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Supply Chain Management in Franchise Systems
Legal Risks and Strategies for Compliance

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1. Introduction

The strength of a franchise system lies, in part, in the system's ability to consistently and effectively offer uniform products and services. Customers expect this when walking into a franchise business, and it plays a critical role in driving repeat business and fostering long-term customer loyalty. As a result, franchisors and franchisees face the pressure of upholding this experience for the customer every time. An effective and efficient supply chain is key to achieving this consistency. For purposes of this paper, "supply chain" refers to the network of organizations, people, activities, information and resources involved in the sourcing, procurement, production, transportation, and distribution of goods and services from suppliers to end customers. For a supply chain to be effective, all of the involved parties must be aligned to common goals and the company's supply chain strategy.[1]

In a franchise system, an effective and well-optimized supply chain ensures that franchisees receive consistent, high-quality products and services in a timely and cost-efficient manner that benefits all parties involved. For franchisees, an effective and well-optimized supply chain enhances margins and supports efficient cost management inventory control. For consumers, it ensures the product consistency, availability, and overall quality that are paramount to the customer experience. Finally, for franchisors, it strengthens brand image, promotes system-wide compliance and consistency, and enhances scalability by supporting efficient growth and expansion. For these reasons, a franchise's supply chain is so much more than a logistical function, it's a strategic pillar that drives operational resilience, competitive adaptability, franchisee success, consumer loyalty, and long-term value creation across the franchise system.

This paper examines supply chain management in a franchise system. It begins with a discussion of two different models of managing a supply chain within a franchise system and explores the benefits and challenges of each. It then identifies certain key legal and business challenges in managing franchise supply chains, followed by a discussion on the role of distributors within the supply chain, and managing the relationship between distributors, the franchisees they serve and the supply chain managers they answer to. Finally, the paper concludes with a discussion on best practices for building a strong and transparent supply chain in a franchise system.

2. Franchise Supply Chain Models

"Supply chain management" refers to "the systemic, strategic coordination of the traditional business functions and the tactics across these business functions within a particular company and across businesses within the supply chain, for the purposes of improving the long-term performance of the individual companies and the supply chain as a whole."[2] Supply chain management is essential for maintaining consistency, cost efficiency, and quality across all locations in a franchise system. There are a variety of different supply chain structures used in franchise systems, and no single structure is

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1 Gina Romo, R. James Straus, & Suzanne Trigg, *Building an Effective Supply Chain and Distribution System,* ABA 35th Forum on Franchising, W-15, at 1 (2012).

2 John T. Mentzer et al., *Defining Supply Chain Management*, 22 J. Bus. Logistics 1, 18 (2001).

inherently superior to another. The effectiveness of a supply chain model depends on multiple factors, including the size and complexity of the franchise network, the industry in which it operates, the relationship between the franchisor and franchisees, and the level of control the franchisor wishes to maintain over procurement and distribution. This paper will address two models for supply chain management within a franchise system: (i) franchisor-managed supply chains, and (ii) purchasing cooperative-managed supply chains. While both models aim to streamline procurement for the benefit of the entire system, they differ in control structures and franchisee participation.

2.1. Franchisor-Managed Supply Chains

Franchisors typically establish a centralized supply chain management function that handles all up-stream and downstream decisions for all franchise units.[3] In a franchisor-managed supply chain, the franchisor is the central coordinator of supply chain decisions, and directly oversees sourcing, vendor relationships, quality standards, and distribution strategies on behalf of the franchise network. The franchisor exercises substantial control over each link of the supply chain system, thereby increasing the franchisor's ability to enforce quality control more effectively. Rather than each franchisee independently identifying suppliers and sourcing supplies, the franchisor's centralized management function (through a dedicated procurement team or supply chain department) handles the procurement sourcing for all franchise outlets in the network. The franchisees do not have direct access to the supply chain, and rely on the franchisor to maintain the supply chain enterprise. The franchisor can achieve this directly by manufacturing and distributing items for the system itself, or through third party suppliers and distributors. The former, commonly referred to as "captive supply", provides the franchisor with the greatest level of oversight and control because the franchisor, or its affiliates, manage everything directly. However, it also requires a much more robust internal system that could be expensive to operate and maintain. The latter provides the franchisor with slightly less control over output and quality, due to the reliance on third parties, but the franchisor is not required to invest nearly as much time, expertise, or capital into the management of the supply chain.

(i) Benefits

A key benefit for the franchisor in a franchisor-managed supply chain is the unfettered ability to ensure consistency of products and quality expectations across all locations. The centralized management function vests the franchisor with ultimate discretion over the inputs that go into the system's products and services. Mechanisms for quality control include standardized products and ingredients, supplier qualification programs and inspections and quality specifications. When supplies are sourced from vetted and approved vendors, the franchisor has more assurance that each franchisee is receiving the same high-quality supplies that aligns with the franchisor's vision for the brand. The franchisor's ability to approve vendors prevents franchisees from sourcing subpar or non-conforming products that could conflict with the brand's reputation and

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[3] Patrick J. Kaufmann & Sevgin Eroglu*, Standardization and Adaptation in Business Format Franchising*, 14 J. Bus. Venturing 69 (1999).

damage the franchise system's image.[4] Likewise, when the franchisor oversees distribution, it can work to streamline logistics across the system to reduce costs and inefficiencies.

Centralizing the supply chain under the franchisor's management also creates cost efficiencies for the franchise system. The aggregation of buying power of the entire system creates a powerful bargaining tool that individual franchisees could not achieve negotiating alone. Individual franchisees may have an incentive to cut costs and supply low-quality products and services because they do not bear the full cost of any resulting deterioration in the trademark's value.[5] Sourcing restrictions also achieve the correlative benefit of eliminating franchisee "free-riding", which is a term that describes franchisee behavior which deviates from the brand standards in order to reduce personal operating costs.[6]

Supply chain management requires coordination between all integral players in the chain. By centralizing sourcing, franchisors serve in the pivotal role of managing the knowledge flow among the supply chain participants and the franchisees, which allows franchisors to integrate their own market research to optimize successful supply chain execution.[7] In this model, Franchisees do not need to become experts in the procurement process. With the franchisor handling the negotiation of the procurement and delivery of products, the franchisees can dedicate more time to the operation of their respective businesses and customer service.

(ii) Challenges

Strict centralized control can be a source of tension between the franchisor and franchisees, especially if the franchisees believe the restrictions imposed in a franchisor-managed supply chain model increase costs at the expense of the franchisee's freedom. One common point of contention in franchisor-managed supply chain models is that the supply chain can be a source of revenue for the franchisors. "Supplier income", refers to income, rebates, or other benefits, received directly or indirectly by the supply chain manager from the suppliers who provide goods and services to the franchisees. Supplier income can be a generous source of revenue and a tempting proposition to franchisors, which can influence the franchisor to make decisions that may prioritize profit over the interests of the franchisees. As an example, a supplier may pay the franchisor a fee to be the exclusive sourcing provider of a particular product for all franchisees in the franchise system. Franchisees may become frustrated by the loss of control over supplier selection in this scenario, as they would be restricted from seeking out more competitive prices or

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4 See Joyce Mazero & Suzie Loonam, *Purchasing Cooperatives: Leveraging a Supply Chain for Competitive Advantage*, 29 Franchise L.J. 148 (Winter 2010).

5 See Uri Benoliel, *The Expectation of Continuity Effect and Franchise Termination Laws: A Behavioral Perspective*, 46 Am. Bus. L.J. 139, 143-4 (2009) (according to the law-and-economics perspective, the free-riding problem typifies franchise contracts.)

6 *Id.*

7 Russell T. Crook et al., *Antecedents And Outcomes Of Supply Chain Effectiveness: An Exploratory Investigation*, J. Managerial Issues, June 22, 2008 (discussing how knowledge sharing across all participants in the supply chain improves performance).

local alternatives.[8] Rebates are another very hotly contested form of supplier income.[9] While supplier rebates can generate cost savings and operational efficiencies, disputes can arise over who benefits from the rebates, whether they align with the best interests of the franchisees, and how they are structured.

A centrally managed supply chain structure can often struggle to accommodate local market needs, and provides little flexibility and customization across different locations over time. Supply chain controls can inhibit franchisees' attempts to serve regional tastes, seasonal promotions, or substitute suppliers in exceptional circumstances. Franchisees in different geographic locations could find a standard franchisor-managed supply chain approach falls short in addressing consumer tastes in their respective markets. For example, an ingredient or product offering may not be well received in a particular region, yet franchisees may be contractually prohibited from making substitutions to such ingredient or product. Decision-making in a centralized franchisor-managed structure can also lack responsiveness at the regional level, given that franchisees have to wait for permission from the franchisor to add new items and suppliers. Effective franchisors can seek to overcome this challenge by granting permission for regional sourcing (with prior approval), or actively seeking feedback from the franchisees to permit adaptation of the supply chain. Achieving an optimal balance between standardization and regional responsiveness remains a source of concern in franchisor-controlled supply chains.

2.2. Purchasing Cooperative-Managed Supply Chains

In a purchasing cooperative-managed supply chain model, the franchisees collectively manage procurement, often in partnership with the franchisor, through a purchasing cooperative - a separate legal entity owned and controlled by the franchisees. In this model, the purchasing cooperative, instead of the franchisor, conducts collective bargaining with suppliers and manages distribution activities.[10] Though the franchisor does not entirely relinquish control over the supply chain when a franchisee-owned supply chain cooperative is utilized, the franchisees generally obtain significant control over the management and operation of the supply chain, and the franchisor’s influence is considerably reduced.[11] When structured and operated effectively, a franchise system purchasing cooperative can reduce its members’ costs, achieve economies of scale, result in additional income to members based on their volume of use of the cooperative, and provide for joint collaboration between the franchisor and its franchisees.[12] Unlike franchisor-managed supply chains, purchasing cooperatives allow franchisees the ability to maintain greater control over sourcing decisions, while still benefiting from economies

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8 *See* Roger D. Blair & David L. Kaserman, A *Note on Incentive Incompatibility Under Franchising*, 9 Rev.
Indus. Org. 323 (1994).

9 For example, in its March 2002 UFOC, Wendy’s received rebates of 1%-15% on franchisee purchases; In April 2006, Subway reports in its UFOC 2%-37%, used at its discretion. Franchisors that control the supply chain, like Domino’s and Quiznos, earn additional revenue through product markups.

10 E. Hayes, “*An Introduction to Cooperative Purchasing*”, (presentation to Seminar Class, Geo. Wash. Univ. L. Sch. by Elizabeth Hayes and Justin Kaufman).

11 Romo et al., at 8.

12 Id. at 55.

of scale. This structure can be particularly advantageous in large, more established franchise systems where franchisees seek a more democratic approach to supply chain management. Membership in the purchasing cooperative can be compulsory, as a requirement of the franchise agreement, or optional, but participation in most instances is heavily promoted. While purchasing cooperatives provide franchisees with increased influence over supply chain decisions, they also require strong governance, transparency, and coordination with the franchisor to align the interests of the individual franchisees with the franchisor's broader goals for the system. Purchasing cooperatives can be structured in a variety of different manners, the specifics of which are outside the scope of this paper, but when considering the formation of a purchasing cooperative, parties should pay particular attention to the tax structure, management, governance and funding of the cooperative, and seek guidance from qualified legal and financial counsel.

In the context of a franchisee purchasing cooperative, franchisees are privy to the discussions that directly affect their financial performance and are involved in the governance activities, yet the franchisor still maintains supervisory powers to ensure the purchasing activities of the cooperative align with the overall strategy of the franchisor. In a successful cooperative, the franchisor supports the cooperative model and engages with the cooperative, thus building trust between parties. The involvement of the franchisor is beneficial to both parties—the franchisor gains vital information about cooperative decisions and is able to influence these decisions to protect key brand interests, and franchisees are given the chance to field input or seek counsel and expertise from the franchisor. The influence exerted by the franchisor is contractual and through involvement on the board of directors rather than through direct decision-making control. The contractual arrangement maintains the cooperative's autonomy in day-to-day management, while achieving a balance with the franchisor's directive on issues of key significance that affect brand quality or consistency expectations.

(i) Benefits

Purchasing cooperatives can enhance the trust between franchisees and franchisors, improve efficiencies in the supply chain, and increase bulk purchasing power - particularly in systems where the franchisor doesn't have the expertise, resources, or desire to manage the supply chain itself.

A source of potential conflict between franchisors and franchisees under a franchisor-controlled supply chain model is the exclusion of franchisees from the procurement, sourcing, and distribution decision-making processes that affect the franchise network. The franchisees' lack of privity, coupled with the franchisor's ability to financially benefit, could be perceived to leave franchisees vulnerable to price-fixing and excessive pricing practices. Conversely, purchasing cooperatives provide franchisees with ownership and governance of the cooperative, thus allowing them the ability to have direct knowledge and control over supply chain decisions. Since decision-making power is held by the franchisees, they can be certain that these decisions are made in accordance with their own interests, rather than being driven by corporate profit. Therefore, franchisees have increased confidence in the pricing and sourcing decisions made, thus strengthening the relationship between franchisors and franchisees by removing doubts over the potential for price increases or supplier rebates to be misappropriated by the franchisor.[13]

The purchasing cooperative model can foster a sense of ownership and shared mission among the stakeholders of the franchise. Franchisees work together to establish purchasing priorities and make supplier and product decisions that reflect the interests and needs to satisfy the demands of the franchise owners in their businesses. Furthermore, the cooperative's finances are typically member-governed and can be subject to auditing procedures. All costs, contracts, and rebates or discounts available are reported to the board and disclosed to the members.[14] Franchisees can ensure that they are paying actual costs, plus the requisite amount necessary to pay overhead, free of any inflation of price. Supplier rebates or volume-based incentives are redistributed back to members or credited to the cooperative to offset costs, and not being hoarded as corporate profit.[15] This transparency ensures active participation by the franchisees, as they are guaranteed to receive the full benefits of their investment, rather than the franchisor making a profit at their expense.[16]

Franchisees pool their buying power by organizing a cooperative structure in order to obtain better terms and conditions otherwise unattainable to an individual franchisee operating in isolation. Access to substantial wholesale, bulk, and consistent purchase orders from the franchisee system is an attractive incentive for suppliers to negotiate terms with the purchasing cooperative. Suppliers offer volume discounts, reduced unit costs, and rebates to the cooperative to secure the cooperative's business. This can result in huge costs savings for the franchise system, which then are passed on to the franchisees. In addition, the cooperative itself gains the power to negotiate better payment terms and coordinate schedules of delivery in an optimal manner.

(ii) Challenges

Purchasing cooperatives should strive to represent the interests of its members. It is therefore crucial to understand the members' various needs, regional differences, and business strategies, which can lead to challenges in decision making and implementation. Additionally, not all franchisees want to have a direct involvement in the supply chain. The Franchise Business Review found that some franchisees prefer the traditional franchisor-managed model because "it allows them to focus entirely on operations without worrying about supply chain intricacies."[17] Thorough and ongoing communication between the board and its members is required to adequately inform members of updates and get feedback, but management can invest considerable time and money in involving

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[13] R. Wyland, N. Hanson-Rasmussen, & F. Clark *The structure-culture alignment activity: Aligning organizational structure elements with diversity, equity, and inclusion cultural values*, 48 K. Mgmt. Educ. 141-67 (2024).

[14] T. Mark McLaughlin, D.G. Smith, & M. Wisniewski *Empowering Franchisees: Franchise Participation in System-Wide Governance* (1994).

[15] *Id*.

[16] David Gurnick & Lee Wharton *Effective franchise associations, advisory boards and councils*, paper presented at the Am. Bar Ass'n Annual Forum on Franchising, (Oct. 2000) (New Orleans, La.).

[17] McFadyen Digital, *Traditional vs. Co-operative Franchise Models: Which One Wins the Procurement Game?* (Nov. 13, 2024), https://mcfadyen.com/2024/11/13/traditional-vs-co-operative-franchise-models-which-one-wins-the-procurement-game/.

members through committees, surveys, and meetings to garner input and build consensus. Cooperatives also have the challenge of integrating feedback from many franchise owners and balancing diverse interests before making any decisions. Disagreements can often occur among members due to the interplay of several dynamics, including misaligned interests between multi-unit owners and smaller single unit owners, as well as owners advocating for local accommodations. Additionally, not all members have equal resources to participate in the procurement process. Larger franchisees often have greater resources which allow them to lobby their interests to the board. Imbalances in representation or participation can make coordination more complicated. One of the primary goals of an effective cooperative is to represent all franchisees equally and fairly, which can require robust governance processes that could increase administration overhead higher than that of a franchisor-managed supply chain.

One of the advantages of cooperatives is the opportunity for franchisees to be represented in the decision-making process. However, the democratic decision-making structure is not without its weaknesses. As earlier suggested, successful decision-making in a cooperative requires a significant level of reciprocal information flow between members and management. Reaching consensus can take longer than it would in a centrally controlled model. Proposals must be communicated, deliberated, and at times, achieve majority consent. This is a disadvantage in fast-moving markets and in times of crisis, when critical action is delayed by the need to reach consensus. Successful purchasing cooperatives must balance the importance of collaborative decision-making, but also the effectiveness of unilateral action during crisis. Many cooperatives strike this balance by entrusting the board with the power of execution in times of emergencies.[18]

3. Key Legal Challenges in Managing Supply Chains in a Franchise System

Regardless of which management model is used, managing supply chains within a franchise system creates unique legal challenges that can impact both franchisors and franchisees. Operating within legal and regulatory boundaries, while simultaneously working to achieve cost control, brand consistency, quality, and efficiency, requires careful legal structuring and consideration.

3.1. Transparency Issues

The dynamic between the franchisor and franchisees is naturally one of information asymmetry. However, transparency in supply chain operations is key to fostering trust between franchisors and franchisees. Legal disputes can often arise when franchisees feel excluded from pricing decisions, vendor selections, or rebate allocations. Transparency is not only encouraged, but often legally required. The Federal Trade Commission (FTC) Rule requires franchisors to comply with disclosure obligations related to certain aspects of the franchise system's supply chain.[19] To ensure adequate transparency, the FTC requires franchisors to disclose any "obligatory purchases,

[18] *Id*. See also T. Mark McLaughlin, D.G. Smith, & M. Wisniewski, *Empowering Franchisees: Franchise Participation in System-Wide Governance* (1994).

[19] Federal Trade Commission Rule on Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. § 436.1 et seq.

restriction on sources of products and services, the amount of revenue franchisors may receive from required suppliers, and purchasing and distribution cooperative."[20] Franchisors that fail to properly disclose these items to franchisees may face legal scrutiny and claims of unfair dealing.

Franchisees may also challenge restrictions on purchasing from approved suppliers, particularly if pricing is not considered to be competitive. Antitrust concerns can also arise if supplier arrangements limit franchisee choices in ways that could be deemed anti-competitive, or are aimed purely at locking up revenue, rather than quality. In *Siegel v. Chicken Delight, Inc.*, the Ninth Circuit affirmed a finding that the franchisor's practice of requiring franchisees to buy all cooking equipment, mixes, and trademark bearing packaging only from Chicken Delight (with no franchise royalty charged separately) was an unlawful tying arrangement, refusing to concede that labeling a product with a trademark symbol could immunize a tie-in from antitrust laws.[21] By contrast, in *Queen City Pizza, Inc. v. Domino's* Pizza, Inc., franchisees were unsuccessful in asserting that the franchisor, Domino's, unlawfully tied the sale of pizza ingredients to the sale of pizza dough. The franchisees challenged Domino's requirement that the franchisees buy ingredients (dough, sauce, etc.) from approved suppliers (often Domino's itself or its designee) as an illegal tie. Domino's sold approximately 90% of the ingredients and supplies used by its franchisees and granted the franchisees the ability to purchase the remaining 10% of required supplies from third party suppliers. The Third Circuit court rejected the antitrust claim, finding that pizza ingredients are readily available commodities, and the contract restriction did not create a separate captive market, because Domino's lacked power required to make a successful tying claim over the general market for food supplies.[22]

3.2. Regulatory Compliance

Franchise supply chains must navigate a complex regulatory landscape, including, without limitation, environmental, social, and governance ("*ESG*") considerations, labor regulations, trade compliance requirements, and, to the extent applicable, industry specific laws and regulations (e.g., food safety laws). Increasing federal and state regulations require businesses to track and reduce their carbon footprint, manage waste responsibly, and source materials sustainably. Laws such as the California Transparency in Supply Chains Act and European Union Corporate Sustainability Due Diligence Directive impose stricter disclosure and compliance obligations on supply chain managers. Publicly traded franchisors may be subject to ESG reporting requirements, such as the Securities and Exchange Commission's climate disclosure rules, requiring transparency on sustainability initiatives, greenhouse gas emissions, and supply chain due diligence.[23] As ESC considerations become more integrated into regulatory

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20 See Federal Trade Commission *Statement of Basis and Purpose and Regulatory Analysis,* 72 Fed. Reg. 15,486. (Mar. 30, 2007) (to be codified at 16 C.F.R. pts. 436-37).

21 See *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43 (9th Cir. 1971)

22 See *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430, 443 (3d. Cir. 1997) (no antitrust violation); see generally *Randy Gordon, Framing Franchise Antitrust Litigation: The Legacy of Kodak and Queen City Pizza*, 40 Sw. U. L. Rev. 247 (2010).

23 SEC Final Rule Release No. 33-11275, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*.

frameworks and consumer expectations, franchise systems must be prepared to take a more proactive approach to compliance, and balancing operational efficiencies and cost management with sustainability initiatives.

The Fair Labor Standards Act ("*FLSA*") establishes federal wage and hour standards, including child labor protections and minimum wage requirements. Ensuring that the system only engages supply chain partners that comply with the FLSA is critical for franchise supply chains, because violations can result in significant legal and financial liability, as well as brand reputational risk. To minimize FLSA-related risks, supply chain managers should (i) ensure that supply chain-related agreements clearly define relationships with suppliers and distributors, and specify independence in employment decisions, to avoid joint employer liability; (ii) require compliance certifications from suppliers to confirm adherence to applicable wage and labor laws; and (iii) implement supplier audits and monitoring programs to ensure compliance.

Franchise systems, whether domestic or international, must be aware of and comply with applicable trade and transportation laws to ensure the seamless delivery of goods, while mitigating costs and legal risks. Supply chain managers must navigate applicable customs regulations, import/export compliance, and transportation laws that impact sourcing, distribution, product cost, and product availability. Franchise systems must ensure that imported goods meet the regulatory requirements of the destination country and comply with tariff classification, country-of-origin rules, and customs valuation requirements to prevent penalties or shipment seizures. Recent shifts in U.S. trade policy, particularly the implementation of new tariffs, have significant implications for supply chains. To navigate the evolving trade environment and associated regulatory implications, supply chain managers need to pay particular attention to where their products and product components are sourced from so that they can understand and work to mitigate the risk of the changing trade policies. Additionally, supply chain managers can explore additional or alternate sourcing options from countries not affected by the recent tariffs. Finally, franchise systems should consider incorporating clauses in their supply chain agreements that allow for renegotiation and/or termination in response to significant changes in trade policies or tariffs. By staying informed and proactively addressing these challenges, franchise systems can work to mitigate the impact of the evolving trade policies, maintain compliance with trade regulations, and work to maintain consistency of supply.

3.3. Drafting and Negotiating Supply Chain Agreements

Supply chain agreements extend far beyond price negotiations, they serve as the foundation for structuring the relationship between the franchise system and the supplier or distributor. A well-drafted supply chain agreement must not only secure favorable pricing, it must also properly address issues such as quality control, indemnification, insurance requirements, regulatory compliance, and dispute resolution procedures, to prevent unnecessary disputes and appropriately allocate liability and risk. Similar to supply chain management structures, there's no one-size-fits-all solution for supply chain agreements. Supply chain agreements should take into consideration the risk profile of the products and/or services being provided, so it's important that supply chain managers work closely with their legal counsel to ensure that the agreement provides an adequate amount of protection for the franchise system. An in-depth analysis of all relevant supply chain agreement provisions is beyond the scope of this paper, and could be its own separate paper entirely; however, we've highlighted several key areas of consideration below.

(i) Indemnification and Insurance

Properly drafted indemnification and insurance provisions in supply chain agreements are essential for mitigating risk and ensuring financial protection within the franchise system, and help to properly allocate liability in the event of product defects, regulatory violations, third-party claims, and supply disruptions. Given the complexity of franchise systems where, depending on the supply chain management model utilized, there may not always be direct privity of contract between the suppliers and/or distributors on the one hand, and the franchisor and franchisees on the other hand, supply chain agreements should seek to include broad indemnification language that requires suppliers or distributors to not only indemnify the other party to the agreement (i.e., the franchisor, purchasing cooperative, or franchisee, as applicable), but also applicable persons within the franchise system that are not direct parties to the agreement, but could still face liability due to the indemnifiable actions or inactions of the supplier or distributor and their products and/or services. This is particularly critical in situations in which the products and/or services provided pose significantly higher risks.

Equally important is the inclusion of appropriate insurance requirements to ensure that suppliers and distributors maintain adequate coverage for foreseeable risks. Insurance provides an additional layer of protection in supply chain agreements by serving as a financial safeguard in cases where a supplier or distributor lacks the liquidity to fully cover its liabilities. Even the most expertly drafted indemnification provision can't protect against a supplier or distributor facing financial distress, bankruptcy, or significant legal exposure. However, the obligation to obtain and maintain adequate insurance coverage provides assurance that there is a dedicated source of funds available to cover liabilities. The types of coverage and minimum amounts will vary depending on the specifics of the supply chain agreement, and supply chain managers should seek counsel from qualified insurance professionals in determining what insurance to require. However, to maximize protection, supply chain agreements typically should require vendors to maintain some level of commercial general liability, worker's compensation, and umbrella/excess coverage. To the extent applicable, recall/product liability, and/or auto insurance should also be considered. Additionally, franchisors, the purchasing cooperative, and the franchisees, each, to the extent applicable, should be listed as additional insureds on the vendor's policies, granting them direct access to coverage in the event of a claim. Waivers of subrogation should also be considered to prevent the insurer from seeking reimbursement from the franchisor, purchasing cooperative, or franchisees.

Broad indemnification obligations and robust insurance requirements help ensure that liability risks are properly allocated and managed, and provide a critical financial stopgap in situations where the franchise system is exposed to liability as a result of the actions or inactions of a supplier or distributor. Without these protections, franchisors and franchisees could find themselves financially and legally vulnerable to supply chain failures or third-party claims arising from vendor misconduct.

(ii) Limitations of Liability

Remedy and damage limitations help define the boundaries of responsibility. A liability clause can be a limitation on remedies, exclusion of certain damages, or a cap on the total amount of liabilities.[24] When drafting and negotiating supply chain agreements, drafters should also evaluate whether it is in their interest to restrict liability through reducing the time to bring claims (i.e., statute of limitations).[25]

Depending on the supply chain model, the franchisor will want to exclude or limit the following types of damages: direct, indirect, consequential and liquidated damages.[26] If the franchisor is a captive distributor or supplier, carving out damages can be a very effective tool to mitigate the franchisor's financial exposure. For example, if the franchisor is the captive supplier for a franchise network, the franchisor is subject to extreme vulnerability by disruptions in the supply chain. If the franchisor experiences a shortage and cannot supply products as agreed upon, the franchisor could be held liable for any damages the non-breaching parties incurred while effecting cover—this could include the costs incurred while looking for a replacement supplier and the cost of the replacement goods.[27]

On the other hand, if the franchisor is not involved in the manufacturing or distribution of products, the franchisor will want to retain its right to damages to the fullest extent. For example, if the franchisor has the right to consequential damages, damages could include lost opportunity costs, loss of goodwill, losses resulting from interruption of buyer's production process, and lost interest.[28]

(iii) Dispute Resolution Mechanisms

Dispute resolution mechanisms are critical in supply chain contracts because they give the parties the opportunity to provide a structured process for addressing conflicts in advance of any issues that may arise. Without clear dispute resolution provisions, disagreements can quickly escalate into costly and time-consuming claims and litigation that could disrupt the flow of products and/or services, and damage business

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[24] Alexandra J. Gage & Sara E. Potts, *Ten Ways Your Limitation of Liability Provision Is Actually Ineffectual,* , Ass'n of Corp. Counsel (Apr. 20, 2023).

[25] See, e.g., *Krumholz v. AJA,* LLC, 691 F.Supp.2d 252, 256-58 (D.Mass. 2010) (upholding one-year contractual limitation); compare 42 P. Conn. Stat. §5501(a) (Pennsylvania allows parties to shorten the statute of limitations as long as the period specified is not "manifestly unreasonable"), with *Vino 100, LLC v. Smoke On The Water, LLC*, No. 09- 4983 (E.D. Pa. July 1, 2011) at 9 (holding one-year statute not manifestly unreasonable).

[26] Deborah S. Coldwell, Altresha Q. Burchett-Williams & Melissa L. Celeste, *Liquidated Damages*, 29-SPG Franchise L.J. 211 (2010) (surveying U.S. jurisdictions).

[27] UCC § 2-715(1) (Comment 1 of Section 2-715 explains that the list is meant to be illustrative, not exhaustive). To recover incidental damages, the buyer must prove the damages were (1) incurred because of the breach and (2) reasonable. *White & Summers*, UCC § 6-5 (4th ed. 2006).

[28] Paul S. Turner, *Consequential Damages: Hadley v. Baxendale Under the Uniform Commercial Code*, 54 S.M.U. L. Rev. 655, 622 (2001).

relationships. A well-crafted dispute resolution clause should define the preferred method and process for resolving disputes, and specify other related key terms, such as governing law, venue and jurisdiction. Franchise systems could benefit from requiring mandatory negotiation between the parties and/or mediation prior to the initiation of any litigation or binding arbitration, as these methods can offer a more efficient, cost-effective, and confidential way to resolve disputes. Additionally, by engaging in negotiations and/or mediation first, the parties have a chance to preserve their relationship due to the less litigious atmosphere, which is particularly valuable when the goal is to maintain a long-term business partnership. A mediation first provision should address any roadblocks that may be encountered in pursuit of mediation, such as selecting a mediator and carving out each party's ability to pursue injunctive relief. Courts across the United States have routinely upheld and enforced mandatory mediation clauses.[29]

If the parties are unable to resolve the dispute through good faith negotiations or mediation, the agreement should outline the next steps in the resolution process (i.e., litigation or binding arbitration). If arbitration is the preferred dispute resolution process, incorporating a clear and detailed arbitration process in the agreement offers several advantages. It allows the parties to contractually set terms and parameters outlining the scope of the arbitration, including, but not limited to, setting conditions such as: (1) the number of arbitrators; (2) the qualifications, if any, that an arbitrator must possess; (3) the issues that are reserved for the arbitrator to decide; (4) the entity that must administer the arbitration; (5) the rules that must govern the arbitration; (6) the scope of discovery and other fact-gathering measures that the parties may take; (7) the speed in which the dispute must be resolved; (8) the ability to proceed in court under limited circumstances for certain forms of relief, such as for a temporary restraining order or preliminary injunction; (9) the parties' obligation to maintain confidentiality of the arbitration beyond that provided in the arbitral forum rules; (10) the ability to bring dispositive motions; and (11) the manner in which the final arbitration hearing will occur.[30] By specifying these and other processes and procedures to be followed, the parties have more control over how their disputes are resolved, reducing uncertainties, and ensuring that both parties understand the steps involved. This transparency can aid the parties in maintaining a healthier business relationship.

Supply chain agreements should also include provisions selecting which state's laws will govern the terms of the contract, and dictating the court or location where any suit or arbitration must be brought. Drafters should use provisions that unambiguously designate the forum in which the parties must enforce their rights under the contract. Where language authorizes jurisdiction in a designated forum but does not expressly prohibit litigation elsewhere, federal and state courts will not dismiss a suit or transfer an

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[29] See, e.g., *Xanitos, LLC v. Am. Healthcare Sys. Ill., LLC*, No. 23-cv-2339-DWD, 2024 U.S. Dist. LEXIS 28900 (S.D. Ill. Feb. 20, 2024); *Jumping Jack Retail II, Inc. v. 7-Eleven, Inc*., No. 22-cv-6144-BLOOM/Valle, 2022 U.S. Dist. LEXIS 173701 (S.D. Fla. Sept. 25, 2022); *Hydration Station U.S. Franchise Sys., LLC v. Seaverns*, No. 19-cv-05192-LMM, 2021 U.S. Dist. LEXIS 269461 (N.D. Ga. Jan. 13, 2021); *R&F, LLC v. Brooke Corp*., No. 07-2175-JWL, 2008 U.S. Dist. LEXIS 7452 (D. Kan. Jan. 31, 2008) (enforcing mandatory mediation provision contained in parties' franchise agreement).

[30] Am. Arb. Ass'n, D*rafting Dispute Resolution Clauses* (2013), https://www.adr.org/sites/default/files/document_repository/Drafting_Dispute_Resolution_Clauses-A_Practical_Guide.pdf.

action when the clause is deemed permissive.[31] A clear provision specifying which state's law will apply will also ensure a better chance of consistency across different jurisdictions. This can be particularly useful for agreements that are carried out across multiple states, as it provides more certainty on which laws will govern the terms of the agreement.[32]

4. Business Challenges (and Opportunities) in Franchise Supply Chain Management

Managing the supply chain in any franchise system presents a unique set of challenges. Unlike a traditional corporate structure where supply chain decisions are centrally managed, franchises must balance the need for standardization with the reality of operating independent business units and diverse locations. This section explores two critical aspects of franchise supply chain management: (i) balancing franchisor control with franchisee autonomy; and (ii) ensuring continuity of supply through risk mitigation strategies.

4.1. Balancing Franchisor Control and Franchisee Autonomy

One of the defining characteristics of a franchise system is the relationship between the franchisor, which establishes brand standards, and the franchisees, who operate their businesses under the franchisor's framework. Supply chain management is a frequent battleground for conflicts between franchisor mandates and franchisee flexibility. It is, of course, the parties' franchise agreement that sets forth the rules of engagement.

(i) Franchisor Mandates vs. Franchisee Flexibility

Franchisors often establish strict requirements regarding the sources of products, ingredients, equipment, and services to ensure consistency across all locations. This is especially critical in industries such as quick-service restaurants, fitness chains, and retail brands, where customer expectations demand uniformity. For example, a franchisor may require all franchisees to purchase specific branded coffee beans, fitness equipment, or retail displays to maintain consistency in product offerings and service quality.

However, franchisees may push back against these mandates, particularly when they perceive that required suppliers charge higher prices than local or alternative vendors. The following sample contract language illustrates a common franchisor requirement:

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31 *Caperton v. A.T. Massey Coal Co.*, 225 W. Va. 128, 133, 690 S.E.2d 322, 327 (2009) ("The second step requires classification of the clause as mandatory or permissive, i.e., whether the parties are required to bring any dispute to the designated forum or are simply permitted to do so."); *Eisaman v. Cinema Grill Sys., Inc.*, 87 F. Supp. 2d 446, 449 (D. Md. 1999) ("Prior to conducting the Bremen analysis, the court must determine whether the forum-selection clause at issue is mandatory or permissive.")

32 The enforceability of these forum selection provisions are very complicated and fact-specific, and must be analyzed case-by-case. See Stephanie J. Blumstein & John M. Doroghazi, *The Litigation Before the Litigation*, Am. Bar Ass'n, 46th Annual Forum on Franchising W-9 at 16-25 (Nov. 1–3, 2023); Bryan W. Dillon & Ann H. MacDonald, *The Long Arm of the Law: The Extraterritorial Scope of State Franchise Registration and Disclosure and Relationship Laws in Litigation*, Am. Bar Ass'n, 45th Ann. Forum on Franchising W-5, at 1–2 (Nov. 2–4, 2022).

"Franchisee shall purchase all designated products, equipment, and supplies exclusively from franchisor-approved suppliers, as listed in Exhibit B. Franchisee may request approval for an alternative supplier, provided such supplier meets the franchisor's quality standards and pricing requirements, as determined in the franchisor's sole discretion."

This language ensures compliance with brand standards while allowing franchisees to propose alternatives—though ultimate control remains with the franchisor.

(ii) Managing Franchisee Pushback and Buy-in Strategies

Franchisee resistance to mandated suppliers can lead to disputes, impacting operational efficiency and brand cohesion. To promote and foster franchisee buy-in, franchisors can implement several strategies:

- Volume Discounts and Rebates: Offering discounts or rebates for bulk purchasing through approved vendors can incentivize compliance. For example, a restaurant franchisor could negotiate a 10% discount for franchisees who order through the designated supplier network.
- Quality and Brand Protection Justifications: Communicating the rationale behind supplier mandates—such as food safety, quality control, or warranty support—can help align franchisees with the franchisor's perspective.
- Franchisee Advisory Councils: Establishing a supply chain advisory council with franchisee representation ensures that their concerns are heard and considered in supplier decisions.
- Flexibility in Non-Essential Items: While core products should remain standardized, granting franchisees flexibility in non-essential supplies (e.g., office supplies, local marketing materials) can create goodwill without compromising brand integrity.

Here is a sample contract clause regarding an advisory council:

> **"Franchisor shall consult with the Franchisee Supply Chain Advisory Council on material changes to designated suppliers. While franchisor retains final decision-making authority, it shall consider input from franchisee representatives to ensure supplier selection aligns with operational needs and cost efficiencies."**

By incorporating these strategies, franchisors can reduce resistance and foster a more cooperative supply chain environment.

4.2. Continuity of Supply and Risk Mitigation

Nowadays more than ever, companies are only as strong as the weakest link in their supply chains. Ensuring a reliable supply of products and materials is critical to maintaining brand standards and avoiding disruptions that could impact customer satisfaction and franchisee profitability. However, supply chain disruptions—from natural disasters to geopolitical events—pose a constant threat.

(i) Supply Chain Disruptions and Contingency Planning

Franchises must prepare for disruptions such as:

- Supplier shutdowns or delays (e.g., COVID-19-related factory closures).
- Transportation bottlenecks (e.g., port congestion, trucking shortages).
- Stop-shipment issues and negotiations related to the tariffs and trade wars.
- Natural disasters (e.g., hurricanes, wildfires).

To mitigate these risks, franchise agreements should include provisions requiring contingency planning. One such example to create some inventory buffer:

> **Franchisee shall maintain a minimum inventory of four weeks' worth of designated critical supplies to ensure continuity of operations in the event of supply chain disruptions.**

Additionally, franchisors can implement a centralized crisis response team to assist franchisees when disruptions occur.

(ii) Diversification vs. Sole-Sourcing Strategies

A key decision in franchise supply chain management is whether to source from a single supplier or multiple vendors.

- Sole-sourcing advantages: Ensures brand consistency, simplifies logistics, and may lead to volume discounts.

- Diversification advantages: Reduces risk by allowing franchisees to source from multiple suppliers in case of disruption.

Most companies elect to employ some combination depending upon the product at issue, the supplier(s), its availability and location. A hybrid approach is often most effective, where core products are sole-sourced, but backup suppliers are approved for contingency use. For example, a franchise agreement may contain the following language with sourcing leeway:

> **Franchisee shall source all primary ingredients from designated suppliers; however, in the event of an approved force majeure event or with other written approvals for good cause shown, franchisor shall**

authorize emergency alternative suppliers to ensure continuity of service.

(iii) Crisis Management and Force Majeure Considerations

Force majeure clauses help protect both franchisors and franchisees in case of unforeseen disruptions. The purpose of a force majeure clause is to excuse a party's performance in the event that a designated event actually prevents a party from performing its contractual obligations (not just that performance becomes more expensive). Well-drafted agreements specify what constitutes a force majeure event and how obligations are adjusted accordingly. Here is an example of a force majeure provision that applies to both franchisor and franchisee:

> **Neither franchisor nor franchisee shall be liable for delays or failures in performance due to events beyond their control, including but not limited to natural disasters, labor strikes, government-imposed restrictions, or global supply chain disruptions. In such events, the party declaring force majeure shall promptly notify the other party and provide regular updates regarding the expected duration of the event. The parties shall use commercially reasonable efforts to mitigate impacts and resume normal operations as soon as practicable.**

As additional protections, franchisors should develop crisis management playbooks outlining steps for:

- Rapid Supplier Substitution: A process for fast-tracking approval of alternate vendors.
- Inventory Allocation Strategies: Prioritizing supply distribution to high-traffic or high-revenue locations.
- Communication Protocols: Guidelines for informing franchisees and customers about shortages or substitutions.

By proactively addressing these challenges, franchise brands can strengthen supply chain resilience and maintain consistency across locations.

Managing a franchise supply chain requires balancing franchisor control with franchisee flexibility while mitigating supply risks. By implementing clear contractual provisions, fostering franchisee buy-in, and preparing for supply disruptions, franchisors can create a more robust and cooperative supply network. In an era of increasing global uncertainty, these strategies will be essential for franchise success.

5. Managing Relationships Between Distributors, Supply Chain Managers (i.e., Franchisors/Purchasing Cooperatives), and Franchisees

Distributors play an integral role in a franchise system's supply chain by purchasing goods and reselling and distributing such goods to the retail outlets. Distributors usually purchase approved products in bulk from suppliers designated or approved by the franchisor or purchasing cooperative and use such products to fulfill and distribute orders directly to the applicable franchise outlets. Distribution companies vary in sizes and operational capacities and can range from small local operators that serve a specific territory, to large national broadline distributors that have the ability to service entire franchise systems. Managing the relationships between third party distributors, the supply chain manager (whether that be the franchisor or a purchasing cooperative) and the franchisees is a critical component of effective supply chain governance in franchise systems. These relationships form the operational framework through which goods flow from the suppliers to the franchise outlets, but they can also create a complicated web of legal obligations, business expectations, and potential conflicts. Distributors, in turn, face challenges in meeting the diverse needs of franchisees across multiple markets, while maintaining consistency, cost efficiency, and service levels.

5.1. Supply Chain Manager's Role in the Distributor Relationship

Typically, the franchisor or purchasing cooperative, as applicable, acts as the primary decision-maker in selecting and managing distributors on behalf of the system and will contract directly with one or more distributors through agreements that govern the terms under which products are sourced, distributed, and delivered throughout the designated delivery area identified in each such agreement. These agreements serve as the legal and operational foundation for the relationship with the distributors and standardize key terms such as pricing, delivery schedules, service level requirements, reporting requirements, quality standards, remedies and termination rights. Maintaining the contract at the supply chain manager level, rather than at the individual franchisee level promotes system-wide consistency, economies of scale, and reduces the administrative burden on individual franchisees. After the agreement is negotiated and executed the supply chain manager's role shifts from direct interaction to oversight. The supply chain manager usually does not submit orders to the distributors directly on behalf of the system. Instead, the supply chain manager's role involves monitoring the distributor's performance, tracking service level compliance, managing and assisting with the resolution of complaints from franchisees and enforcing contractual obligations on behalf of the system.

5.2. Distributor Challenges in Franchise Supply Chains

The complexity of franchise networks can present a unique set of challenges on distributors that can strain distributor performance and leave distributors caught in the middle between the requirements of the franchisor or purchasing cooperative and the individual demands of franchisees.

Franchise systems can span multiple regions and can include franchisees of varying sizes, operational capabilities and order volumes. Broadline distributors that have the operational capabilities to serve larger portions of, or multiple regions of a franchise system are required to service a customer base with varying needs, while at the same time maintaining consistency in delivery, product availability, and pricing. Successfully navigating this complex landscape requires distributors to operate and maintain a robust infrastructure, flexible logistics, and scalable systems – particularly when servicing growing franchise systems with an expanding number of outlets in the distributor's service territory.

As noted above, distributors typically enter into agreements with the franchisor or purchasing cooperative, but orders for fulfillment are placed with the distributor by the individual franchisee locations. As a result, distributors are frequently caught in the middle of the desires and expectations of the franchisors or purchasing cooperatives, and those of the franchisees. The lack of a direct contractual relationship with franchisees can also make it difficult for distributors to enforce payment terms, resolve disputes, or navigate and effectively respond to individual franchisee needs. Confidentiality obligations within the distribution agreement entered into with the franchisor or purchasing cooperative can also limit the distributor's ability to share certain information with individual franchisees, thus negatively impacting the flow of information between the distributor and franchisees, which can lead to a source of frustration and a lack of trust from the franchisees.

Finally, distributors often face operational challenges when servicing larger portions of a franchise system. Master distribution agreements typically require distributors to meet specific service level requirements (e.g., minimum order fill rates, order accuracy percentages, response times, shipping times, quality standards, etc.) and failure to meet such requirements can lead to penalties, strained relationships, and in worst case scenarios, termination of the agreement. The service level requirements often impose uniform standards across the system, that don't take into consideration regional differences or logistical complexity and may not reflect the on-the-ground realities of serving diverse franchise locations. Mitigating factors such as traffic congestion, remote franchisee locations, or delays from upstream suppliers can make consistent performance difficult – particularly when the same standards area applied across urban, suburban, and rural areas. As a result, although intended to ensure consistency and protection for the brand, these service level requirements can place a substantial operational and financial burden on distributors.

5.3. Franchisee Concerns and Pushback

Despite the benefits of contracting with distributors at the supply chain manager level, franchisees can still raise concerns about the terms of the agreements, and/or the performance of individual distributors, and these centralized agreements can be a source of frustration to franchisees who feel disadvantaged by the outcomes. Understanding and addressing these concerns is critical to maintaining franchisee trust (both at the distributor and supply chain manager level) and minimizing disputes.

Franchisees often question whether they are being charged fair and competitive prices under the distributor arrangement – particularly when they are required to purchase specified products directly from select distributors. Concerns often arise if there are administrative or delivery fees charged by the distributor that may be perceived by the franchisees to be arbitrary, or if price changes occur without sufficient notice. Additionally, franchisees may push back if they feel they could obtain the same product at a lower cost through local sources.

As with many areas of business, parties are less inclined to raise objections or concerns when things are going smoothly, but when things don't go as planned, all bets are off. When distributors fail to meet service expectations, have frequent late deliveries, deliver incomplete or incorrect orders, or can't fulfill volume demands, franchisees may blame both the distributor and the franchisor or purchasing cooperative. This blame, and the associated frustration, is likely to be further ignited by the fact that the franchisees' ability to resolve issues directly is limited because the franchisees often lack a direct contractual relationship with the distributors, and the franchisees must rely on the franchisor or purchasing cooperative to find a resolution. The inability to resolve issues directly can strain franchisee relationships with supply chain managers if the franchisees feel their concerns are not being addressed adequately or quicky enough.

As issues arise, franchisees may also express concern and frustration over restrictions that limit their ability to source locally in order to respond to supply shortages or reduce costs. Mandatory purchasing requirement that exclude local alternatives can be particularly frustrating for franchisees operating in remote or rural areas where distributor performance is costly and/or inconsistent. Pushback may also arise when approved products don't align with local market demands and the franchisees have no exceptions for substitutions.

5.4. Best Practices for Aligning Interests Among Distributors, Franchisors/ Purchasing Cooperatives, and Franchisees

(i) Build Clear and Balanced Distribution Agreements

Distribution agreements should clearly define the obligations of all parties, fairly allocate risk and responsibility, and incorporate flexible terms that reflect real-world operational challenges that are specific to the particular franchise system. During the contract negotiation process, franchisors or purchasing cooperatives should collaborate with distributors to set realistic, data-driven service level requirements that reflect the franchise system's variability and operational constraints of the distributor. Effective contractual drafting and ongoing communication are key to aligning expectations with reality, minimizing risk and operational delays, and maintaining long-term, productive distributor relationships.

(ii) Foster Franchisee Input and Transparency

As already discussed, transparency can go a long way in fostering a positive relationship with franchisees. To maintain franchisee trust and buy-in, franchisors and purchasing cooperatives should prioritize transparency and communication in managing distributor relationships. Transparency around pricing, markups, volume rebates, and service commitments is critical to avoid perceptions of unfairness or mismanagement. Franchisors and purchasing cooperatives can also create structured opportunities for franchisees to provide input on distributor selection and performance evaluations to give the franchisees a sense of involvement in the process.

(iii) Design Collaborative Performance Monitoring Systems

Supply chain managers should implement data-driven systems to monitor distributor performance against the service level requirements. These systems should be accessible to both distributors and franchisees, enabling a shared understanding of expectations and performance. Where service failures occur, there should be a clear escalation process and dispute resolution mechanisms that ensure timely and fair outcomes that all parties are aware of.

(iv) Provide Flexibility for Local and Alternative Sourcing in Defined Circumstances

Rigid supply chain structures that prohibit any local sourcing, particularly in remote or rural areas, can lead to franchisee pushback and place significant operational burdens on distributors that are required to maintain system-wide performance requirements. Supply chain managers should consider establishing controlled pathways for franchisees to request exceptions or substitutions – subject to quality and brand compliance standards. Allowing for some level of controlled flexibility can reduce conflict and franchisee pushback, and operational strains for the distributors.

6. Best Practices for a Strong and Transparent Supply Chain

As an initial matter, there is no such thing as an unbreakable supply chain. However, there are best practices that can be implemented and lessons that we have all learned over the last 5+ years to improve supply chain resiliency.

A well-structured and transparent supply chain is essential for franchise systems to maintain brand consistency, operational efficiency, and franchisee satisfaction. Franchisors must implement best practices in contracting, pricing transparency, and collaboration between legal and business teams to ensure smooth operations and protect against risks. This section outlines key strategies for structuring supplier agreements, maintaining fairness in pricing, and fostering cooperation between legal and business teams to balance compliance with commercial success.

6.1. Contracting Best Practices

Clear, well-drafted supply chain agreements serve as the foundation of a strong franchise supply network. These contracts must balance franchisor control, supplier obligations, and franchisee needs while maintaining the flexibility necessary to adapt to disruptions.

(i) Clear and Fair Supplier Agreements

Supplier agreements should explicitly define obligations, pricing structures, quality standards, and dispute resolution mechanisms. Ambiguity in supplier contracts can lead to operational bottlenecks, compliance risks, and franchisee dissatisfaction.

Key elements of a strong supplier agreement include:

- Defined Scope of Supply: Specify which products or services the supplier will provide, including quality and delivery standards.
- Delivery Dates: If time is of the essence, then it needs to be noted with strict parameters included for delivery targets and consequences or penalties in the event the dates are not met.
- Performance Metrics: Establish benchmarks such as lead times, order fulfillment rates, and defect tolerances.
- Dispute Resolution Mechanisms: Include dispute escalation, mediation and/or arbitration clauses to resolve conflicts without costly litigation, but always include a carveout to seek emergency injunctive relief in any court of competent jurisdiction.

Here is some sample contract language regarding quality control:

> **Supplier agrees to provide the products listed in Exhibit A in accordance with franchisor's quality control standards. Supplier shall maintain an order fulfillment rate of at least 98% and ensure product availability within the agreed lead time of five (5) business days. Any disputes shall be resolved through arbitration under the American Arbitration Association rules.**

By ensuring clarity in supplier obligations, franchisors can create a stable and efficient supply chain that minimizes operational disruptions.

(ii) Transparency in Pricing and Rebates

Lack of transparency in pricing and supplier rebates is a common friction point in franchise supply chains. Franchisees often push back when they suspect franchisors are benefiting from undisclosed rebates or inflated pricing structures.

To build trust, franchisors should:

- Disclose supplier rebates and volume discounts to ensure franchisees understand cost structures.

- Ensure pricing parity where franchisees receive the same or better pricing than independent buyers.

- Negotiate tiered pricing models that allow franchisees to benefit from volume-based discounts.

Here is some sample contract language for transparency:

> **Franchisor shall disclose any rebates, incentives, or discounts received from approved suppliers. Any volume-based rebate programs negotiated by franchisor shall be equitably allocated among participating franchisees, proportionate to their purchases.**

This type of contractual provision reassures franchisees that they are receiving fair pricing and prevents legal disputes over hidden fees.

(iii) Structuring Agreements to Allow Flexibility in Supply Chain Disruptions

Given the increasing frequency of supply chain disruptions—ranging from raw material shortages to geopolitical issues—franchise supply contracts must include flexibility mechanisms.

Best practices include:

- Alternative Sourcing Clauses: Allow franchisees or the franchisor to procure from secondary suppliers in case of disruptions.

- Force Majeure Clauses: Define conditions under which contractual obligations may be suspended due to uncontrollable events.

- Minimum Inventory Requirements: Mandate that franchisees maintain buffer stock to cushion against supply chain shocks.

Here is sample contract language for supply chain flexibility that ties into the force majeure provision:

> **In the event of a supply chain disruption, including but not limited to any force majeure event, franchisor shall have the right to approve alternative suppliers to ensure continuity of operations. Franchisee shall maintain a minimum inventory of four (4) weeks' supply of all essential products to mitigate supply chain risks.**

By incorporating these provisions, franchisors can protect their brand while ensuring franchisees have the flexibility needed to adapt to supply disruptions—which likely are inevitable.

6.2. Collaboration Between Legal and Business Teams

A well-functioning franchise supply chain requires close collaboration between legal teams, responsible for compliance and risk mitigation, and business teams, which focus on efficiency and profitability. Ensuring alignment between these two groups minimizes operational bottlenecks and maximizes commercial success.

(i) Legal's Role in Ensuring Compliance and Mitigating Risks

Legal teams play a crucial role in drafting enforceable agreements, maintaining regulatory compliance, and protecting franchisors from liability. Key responsibilities include:

- Regulatory Compliance: Ensuring contracts align with franchise laws, trade regulations, and supplier agreements.
- Contract Enforcement: Monitoring supplier and franchisee compliance with agreed-upon terms.
- Risk Management: Identifying legal risks in pricing, sourcing, and supply continuity.

Here is just one example:

> **Franchisee acknowledges that all designated suppliers must comply with applicable health and safety regulations, including FDA, USDA, and OSHA requirements. In the event of a regulatory violation, franchisor reserves the right to terminate the supplier relationship and approve an alternative vendor.**

This ensures that supply agreements remain compliant with industry regulations, protecting the brand from legal liability.

(ii) Business Team's Role in Supply Chain Efficiency and Negotiation

The business functions and targets are paramount. Of course, the ultimate terms will depend on leverage and appetite for risk (as framed by legal). The business team will be the gatekeeper to ensure that the supply chain operations are cost-effective and efficient. Their key responsibilities include:

- Negotiating favorable supplier terms to maximize cost savings for franchisees.

- Monitoring supply chain performance to identify inefficiencies and improve service levels.

- Balancing cost with quality to ensure that pricing decisions do not compromise brand standards.

Business teams should work closely with legal teams to ensure that commercial decisions align with contractual obligations.

Here is one example of business-driven pricing strategy that would be revisited on a quarterly basis:

> **Franchisor shall negotiate volume discounts with designated suppliers on behalf of franchisees. Franchisee pricing shall reflect all available rebates, and franchisor shall provide quarterly reports summarizing savings achieved through consolidated purchasing.**

Provisions like this help business teams communicate pricing strategies transparently while maintaining legal compliance.

(iii) Bridging Gaps Between Legal Risk Mitigation and Business Objectives

Conflicts can arise when legal teams prioritize risk mitigation while business teams push for operational flexibility. To bridge this gap:

- Create Cross-Functional Supply Chain Committees: Establish joint working groups that include representatives from legal, procurement, and franchise operations to ensure alignment.

- Use Clear, Business-Friendly Contract Language: Avoid overly rigid legal language that may hinder operational decisions.

- Develop Playbooks for Supply Chain Challenges: Draft pre-approved responses for common issues, such as supplier failures, so business teams can act quickly without seeking legal approval for every decision.

By fostering collaboration between legal and business teams, franchise brands can optimize supply chain efficiency while ensuring legal protection.

6.3. Fostering a Positive Franchisor/Franchisee Relationship

(i) Clarifying Franchise Agreement Terms

The franchise agreement typically gives the franchisor complete discretion to impose various restrictions on the supply chain. Some franchise agreements leave franchisees with the option to use their own suppliers or distributors if the good or service meets the franchisor's standards and specifications; however, the franchisor may require that the proposed supplier or distributor pass a stringent approval process. Franchisors may develop and modify their standards and specifications periodically, so the franchise agreement should provide the franchisor with this flexibility. The following is a sample franchise agreement provision limiting the franchisee's role in the supply chain while giving the franchisor broad flexibility to manage the supply chain:

We reserve the right to require you to purchase merchandise and other products, supplies, furniture, fixtures, equipment and services used in the development or operation of the Franchised Business only from suppliers that we designate or approve (which may include or even be limited to us, our affiliates, other restricted sources or some combination of these), and then use them or offer them for sale (as applicable) in the Franchised Business. You may not manufacture, use, sell, or distribute, or contract with any party other than us or our affiliates to manufacture, use, sell, or distribute, any merchandise or equipment bearing any of our marks without our prior written approval, which we may withhold in our sole discretion. We have the right to derive revenue from you and to derive revenue and receive payments from manufacturers and suppliers on account of sales to you and to use all such amounts we receive without restriction for any purposes we deem appropriate.[33]

(ii) Transparency and Restrictions Over Supplier Income

As noted earlier, supplier income can be a source of great contention between a franchisor and its franchisees. Compliance with the FDD disclosure requirements will check the regulatory box, but will not guaranty that conflicts won't arise between the franchisor and its franchisees. Franchisors can attempt to mitigate the pushback on supplier income by restricting the types of payments that the franchisor is permitted to receive and memorializing such restriction in the franchise agreement or a separate agreement.[34] When considering this type of approach, a franchisor will want to consider the impact that these types of restrictions would have on the potential revenue of the franchisor and the types of supplier income that may be a source of greater contention with the franchisees.

The following are types of supplier income that franchisees will generally regard as appropriate:

- Marketing and promotional allowances from vendors that are distributed pro rata among the franchisor and franchisees based on purchasing volume;
- Discounts and rebates that are provided to franchisees as well as the franchisor pro rata based on purchasing volume;

[33] Romo et al., at 52-53.
[34] Id. at 49.

- Higher prices for goods or equipment charged by approved suppliers to amortize the approved suppliers' expenses related to research and development of new goods and equipment (preferably with approval by the franchisees);

- Reasonable fees (not exceeding a franchisor's actual costs) charged to approved suppliers and distributors in connection with the approval/disapproval process and in connection with quality assurance;

- Benefits to the franchisor in the form of product development ideas or consumer research provided by approved suppliers and approved distributors in the ordinary course of business that does not impact the cost or other terms for the sale of goods or equipment from those suppliers and distributors;

- Supplier income and other benefits solicited or managed by the franchisor to sponsor franchisee conventions or other franchisee meetings, where the franchisees have approved the supplier income or benefits;

- Supplier income related to the franchisor's proprietary products to the extent permitted under the franchise agreement; and

- Supplier income for specific products or from specific suppliers or distributors that is approved by the franchisees.[35]

7. Conclusion

A strong and transparent franchise supply chain requires intentional and strategic supply chain management, clear contracting, fair pricing, effective collaboration between legal and business teams, and transparency and effective communication between the supply chain manager and the franchisees. By implementing best practices in supplier agreements, maintaining transparency in pricing structures, fostering cross-functional collaboration, and focusing on building and maintaining a strong relationship with franchisees, supply chain managers can build a resilient supply chain that benefits both corporate leadership and franchisees. In an increasingly complex global market, these strategies will be essential for maintaining operational stability and franchise system success.

[35] Id. at 49.

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Toni Brown is a shareholder in Greenberg Traurig's Atlanta office. Toni specializes in drafting and negotiating commercial contracts, with a distinct emphasis on supply chain and distribution agreements. Leveraging a wealth of practical experience that she developed both in private practice, and in over the decade she spent in-house, Toni takes a uniquely business-focused approach to document review and negotiation. With an astute understanding of corporate dynamics and the complexities of supply chain operations, Toni regularly counsels clients on optimizing contractual arrangements for seamless supply chain and distribution operations, and consistently seeks to ensure clients have adequate protections and practical remedies in their agreements. Toni has represented some of the largest franchise brands in the food and beverage industry. However, her skills and experience easily translate across a variety of industries, helping her to serve clients outside of the food and beverage industry as well.

Prior to joining Greenberg Traurig, she served as senior director of supply chain for a multi-brand restaurant company whose portfolio at the time of her employment included nearly 32,000 locations. In this role, she was the primary legal support for the procurement and distribution teams responsible for the development and maintenance of a centralized multi-concept contracting process designed to ensure uniform contracting across brands, maximize efficiencies, and drive value. Toni earned her law degree, with honors, from The University of Texas School of Law and her MBA, magna cum laude, from Florida A&M University.

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Kim S. Magyar is the General Counsel for McLane Company, Inc.'s Retail division. McLane provides retail and restaurant supply chain solutions to convenience stores, mass merchants, drug stores, restaurants and warehouse clubs. McLane and its subsidiaries operate 80 distribution centers and one of the nation's largest private fleets. The Retail division optimizes the purchase, flow and sale of tens of thousands of consumer products to over 46,000 retail locations across the United States. Kim provides strategic legal advice on retail transactional, litigation and operational matters. She focuses on legal services that reduce overall legal, regulatory and compliance risk, while growing revenue and income through flexible and innovative business arrangements and ventures. Kim earned her bachelor's degree from the University of Wisconsin at Madison and her law degree from Marquette University. Kim has served on the U.S. Chamber of Commerce's litigation center's advisory committee and currently serves on the Board of Directors of the Temple Symphony Orchestra located in Temple, Texas.

Vanessa Miller

Vanessa Miller is a litigation partner with Foley & Lardner LLP and Chair of the firm's national Automotive Team, as well as on the advisory committee of the firm's Manufacturing Sector. She served as a former chair of the Detroit office's Litigation Department. Vanessa's practice focuses on a wide array of supply chain disputes, including breach of contract and warranty claims, automotive supply chain issues and maintaining continuity of supply, defending manufacturers against class actions, trade secret misappropriation claims and business torts. Recognized as a nationally ranked top lawyer by Chambers for Transportation: Road (Automotive) for the past two years, showcasing her deep expertise and leadership in the field.

Vanessa has successfully managed, litigated and tried cases in state and federal courts, as well as handled appellate proceedings. She has significant experience handling complex international arbitrations in various venues, including the Court of Arbitration of the International Chamber of Commerce (ICC), the American Arbitration Association (AAA), the Judicial Arbitration and Mediation Services Inc. (JAMS) and the Singapore International Arbitration Centre (SIAC). Vanessa also has represented clients in commercial mediations, resulting in early resolution of legal disputes and creative business solutions for parties continuing to do business together.

In addition to her litigation, international arbitration and mediation experience, Vanessa regularly counsels clients on various commercial contracts, supply chain agreements, supply chain shortages, force majeure issues, pricing disputes and related negotiations.