99-2855, 2001 WL 1850888 (S.D. Fla. Nov. 30, 2001).

²⁴⁸ See *Zuckerman v. McDonald's Corp.*, 35 F. Supp.2d 135, 138 (D. Mass. 1999).

²⁴⁹ See *id.*

²⁵⁰ *Richter v. Dairy Queen of S. Ariz., Inc.*, 643 P.2d 508 (Ariz. Ct. App. 1982).

²⁵¹ *Id.* at 509.

²⁵² *Id.* at 510.

²⁵³ *Id.*

carefully review all of the elements the franchisor articulates as bases for granting or denying consent to a change in ownership and the benefit to the franchisor of including an extensive list of items it can consider.²⁵⁴

3. **Comparably Qualified**

A standard that can be justified as more commercially reasonable than absolute discretion or refraining from acting arbitrarily is a requirement that the prospective transferee be “comparably qualified”. This standard can be applied in more than one way: (a) to require that the transferee have qualifications comparable to those the existing franchisee (i) had when it was granted the franchise, perhaps adjusted for changes in economics, or (ii) now has, a standard that might require the transferee to be an experienced operator of a comparable business; or (b) to require that the transferee have qualifications comparable to those the franchisor is presently requiring new franchisees to have. Requiring a transferee to have qualifications comparable to those the franchisor is presently requiring provides a seemingly easily identifiable objective standard that might appear to be likely to reduce the vulnerability of a refusal to consent. But it also may remove the franchisor’s ability to make a subjective choice of the sort it might choose to make when it is selecting new franchisees. That fact leads back to the desirability from the franchisor’s standpoint of use of a standard that gives the franchisor the broadest discretion.

D. **Absence of Express Term in Franchise Agreement**

Express statement in the franchise agreement of a standard for consent is important to establish certainty and predictability but may not be critical to the franchisor being able to refuse consent, a fact demonstrated by the results in cases where the agreement did not contain an express standard.²⁵⁵ The principal reported cases involve dealerships but should apply with equal force in franchising. In *Enfield Equip. Co. v. John Deere Co.* the agreement between the manufacturer and the dealer provided only that the dealership contract could not be assigned without the manufacturer’s prior written consent.²⁵⁶ Relying on the “personal nature” of the relationship between the manufacturer and its dealers and the “close relationship” that exists in dealer and distributor arrangements, the court held that imposition of a reasonable requirement would undermine the manufacturer’s bargained for right to prevent assignment or the distributorship to a party it found undesirable.²⁵⁷

The court in *James v. Whirlpool Corp.*²⁵⁸ had employed the same line of reasoning. Like the agreement in *Enfield*, the *Whirlpool* agreement required the manufacturer’s prior written consent to a transfer.²⁵⁹ Whirlpool’s refusal to consent to an assignment to a proposed assignee it conceded was a quality distributor resulted in a suit by the distributor for breach of

²⁵⁴ See *Perez v. McDonald’s Corp.*, Bus. Franchise Guide ¶ 11538 (Cal. Dist. Ct. Nov. 18, 1998).

²⁵⁵ See, e.g., *Taylor Equip., Inc. v. John Deere Co.*, 98 F.3d 1028 (8th Cir.); see also *supra* notes 106-112 and accompanying text.

²⁵⁶ *Enfield Equip. Co. v. John Deere Co.*, No. 99-2394, 2000 WL 991636, at *1 (4th Cir. July 19, 2000).

²⁵⁷ *Id.* at *2.

²⁵⁸ *James v. Whirlpool Corp.*, 806 F. Supp. 835 (Miss. Dist. Ct. 1992).

²⁵⁹ *Id.* at 839.

contract²⁶⁰ and tortious interference.²⁶¹ The court upheld the manufacturer's right to refuse consent, finding that the absence of any standard in the contract gave Whirlpool unlimited authority to withhold approval,²⁶² and went on to hold that Whirlpool did not have to give any justification for its decision.²⁶³

But the importance of creating predictability by providing an express standard is demonstrated by *Larese v. Creamland Dairies, Inc.*²⁶⁴ In this franchise case, the contract contained no language limiting the franchisor's right to refuse consent to a transfer.²⁶⁵ But the court held:

[T]he franchisee has invested time and money into the franchise and, in doing so, has created benefits for the franchisor. We do not find it an excessive infringement of the franchisor's rights to require that the franchisor act reasonably when the franchisee has decided that it wants out of the relationship. The franchisee should not be forced to choose between losing its investment or remaining in the relationship unwillingly when it has provided a reasonable alternative franchisee.²⁶⁶

The court's imposition of a reasonableness standard where none existed in the franchise agreement was based on the covenant of good faith and fair dealing.²⁶⁷ Interestingly, it reached this result in part based on the unique relationship between a franchisee and its franchisor²⁶⁸— thus reaching the opposite result for the same reason the *Enfield* court used to justify its conclusion that the manufacturer could refuse consent.²⁶⁹

IV. SOME COMMON REQUIREMENTS AND CONSIDERATIONS

A. Transfer Fee

The franchisor's consent to a change in ownership is usually conditioned upon payment of a transfer fee. The amount of the fee depends upon the franchisor's perception of its purpose.

Some franchisors treat the fee as a source of reimbursement for the costs attendant to a transfer: internal personnel and perhaps outside counsel time spent on reviewing the qualifications of the proposed transferee, the terms of the deal between the franchisee and the

²⁶⁰ *Id.* at 840.

²⁶¹ *Id.* at 844.

²⁶² *Id.* at 843-844.

²⁶³ *Id.* at 844.

²⁶⁴ *Larese v. Creamland Dairies, Inc.*, 767 F.2d 716 (10th Cir. 1985).

²⁶⁵ *Id.* at 716-717.

²⁶⁶ *Id.* at 717-718.

²⁶⁷ *Id.* at 717.

²⁶⁸ *Id.*

²⁶⁹ *Enfield Equip. Co. v. John Deere Co.*, No. 99-2394, 2000 WL 991636, at *2n.2 (4th Cir. July 19, 2000).

transferee, and the documents underlying that deal; preparing the franchisor's form of consent to transfer documentation; and providing training and initial supervision for the new operator and the new operator's personnel. When these are the basis for setting the fee, it is often expressed as a fixed sum based on the franchisor's assessment of the average cost for these items.

More flexibility for the franchisor but less predictability for the franchisee can be provided by having the fee be an amount set in the fee schedule in the franchisor's operations manual that can be adjusted periodically. Even more flexibility for the franchisor can be provided by setting the fee as the franchisor's actual expenditures for the cost items listed above, perhaps using the amount the franchisor is then charging for additional training as the basis for the training cost included in the transfer fee. This latter approach can be justified by the facts that the time the franchisor's personnel will spend varies depending upon the nature and documentation of the deal between the franchisee and transferee and the amount of training necessary depends on the background and experience of the transferee. Using that rationale, the training fee for a sale to another franchisee of the franchisor or a manager of the franchised business should be low or nonexistent, making this formulation potentially advantageous for the franchisee.

Other franchisors treat the fee not only as a cost reimbursement mechanism but a way of realizing some or all of the goodwill value the franchisee has built using the franchisor's intellectual property. Using this rationale the transfer fee might be a percentage of the sale price with or without reimbursement for some or all of the cost items described above. This approach is consistent with the premise that the goodwill of the franchised business belongs to the franchisor but antithetical to the franchisee who believes the value of the going concern is a product of its sweat equity and belongs to it and that the franchisor has been compensated by the initial franchise fee and royalties the franchisee has paid during the term of the franchise agreement.

Another way for the franchisor to recover some of the value of the franchised business upon transfer is for the franchisor to collect a new initial franchise fee from the transferee—often the current franchise fee rather than the one paid at the time the franchise was first sold. Similarly, as discussed in III (B) below, the franchisor ordinarily requires the transferee to enter into the franchisor's new form of franchise agreement, including the then current royalty, advertising, and other fees being charged by the franchisor. This requirement can be characterized as a way for the franchisor to realize the growth in value of the franchise system.

It is not uncommon for the transfer fee to be waived for transfers to a family trust, change in ownership of a less than controlling interest in an entity franchisee, or between owners upon dissolution of a marriage or domestic partnership or a business relationship.

B. Execution of the Franchisor's Current Form of Franchise Agreement

Transfer of the franchised business is often conditioned on the transferee executing the franchisor's then-current form of franchise agreement, though some franchisors give themselves the option of permitting the transferee to take an assignment of the existing franchise agreement for the remainder of the term or require the transferee to execute the current form of franchise agreement. Those franchisors that require execution of the current form of franchise agreement most often provide for the new franchise agreement to have a term equal to the term remaining on the existing franchisee's franchise agreement though some give the transferee a new term. Another choice a franchisor makes about execution of the then current form of franchise agreement is whether to waive the initial franchise fee, which is a common practice.

If the transferee is required to execute the franchisor's then current form of franchise agreement, the franchisor must disclose that requirement in Item 17 of the FDD; some state regulators also require specific disclosure in the state addendum.²⁷⁰ If there is no limit on the nature or number of changes between the franchisee's franchise agreement and the one a transferee is required to sign, this requirement can have a significant impact on any transfer, but particularly the value of the franchised business in a sales transaction, with the extent of the impact most often depending on the age of the existing franchise agreement. Because the current form of franchise agreement the transferee is required to execute is typically modified to provide for a term and renewals equal only to what remains on the existing franchise agreement, it is important for the transferee to calculate whether the remaining term, with any options, will provide a sufficient period in which to recoup the purchase price. Subject to being able to negotiate continued occupancy of any bricks and mortar location, the franchisee may be well-advised to seek to negotiate additional renewal options.

One important impact of requiring the transferee to execute the franchisor's then-current form of franchise agreement is to convert what might otherwise be a sale for the franchisee's own account that is exempt from the disclosure requirements of the FTC Rule²⁷¹ and state registration and disclosure requirements²⁷² into a sale by the franchisor. This can pose a problem for a franchisor that is no longer actively selling new franchises or is no longer registered to offer and sell in a particular state. That franchisor may either have to forego taking advantage of an opportunity to bring an older franchise onto a newer franchise agreement or find a way to make the offer exempt under the FTC Rule if the franchisor does not have a current FDD or the law of the particular state involved if the franchisor has a current FDD but is not registered in the state.

Iowa is unique in prohibiting a franchisor from requiring execution of a new or different franchise agreement as a condition to the transfer of a franchised business.²⁷³

C. **Continuing Right to Occupy Any Franchise Location**

If the franchised business is operated from a leased bricks and mortar location, the transferee must obtain the right to occupy that location. That requires the landlord's approval, a requirement that should be a condition to the franchisor's consent to the transfer.

D. **Review and Approval of Sale or Other Transfer Documents**

The franchisor should assure that the terms of the acquisition are not so burdensome or costly and do not impose ongoing financial requirements on the assignee that will impair its ability to succeed in operating the franchised business. For that purpose, the franchisor will

²⁷⁰ This requirement has been imposed by regulators in Illinois, for example.

²⁷¹ Fed. Trade Comm'n, *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities; Final Rule*, 72 Fed. Reg. 15,444, 15,445-15,449 (Mar. 30, 2007) (to be codified at 16 C.F.R. pt. 436 and 437) (establishing Statement of Basis and Purpose); see 16 C.F.R. § 436.1(t) (2007); see also *infra* Appendix A citing FTC COMPLIANCE GUIDE, *supra* note 6, at 18 ("What Happens When an Existing Franchisee Sells His or Her Outlet?").

²⁷² See *infra* Appendix B.

²⁷³ IOWA CODE ANN. § 523H.5(4) (2014) ("A franchisee may transfer the franchisee's interest in the franchise, for the unexpired term of the franchise agreement, and a franchisor shall not require the franchisee or the transferee to enter into a new or different franchise agreement as a condition of the transfer.").

want to have the right to review and approve all of the documentation of the acquisition. That should include not only the purchase and sale agreement between the franchisee and the proposed transferee but also third party loan documentation, any requirements that may be imposed by third party vendors, and documents pertaining to the transferee's finances. If the franchisor's personnel discuss the results of this investigation with the transferee, they should be mindful of the need to avoid any statements that might be construed as earnings claims.

The franchisee may object to this requirement as an intrusion on its transaction with the transferee and if the result of the investigation is a refusal to consent to the transfer may assert a variety of claims. Reported cases include claims for breach of contract, breach of the covenant of good faith and fair dealing, tortious interference with contract, and Sherman Act claims.²⁷⁴

E. Transfer of All Assets of Franchised Business

The franchised business is a going concern. All of the constituent parts of the going concern should be included in the sale. That will include not only assignment of any lease of the franchise location as noted in paragraph C of this Section, but also all furniture, fixtures, equipment, small wares, and inventory as well as transfer of service and similar contracts and assignment of the franchise agreement. The franchisor's review of the transfer documentation should include confirming that all of the assets of the franchised business are being transferred.

F. Payment of All Sums Due at Time of Transfer

Requiring the franchisee to pay when the transfer takes place all sums due to the franchisor at that time should be a noncontroversial and simple provision of the franchise agreement change of ownership provisions. The franchisor should have systems in place for polling the franchisee's point of sale computer and obtaining payment at the closing, which may be a simple matter if the franchisee's payments are made by electronic transfer from a bank account or preapproved charge to a credit card. The franchise agreement should prevent the franchisee from ending the franchisee's right to electronic or automated transfers until all sums have been paid; conversely, the franchisee will want to be sure charges cannot be made to its account after the transfer closes.

G. Franchisee Not in Default

The franchisor's consent is commonly conditioned on the franchisee not being in default under the franchise agreement at the time consent is requested and at the time the transfer is to occur—or at least curing defaults prior to or concurrently with the change of ownership. This requirement may be taken one step further by employing the common business sale requirement that there not be any event or situation that with the giving of notice or the passage of time will result in a default either at the time the consent is requested or at the time the transfer occurs. A rarely seen more extreme position would be a requirement that the franchisee not have been in default during the term of the franchise agreement or for some period prior to the transfer, a standard that might be justifiable (if ever) where the franchisee is choosing to sell and capitalize on the value of the franchised business but that is difficult to justify where the franchisee is selling because it has not succeeded in the operation of the franchised business.

²⁷⁴ See discussion, *supra* notes 129-135 and accompanying text, *Burger King Co. v. H&H Rests., LLC*, No. 99-2855, 2001 WL 1850888 (S.D. Fla. Nov. 30, 2001); See also, e.g., *Burger King Corp. v. Ashland Equities, Inc.*, 217 F. Supp.2d 1266 (S.D. Fla. 2002); *Walner v. Baskin-Robbins Ice Cream Co.*, 514 F. Supp. 1028 (N.D. Tex. 1981).

The existence of monetary defaults may be readily apparent, but a site visit both when the consent is requested and on the eve of the transfer is necessary to be certain there are not other defaults or situations that could become a default. The franchisor should be able to employ its ordinary site inspection and testing checklist to reveal any problems that should be addressed before the transfer is effected. Alternatively, the franchisor may be willing to have the transferee undertake to cure these defaults either at the closing or in an agreed upon time period after the closing—a solution that is particularly well-advised when the transfer is being made because the franchisee is in default and cannot afford to cure or when the franchisee is insolvent or short of funds, a situation in which the franchisor and franchisee should have a shared interest in the franchised business being taken over by a new operator.

It may seem obvious that the franchisee should address with the franchisor any pending default so that the default does not turn into a breach that gives rise to the franchisor's right to terminate. Termination will, of course, make the issue of consent to a transfer moot—a fact supported by case law.²⁷⁵

H. Renovating, Remodeling, and Upgrading Franchise Location

For the franchisor, transfer of the franchised business is a convenient time to require an update in physical facilities, fixtures, and equipment. The franchise agreement either directly or by reference to requirements in the operations manual may permit the franchisor to impose these requirements even in the absence of a change in ownership, muting a claim by the transferring franchisee that imposition of these requirements is unfair and impairs the franchisee's ability to realize the value it has built in the franchised business. But to the extent these requirements could not otherwise be imposed, imposition of them (particularly requiring renovation or remodeling of physical facilities) can be met with objections based on the economic burden and the impact on the price a selling franchisee can obtain or simple absence of available funds in any kind of transfer.

Creative solutions to this problem can include deferring some or all of the upgrades, requiring creation of a reserve fund for subsequent performance, and working with the existing and new owners to agree on deferred payment of a portion of the purchase price to provide funds to perform the most critical renovation or remodeling. Another approach is to reason that the need for renovation of the franchise location affects value and therefore justifies reduction of the sale price. Which approach is adopted will depend on what is appropriately required in light of the age and condition of the assets of the franchised business and the proximity of the change in ownership to the time when the franchise agreement would permit the franchisor to require renovation, remodeling, or upgrading. The goal of all involved should be to permit the existing franchisee to obtain market value for the franchised business in light of the physical condition of its assets or to adapt to the circumstances that create an involuntary change of ownership, whether those are death or disability or insolvency of the franchised business.

I. New Owner's Successful Training

Requiring a new owner to satisfactorily complete the franchisor's training course should not be controversial: the franchisor has the same interest in completion of training by a transferee that it had for the original franchisee. What may be different is timing, particularly where the change in ownership results from death or disability or is being made to turn over

²⁷⁵ See, e.g., *Dunkin' Donuts Inc. v. Taseki*, 47 F. Supp.2d 867 (E.D. Mich. 1999) (franchisor granted summary judgment on franchisee's causes of action for breach of contract and breach of implied covenant of good faith and fair dealing based on franchisor's refusal to consent to post-termination transfer).

operation of an unsuccessful or even insolvent franchise business. The use of interim managers can be used to permit deferral of training until shortly after a transfer is completed if completion of the transfer is urgent or at least time sensitive.

J. Assignor's Secondary Liability

Common business practice would dictate that the existing franchisee remain secondarily liable for the performance of the franchisee's obligations under the franchise agreement—in effect standing as guarantor of the new franchisee's performance. Whether that is logically appropriate in any given change of ownership depends upon the circumstances of the change.

Should the heirs of a deceased franchisee who cannot qualify or are not in a position to become the successor franchisee be required to stand behind the operation of the franchised business by a new operator? Some would argue that they should – at least for the balance of the term of the existing franchise agreement – because they have received the economic benefit of the sale to the new operator. Others would say they should not be responsible because they were effectively forced to sell in circumstances that were uncontrollable and involuntary, the specter of liability for damages poses an unreasonable financial burden, and the franchisor has a new operator that it approved, has personal guaranties if the new operator is an entity, and reaped the benefit of moving the franchised business to the current form of franchise agreement.

Should a franchisee that has chosen to sell the franchised business to realize its going concern value be required to stand behind the operator it selected—albeit one the franchisor approved? Based on common business practice and perhaps most obviously by analogy to an assigning tenant under a commercial lease the answer would be yes. But the circumstances must be examined and the benefit the franchisor may realize from the transfer (including any required upgrades or renovation and the step up to the current franchise agreement) must be considered. In the end this will be a business negotiation, but for the transferring franchisee, its negotiating position is impacted by the requirements of the franchise agreement.

K. Release

Perhaps the most controversial requirement of approval of a change of ownership is execution of a release—generally a unilateral one. The existence of this requirement must be disclosed in Item 17m of the FDD as part of the summary of the conditions for franchisor approval of transfers. Some state statutes have anti-waiver provisions expressly prohibiting a franchisor from requiring a release of statutory claims²⁷⁶ and state regulators may require a state addendum addressing the statutory requirements.²⁷⁷

The Michigan case of *Franchise Management Unlimited v. America's Favorite Chicken*²⁷⁸ described above supports the enforceability of a unilateral release requirement in the

²⁷⁶ See discussion on state relationship laws for Arkansas, California, Hawaii, Indiana, Iowa, Michigan, Minnesota, and New Jersey *supra* Part II.B.

²⁷⁷ See, e.g., addendum language required by Washington in the Washington Franchise Investment Protection Act of 2012 § 19.100.220 (2014) (“A release or waiver of rights executed by a franchisee shall not include rights under the Washington Franchise Investment Protection Act except when executed pursuant to a negotiated settlement after the agreement is in effect and where the parties are represented by independent counsel.”).

²⁷⁸ *Franchise Mgmt. Unlimited v. America's Favorite Chicken*, 561 N.W.2d 123 (Mich. Ct. App. 1997). See *supra* text accompanying notes 87-99.

face of a protective statute. As discussed in Section III, the Michigan court ruled that the franchisee's refusal to provide a release gave the franchisor good cause to deny consent to the assignment, interpreting good cause to require that the franchisor act in a commercially reasonable manner and determining that it was commercially reasonable for the franchisor to want to resolve all claims against it arising out of the business relationship when the relationship was coming to an end. However, the court's ruling excepted any release of claims under the Michigan franchise relationship statute.²⁷⁹ Because the franchisee had a separate lawsuit pending against the franchisor that it would have to dismiss in order to accomplish its sale, this case can be viewed as severely limiting the benefit to the franchisee of a statutory good cause requirement.

The Michigan case is not alone. This issue is frequently raised, particularly in states that have franchise relations acts. Courts generally uphold a franchisor's right to require a release when a franchised business is transferred.²⁸⁰

A franchisor's response to the assertion that fairness dictates making the release mutual might be that releasing claims against the franchisor is an appropriate *quid pro quo* for the franchisor's consent to the change because, among other reasons, the franchisee has been operating an ongoing business for which claims not presently known may arise well after ownership of the franchise changes. Does that logic hold up when the transfer is the result of death, permanent disability, or some other involuntary event?

One common franchisee complaint about unilateral releases is that the franchisee is required to give up valid claims in a setting that from the franchisee's perspective amounts to economic coercion. The franchisee typically argues that the franchisor should share its interest in selling the business because the sale mitigates the franchisee's damages. If the franchisee articulates its claims, the mutual interest in permitting the franchisee to end the relationship that is the source of the claim and cap its damages can be served by carving out the specific claim from an otherwise general release and permitting the parties to resolve it after the change of ownership. But a franchisor may insist upon a resolution before sale, believing that disclosure of the franchisee's complaint to the prospective purchaser may add to the franchisee's damage claim by affecting the sale value of the franchised business. This possibility must be balanced against the mutual interest in permitting the franchisee to take advantage of a sale opportunity.

L. Prohibition on Transfer to Competitor

Regardless of the standard employed by the franchisor to grant or withhold consent, the franchisor will want to assure that the franchised business is not being transferred to anyone with an interest in a competitor or a competing franchise. The latter occurrence should not be difficult to avoid because acquiring a competing franchise would certainly be a breach of the franchise agreement between the franchisee and that competitor—putting aside the possibility of a nefarious intent to have a franchisee acquire a competing franchise and use what it learns for the benefit of the competing franchisor. An issue is where to draw the line: clearly the franchised business should not be transferred to a member of the immediate family of the owner of a competing franchise, but what if a competitive franchise is owned by an in-law, a cousin, a

²⁸⁰ See, e.g., *Stradling v. Southland Corp.*, 924 F. Supp. 38 (M.D.Pa. 1996) (release that was only retroactive and would not cover franchisee's actions after moved to New Jersey found not to violate New Jersey Franchise Practices Act); *America's Favorite Chicken v. Suryoutomo*, 889 F. Supp. 916 (E.D. La. 1995) (franchisor's consent to transfer is adequate consideration for required general release).

former spouse? These are judgment calls for the franchisor. Case law discussing the issues could not be located.

V. THIRD PARTY CONSIDERATIONS

A. Landlords

Leases commonly contain restrictions on changes in ownership. The standards may vary, but because many state laws limit damages for breach of a lease if the tenant is prohibited from assigning the lease, the standard most commonly found in commercial leases is that the landlord will not unreasonably withhold consent to a transfer.²⁸¹ Frequently the lease transfer provision goes on to explicate requirements that are deemed not to be unreasonable or conditions that will be imposed on a transfer. Conversely, the lease transfer provision may describe transfers that are not acceptable. Often the requirements that are deemed permissible and the conditions that are deemed unacceptable parallel those in the franchise agreement.

Reasoning that a lease transfer is frequently accomplished because the value of the lease exceeds its cost, landlords often seek to protect their economic ownership by including a right of first refusal in connection with any transfer of an interest in the lease. Franchisors and franchisees wishing to provide for transferability of the franchise business, an interest that is shared in some respects, should include in the process of initial review and approval of leases elimination of these rights of first refusal, at least when transfer of the leasehold accompanies a transfer of the franchised business.

Regardless of the scope or terms of the lease transfer clause, obtaining the landlords consent to the transfer of ownership of the franchised business must be a condition to the franchisor's consent to the transfer.

B. Lenders

Commercial loan agreements generally contain quite stringent change of ownership limitations, often making any change in control of the borrower a default or at least an occasion that permits the lender to accelerate payment. Short of changes in control, these limitations generally include death or permanent disability of even a single owner of a family owned entity. Lenders do not generally agree to mitigate or reduce these requirements in advance, though they may agree to remove death of an owner of a family entity as an acceleration event if the death does not result in a change of the person with day to day operational responsibility or a change in control of the family entity.

Lender permission can easily be overlooked when there is a change of ownership that does not result in payment of the loan. Franchisors should be certain to include lender permission as a condition to approval of any change in ownership, whether or not voluntary, unless the loan will be paid in full as part of the transfer. Franchisees must be equally mindful of the need to inform the lender of changes and obtain any necessary consent.

²⁸¹ *But see*, AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION, STANDARD INDUSTRIAL/COMMERCIAL MULTI-TENANT LEASE-NET, § 12-13 (1999), [http://www.airea.com/DOWNLOAD/PDF/FORMS/SAMPLES/Standard_Industrial_and_Commercial_Lease/Multi-Tenant_Lease_-_net_\(2014\).pdf](http://www.airea.com/DOWNLOAD/PDF/FORMS/SAMPLES/Standard_Industrial_and_Commercial_Lease/Multi-Tenant_Lease_-_net_(2014).pdf).

VI. EVALUATING AND PAPERING THE TRANSFER PROCESS

A. Process for Review

Franchise transfers give the franchisor a unique opportunity to improve the franchise system by requiring proposed transferees to satisfy the franchisor's "then-current" minimum qualifications for new franchisees entering the system. The franchisor should require the proposed franchisee to submit a formal franchise application. The proposed transferee's failure to submit a completed franchise application constitutes valid grounds for the franchisor to deny the proposed transfer, and courts will uphold a contractual requirement that the prospective transferee satisfy the franchisor's then-current qualifications for new franchisees.²⁸²

In evaluating the application, the franchisor should strive to employ objective criteria to reduce the risk of potential claims that it acted unreasonably or arbitrarily in withholding its consent to the proposed transfer.²⁸³ While it may be enticing to lower the bar to facilitate the sale of a failing or underperforming franchised outlet, requiring each proposed transferee to satisfy a standard set of minimum requirements applicable to new franchisees will help reduce the risk of future claims against the franchisor by disgruntled franchisees seeking to challenge the franchisor's rejection of a proposed buyer for their outlet.²⁸⁴

It is a good idea to create a transfer checklist, which should include the franchisor's current evaluation criteria for new franchisees and a list of transfer conditions contained in the franchise agreement. The franchisor's qualifications and standards for new franchisees may include, for example, minimum net worth and other financial qualifications, acceptable credit score, relevant business experience in the same or a similar industry, no criminal history, and character of the proposed transferee.

The franchisor should keep a record of the decision making process, since applicable state relationship statutes or the express terms of the contract may require the franchisor to provide the franchisee with written notice of the franchisor's decision, specifying the material reasons for denying a proposed transferee. Any such explanation should clearly and concisely articulate the reasons for rejecting the proposed transferee, to avoid allegations of bad faith.²⁸⁵

B. Transfer Consent Form and Effectiveness

The franchisor should document all transfers, whether the transfer involves the transfer of all or a partial ownership interest, or substantially all of the franchised business assets. The provisions of the consent to transfer form will depend on the transfer conditions of the franchise agreement.

²⁸² Tractenberg, *supra* note 162, at 293 (citing *Clark v. America's Favorite Chicken Co.*, Bus. Franchise Guide (CCH) ¶ 10,841 (E.D. La. 1996), *aff'd*, 110 F.3d 295 (5th Cir. 1997)); see also *C.L. Thompson Co. v. Festo Corp.*, 708 F. Supp. 221 (E.D. Wis. 1989) (franchisor had good cause to terminate based on distributor's transfer without franchisor's consent, where franchisor had legitimate concerns about the transferee's competence and trustworthiness).

²⁸³ Tractenberg, *supra* note 162, at 291.

²⁸⁴ *Id.*

²⁸⁵ Fredric A. Cohen & Nicole L. Micklich, *Transfers of Franchises: Disputes Arising from Assignments*, (Workshop 13 at the ABA 36th Annual Forum on Franchising, 2013) at 33.

Appendix F contains two alternate sample forms for transfer. Form 1 is a Consent to Transfer of Ownership Interests, which may be utilized where the franchise agreement permits the franchisee to transfer non-controlling interests in the franchise to one or more persons. In these cases, it is typical for the franchise agreement to require the franchisor's prior written consent and also to require the new owners to sign the franchisor's then-current form of owner's guarantee. However, other transfer conditions, such as the payment of a transfer fee and a requirement to sign the franchisor's "then-current" form of franchise agreement, may not apply in the case of a transfer of a minority ownership interest in the business. Form 1 reflects limited transfer conditions on which the franchisor's consent to transfer is made contingent.

Form 2 is an Assignment and Assumption of Franchise Agreement, which can be used if the franchisee requests to transfer or assign a controlling interest in the franchised business or to sell or transfer all (or substantially all) of the assets of the franchised business. This type of transfer consent form incorporates additional transfer conditions that would typically apply in these situations, such as requiring the transferee sign a new franchise agreement; imposing a transfer fee; requiring the payment of all outstanding sums owed to the franchisor or its affiliate; and requiring the transferor to sign a general release of any and all claims against the franchisor and its affiliates. The assignment provisions of the franchise agreement will dictate the transfer conditions that apply to a particular transfer, and those conditions should be incorporated into the consent to transfer agreement, as appropriate.

In either case, if the franchise agreement gives the franchisor a right of first refusal to acquire the interest(s) being transferred, the consent to transfer agreement should acknowledge that the franchisor has elected not to exercise its right of first refusal with respect to the proposed transfer.²⁸⁶

Regardless of the type of form that is used, the franchisor's consent should always be made contingent on the franchisee's and the transferee's satisfaction of all of the transfer conditions set forth in the franchise agreement. In other words, the effectiveness of the consent to transfer agreement should be made expressly contingent on the parties' satisfaction of all applicable transfer conditions at or prior to the time of the assignment (unless the franchisor agrees to some other time period).

VII. CONCLUSION

The laws, regulations and practical considerations involving franchise transfers are more complex than initial franchise sales. The process combines franchise registration and disclosure considerations with the impact of franchise relationship laws, along with an overlay of contractual and tort law application, often involving third parties. Managing a transfer process requires close attention to detail and the ability to be sensitive to many competing concerns. We hope this paper assists franchise counsel in handling, processing and advising clients in the franchise transfer process.

²⁸⁶ If the franchisor has, in fact, elected to exercise a contractual right of first refusal to acquire the interests being transferred, then the franchisor would not sign a consent to transfer agreement; rather, the franchisor would need to provide notice of the exercise of its right of first refusal under the franchise agreement.

APPENDIX A

FTC RULE APPLICATION TO FRANCHISE TRANSFERS

A. THE FTC RULE.

The FTC's Franchise Rule (Part 436 – Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. Part 436, Jan. 23, 2007) addresses franchise transfers indirectly through certain definitional elements (the “**FTC Rule**”). Under the FTC Rule, a franchisor is required to provide presale disclosure through the furnishing of a franchise disclosure document only to prospective franchisees, in connection with the offer or sale of a franchise to be located in the United States of America (16 C.F.R. §436.2). The following definitions relate to how a franchise transfer is interpreted by the FTC for purposes of the obligation to furnish disclosure documents:

“**Franchisee** means any person who is granted a franchise.” 16 C.F.R. §436.1(i)

“**Franchise seller** means a person that offers for sale, sells, or arranges for the sale of a franchise. It includes the franchisor and the franchisor's employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities. It does not include existing franchisees who sell only their own outlet and who are otherwise not engaged in franchise sales on behalf of the franchisor.” 16 C.F.R. §436.1(j)

“**Franchisor** means any person who grants a franchise and participates in the franchise relationship.” 16 C.F.R. §436.1(k)

“**Prospective franchisee** means any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship.” 16 C.F.R. §436.1(r)

“**Sale of a franchise** includes an agreement whereby a person obtains a franchise from a franchise seller for value by purchase, license, or otherwise. It does not include extending or renewing an existing franchise agreement where there has been no interruption in the franchisee's operation of the business, unless the new agreement contains terms and conditions that differ materially from the original agreement. It also does not include the transfer of a franchise by an existing franchisee where the franchisor has had no significant involvement with the prospective transferee. A franchisor's approval or disapproval of a transfer alone is not deemed to be significant involvement.” 16 C.F.R. §436.1(t)

B. FTC STATEMENT OF BASIS AND PURPOSE

The FTC explained its position on the regulation of franchise transfers in its Statement of Basis and Purpose accompanying the FTC Rule (see 72 Fed. Reg. 15, 445 at III.A.20) reproduced below with the accompanying footnotes:

20. Section 436.1(t): Sale of a franchise

The part 436 disclosure obligations are triggered only when there is an offer for the sale of a franchise.²⁸⁷ Section 436.1(t) defines the term “sale of a franchise” as follows:

an agreement whereby a person obtains a franchise from a franchise seller for value by purchase, license, or otherwise. It does not include extending or renewing an existing franchise agreement where there has been no interruption in the franchisee’s operation of the business, unless the new agreement contains terms and conditions that differ materially from the original agreement. It also does not include the transfer of a franchise by an existing franchisee where the franchisor has had no significant involvement with the prospective transferee. A franchisor’s approval or disapproval of a transfer alone is not deemed to be significant involvement.

Like the original Rule provision, the final amended provision embodies the concept that franchisees extending or renewing an existing franchise agreement, where there is no interruption in business operations, will not be deemed to be entering into a sale, unless their new agreement contains terms and conditions materially different from their original agreement.²⁸⁸

The final amended Rule provision differs substantially from the provision as proposed in the FTC’s Notice of Proposed Rulemaking²⁸⁹ because it incorporates the Commission policy, as stated in the Interpretive Guides, that the term “sale of a franchise” does not encompass the transfer of a franchise by an existing franchisee where the prospective purchaser has no significant contact with the franchisor.²⁹⁰ Under long-standing Commission policy, a franchisor or subfranchisor must provide disclosures to **prospective franchisees**, but “a person who purchases an existing franchise directly from the franchisee who owns it, without significant contact with the franchisor, is not a prospective franchisee.”²⁹¹ Where a franchisor is not involved in the private sale of an existing franchise, the franchisor makes no representations to the prospective new purchaser. If there is any fraud in the private sale, it could be only by the current franchisee owner, and pre-sale disclosure by the franchisor would not likely prevent it. Accordingly, section 436.1(t) of part 436 makes clear that a transfer without significant involvement of the franchisor is not the sale of a franchise within the ambit of the Rule. Further, the franchisor’s mere approval or

²⁸⁷ See 16 C.F.R. § 436.2 (2007).

²⁸⁸ See *Id.* § 436.1(t); see also Fed. Trade Comm’n, Interpretive Guides, 44 Fed. Reg. 49,966, 49,969 (Aug. 24, 1979).

²⁸⁹ Franchise Rule, 64 Fed. Reg. 57,294, 57,333 (Oct. 22, 1999) (to be codified at 16 C.F.R. pt 436).

²⁹⁰ See 16 C.F.R. § 436.1(t); see also Interpretive Guides, 44 Fed. Reg. at 49,969.

²⁹¹ Interpretive Guides, 44 Fed. Reg. at 49,969.

disapproval of the purchaser alone is not considered to be significant involvement.²⁹²

C. **FTC COMPLIANCE GUIDE**

The FTC also provides further guidance in its Compliance Guide (<http://www.business.ftc.gov/documents/bus70-franchise-rule-compliance-guide>). On page 18 of the Compliance Guide the FTC explains its view of the franchisor's disclosure obligations when an existing franchisee transfers its franchise:

What Happens When an Existing Franchisee Sells His or Her Outlet?

A transferee – a person who purchases an existing franchise directly from the franchisee who owns it, without any significant contact with the franchisor – is not a prospective franchisee. Even if the franchisor has, and exercises, the right to approve or disapprove a subsequent sale (transfer) of a franchised unit, the transferee will not be entitled to receive disclosures unless the franchisor plays some more significant role in the sale. For example, if the franchisor provides financial performance information to the prospective transferee, the franchisor would be required to provide the transferee with its disclosure document.

The FTC Rule, however, makes clear that for purposes of Item 19, financial performance information does not include actual operating results for the franchise to be transferred:

(4) If a franchisor wishes to disclose only the actual operating results for a specific outlet being offered for sale, it need not comply with this section, provided the information is given only to potential purchasers of that outlet. 16 C.F.R. §436.5(s)(4).

²⁹² See *id.* at 49,969-49,970. In contrast, a franchisor who actively participates in a franchise transfer must make disclosures to a potential transferee, no less than to a prospective franchisee. In such an event, the prospective transferee may rely on the franchisor's representations in deciding to purchase the franchise, and therefore, should receive the benefit of pre-sale disclosure.

APPENDIX B

SUMMARY OF STATE LAWS ON APPLICATION OF REGISTRATION/DISCLOSURE TO FRANCHISE TRANSFERS

Several states have statutory or rule exemptions for the application of their franchise registration and disclosure laws on transfers of franchises by an existing franchisee to a purchaser. The applicable excerpts from these statutes and rules are set forth below with their citation and a notation as to whether the exemption applies to registration and disclosure (“**both R&D**”) or registration only (“**R only**”).

CALIFORNIA

Citation: CAL. CORP. CODE § 31102 (2014); Bus. Franchise Guide (CCH) ¶ 3050.26.

Exemption: R&D

The offer or sale of a franchise by a franchisee for his own account or the offer or sale of the entire area franchise owned by a subfranchisor for his own account, is exempted from the provisions of Section 31110 if the sale is not effected by or through a franchisor. A sale is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove a different franchisee.

HAWAII

Citation: HAW. REV. STAT. § 482E-4(a)(7) (2014); Bus. Franchise Guide (CCH) ¶ 3110.04.

Exemption: R&D

Sections 482E-3, 482E-5(a) and 482E-5(c) shall not apply to:

(7) the offer or sale of a franchise by a franchisee for the franchisee’s own account, or the issuance of a new franchise agreement pursuant to a sale by a franchisee for the franchisee’s own account, if the sale is an isolated sale and not part of a plan of distribution of franchises.

ILLINOIS

Citation: 815 ILL. COMP. STAT. 705/7 *et. Seq.* (2014); Bus. Franchise Guide (CCH) ¶ 3130.07.

Exemption: R&D

There shall be exempted from the provisions of Sections 5, 10, 11, 13 and 15 of [the Illinois Franchise Disclosure Act of 1987] the offer or sale of a franchise by a franchisee for its own account if the sale is not effected by or through a franchisor. A sale is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove a different franchisee or requires payment of a reasonable transfer fee or requires the new franchisee to execute a franchise agreement on terms not materially different from the existing franchise agreement.

INDIANA

Citation: IND. CODE § 23-2-2.5-4 (2014); Bus. Franchise Guide (CCH) ¶3140.04.

Exemption: R&D

The offer of [or] sale of a franchise by a franchisee who is not an affiliate of the franchisor for his own account is exempt from Section 9 [of the Indiana Code] if the offer or sale is not effected by or through a franchisor. A sale is not effected by or through a franchisor if a franchisor is entitled to approve or disapprove a different franchisee.

MARYLAND

Citation: MD. CODE ANN., BUS. REG. § 14-214(c)(1) (2014); Bus. Franchise Guide (CCH) ¶ 3200.14.

Exemption: R only

The registration requirement of [Section 14-214 of the Annotated Code of Maryland] does not apply to the offer to sell or sale of a franchise by a franchisee for the franchisee's own account, or the offer to sell or sale of the entire area franchise owned by a subfranchisor for the subfranchisor's own account.

MICHIGAN

Citation: MICH. COMP. LAWS § 445.1506 Sec. 6(1)(f) (2014); Bus. Franchise Guide (CCH) ¶ 3220.06.

Exemption: R&D

Except as provided in subsection (2), the offer and sale of a franchise is exempt from sections 7a and 8 if any of the following circumstances apply:

(f) the offer or sale of a franchise by a franchisee for the franchisee's own account if all of the following conditions are met:

(i) the sale is an isolated sale, and not part of a plan of distribution of franchises; and

(ii) the franchisee provides to the prospective purchaser full access to the books and records related to the franchise in actual or constructive possession of the franchisee. (Section 445.1506. Section. 6(1)(f) of the Michigan Franchise Investment Law)

MINNESOTA

Citation: MINN. STAT. § 80C.03(a) (2014); Bus. Franchise Guide (CCH) ¶ 3230.03.

Exemption: R only

The registration requirement imposed by section 80C.02 [of the Minnesota Statutes] shall not apply to the following provided that the method of offer or sale is not used for the purpose of evading sections 80C.01 to 80C.22:

(a) the offer or sale of a franchise owned by that franchisee, or the offer or sale of the entire area franchise owned by the subfranchisor making the offer or sale if the sale is not effected by or through a franchisor; provided, however, that no person shall make more than one sale during any period of 12 consecutive months of a franchise or area franchise granted by a single franchisor. A sale is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove a different franchisee;

NEW YORK

Citation: N.Y. GEN. BUS. LAW § 684.5 (2014); Bus. Franchise Guide (CCH) ¶ 3220.05.

Exemption: R&D

The offer or sale of a franchise by a franchisee for his own account or the offer and sale of an entire area franchise owned by a subfranchisor for his own account is exempted from the registration provisions of section six hundred eighty-three of this article if:

(a) the sale is an isolated sale and not part of a plan of distribution of franchises; and (b) the sale is not effected by or through a franchisor; and (c) the franchisee furnishes to the prospective purchaser, at least one week prior to the execution of any binding contract or purchase agreement, or at least one week prior to the receipt of any consideration, whichever occurs first, a copy of the offering prospectus of the franchisor (including amendments, if any) currently registered with the [New York Department of Law].

A sale is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove a different franchisee.

NORTH DAKOTA

Citation: N.D. CENT. CODE § 51-19-04.2 (2014); Bus. Franchise Guide (CCH) ¶ 3340.04.

Exemption: R only (modified disclosure)

The offer or sale of a franchise by a franchisee for his own account or the offer or sale of the entire area franchise owned by a subfranchisor for his own account is exempted from the provisions of Section 51-19-03 if the sale is not effected by or through a franchisor; provided, however, that no subfranchisor may offer or sell a franchise under this subsection without first obtaining the written approval of the commissioner. The commissioner may require that the subfranchisor and the

franchisor provide the prospective purchaser and the commissioner with such information and disclosures as he deems necessary or appropriate to carry out the purposes of this chapter. A sale is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove a different franchisee.

OREGON

Citation: OR. ADMIN. R. § 441-325-0030(4)(a)-(d) (2014); Bus. Franchise Guide (CCH) ¶ 5370.03.

Exemption: R&D

(4) The sale or offer to sell is a sale or offer to sell by a franchisee for the franchisee's own account of a franchise or an entire franchise if:

(a) The sale or offer to sell is not effected by or through the franchisor. A sale is not effected by or through a franchisor merely because the franchisor has a right to approve or disapprove a different franchisee, requires the tender of a reasonable transfer fee, or requires appropriate documents executed;

(b) The franchisor does not aid in the sale;

(c) The sale is an isolated sale, and not a part of a plan of distribution of franchises; and

(d) At least 14 calendar days before the prospective purchaser executes any agreement with the franchisor relating to the sale, or tenders or is required to tender to the franchisee any consideration for the franchise or area franchise including any refundable deposit, whichever occurs first, the selling franchisee or subfranchisor has provided the prospective purchaser full access to the books, records, and disclosure documents of the franchise business.

Citation: OR. ADMIN. R. § 441-325-0040 (2014); Bus. Franchise Guide (CCH) ¶ 5370.04.

Exemption: R&D

The offer or sale of a franchise by a franchisee for his own account or the offer or sale of the entire area franchise owned by a subfranchisor for his own account, is exempted from the provisions of ORS chapter 650 if sale is not effected by or through a franchisor, and the franchisor does not participate or aid in the sale thereof. A sale is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove a different franchisee.

RHODE ISLAND

Citation: R.I. GEN. LAWS §19-28.1-6(b) (2014); Bus. Franchise Guide (CCH) ¶ 3390.06.

Exemption: R only

The following transaction is exempt from the provisions of §19-28 1-5:

(b) the offer or sale of a franchise by a franchisee who is not an affiliate of the franchisor for the franchisee's own account if the franchisee's entire franchise is sold and the sale is not effected by or through the franchisor. A sale is not effected by or through a franchisor merely because a franchisee signs agreements with terms which do not materially differ from the agreements with the existing franchisee or because a franchisor has a right to approve or disapprove the sale or requires payment of a reasonable transfer fee. This exemption applies to the offer or sale of a master franchise if the entire master franchise is sold.

SOUTH DAKOTA

Citation: S.D. CODIFIED LAWS § 37-5B-1(28) (2014); Bus. Franchise Guide (CCH) ¶ 3411.01.

Exemption: R&D by definition

Terms used in this Act, unless the context otherwise requires, mean:

(28) "Sale of a franchise," any agreement whereby a person obtains a franchise from a franchise seller for value by purchase, license, or otherwise. ... The term also does not include the transfer of a franchise by an existing franchisee if the franchisor has had no significant involvement with the prospective transferee. A franchisor's approval or disapproval of a transfer alone is not deemed to be significant involvement;

VIRGINIA

Citation: 21 VA. ADMIN. CODE § 5-110-75 (2014); Bus. Franchise Guide (CCH) ¶ 5460.075.

Exemption: R only

Any offer or sale of a franchise in a transaction that meets the requirements of this section is exempt from the registration requirement of §13.1-560 of the Act.

1. Sale or transfer by existing franchisee. The sale or transfer of a franchise by a franchisee who is not an affiliate of the franchisor for the franchisee's own account is exempt if:

a. The franchisee's entire franchise is sold or transferred and the sale or transfer is not effected by or through the franchisor.

b. The sale or transfer is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove the sale or transfer or requires payment of a reasonable transfer fee.

WASHINGTON

Citation: WASH. REV. CODE § 19.100.030(1) (2014); Bus. Franchise Guide (CCH) ¶ 3470.03.

Exemption: R only

The registration requirements of this chapter shall not apply to:

(1) the offer or sale or transfer of a franchise by a franchisee who is not an affiliate of the franchisor for the franchisee's own account if the franchisee's entire franchise is sold and the sale is not effected by or through the franchisor. A sale is not effected by or through a franchisor merely because a franchisor has the right to approve or disapprove the sale or requires payment of a reasonable transfer fee. Such right to approve or disapprove the sale shall be exercised in a reasonable manner.

WISCONSIN

Citation: WIS. STAT. § 553.23 (2014); Bus. Franchise Guide (CCH) ¶ 3490.05.

Exemption: R only

The sale of a franchise by a franchisee for the franchisee's own account and the sale of the entire area franchise owned by a subfranchisor for the subfranchisor's own account are exempted from s. 553.21 if the sale is not effected by or through a franchisor. A sale is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove a different franchisee or because a franchisor imposes or has the right to impose a fee or charge to reimburse the franchisor for reasonable and actual expenses incurred in connection with the sale.

APPENDIX C

**SUMMARY OF LAWS REGULATING FRANCHISE TRANSFERS
ON FRANCHISORS**

The following states have statutes regulating the conduct of franchisors in the context of the transferring of a franchise from an existing franchisee to a purchaser. The following is the statute, citation, and a summary of the statutory terms.

State & Citation	Transfer Restrictions on Franchisor	Summary of Transfer Restrictions on Franchisor
<p>Arkansas</p> <p>ARK. CODE ANN. § 4-72-205(b)(1)-(2) (2014); Bus. Franchise Guide (CCH) ¶ 4040.05.</p>	<p>The franchisor shall within sixty (60) days after receipt of the notice either approve in writing to the franchisee the sale to the proposed transferee or by written notice advise the franchisee of the unacceptability of the proposed transferee, setting forth a material reason relating to the character, financial ability, or business experience of the proposed transferee. If the franchisor does not reply within the specified sixty days, his approval is deemed granted.</p>	<p>Franchisor must either approve or disapprove Transfer within 60 days of notice from Franchisee. Must provide material reasons for refusal to approve Transfer. Approval is deemed granted if Franchisor does not respond within 60 days.</p>
<p>California</p> <p>California Franchise Relations Act, CAL. BUS. & PROF. CODE § 20027 (West 2013); Bus. Franchise Guide (CCH) ¶ 4050.161.</p>	<p>(a) No franchisor shall deny the surviving spouse, heirs, or estate of a deceased franchisee or the majority shareholder of the franchisee the opportunity to participate in the ownership of the franchise under a valid franchise agreement for a reasonable time after the death of the franchisee or majority shareholder of the franchisee. During that time the surviving spouse, heirs, or estate of the deceased shall either satisfy all of the then current qualifications for a purchaser of a franchise or sell, transfer, or assign the franchise to a person who satisfies the franchisor's then current standards for new franchisees. The rights granted pursuant to this section shall be granted subject to the surviving spouse, heirs or estate of the deceased maintaining all standards and obligations of the franchise.</p> <p>(b) Nothing in subdivision (a) shall prohibit a franchisor from exercising the right of first refusal to purchase a franchise after receipt of a bona fide offer to purchase the franchise by a proposed purchaser of the franchise.</p> <p>(c) This article shall not apply to any agreement or contract in effect prior to January 1, 1984, except an agreement or contract of an indefinite duration. This section shall not apply to any bequest or intestate succession that took effect prior to January 1, 1984.</p>	<p>Statute specifically authorizes franchisors to exercise rights of first refusal. Otherwise, the statute focuses on succession after a franchisee's or majority shareholder of a franchisee's death. A franchisor cannot prevent the surviving spouse, heirs or estate from participating in franchise ownership for a reasonable time after death. During that time, the survivor must satisfy all of the franchisor's qualifications itself, or sell to a transferee who does. The rights are subject to the survivor maintaining all standards and obligations of the franchise.</p>
<p>Hawaii</p> <p>HAW. REV. STAT.</p>	<p>For the purposes of this chapter and without limiting its general application, it shall be an unfair or deceptive act or practice or an unfair method of competition for a franchisor or subfranchisor to:</p>	<p>Franchisor must have good cause to refuse Transfer of franchise. Good cause includes proposed Buyer's failure to meet reasonable</p>

State & Citation	Transfer Restrictions on Franchisor	Summary of Transfer Restrictions on Franchisor
<p>§ 482E-6(2)(l)(i)-(iv) (2014); Bus. Franchise Guide (CCH) ¶ 4110.01.</p>	<p>Refuse to permit a transfer of ownership of a franchise, or of a proprietorship, partnership, corporation or other business entity that is a franchisee or subfranchisor, except for good cause. For purposes of this paragraph good cause shall include, but not be limited to:</p> <p>(i) The failure of a proposed transferee to meet any of the franchisor's or subfranchisor's reasonable qualifications or standards then in effect for a franchisee or subfranchisor;</p> <p>(ii) The fact that the proposed transferee or any affiliated person of the proposed transferee is a competitor of the franchisor or subfranchisor;</p> <p>(iii) The inability or unwillingness of the proposed transferee to agree in writing to comply with and be bound by all lawful obligations imposed by the franchise, including without limitation all instruction and training obligations, and to sign the current form of franchise agreement used by the franchisor or subfranchisor; and</p> <p>(iv) The failure of the franchisee or proposed transferee to pay any sums owing to the franchisor and to cure any default in the franchise agreement or other agreements with the franchisor existing at the time of the proposed transfer.</p> <p>A franchisor or subfranchisor shall have thirty days after being notified in writing of a proposed transfer to approve or disapprove in writing a proposed transfer of ownership or control of a franchise, or of a proprietorship, partnership, corporation or other business entity that is a franchisee or subfranchisor, stating its reason for disapproval. If a franchisor or subfranchisor fails to approve or disapprove a proposed transfer in writing within such period, the franchisor or subfranchisor shall be deemed to have approved such transfer.</p>	<p>qualifications or standards or that proposed transferee is a competitor, or its refusal to agree to comply with lawful obligations opposed by Franchisor, or failure to pay monies owed or cure defaults. Franchisor' failure to respond in writing within 30 days of receipt of notice of proposed Transfer is deemed an approval of the Transfer.</p>
<p>Indiana</p> <p>IND. CODE § 23-2-2.7-2(3) (2014); Bus. Franchise Guide (CCH) ¶ 4140.02.</p>	<p>It is unlawful for any franchisor who has entered into any franchise agreement with a franchisee who is either a resident of Indiana or a nonresident operating a franchise in Indiana to engage in any of the following acts and practices in relation to the agreement:</p> <p>(3) Denying the surviving spouse, heirs, or estate of a deceased franchisee the opportunity to participate in the ownership of the franchise under a valid franchise agreement for a reasonable time after the death of the franchisee, provided that the surviving spouse, heirs, or estate maintains all standards and obligations of the franchise.</p>	<p>Franchisor cannot refuse to permit the franchise to be transferred to the surviving spouse, heirs or estate of a deceased Franchisee. Franchisor must provide them the opportunity to participate in the ownership of the franchise under valid Franchise Agreement for a reasonable period of time after the death of the Franchisee, provided that the surviving spouse, heirs or estate maintains all the obligations of the franchise.</p>

State & Citation	Transfer Restrictions on Franchisor	Summary of Transfer Restrictions on Franchisor
<p>Iowa</p> <p>IOWA CODE § 523H.5.1 (2014); Bus. Franchise Guide (CCH) ¶ 4150.05.</p> <p>IOWA CODE § 523H.5.4 (2014); Bus. Franchise Guide (CCH) ¶ 4150.05.</p> <p>IOWA CODE § 523H.5.7 (2014); Bus. Franchise Guide (CCH) ¶ 4150.05.</p> <p>IOWA CODE § 523H.5.8 (2014); Bus. Franchise Guide (CCH) ¶ 4150.05.</p>	<p>1. A franchisee may transfer the franchised business and franchise to a transferee, provided that the transferee satisfies the reasonable current qualifications of the franchisor for new franchisees. For the purposes of this section, a reasonable current qualification for a new franchisee is a qualification based upon a legitimate business reason. If the proposed transferee does not meet the reasonable current qualifications of the franchisor, the franchisor may refuse to permit the transfer, provided that the refusal of the franchisor to consent to the transfer is not arbitrary or capricious.</p> <p>4. A franchisee may transfer the franchisee's interest in the franchise, for the unexpired term of the franchise agreement, and a franchisor shall not require the franchisee or the transferee to enter into a new or different franchise agreement as a condition of the transfer.</p> <p>7. A transfer by a franchisee is deemed to be approved sixty days after the franchisee submits the request for consent to the transfer unless the franchisor withholds consent to the transfer as evidenced in writing, specifying the reason or reasons for withholding the consent. The written notice must be delivered to the franchisee prior to the expiration of the sixty-day period. Any such notice is privileged and is not actionable based upon a claim of defamation.</p> <p>8. A franchisor shall not discriminate against a proposed transferee of a franchise on the basis of race, color, national origin, religion, sex, or disability.</p>	<p>Franchisor cannot prohibit a Transfer if the Buyer satisfies Franchisor's reasonable current qualifications for new franchisees. Reasonable current qualifications include qualifications based upon legitimate business reasons, and which are not arbitrary or capricious.</p> <p>Franchisor must permit the transfer of Seller's unexpired term of the franchise and cannot require Buyer to sign a new or different franchise agreement as condition of transfer if an unexpired franchise.</p> <p>If Franchisor does not respond within 60 days of Seller's notice of proposed transfer, such Transfer is deemed approved.</p> <p>Iowa law restricts Franchisor's right to obtain releases in transfer situations and to discriminate against proposed transferees (the Buyer) based on race, color, national origin, religion, sex and disability. Numerous other restrictions apply to the Transfer of franchises in Iowa.</p>
<p>Michigan</p> <p>MICH. COMP. LAWS § 445.1527(g) (2014); Bus. Franchise Guide (CCH) ¶ 4220.01.</p>	<p>A provision which permits a franchisor to refuse to permit a transfer of ownership of a franchise, except for good cause. This subdivision does not prevent a franchisor from exercising a right of first refusal to purchase the franchise. Good cause shall include, but is not limited to:</p> <p>(i) The failure of the proposed transferee to meet the franchisor's then current reasonable qualifications or standards.</p> <p>(ii) The fact that the proposed transferee is a competitor of the franchisor or subfranchisor.</p> <p>(iii) The unwillingness of the proposed transferee to</p>	<p>Franchisor cannot enforce a provision in a franchise agreement that permits it to refuse to permit a Transfer of the franchise for any cause other than "good cause." Good cause includes the failure of the propose Buyer to meet the Franchisor's then current reasonable qualifications or standards, the proposed transferee being a competitor of the Franchisor, the proposed transferee's unwillingness to agree</p>

State & Citation	Transfer Restrictions on Franchisor	Summary of Transfer Restrictions on Franchisor
	<p>agree in writing to comply with all lawful obligations.</p> <p>(iv) The failure of the franchisee or proposed transferee to pay any sums owing to the franchisor or to cure any default in the franchise agreement existing at the time of the proposed transfer.</p>	<p>in writing to comply with all lawful obligations imposed by Franchisor, and the proposed Seller's failure to pay any sums owing to the Franchisor or cure defaults under the franchise agreement.</p>
<p>Minnesota</p> <p>MINN. R. 2860.4400(H); Bus. Franchise Guide (CCH) ¶ 5230.31.</p>	<p>All franchise contracts or agreements and any other device or practice of a franchisor, shall conform to the following provisions. It shall be unfair and inequitable for any person to:</p> <p>unreasonably withhold consent to any assignment, transfer, or sale of the franchise whenever the franchisee to be substituted meets the present qualifications and standards required of the franchisees of the particular franchisor;</p>	<p>Franchisor cannot unreasonably withhold its consent to the assignment, transfer or sale of franchise if the Buyer meets the Franchisor' present qualifications and standards for franchisees.</p>
<p>Nebraska</p> <p>NEB. REV. STAT. § 87-405 (2014); Bus. Franchise Guide (CCH) ¶ 4270.05.</p>	<p>The franchisor shall within sixty days after receipt of [the franchisee's proposed transfer] either approve in writing to the franchisee such sale to the proposed transferee, or by written notice advise the franchisee of the unacceptability of the proposed transferee setting forth material reasons relating to the character, financial ability or business experience of the proposed transferee. If the franchisor does not reply within the specified sixty days, his approval is deemed granted. No such transfer, assignment or sale shall be valid unless the transferee agrees in writing to comply with all the requirements of the franchise then in effect.</p>	<p>Franchisor must respond within 60 days of Seller's notice of the proposed Transfer. If Franchisor does not respond with 60 days, the proposed Transfer is deemed approved. Any denial of the proposed Transfer must include grounds setting forth unacceptability of the proposed Buyer and the material reasons for disapproving the proposed Buyer.</p>
<p>N.J. STAT. ANN. § 56:10-6 (2014); Bus. Franchise Guide (CCH) ¶ 4300.06.</p>	<p>It shall be a violation of this act for any franchisee to transfer, assign or sell a franchise or interest therein to another person unless the franchisee shall first notify the franchisor of such intention by written notice setting forth in the notice of intent the prospective transferee's name, address, statement of financial qualification and business experience during the previous 5 years. The franchisor shall within 60 days after receipt of such notice either approve in writing to the franchisee such sale to proposed transferee or by written notice advise the franchisee of the unacceptability of the proposed transferee setting forth material reasons relating to the character, financial ability or business experience of the proposed transferee. If the franchisor does not reply within the specified 60 days, his approval is deemed granted. No such transfer, assignment or sale hereunder shall be valid unless the transferee agrees in writing to comply with all the requirements of the</p>	<p>Franchisor must respond within 60 days of Seller's notice or the proposed transfer is deemed approved, Any denial of the proposed Transfer must include grounds setting forth unacceptability of the proposed Buyer and material reasons for disapproving the proposed Buyer.</p>

State & Citation	Transfer Restrictions on Franchisor	Summary of Transfer Restrictions on Franchisor
	franchise then in effect.	
Washington WASH. REV. CODE § 19.100.030(1) (2014); Bus. Franchise Guide (CCH) ¶ 3470.03.	The registration requirements of this chapter shall not apply to: (1) The offer or sale or transfer of a franchise by a franchisee who is not an affiliate of the franchisor for the franchisee's own account if the franchisee's entire franchise is sold and the sale is not effected by or through the franchisor. A sale is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove the sale or requires payment of a reasonable transfer fee. Such right to approve or disapprove the sale shall be exercised in a reasonable manner.	Franchisor must exercise right of approval in a reasonable manner.

The Director of the Securities Division of the Washington Department of Financial Institutions has issued an interpretive statement relating to restrictions on the transfer of franchises. The interpretive statement, as published in the Business Franchise Guide (CCH), ¶ 5470.76, is reproduced below:

No. FIS-2. *Question Presented:*

What restrictions on transfer of a franchise by a franchisee may be allowed consistent with RCW 19.100.180?

Discussion:

Many franchise agreements include provisions restricting transfer of the franchise by the franchisee. These provisions often prohibit certain types of transfers, create rights of first refusal in favor of the franchisor, or require consent of the franchisor prior to the transfer. The transfer restrictions often require payment of fees and the signing of the current franchise agreement. The restrictions on transfer may be so severe that they greatly reduce or eliminate the value of the franchise to the franchisee. The provisions in the franchise agreement may allow the franchisor unlimited discretion to decide whether to allow a transfer.

Transfers of franchises can be categorized in two ways: whether a transfer is voluntary or involuntary and whether a transfer is of the entire interest in a franchise or of less than the entire interest in the franchise.

Involuntary Transfers

The permissibility of some involuntary transfers has already been specifically dealt with in the statute itself or in other interpretive statements. RCW 19.100.180(2)(j) permits the franchisor to terminate a franchise without prior notice if the franchisee is adjudicated bankrupt or insolvent. This provision is, of course, subject to the provisions of the federal Bankruptcy Act. The issue of transfer of the franchise upon death of the franchisee has already been dealt with in Franchise Act Interpretive Statement FIS-3. Other involuntary transfers should be viewed in a similar manner. Examples

include property division in marriage, dissolutions, imposition of guardianships, and other court ordered transactions.

Voluntary Transfers

Voluntary, either complete or partial, transfers of a franchise by the franchisee and voluntary transfers of ownership interests in the franchise are often subject to restrictions in the franchise agreement. In order to meet the good faith standard of subsection (1) and the fair practices standard of (2)(c) and (h) of RCW 19.100.180, the restrictions on transfer in the franchise agreement may not allow the franchisor to unreasonably withhold its consent to a transfer or otherwise unreasonably restrict transfer. In this context, it is unreasonable for a franchisor to withhold consent to any transfer where the transferee meets the franchisor's criteria for purchase of an initial franchise. For example, if the franchisor will initially sell its franchises to corporations, it may not prohibit a franchisee from incorporating and may not prohibit the franchisee from transferring the franchise to a corporate franchisee. The same principle applies to restrictions on transfer of the stock of a corporate franchisee and transfer of less than the entire interest of the franchise. In addition to the "initial franchisee" criteria used by the franchisor, franchise agreement provisions which require personal participation of the franchisee in the franchise business are relevant in determining whether restrictions of transfers are reasonable.

Transfer Fee and Release Requirements

Franchisors may also attempt to restrict transfers indirectly by imposing exorbitant transfer fees and requiring the transferor to sign a release of all claims against the franchisor. The transferee may be required to sign the current franchise agreement rather than take an assignment of the franchisee's existing agreement.

Restrictions on transfer may only be imposed in good faith and must be reasonable. RCW 19.100.180(1) and (2)(h). Transfer fees are permissible only to the extent they compensate the franchisor for expenses directly incurred as a result of transfer. The franchise agreement may specify the amount of the transfer fee so long as such amount is a reasonable estimate of anticipated transfer expenses. The requirement of a release by the franchisee to the franchisor is acceptable so long as it does not include a release of the franchisee's claims under the Washington Franchise Investment Protection Act. Requiring inclusion of such claims in the release violates RCW 19.100.180(2)(g).

APPENDIX D

**SUMMARY OF LAWS REGULATING FRANCHISE TRANSFERS
ON FRANCHISEES**

The following states have statutes regulating the conduct of franchisees in the context of the transferring of a franchise from an existing franchisee to a purchaser. The following is the statute, citation, and a summary of the statutory terms.

State & Citation	Transfer Restrictions on Franchisee	Summary of Transfer Restrictions on Franchisee
Arkansas ARK. CODE ANN. § 4-72-205(a) (2014); Bus. Franchise Guide (CCH) ¶ 4040.05.	It shall be a violation of this subchapter for any franchisee to transfer, assign, or sell a franchise or interest therein to another person unless the franchisee first notifies the franchisor of that intention by written notice, setting forth in the notice of intent the prospective transferee's name, address, statement of financial qualification, and business experience during the previous five (5) years.	Franchisee must give Franchisor prior written notice of its intent to transfer, including transferee's name, address, qualification and business experience during previous 5 years.
Iowa IOWA CODE § 523H.5.5 (2014); Bus. Franchise Guide (CCH) ¶ 4150.05.	A franchisee shall give the franchisor no less than sixty days' written notice of a transfer which is subject to the provisions of this section, and on request from the franchisor shall provide in writing the ownership interests of all persons holding or claiming an equitable or beneficial interest in the franchise subsequent to the transfer or the franchisee, as appropriate. A franchisee shall not circumvent the intended effect of a contractual provision governing the transfer of the franchise or an interest in the franchise by means of a management agreement, lease, profit-sharing agreement, conditional assignment, or other similar device.	Franchisee must give Franchisor not less than 60 days written notice of proposed transfer.

State & Citation	Transfer Restrictions on Franchisee	Summary of Transfer Restrictions on Franchisee
<p>Nebraska</p> <p>NEB. REV. STAT. § 87-405 (2014); Bus. Franchise Guide (CCH) ¶ 4270.05.</p>	<p>It shall be a violation of sections 87-401 to 87-410 for any franchisee to transfer, assign or sell a franchise or interest therein to another person unless the franchisee shall first notify the franchisor of such intention by written notice by certified mail setting forth in the notice of intent the prospective transferee's name, address, statement of financial qualification and business experience during the previous five years. The franchisor shall within sixty days after receipt of such notice either approve in writing to the franchisee such sale to the proposed transferee, or by written notice advise the franchisee of the unacceptability of the proposed transferee setting forth material reasons relating to the character, financial ability or business experience of the proposed transferee. If the franchisor does not reply within the specified sixty days, his approval is deemed granted. No such transfer, assignment or sale shall be valid unless the transferee agrees in writing to comply with all the requirements of the franchise then in effect.</p>	<p>Franchisee must give 60-day advance written notice to Franchisor of its intent to transfer, assign or sale the franchise, or an interest in it. This Notice must include the proposed Buyer's name, address, financial capabilities, work experience, etc.</p> <p>Proposed Buyer must agree in writing to comply with all the requirements of the franchise then in effect.</p>
<p>New Jersey</p> <p>N.J. STAT. ANN. § 56:10-6 (2014); Bus. Franchise Guide (CCH) ¶ 4300.06.</p>	<p>It shall be a violation of this act for any franchisee to transfer, assign or sell a franchise or interest therein to another person unless the franchisee shall first notify the franchisor of such intention by written notice setting forth in the notice of intent the prospective transferee's name, address, statement of financial qualification and business experience during the previous 5 years. The franchisor shall within 60 days after receipt of such notice either approve in writing to the franchisee such sale to proposed transferee or by written notice advise the franchisee of the unacceptability of the proposed transferee setting forth material reasons relating to the character, financial ability or business experience of the proposed transferee. If the franchisor does not reply within the specified 60 days, his approval is deemed granted. No such transfer, assignment or sale hereunder shall be valid unless the transferee agrees in writing to comply with all the requirements of the franchise then in effect.</p>	<p>Franchisee must give 60-day advance written notice to Franchisor of its intent to transfer, assign or sale the franchise, or an interest in it. Notice must include the proposed Buyer's name, address, financial capabilities, work experience, etc.. Buyer must agree in writing to comply with all the requirements of the franchise then in effect.</p>

APPENDIX E

ASSIGNMENT, TRANSFER, AND RIGHT OF FIRST REFUSAL SAMPLE PROVISIONS

THESE MODEL PROVISIONS ARE ONLY A STARTING POINT. EACH SHOULD BE MODIFIED, CUSTOMIZED, SUPPLEMENTED, AND REVISED TO FIT PARTICULAR CIRCUMSTANCES AND NEEDS.

LIMITATIONS ON ASSIGNMENT.

##.1 Consent Required. To assure your continued personal responsibility for the operation of the Franchised Business and to protect the Name, Marks, Method, goodwill, and reputation and the Other Proprietary Information for the benefit of us, our Interested Parties, and all franchisees, neither all nor any part of your interest in this Franchise Agreement, the Franchised Business, or the Franchise Location shall be assigned, sold, transferred, encumbered, or otherwise disposed of, voluntarily or by operation of law, without our prior written consent, which we may withhold in our sole and absolute discretion or condition on fulfillment of any conditions we choose.

##.2 Deemed Transfers. The following shall be deemed to be transfers requiring consent under this Article: (a) any transfer to a corporation, partnership, limited liability company, or other entity or any conversion of an entity to a different form of entity; (b) if you are a corporation or limited liability company, (i) any conversion, dissolution, merger, consolidation, or other reorganization, (ii) any issuance, sale, or other transfer of any shares or membership units in an amount sufficient to affect voting control or to a person or entity that is not an existing shareholder or member, (iii) any sale of assets not in the ordinary course of business, or (iv) any change in the chief executive, operating, or financial officer or any manager; (c) if you are a partnership, any change in or withdrawal of any partner or conversion, merger, consolidation, or other reorganization or any dissolution of the partnership; and (d) if you consist of more than one person, any transfer from one person to any other.

##.3 Additional Conditions.

A. Without limiting the complete discretion granted to us in Section *.1, in addition to the conditions in Section ##.1, our consent to an assignment, sale, transfer, or other disposition of your interest in this Franchise Agreement or the Franchised Business or your conversion to a corporation or limited liability company may be conditioned on any or all of the following: (i) all the shares of stock or units of membership of the corporation or company being owned by the same individuals and in the same proportions as interests in the Franchised Business are presently owned or our consenting to the transfer of a portion of the shares or units to holders other than you and you agreeing in writing to own legally and beneficially a majority of the shares or units at all times during the term of this Franchise Agreement; (ii) the certificates evidencing shares or units bearing an appropriate legend prominently disclosing the existence of the restrictions on transfer contained in this Franchise Agreement; (iii) you or your principal executive officer agreeing to serve as the principal executive officer of the corporation or manager of the corporation or company at all times during the term of this Franchise Agreement; and (iv) each shareholder or member executing a personal guarantee of the corporation or company's obligations to us.

B. Without limiting the complete discretion granted to us in Section *.1, in addition to the conditions in Section ##.1 and any other conditions, our consent to an assignment, sale, transfer, or other disposition of your interest in this Franchise Agreement or the Franchised Business or your conversion to a partnership may be conditioned on any or all of the following: (i) our approval of the composition of the partnership and the business acumen, aptitude, experience, financial stability or responsibility, and other relevant characteristics of each partner; (ii) the execution of a written partnership agreement that provides that no interest in the partnership shall be transferred or change in partnership composition made without our prior written consent and approval; and (iii) the partnership being a general partnership.

##.4 Effect; Information.

A. Any attempt to assign, sell, transfer, encumber, or otherwise dispose of any interest in this Franchise Agreement or the Franchised Business other than in accordance with the provisions of this Franchise Agreement shall be null and void. Our consent to one assignment, sale, transfer, encumbrance, or other disposition shall not be deemed a waiver of this provision or consent to any subsequent assignment, sale, transfer, encumbrance, or other disposition. Our approval of any proposed transfer by you shall not be construed as a representation or warranty by us that the terms or conditions of the proposed transfer are economically sound or that the proposed transferee will be capable of successfully conducting the Franchised Business.

B. We may, but are not obligated, to furnish any prospective transferee with copies of any financial information relating to the Franchised Business in our possession. We may, but are not obligated to inform any prospective transferee of any claimed uncured breach or default by you under this Franchise Agreement or any other agreement relating to the Franchised Business.

##.5 Transfer by Us. We may sell or assign all or any portion of our interest in this Franchise Agreement or the System to any person or entity who expressly assumes those obligations in writing at the time of the transfer. We may encumber all or any part of our interest in this Franchise Agreement or the System at any time.

##.0 RIGHT OF FIRST REFUSAL.

##.1 Right. If you propose to assign, sell, transfer, encumber, or otherwise dispose, with or without consideration, of all or any portion of your interest in this Franchise Agreement, the Franchised Business or, if you are an entity, any interest in you, you shall promptly give us written notice of the proposed assignment, sale, transfer, or other disposition, including a description of the interest of which you propose to dispose, the identity of the proposed transferee, the nature of the proposed disposition, and the proposed consideration, terms, and conditions, if any. Unless the transfer described in the notice is a conversion to a different form of entity without any change in equity ownership or a lifetime transfer to your spouse, domestic partner, or issue or the trustee of a trust the sole beneficiaries of which are you, your spouse, domestic partner, or issue, or some combination of them and will not result in any change in the day-to-day management of the Franchised Business, we or our nominee shall have the first right to acquire the interest described in your notice by giving you notice of the exercise of that right within 30 days after we receive your notice and all of the information described in this Section. The notice of exercise shall set a place and a date no less than 30 nor more than 120 days later for transfer to us or our nominee of the interest described in your notice in return for the consideration, if any, described in your notice, except that we or our nominee may substitute an equivalent sum of cash for any consideration other than cash. On the date and at the place

described in the notice of exercise, you shall deliver appropriate written evidence of transfer to us or our nominee of the interest described in your notice, subject to delivery by us or our nominee of the consideration, if any, described in your notice, as modified by this Section.

##.2 Non-Exercise. If we do not exercise the right of first refusal in Section ##.1, subject to the provisions of Articles # and #, you may dispose of the interest described in your notice to the party named in your notice, in the manner, for the consideration, if any, and on the terms and conditions, if any, in your notice; provided, however, that if the transfer is not made within 90 days after the expiration of the right of first refusal in Section ##.1, any subsequent disposition shall be deemed to be a disposition subject to that right of first refusal. Any change in the consideration, terms, and/or conditions in your notice shall constitute a new offer and require compliance with Section ##.1. Nothing contained in this Section ##.2 shall be deemed or construed to give you the right to dispose of any interest in this Franchise Agreement or the Franchised Business other than in compliance with Articles ## and ##.

##.0 RIGHT TO REQUIRE SALE ON DEATH, DISABILITY, OR DEADLOCK; RIGHT TO INTERIM MANAGER.

##.1 Right.

A. If you are (i) an individual and you die, are rendered incapable of attending to the Franchised Business for a period in excess of 60 days, are certified as mentally incompetent by a medical doctor duly licensed to practice medicine, or have a guardian or conservator appointed, or (ii) an entity or more than one individual and we deliver written notice that we have determined that a dispute has developed between or among the owners of the entity or you that is adversely affecting the Franchised Business (all, individually and collectively, an "Option Occurrence"), whether or not the Franchised Business has previously been transferred to a trust, we may require that you or your heirs, beneficiaries, personal representative, estate, guardian, conservator, or other successor in interest or the trustee of any trust (individually and collectively, "Your Successor") list with a licensed business opportunities broker qualified to sell franchised businesses and sell within 180 days for the best offer obtained within 120 days after listing, all of your interest in this Franchise Agreement, the Franchised Business, and the FFE, and lease, sublease, or otherwise grant the buyer the right to occupy the Franchise Location on terms acceptable to us (including, without limitation, the requirements of Section ##) for the balance of the term of this Franchise Agreement.

B. Within 10 days after any Option Occurrence described in Paragraph A(i), you or Your Successor shall deliver to us written notice of the Option Occurrence. We shall exercise the right given us in clause (i) of Paragraph A by giving you or Your Successor notice of exercise within 120 days after we receive written notice from you or Your Successor or otherwise learn of an Option Occurrence described in Paragraph A(i) or concurrently with or at any time after we deliver the notice provided for in Paragraph A(ii). Within 20 days after receipt of our notice of exercise of the rights in Paragraph A, you or Your Successor shall deliver to us written evidence of the listing required by Paragraph A.

C. If we do not exercise any of the rights in Paragraph A after an Option Occurrence described in Paragraph A(i) and you are not then in default under this Franchise Agreement, you may continue to operate the Franchised Business or Your Successor may succeed to your interest in this Franchise Agreement and the Franchise Location and operate the Franchised Business after satisfying the conditions in Article ##.

##.2 Manager. During any period of your incapacity if you are an individual or on the happening of any Option Occurrence, whether or not we exercise any of the rights in Section ##.1A, we may appoint a manager (who may be our employee) to oversee operation of the Franchised Business until, if you are an individual and temporarily disabled, you are capable of attending to the Franchised Business or, in any other case, a transfer of your interest in this Franchise Agreement is effected in accordance with this Franchise Agreement, as the case may be. You or Your Successor shall pay our charge for the manager's salary, any transportation, travel, lodging, or related living expenses, and the management administration fee in the Fee Schedule within 30 days after receipt of an invoice.

##.0 CONDITIONS TO ASSUMPTION OF YOUR INTEREST; FEE. No person or entity may succeed to your interest in this Franchise Agreement or operate the Franchised Business in your place unless and until:

- a. That person's Manager satisfactorily completes a course of training we prescribe and we receive payment for that training;
- b. That person or entity has agreed in writing to be bound by and executed a copy of the form of Franchise Agreement we are then offering to prospective single unit franchisees (provided that the provision for payment of an initial franchise fee shall be deleted and the provisions relating to duration, options to renew, and initial training shall be appropriately revised);
- c. That person or entity has the right to occupy the Franchise Location for the balance of the term of the Franchise Agreement;
- d. Concurrently with the request for approval, we have received payment of the nonrefundable franchise transfer fee in the Fee Schedule;
- e. Any breach of your obligations to us has been cured;
- f. All sums payable by you to us before the effective date of the transfer have been paid or arrangements satisfactory to us have been made for the assumption of those obligations by Your Successor; and
- g. You have executed our form of general release in our favor.

APPENDIX F

FORMS OF CONSENT TO TRANSFER

Form 1 is a Consent to Transfer of Ownership Interests, which may be utilized where the franchise agreement permits the franchisee to transfer non-controlling interests in the franchise to one or more persons.

Form 2 is an Assignment and Assumption of Franchise Agreement, which can be used if the franchisee requests to transfer or assign a controlling interest in the franchised business or to sell or transfer all (or substantially all) of the assets of the franchised business.

Form 1

[COMPANY LETTERHEAD]

_____, 20__

VIA CERTIFIED MAIL

Re: CONSENT TO TRANSFER OF OWNERSHIP INTERESTS

Dear Glen:

Pursuant to the terms of the Franchise Agreement dated _____, 20__ (“**Franchise Agreement**”) by and between _____ (as “**Franchisee**”) and _____ (as “**Franchisor**”), you have requested our consent to a transfer of certain ownership interests in the Franchisee business entity. As a result of the proposed transfer, all of the issued and outstanding membership interests in Franchisee will be as follows:

Owner’s Name and Address	Description of Interest
	_____%
	_____%
	_____%

The proposed transfer is subject to our consent. We consent to such transfer, subject to our receipt of the following items, signed and completed as contemplated by Section __ of the Franchise Agreement:

- Confidentiality, Nonsolicitation and Noncompetition Agreement (Exhibit __); and
- Guaranty and Assumption Agreement (Exhibit __).

The Franchisor [will/will not] require payment of a transfer fee under Section __ and [will/will not] seek to exercise its right of first refusal under Section __.

Please do not hesitate to contact us should you have any questions or concerns regarding the above.

[NAME OF FRANCHISOR]

By: _____
Its: _____

Form 2

**ASSIGNMENT AND ASSUMPTION
OF FRANCHISE AGREEMENT**

THIS ASSIGNMENT AND ASSUMPTION OF FRANCHISE AGREEMENT (this "Assignment") is between [NAME OF FRANCHISOR] (the "Franchisor"), _____, a _____ [corporation/limited liability company], and _____ (collectively the "Assignor"), and _____ a _____ [corporation/limited liability company], and _____ (collectively, the "Assignee" or "you" or "your").

BACKGROUND INFORMATION

The Assignor entered into a Franchise Agreement with the Franchisor dated _____ (the "Prior Agreement"), to operate a [BRAND] Franchise (the "Franchised Business") located at _____. The Assignor wants to transfer its interest in the Prior Agreement and the Franchised Business to the Assignee, and the Assignee wants to assume all of the Assignor's rights and duties under the Prior Agreement and interests in the Franchised Business. The Franchisor is willing to consent to such assignment and assumption as long as the transfer conditions of the Prior Agreement are met and the Assignee signs the Franchisor's current form of Franchise Agreement (the "New Agreement") and ancillary agreements. In addition, each of the Assignee's owners must sign the Franchisor's standard form of Principal Owner's Guaranty.

OPERATIVE TERMS

Accordingly, the parties agree as follows:

1. **Assignment.** The Assignor assigns and transfers all of its right, title and interest in and to the Franchised Business and the Prior Agreement to the Assignee, as of the Effective Date (defined below). After the Effective Date: (a) the Assignee has all of the rights, powers and privileges under the New Agreement, as amended by this Assignment, to operate the Franchised Business in accordance with the terms of the New Agreement; and (b) the Assignor no longer has any rights to operate the Franchised Business under the Prior Agreement and relinquishes any rights it may have had to do so.

2. **Assumption.** As of the Effective Date: (a) the Assignee assumes all of the obligations of the Assignor under the Prior Agreement; and (b) the Assignee executed and delivered to Franchisor the New Agreement and any ancillary agreements, which will then replace the Prior Agreement. The New Agreement, including any ancillary agreements and addenda, will then govern the relationship between the Franchisor and the Assignee. The Prior Agreement is cancelled, except those provisions which expressly survive termination, which are incorporated into this Assignment by this reference and will continue to bind the Assignor.

3. **Acceptance and Consent.** In reliance on all of the foregoing, and on the Franchisor's receipt of the fully signed Assignment, the New Agreement (including all ancillary agreements and addenda), the general release attached as Exhibit A (the "Release") and Franchisor's receipt of the transfer fee in the amount of \$_____ (the "Transfer Fee"), the Franchisor hereby waives its right of first refusal under Section ___ of the Prior Agreement and consents to the following:

- (a) this Assignment;
- (b) the assignment of the Prior Agreement and the Franchised Business to the Assignee;
- (c) the Assignee's assumption of the Prior Agreement and all of Assignor's obligations under it; and
- (d) the termination of the Prior Agreement.

4. **Post-Termination Compliance.** The Assignor agrees to comply with all post-termination obligations and other provisions of the Prior Agreement that expressly survive the termination of the Prior Agreement and continue to bind the Assignor, including, without limitation, all: (a) indemnification obligations for anything that occurred prior to (and including) the Effective Date of this Assignment; and (b) post-term competitive restrictions and confidentiality requirements of the Prior Agreement.

5. **Certain Conditions.** Notwithstanding anything to the contrary contained herein, this Assignment will not become effective unless and until:

- (a) The Assignor has (i) paid all outstanding amounts owed to the Franchisor, including, but not limited to, royalties, marketing fees and any other amounts due the Franchisor under the Prior Agreement as of and through the Effective Date; (ii) paid all amounts owed to third party suppliers and creditors of the Franchised Business as of and through the Effective Date; and (iii) submitted to the Franchisor all required reports and statements required under the Prior Agreement;
- (b) The Franchisor has received this fully signed Assignment;
- (c) The Franchisor has received the fully signed New Agreement, together with all ancillary agreements and addenda, from the Assignee;
- (d) The Franchisor has received payment in full of the Transfer Fee; and
- (e) The Franchisor has received the Release signed by the Assignor.

6. **Incorporation of Terms and Precedence.** This Assignment is an integral part of, and is incorporated into, the New Agreement. Nevertheless, this Assignment governs, controls and supersedes any inconsistent or conflicting provisions of the New Agreement. Terms not otherwise defined in this Assignment have the meanings as defined in the New Agreement. Otherwise, the remaining terms of the New Agreement remain in full force and effect and are binding on the Franchisor and the Assignee.

7. **Background Information.** The background information is true and correct and is incorporated into this Assignment.

8. **Counterparts.** This Assignment may be executed in one or more counterparts, each of which will be deemed an original and all of which together will constitute one and the same instrument. Facsimile signatures and electronic (scanned) signatures shall have the same force and effect as originals.

9. **Effectiveness.** This Assignment is effective as of _____, 20__ (the "Effective Date"), regardless of the actual date of signature. However, it will not become effective until all conditions for effectiveness specified in this Assignment have been fully satisfied.

Intending to be bound, the parties sign below:

THE "ASSIGNEE":

(Entity Name)

By: _____
Print Name: _____
Title: _____
Date: _____

Print Name: _____, an individual
Date: _____

Print Name: _____, an individual
Date: _____

THE "ASSIGNOR":

(Entity Name)

By: _____
Print Name: _____
Title: _____
Date: _____

Print Name: _____, an individual
Date: _____

Print Name: _____, an individual
Date: _____

THE "FRANCHISOR":

[NAME OF FRANCHISOR]

By: _____
Print Name: _____
Title: _____
Date: _____

EXHIBIT "A"
RELEASE

THIS RELEASE is given by _____ and _____ and their predecessors, affiliates, owners, officers, directors, employees, representatives, agents, successors and assigns (collectively, the "**Assignor**"), to [NAME OF FRANCHISOR], and all of its predecessors, affiliates, owners, officers, directors, employees, representatives, agents, successors and assigns (collectively, the "**Franchisor**").

Effective on the date of this Release, the Assignor forever releases and discharges the Franchisor from any and all claims, causes of action, suits, debts, agreements, promises, demands, liabilities, contractual rights and/or obligations, of whatever nature or kind, in law or in equity, which the Assignor now has or ever had against the Franchisor, including without limitation, anything arising out of that certain Franchise Agreement dated _____, and all contracts the Franchisor entered into with the Assignor associated with such Franchise Agreement (collectively, the "Franchise Agreement"), the franchise relationship between the Franchisor and the Assignor, and any other relationships between the Franchisor and the Assignor, except for (a) those provisions which expressly survive termination and (b) the Assignor's obligations under the Assignment and Assumption Agreement dated effective _____. This Release is effective for: (i) any and all claims and obligations, including those of which the Assignor is not now aware; and (ii) all claims the Assignor has from anything which has happened up to now.

The Assignor is bound by this Release. The Assignor freely and voluntarily gives this Release to the Franchisor for good and valuable consideration, and the Assignor acknowledges its receipt and sufficiency.

The Assignor represents and warrants to the Franchisor that the Assignor has not assigned or transferred to any other person any claim or right the Assignor had or now has relating to or against the Franchisor.

In this Release, each pronoun includes the singular and plural as the context may require. This Release is governed by _____ law. This Release is effective as of _____, 20____, notwithstanding the actual date of signatures.

IN WITNESS WHEREOF, the Assignor signs this Release:

(Name of Entity)

Print Name: _____, an individual
Date: _____

By: _____
Print Name: _____
Title: _____
Date: _____

STATE OF _____)
COUNTY OF _____)

The foregoing instrument was acknowledged before me this _____, 20____,
by _____, as _____ of _____
_____, who is personally known to me or has produced _____ as identification.

Signature of Notary
Printed Name of Notary _____
Notary Public, State of _____
Serial Number of Notary _____

STATE OF _____)
COUNTY OF _____)

The foregoing instrument was acknowledged before me this _____, 20____,
by _____, who is personally known to me or has produced _____
as identification.

Signature of Notary
Printed Name of Notary _____
Notary Public, State of _____
Serial Number of Notary _____

DAVID BEYER

David Beyer is a partner at Quarles & Brady LLP in Tampa, Florida. He concentrates his practice in organizing and structuring franchise and other distribution programs; negotiating and preparing complex franchise, subfranchise, and distribution agreements; representing franchisors and subfranchisors in compliance with franchise disclosure and registration laws; evaluating and negotiating supply relationships; counseling on the impact of antitrust and trade regulation laws; international franchising and distribution matters; preventing and resolving franchise disputes; assisting in franchise and dealership terminations; joint ventures, mergers, acquisitions and capital raising for franchise and growth companies; structuring dealership and licensing programs; and other related corporate and business matters. His practice also involves counseling on other sales and distribution methods, such as licensing, multi-level distribution, direct selling, sales representatives, dealerships and business opportunities, with a special emphasis on avoiding burdensome franchise sales laws. He is a frequent speaker and author on legal aspects of franchising and distribution. He has served on the Editorial Board of the ABA's Franchise Law Journal. He is a former multiple-term Chairman of the Antitrust, Franchise and Trade Regulation Committee of the Business Law Section of The Florida Bar. David has been recognized in The Best Lawyers in America®, Florida Super Lawyers®, the International Who's Who of Business Lawyers, and as a "Legal Eagle" by *Franchise Times*. He earned his J.D. from Vanderbilt University School of Law and his B.A. and M.B.A. from Tulane University.

PHYLLIS ALDEN TRUBY

Phyllis Alden Truby is a sole practitioner in Los Angeles, California with more than 35 years of law practice experience, concentrating on franchising and distribution, business, and real estate law. Ms. Truby is a State Bar of California Board of Legal Specialization Certified Specialist, Franchise and Distribution Law. She presently serves as a Commissioner on the California State Bar Franchise and Distribution Law Accreditation Commission. Ms. Truby has been named in *The Best Lawyers in America* in the Franchise Law practice area every year since 2006. Most recently, *The Best Lawyers in America* named Ms. Truby the 2015 Los Angeles Franchise Law Lawyer of the Year.

Ms. Truby is a former member of the Governing Committee of the American Bar Association Forum on Franchising and has held various other leadership positions in the Forum. She is a past chair of the California State Bar Business Law Section's Franchise Law Committee and past Vice Chair of the Business Law Section Executive Committee.

She has repeatedly been a franchise law program panelist at the California State Bar Conference, for California Continuing Education of the Bar, and at the American Bar Association's Forum on Franchising. She has also spoken on franchise law for the Denver Bar Association's Patent and Trademark Law Section, for the National CLE Conference, and at the American Bar Association's Annual Meeting. Ms. Truby is the co-author of numerous articles and papers on franchise law and was a co-author of the California law chapter of the first edition of the American Bar Association Forum on Franchising publication *The Franchise Deskbook*.

Ms. Truby holds Bachelor of Arts and Master of Journalism degrees from the University of California at Los Angeles and a Juris Doctor degree from Loyola University of Los Angeles.