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Redrawing and Redefining: Best Practices to Affect Systemwide Change

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I. INTRODUCTION.

Gillian Hadfield, wrote an article in which she referred to franchise agreements as incomplete contracts.[1] She pointed out the basic, problematic nature of the franchise relationship, which, she posited, was partly caused by the fact that the franchisor alone retains the power to change the business over the course of the relationship and the franchisee has little power to resist. Hadfield points out the inherent tension in the franchise relationship, writing "[a]lthough franchisees often make very large sunk investments in their franchises, an exercise of franchisor control may easily threaten a franchisee's investment. In turn, franchisees can reduce, sometimes significantly, the accumulated reputation capital of the franchisor by failing to maintain quality control."[2] Hadfield recommended a framework for addressing franchise disputes that took the realities of the unusual franchisee/franchisor relationship into account. While no such framework has been codified, over the decades since Hadfield's paper was published, a large body of caselaw has developed to address franchisor control with respect to changes to a franchise system.

From the franchisor's perspective, as the marketplace changes, it is the franchisor's role and responsibility to adapt the system to respond. From the franchisee's perspective, franchisors should not undertake changes that threaten the health and stability of their franchisees' businesses. Both are correct. Some systems that were once very successful are no longer with us because they were rendered irrelevant by technology. Just 20 years ago, the Blockbuster franchise system had more than 9,000 locations worldwide. Now, there is only one remaining location. Many one-hour photo developing franchise systems were once popular. Today, there is little need to develop photographs at all, let alone wait an hour to see them. But what about the Howard Johnson's restaurant system, with its bright orange roofs and 28 flavors of ice cream? Once, more than 1,000 of them clustered on roadsides across the country; the last one closed three years ago. Customers have never stopped eating at restaurants, but the Howard Johnson's restaurants failed to meet changing consumer needs. Franchise systems *must* change if they are to remain vital, but change often brings tension with franchisees.

In this paper, we look at common system changes and sample contract provisions that can allow for those changes, we examine notable examples of litigation where franchisees have resisted particular changes, review methods for enacting changes, examine challenges to changes, whether from contracts, developing caselaw, or statutory restrictions, and make recommendations to franchisors and franchisees.

II. COMMON SYSTEM CHANGES AND SAMPLE CONTRACT PROVISIONS.

The foundations for system change are, of course, the franchise agreement and the Operations Manual and the provisions within them that allow for changes. Most franchise agreements contain provisions allowing franchisors to make changes to the system over time. For example, this provision reserves the franchisor's general right to vary, amend, add to or delete from standards:

> *As franchisor, we have the right to establish "Standards" for various aspects of the System that include the location, specifications, physical characteristics and quality of operating systems .... We make those Standards available to you in our manuals and in other forms of communication, which we may update from time to time…and we may from time to time vary Standards as we deem necessary or desirable.*

Often, the Operations Manual is a vehicle for change in the system, and the franchise agreement provides that changes will be implemented through the Manual. Typically, changes to the Operations Manual are limited to the actual operation of the business and do not affect fees, advertising obligations, or substantial

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[1] Gillian Hadfield, *Problematic Relations*: *Franchising and the Law of Incomplete Contracts,* 42 STAN. L. REV. 927 (1990).

[2] Id.

investments in the franchised business. Franchisors and franchisees should be mindful of whether a change in the Operations Manual may amount to a de-facto amendment of the franchise agreement.

Many agreements contain additional provisions laying the foundations for change. Perhaps the most obvious are those requiring physical refreshes of the franchise property, or complete renovation every few years.

Finally, provisions conditioning renewal of an existing agreement upon the franchisee's acceptance of a new agreement – the "then current" agreement – may provide a basis for the franchisor to impose entirely new provisions on the franchisee.

The discussion below focuses first, on how courts have construed existing provisions in franchise agreements and, second, on renewal provisions.

a. Types of Change and Relevant Contract and Operations Manual Provisions.

Virtually every franchise agreement gives the franchisor the power to effectuate changes in the system. These broad rights typically appear in the recitals, and in sections describing the "system," the franchisee's obligations, and trademarks. These include broadly-worded provisions and provisions that require the franchisee to comply with specifically-enumerated changes to particular aspects of the system.

The sections below consider, first, broadly-worded provisions giving franchisors general powers to change the system, and second, specific provisions.

i. Updates to Customer Offerings.

As stated above, franchise agreements often contain broadly-worded provisions encompassing a vast array of changes to the system. As an example:

> *Operation of Franchised Business Location. In order to maintain the highest degree of quality and service on a uniform System-wide basis, Franchisee shall operate the Franchised Business in conformity with the methods, standards and specifications prescribed by Franchisor. Franchisee agrees to comply with the Manual, as it is modified from time to time, and all directives, rules and procedures specified by Franchisor… [and goes on to specifically enumerate other obligations of the Franchisee in operating the business according to the Franchisor's specifications, all of which are subject to change…]*

Sometimes a broadly-worded provision might backfire. A specific provision that allows a franchisor to make a particular change provides clear support for the Franchisor seeking to make that change. By contrast, Franchisor making a big or fundamental change to its system and then seeking to argue that such a change constitutes a "method, standard, or specification" may face significant opposition from franchisees, as the cases below show.

An early Burger King case, in 1966, challenged the franchisor's right to increase the meat content in its hamburgers. The court held that a general contract provision under which the franchisee agreed "not to deviate from the forms or specifications of materials and standards of cleanliness or sanitation set by [franchisor]" required the franchisee to follow standards as they may be changed over time because "one of the objects [of the agreement] is to provide uniformity among all franchised restaurants" and that uniformity could be achieved only through the franchisor's promulgation of standards, which could change from time to time.[3]

In *In re Sizzler Restaurants, Int'l, Inc.*[4] relying on broad provisions under which the franchisor provided the franchisee with operations manuals, training, management programs and other assistance, the court ruled that Sizzler had broad discretion to modify the franchise system, unless it "acted dishonestly or outside of accepted commercial practices, or with an improper

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[3] *Trail Burger King, Inc. v. Burger King of Miami, Inc.*, 187 So. 2d 55 (Fla. Dist. Ct. App. 1966).

[4] *In re Sizzler Restaurants Int'l, Inc.*, 225 B.R. 466 (Bankr. C.D. Cal. 1998), Bus. Franchise Guide (CCH) ¶11,408 (C.D. Cal May 11, 1998).

motive or in an unreasonable manner that was arbitrary, capricious, or inconsistent with the reasonable expectations of the parties."[5] In that case, the proposed change – the removal of a buffet court concept – was backed by sales data and endorsed by the trustees of the National Sizzler Franchisee Association.[6] Sizzler's changes were intended to address system-wide problems, such as declining average checks and reduced customer perceptions of quality.[7] The court declined to doubt Sizzler's business judgment because it had been exercised honestly and not in bad faith.[8]

ii. Franchisee Renovations and Refurbishment.

Requirements that franchisees undertake refurbishment of the physical premises may be viewed as onerous by franchisees. If properly drafted and implemented, however, they will usually be enforced. The following is an example of a well-drafted provision:

> *To assure the continued success of the Store, you shall, upon our request, upgrade, remodel and/or redecorate the Store premises, equipment (including point of sale or computer hardware and software systems), signs, interior and exterior decor items, fixtures, furnishings, supplies and other products and materials required for the operation of the Store to our then-current System-wide standards and specifications. We agree that we shall not request such upgrading, remodeling and/or redecorating more frequently than every five (5) years during the term of this Agreement, except that* ***if*** *the Store is transferred, we may request that the transferee remodel and/or redecorate the Store premises as described herein.*

Unlike the broadly-worded provision cited in II(a)(i), these more specific provisions provide franchisors with even greater support to enact their change initiatives. In *Park 80 Hotels, LLC v. Holiday Hospitality Franchising, LLC,*[9] for example, the franchise agreement at issue gave the franchisor the authority to modify, alter, or remove specifications and policies on construction, furnishing, operations, appearance, and hotel services. The court held the franchisor, therefore, had acted within its contractual rights in requiring expensive property improvement plans, mandatory suppliers, and marketing programs, even though there had been no prior disclosure.[10]

iii. Point-of-Sale System Updates.

Disputes over point-of-sale ("POS") system upgrades highlight the tension between franchisors' need to modernize operations and franchisees' desire to limit costly changes. Courts have repeatedly examined whether such mandates fall within the franchisor's contractual authority or constitute unauthorized modifications.

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5 *Id.* at 474.

6 *Id.*

7 *Id.* at 471.

8 *Id.* at 474.

9 *Park 80 Hotels, LLC v. Holiday Hosp. Franchising, LLC*, No. 1:21-CV-04650-ELR, 2023 WL 2445437 (N.D. Ga. Feb. 16, 2023), reconsideration denied, No. 1:21-CV-04650-ELR, 2023 WL 5523617 (N.D. Ga. Aug. 4, 2023), and appeal dismissed, No. 25-10068-GG, 2025 WL 1859421 (11th Cir. May 20, 2025).

10 *Id.* at *6-10.

In *D.Q.S.A. LLC v. American Dairy Queen Corporation*,[11] the franchisor required franchisees to install a new electronic POS system within a set timeframe.[12] A franchisee claimed that the upgrade was merely "modernization" and pointed to a clause that listed three specific events triggering modernization obligations.[13] The court noted that separate provisions explicitly authorized the franchisor to implement POS updates and require compliance. It rejected the franchisee's interpretation, finding it inconsistent with the agreement's clear language. The court clarified that the modernization clause did not limit the franchisor's authority under other explicit contractual terms referencing POS upgrades.[14]

The court in *Peterbrooke Franchising of America, LLC v. Miami Chocolates, LLC*[15] held that provisions permitting the franchisor to require a new POS system included the power to specify the brand of the POS system, and did not require the franchisor to show the system would be of benefit to franchisees.[16] Interestingly, the appellate court, held that the franchisee's failure to adopt the new POS system was not a material breach of the franchise agreement, based on contractual language (certain provisions in the franchise agreement specified that a breach of obligations therein would be material; the POS system provision did not contain this language), and also based on evidence that some franchisees were allowed to operate with old POS systems, and the old POS system had the same functionality as the new one. As a result, the Eleventh Circuit reversed summary judgment on Peterbrooke's unfair competition claim, and held that summary judgment on the franchisee's claim for wrongful termination was inappropriate.

In *La Quinta Corp. v. Heartland Properties LLC*[17] and *Marco's Franchising, LLC v. Soham, Inc.*,[18] the court held that the franchisor had not breached the franchise agreements by implementing new computer system standards because the agreements expressly granted such discretion to the franchisor. Although the language in one of the Marco's Franchising agreements used the word "upgrade" instead of the word "replace," the court held that "a requirement to upgrade includes a requirement to replace."[19]

Notwithstanding broad rights in many franchise agreements, courts have not given franchisors free reign to implement all changes. In a case limiting a franchisor's power to mandate upgrades, the *Burger King Corp. v. Cabrera* court denied the franchisor's application to enjoin the franchisee from continuing to operate using an old POS system. [20] Although the agreement in that case allowed the franchisor to require upgrades under certain conditions, the court held the franchisor had failed to show likelihood of success on the merits because it had not proven the existing system was "obsolete" – one of the conditions for mandatory upgrades in the contract.[21]

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11 *D.Q.S.A. LLC v. Am. Dairy Queen Corp.*, 680 F. Supp. 3d 1113, 1116 (D. Ariz. 2023*), appeal dismissed*, No. 23-16069, 2023 WL 9476764 (9th Cir. Sept. 8, 2023).

12 *Id.* at 1115.

13 *Id.* at 1118.

14 *Id.* at 1123-1124.

15 *Peterbrooke Franchising of Am., LLC v. Miami Chocolates, LLC*, No. 21-10242, 2022 WL 6635136 (11th Cir. Oct. 11, 2022).

16 *Id.* at *4.

17 *La Quinta Corp. v. Heartland Props. LLC*, 603 F.3d 327,330 (6th Cir. 2010).

18 *Marco's Franchising, LLC v. Soham, Inc.*, 365 F. Supp. 3d 891, 899 (N.D. Ohio 2019).

19 *Id.*

20 *Burger King Corp. v. Cabrera*, No. 10-20480-CIV, 2010 WL 5834869 (S.D. Fla. Dec. 29, 2010).

21 *Id.*

In *Mainstream Fashion Advertising, Inc. v. All These Things, LLC,*[22] the court hinted at broader concerns for franchisors, holding that the franchisees may even be able to prove that the decision to require franchisees to migrate to a new POS system was a violation of the duty of good faith and fair dealing. As set forth below, many franchisees have pursued claims under this theory, with mixed results.

iv. Reservation Systems.

Many franchise systems rely on apps or other technology to manage inventory, rates, bookings, and other aspects of operations. Many of these products are administered through third-parties, but increasingly franchisors are mandating that franchisees use technology or apps owned by the franchisor and/or its affiliates or investors, and, critically, charging a fee for the use of the technology. Franchisees often challenge the change in technology and, critically, the fees. In one such case, *Sirrah Companies, Inc. v. Budget Rent-A-Car Corp.*,[23] the court held that a franchisor could impose a fee for a new reservation system. The franchisee argued it was entitled to free reservations under a 1953 form of agreement. The franchisor sought to charge for the software for an on-line system. The court found that it was "commercially impracticable to enforce the 1961 El Paso prime license agreement in the manner proposed by Plaintiffs"[24] and permitted the franchisor to charge fees for the new systems.[25]

v. Pricing.

Since the end of vertical price restraints, courts have enforced provisions of franchise agreements requiring franchisees to adhere to franchisor pricing requirements. In *Burger King Corp. v. E-Z Eating, 41 Corp.*[26] the provisions in the franchise agreements stated the franchisee "agrees that changes in the standards, specification and procedures may become necessary and desirable from time to time and agrees to accept and comply with such modifications, revisions and additions …" The appellate court held this gave Burger King the authority to require franchisees to adopt its Value Menu pricing.[27] One section of the agreement gave Burger King discretion to decide whether to provide services and another specifically required franchisees to adhere to Burger King's "comprehensive restaurant format and operating system."[28] The court held there was "simply no question that [Burger King] had the power and authority under the Franchise Agreements to impose the Value Menu on its franchisees."[29]

While the franchisor prevailed in this case, it wound up in a protracted legal battle with its franchisees. A subsequent case brought by the franchisee association, challenged the franchisor's imposition of maximum prices on the grounds that a value meal priced below cost violated an express provision of the franchise agreement stating that the franchisor would make pricing

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22 2020 WL 1812501 (D.Minn. Apr. 9, 2020)

23 *Sirrah Companies, Inc. v. Budget Rent-A-Car Corp.*, No. CIV.A. SA-06-CA523OG, 2009 WL 563654 (W.D. Tex. Mar. 4, 2009).

24 *Id.* at *7.

25 *Id.*

26 *Burger King Corp. v. E-Z Eating, 41 Corp.*, 572 F.3d 1306 (11th Cir. 2009).

27 *Id.* at 1313.

28 *Id.* at 1314.

29 *Id.*

decisions in "good faith."[30] The Court rejected the franchisee's argument that below-cost pricing on a single item was evidence of bad faith; rather, the entire mix of the franchisee's menu had to be considered, and in this context, there was no violation of good faith. Further, the inclusion in the contract of an express provision on good faith mooted the franchisee's claim for violation of an implied covenant of good faith.

vi. Marketing and Branding.

Courts have given franchisors wide latitude to change marketing and branding programs. In *TLH Int'l v. Au Bon Pain Franchising Corp.*,[31] the court held the provision in the operative agreement stating the marketing system "may be changed, improved, and further developed by Franchisor from time to time"[32] gave the franchisor the right to change the system marketing concept from café and bakery concept to a restaurant.[33]

In *Economou v. Physicians Weight Loss Centers of Am.*,[34] a franchisor of weight-loss clinics changed its dietary guidelines and, as a result, changed its marketing materials as well. Among other things, the new marketing materials touted a two-pound per week weight loss (whereas old marketing materials under the old dietary guidelines promised five to seven pounds per week of weight loss). The plaintiff-franchisee argued the changes to the marketing materials impacted its sales. The court held that the franchisor's change to its diet program was in its discretion, even though the plaintiffs attributed their financial problems to the change because "the franchise agreements specifically allow[ed] [the franchisor] to make such changes."[35]

vii. Frequent Guest Rewards Programs.

Franchise systems often utilize reward or loyalty programs for customers, which are mandated for franchisees. Here, courts have been more hesitant in granting franchisors broad rights, with decisions analyzing a number of factors in determining whether the change was permissible. One critical component the courts analyze is whether an increase to fees is specifically permitted under the franchise agreement.

In *Custom House v. DoubleTree*,[36] Hilton acquired the DoubleTree brand from Promus, then adopted a system-wide brand standard that required all DoubleTree hotels to adopt the Hilton HHonors frequent guest reward program. The plaintiff-franchisee challenged Hilton's right to change the system. The operative franchise agreement made no mention of a rewards program or system changes. At trial, the arbitration panel considered the following factors: (1) that the proposed change made sound business sense for the overall brand; (2) that all other franchisees in the system had already implemented the change and were generally benefiting from it; and (3) that

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30 *National Franchisee Association v. Burger King Corp.,* No. 09-23435-CIV, 2010 WL 4811912 (S.D. Fla. 2010).

31 *TLH Int'l v. Au Bon Pain Franchising Corp.*, No. CIV.A. 86-2061-MA, 1986 WL 13405 (D. Mass. Nov. 13, 1986).

32 *Id.*

33 *Id.* at *5.

34 *Economou v. Physicians Weight Loss Centers of Am.*, 756 F. Supp. 1024 (N.D. Ohio 1991).

35 *Id.* at 1037.

36 Bus. Franchise Guide (CCH) ¶13,067, 13,068 (Az. Sup. Ct. Apr. 13, 2005).

the program was administered by a nonprofit entity that did not generate profits for Hilton. Taking these factors together, the panel unanimously determined that the guest rewards program constituted a new system standard that the franchisee was required to adopt.[37] These factors included in the decision suggest that the panel would not have issued a blanket approval of any change implemented by Hilton.

Other courts have limited franchisor rights to make changes to loyalty programs. In *Bird Hotel Corp. v. Super 8 Motels, Inc.*,[38] the parent corporation of a hotel franchisor replaced its V.I.P. loyalty program with the TripRewards platform and increased the loyalty-related fee from 2% to 7%. Franchisees sued, arguing the franchisor lacked contractual authority to impose the new 5% charge.[39] The court held the franchisor had breached the franchise agreement by imposing the additional fee because the contract expressly capped loyalty-program costs and did not permit the franchisor to add new recurring charges.[40] Although the franchisor in that case retained broad authority to revise system standards and operational rules, that did not authorize unilateral changes to the agreement's financial terms, meaning that the franchisor could modify the loyalty program's structure and benefits but could not increase franchisees' payment obligations without their consent.[41] This decision is in stark contrast to the *Sirrah Companies, Inc.* case referred to above, where the court upheld the franchisor's right to impose new fees that were commercially practical.[42]

In *Promus Hotels, Inc. v. Inn on Robinwood, Inc.,*[43] the court's decision turned on an unlikely factor: The amount of control the franchisor was exerting over day-to-day operations. In that case, Hampton Inn sought to implement a "100% Satisfaction Guarantee" program which granted the franchisor the right to step in to resolve disputes with guests if the franchisee failed to do so within two days. The court refused to allow the new program because the franchisor was interfering with the day-to-day operations of the location, which were the franchisee's responsibility under the agreement.

b. Renewal Conditions.

Most franchise agreements permit the franchisee to renew its agreement, but condition the renewal upon the franchisee's acceptance of the "then-current" form of franchise agreement at the time of renewal. These provisions lay the foundation for potentially radical or fundamental change, as there is no apparent limit on what the "then-current" agreement can include or how drastically it can differ from the franchisee's former agreement.

Case law generally upholds the franchisor's power to impose fundamental changes in the renewal agreement. In *Bresler's 33 Flavors Franchising Corp. v. Wokosin*, the court upheld the franchisor's right to require renewal upon "the form then being used by the licensor," even though

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37 *Id.*

38 No. CIV 06-4073, 2010 WL 572741 (D.S.D. Feb. 16, 2010).

39 *Id.* at *5-*6.

40 *Id.* at *8.

41 *Id.*

42 *Sirrah Companies, Inc. v. Budget Rent-A-Car Corp.*, No. CIV.A. SA-06-CA523OG, 2009 WL 563654 (W.D. Tex. Mar. 4, 2009).

43 Bus. Franchise Guide (CCH) ¶ 12,570 (Tenn. Chancery Ct. 2003).

it required higher advertising contributions, higher royalties, and remodeling of the shop to current standards.[44] Other cases have upheld new agreements imposing new technology requirements, higher royalties, costs, advertising terms and other materially different terms.[45]

In *Payne v. McDonald's Corp.*,[46] McDonald's conditioned renewal on modernization of the premises when the franchisee's twenty-year term expired. The franchisee argued that requiring renovations as a condition for renewal violated the covenant of good faith and fair dealing. The court disagreed, noting that McDonald's was "at liberty to impose conditions for renewal deemed appropriate by it for the furtherance of its business interests."[47]

Perhaps the high-water mark for change in franchise systems was the rebranding of the entire Mailboxes Etc. system as the UPS Store – a change that involved not only a change in name, but significant changes in the primary service vendor, pricing, unit profitability and market positioning. The franchisees challenged the franchisor's right to change the fundamental nature of the business, as well as the trademark, under the agreement's provision requiring them to accept the "then-current" form of agreement. The Court of Appeal held that the franchisor was required only to offer renewal under the franchise format it was selling at the time of renewal—namely, The UPS Store, because the renewal provision did not impose any obligation on the franchisor to renew the franchise on the same terms as the original agreement. [48] Instead, it stated that any renewal would occur "on the same terms and conditions as are contained in the then current Franchise Agreement for the sale of new MBE Centers." Because the Mail Boxes, Etc. model had been discontinued, the franchisor had no duty to offer renewal under the former MBE terms.[49]

III. HOW TO INTRODUCE CHANGE.

The approach to incorporating changes depends on the change itself. For external forces that reshape the business environment, such as technological advancements, new regulatory frameworks, or changing consumer expectations, franchise systems must adapt quickly by integrating digital ordering platforms, responding to new data privacy statutes, or adjusting operations in light of economic disruptions.[50] For change driven by marketing shifts, reflecting the need to reposition the brand, update product offerings, or reach new customer segments, the franchise system can and should take its time and move deliberately. Franchisors have a number of tools in their toolbox to address change. Systemwide communication is critically important for introducing change. Franchisors can also utilize tools like pilot programs, incentive programs, loans/financing for franchisees, and can implement changes through amendments or renewal agreements.

a. Systemwide Communications.

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44 *Id.* at 1538.

45 *W. L.A. Pizza, Inc. v. Domino's Pizza, Inc.*, No. 207CV07484FMCMANX, 2008 WL 11424181, at *9 (C.D. Cal. Feb. 26, 2008).

46 *Payne v. McDonald's Corp.*, 957 F. Supp. 749, Bus. Franchise Guide (CCH) ¶11,140 (D. Md. Feb. 13, 1997).

47 *Id.* at 758. *See also Test Services, Inc. v. The Princeton Review, Inc.*, No. 05-CV-01674-MSK-CBS, 2005 WL 3211594, Bus. Franchise Guide (CCH) ¶13,450 (D. Colo. Nov. 29, 2005).

48 *Id.* at *10-11.

49 *Id.*

50 W-16 - Implementing Challenging Technologies in Franchise Systems," American Bar Association Forum on Franchising (2023), 1–5, 24–29; "W-20 Implementing Systemwide Changes to Maximize Compliance and Minimize Conflict," American Bar Association Forum on Franchising (2024), 1–4.

Effective systemwide communication is the cornerstone of successful change in franchise systems, particularly when responding to either evolving industry landscapes or shifts in marketing strategies. Systemwide changes require systemwide communication strategies that are transparent, proactive, and inclusive. Utilizing tools such as Franchise Advisory Councils, regular webinars, and written updates, franchisors can articulate the rationale for change, set expectations, and solicit valuable feedback, thereby reducing resistance and fostering a culture receptive to continuous improvement.[51]

While franchisors often reserve the right to implement systemwide changes unilaterally, many of the most successful and enduring changes are those reached through negotiation and consensus with franchisees. This approach not only reduces the risk of resistance and unrest but also leverages the experience and insights of franchise operators, resulting in more practical and widely accepted solutions. Consensual changes are typically facilitated through mechanisms such as Franchise Advisory Councils, franchisee associations, or special committees formed to address a particular issue or initiative.[52]

For example, when one large restaurant brand sought to overhaul its in-store technology platform, it initiated a collaborative process with its franchisee association. The franchisor presented data from pilot programs, invited franchisee representatives to participate in vendor selection, and negotiated timelines and financing options based on feedback from the field. This process led to a phased rollout, with franchisees given flexibility on implementation scheduling and additional support for those facing unique operational challenges. As a result, the technology upgrade was met with broad acceptance and minimal litigation, in contrast to more contentious system changes imposed without input.[53]

These negotiated changes benefit from franchisee buy-in, enhance system morale, and often produce better financial outcomes for all stakeholders.

In addition to negotiating the change itself and/or the logistics of the implementation of the change, franchisors should take care to communicate with franchisees about how the change will be documented. Amending franchise agreements or implementing changes upon renewal is often a necessary step when implementing systemwide changes that alter franchisee obligations, operational standards, or financial commitments. Successful amendments (or changes upon renewal) typically involve clear communication about the reasons for change, negotiation with representative franchisee groups or advisory councils, and, where appropriate, the use of incentives to encourage adoption.[54] In some instances, as set forth in more detail below, regulatory disclosure requirements may be triggered, necessitating updates to the Franchise Disclosure Document (FDD) and compliance with state registration laws. Ultimately, effective management of franchise agreement amendments and renewal agreements not only reduces legal risk but also fosters trust and cooperation, smoothing the path for systemwide innovation and growth.

b. Pilot Programs at Company-Owned or Select Franchise Stores.

When introducing systemwide changes-particularly those involving significant investment or operational disruption—franchisors increasingly rely on real data to demonstrate the potential for long-term

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[51] W-17 - Zor and Zee Perspectives in Changing System Standards.pdf," American Bar Association Forum on Franchising (2020), 28–32; W-20, 25–28.

[52] W17 - Zor and Zee Perspectives in Changing System Standards.pdf," American Bar Association Forum on Franchising (2020), 28–32; "W-20 Implementing Systemwide Changes to Maximize Compliance and Minimize Conflict," American Bar Association Forum on Franchising (2024), 25–28.

[53] W-20, 27–29.

[54] American Bar Association, "W-17: No General Counsel, No Problem—Best Compliance Practices for Small System Franchisors," in *46th Annual Forum on Franchising* (Dallas, TX: ABA, 2023), 19–20.

profitability improvements. This evidence-based approach not only strengthens the business case for change, but also enhances franchisee buy-in, as decisions are grounded in measurable outcomes rather than abstract promises. For example, before rolling out new technology platforms or marketing initiatives, many franchisors conduct pilot programs in company-owned or select franchise locations, carefully tracking key performance indicators such as sales growth, customer engagement, and operational efficiency. The results of these pilots, when positive, are shared systemwide to illustrate the tangible benefits of the proposed change and to address franchisee concerns about costs or implementation risks.[55]

Data-driven communication is especially effective in overcoming skepticism or resistance among franchisees, who may otherwise be wary of changes that disrupt established routines or require new investments. As seen in the experience of major brands, providing transparent metrics on increased average unit volume, improved customer retention, or higher profit margins following implementation of new systems can turn reluctant franchisees into advocates for change. Moreover, ongoing collection and sharing of performance data post-implementation fosters a culture of accountability and continuous improvement, as franchisees can see for themselves how the changes impact their bottom line over time. In this way, real data serves as both a persuasive tool and a foundation for collaborative system advancement.[56]

One notable example comes from the KFC franchise system. When KFC implemented a significant systemwide remodel initiative, the company first piloted the new design in select locations and tracked the impact on average unit volume (AUV) and customer traffic. The pilot data showed measurable increases in both sales and guest counts at remodeled units compared to non-remodeled units. This data was then used in communications with franchisees to demonstrate the likely return on investment for participating in the systemwide remodel program, ultimately resulting in broader franchisee buy-in and a more unified brand image systemwide.[57]

In another example, a major quick service restaurant brand introduced a new point-of-sale (POS) system at company-owned and select franchise units. The franchisor tracked key metrics such as order accuracy, transaction speed, and average ticket size. The data revealed that locations adopting the new POS system saw statistically significant improvements in order processing times and an uptick in sales, compared to control units. These results were shared with the entire franchise network, helping to overcome resistance to technology investment by providing objective evidence of operational and financial benefits.[58]

Another example concerns digital menu boards. Pilot projects at several franchise locations demonstrated that digital menu boards increased the average check size due to improved upselling and visual merchandising. The franchisor used these results to justify the required investment and to negotiate financing support for franchisees. Franchisees were more willing to accept the mandated change once they were presented with real-world data showing a clear path to increased profitability.[59]

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[55] W-16 - Implementing Challenging Technologies in Franchise Systems.pdf," American Bar Association Forum on Franchising (2023), 35–43.

[56] "W-17 - Zor and Zee Perspectives in Changing System Standards.pdf," American Bar Association Forum on Franchising (2020), 28–32; "W-20 Implementing Systemwide Changes to Maximize Compliance and Minimize Conflict," American Bar Association Forum on Franchising (2024), 27–29.

[57] W-20 Implementing Systemwide Changes to Maximize Compliance and Minimize Conflict," American Bar Association Forum on Franchising (2024), 27–28.

[58] W-16 - Implementing Challenging Technologies in Franchise Systems; American Bar Association Forum on Franchising (2023), 36–38

[59] Id., 37–38

By piloting new initiatives - whether technological upgrades, menu items, or operational procedures - in a controlled environment, franchisors can collect operational feedback, identify unforeseen challenges, and make necessary adjustments before broader implementation. This approach not only mitigates risk but also signals to franchisees that the franchisor is invested in the system's overall success and willing to share in the risks associated with change.[60] When select franchisees are invited to participate in pilot programs, their direct involvement often generates more robust feedback and helps to cultivate early advocates for the initiative within the system.[61] Transparency about pilot program objectives and outcomes, along with provision of adequate support and training, are essential for building credibility and franchisee buy-in.[62] Ultimately, pilot programs serve as both a technical proving ground and a relationship-building exercise, smoothing the path for successful systemwide adoption and reducing the likelihood of widespread franchisee unrest.[63]

c. Systemwide Incentive Programs.

System-wide incentive programs tied to performance goals are a proven tool for franchisors seeking to encourage the adoption of new initiatives and foster engagement throughout the franchise network. By offering rewards—such as reduced fees, marketing support, or public recognition—to franchisees who achieve specified benchmarks, franchisors can motivate operators to embrace system changes, maintain high operational standards, or participate in pilot projects.[64]

Similarly, franchisors often structure technology funds and marketing initiatives as "opt-in" programs at first, allowing franchisees to experience the benefits before a full mandate is considered. In one recent example, a franchisor introduced a digital ordering platform as a voluntary program, tracking its impact on participating units. After positive results were shared, a majority of franchisees voted to adopt the platform systemwide, transforming a potentially controversial change into a consensual, data-backed decision.[65]

When structured thoughtfully, these incentive programs align the interests of franchisor and franchisees, shifting the perception of change from a burdensome mandate to an opportunity for shared success.[66] Incentives tied to measurable outcomes, such as sales growth, customer satisfaction, or compliance with new technology rollouts, help create a culture of accountability and continuous improvement across the system. Moreover, publicizing top-performing franchisees or stores can have a cascading effect, as peer recognition often spurs healthy competition and broader buy-in.[67] To be effective, incentive programs should be transparent, attainable, and clearly communicated, with performance goals

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[60] American Bar Association, "W-20: Implementing Systemwide Changes to Franchise Systems," in *46th Annual Forum on Franchising* (Dallas, TX: ABA, 2023), 20–21.
[61] American Bar Association, "W-6: Now is the Winter of Our Discontent—Dealing with Widespread Franchise System Unrest," in *46th Annual Forum on Franchising* (Dallas, TX: ABA, 2023), 27–28.
[62] American Bar Association, "W-17: No General Counsel, No Problem—Best Compliance Practices for Small System Franchisors," in *46th Annual Forum on Franchising* (Dallas, TX: ABA, 2023), 25–26.
[63] American Bar Association, "W-16: Implementing Challenging Technologies in Franchise Systems," in *46th Annual Forum on Franchising* (Dallas, TX: ABA, 2023), 43–44.
[64] American Bar Association, "W-20: Implementing Systemwide Changes to Franchise Systems," in *46th Annual Forum on Franchising* (Dallas, TX: ABA, 2023), 29–30.
[65] W-16 - Implementing Challenging Technologies in Franchise Systems.pdf," American Bar Association Forum on Franchising (2023), 35–39.
[66] American Bar Association, "W-6: Now is the Winter of Our Discontent—Dealing with Widespread Franchise System Unrest," in *46th Annual Forum on Franchising* (Dallas, TX: ABA, 2023), 24–25.
[67] American Bar Association, "W-16: Implementing Challenging Technologies in Franchise Systems," in *46th Annual Forum on Franchising* (Dallas, TX: ABA, 2023), 36.

tailored to the realities of different markets and store types. Ultimately, well-designed incentive systems not only accelerate change initiatives but also strengthen system morale and brand equity.

d. Loan/Finance Programs.

Loan and finance programs are an essential mechanism for facilitating the adoption of systemwide changes, particularly when those changes require significant capital investment by franchisees. Whether the initiative involves new technology platforms, equipment upgrades, or store remodels, the upfront costs can be prohibitive for many operators, risking uneven adoption or even resistance within the network. By partnering with preferred lenders or offering in-house financing solutions, franchisors can lower financial barriers, promote compliance, and demonstrate a commitment to the long-term success of their franchisees.[68] Well-structured finance programs may include deferred payment schedules, reduced interest rates, or grants for early adopters, aligning the timing of repayment with anticipated returns from the system change.[69] These tools not only accelerate implementation but also help maintain morale and trust by ensuring that access to capital does not become an obstacle to participation. Transparent criteria for eligibility and clear communication of loan terms are critical to the integrity and effectiveness of such programs. Ultimately, loan and finance initiatives are a practical way for franchisors to share risk, support franchisee investment, and drive systemwide progress.

e. Associations/FACS.

Franchisee associations and franchise advisory councils are powerful tools for franchisees seeking to engage with franchisors on the issue of change. Franchisors should carefully engage Associations and FACs and seek to collaborate, because while individual franchisees may lack the resources, leverage, or legal standing to effectively challenge a franchisor's system changes on their own, franchisees acting collectively through organized bodies can present a formidable obstacle to a franchisor's ability to implement changes efficiently and without conflict. Understanding the legal framework governing franchisee associations and franchise advisory councils - including the rights of franchisees to organize, the obligations of franchisors to engage with organized franchisee groups, and the legal risks associated with franchisor efforts to suppress or co-opt franchisee organizing activity - is therefore an essential component of any franchisor's change management strategy.[70]

i. Types of Franchisee Organizations

Franchisee organizations in the franchise context generally fall into two broad categories: independent franchisee associations ("IFAs") and franchisor-sponsored franchise advisory councils ("FACs"). Understanding the distinction between these two types of organizations - and the different legal and practical implications of each - is essential for franchisors navigating the challenges they present to a change agenda.

An independent franchisee association is an organization formed and controlled by franchisees themselves, without the involvement or sponsorship of the franchisor. Independent franchisee associations may be formed at the system level - representing franchisees across an entire franchise system - or at the regional or local level, representing franchisees in a particular geographic area. Independent franchisee

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[68] American Bar Association, "W-20: Implementing Systemwide Changes to Franchise Systems," in *46th Annual Forum on Franchising* (Dallas, TX: ABA, 2023), 27–28.

[69] American Bar Association, "W-6: Now is the Winter of Our Discontent—Dealing with Widespread Franchise System Unrest," in *46th Annual Forum on Franchising* (Dallas, TX: ABA, 2023), 22–23.

associations are typically incorporated as separate legal entities, with their own governance structures, bylaws, and membership requirements. They may retain their own legal counsel, engage in collective bargaining or negotiation with the franchisor, pursue litigation on behalf of their members, and engage in public advocacy on franchisee issues.[71] The existence of a well-organized and well-funded independent franchisee association can significantly complicate a franchisor's ability to implement system changes, as the association provides a collective voice and a legal vehicle through which franchisees can coordinate their resistance to proposed changes.

A franchise advisory council, by contrast, is typically a body created and sponsored by the franchisor itself, with the stated purpose of providing a forum for franchisee input into the franchisor's decision-making processes. FACs are generally composed of franchisee representatives selected through some form of election or appointment process, and they typically meet periodically with franchisor management to discuss system issues, provide feedback on proposed changes, and serve as a communication channel between the franchisor and the franchisee community.[72] While FACs are often presented by franchisors as evidence of their commitment to franchisee engagement and collaborative decision-making, they can also serve as a mechanism for managing and channeling franchisee dissent in a manner that is more favorable to the franchisor than an independent franchisee association would be.

ii. The Role of Franchisee Associations in System Change Disputes

When a franchisor seeks to implement a system change that is opposed by a significant portion of the franchisee community, franchisee associations and FACs can play a central role in organizing and channeling franchisee resistance. The mechanisms through which franchisee associations may challenge system changes include collective negotiation with the franchisor, the filing of regulatory complaints with the FTC or state franchise regulators, the pursuit of litigation on behalf of association members, and the engagement of media and public advocacy to bring pressure on the franchisor.

Collective negotiation is often the first mechanism employed by franchisee associations when a system change is proposed. Where a franchisor is willing to engage in good faith negotiation with a franchisee association, collective negotiation can be an effective mechanism for resolving disputes about system changes without litigation, and may result in modifications to the proposed change that address franchisee concerns while preserving the franchisor's core objectives. Franchisors who refuse to engage in good faith negotiation with franchisee associations, or who implement system changes over the association's objection without meaningful consultation, risk escalating the dispute to litigation or regulatory action, which is typically more costly and disruptive than negotiated resolution.

iii. Practical Strategies for Managing Franchisee Associations During System Changes

The most effective strategy for managing the challenges that franchisee associations present to a franchisor's change agenda is proactive engagement rather than reactive defense. Franchisors who involve franchisee associations and FACs meaningfully in the change management process - by sharing information about proposed changes early, soliciting and genuinely considering franchisee input, and communicating transparently about the rationale for changes - are far more likely to achieve successful implementation

with minimal conflict than franchisors who present changes as faits accomplis and expect franchisees to comply.[73]

Several practical strategies can help franchisors manage franchisee associations effectively during system changes. First, franchisors should establish clear and consistent protocols for engaging with franchisee associations and FACs, including regular communication channels, defined processes for soliciting and responding to franchisee input, and clear timelines for implementation of system changes.[74] Second, franchisors should ensure that the role of the FAC in system governance is accurately and consistently described in the FDD, franchise agreement, and all communications with franchisees, so that franchisees have accurate expectations about the extent of their participation in system decision-making.[75] Third, franchisors should treat franchisee association representatives with respect and professionalism, recognizing that the association's leadership is performing a legitimate and valuable function in representing franchisee interests, even when the association's positions are adverse to the franchisor's change agenda.[76] Fourth, franchisors should be willing to modify proposed system changes in response to legitimate franchisee concerns, recognizing that a change that is implemented with broad franchisee support is far more likely to achieve its intended objectives than one that is imposed over widespread franchisee opposition.[77] Finally, franchisors should document all interactions with franchisee associations and FACs during the change management process, maintaining records that can be used to demonstrate good faith engagement if the change is later challenged in litigation or regulatory proceedings.[78]

IV. STATE STATUTORY CHALLENGES TO FRANCHISOR'S ABILITY TO ENACT CHANGES.

a. Constructive Termination.

Several states have enacted statutes that require franchisors to act in good faith or that require good cause for termination or non-renewal. Franchisees frequently bring claims under these statutes, arguing that a franchisor's mandated changes violate these statutes. For example, a franchisee may have operated under a particular business plan for 20 years when the franchisor decides to discontinue it. Upon renewal, the franchisor may try to encourage the franchisee to adopt a new business plan. Franchisees faced with this type of scenario argue they have been constructively terminated, or that the renewal isn't a renewal at all, and, thus, that it is a violation of a protective statute. While decisions are split, it seems clear that courts interpreting constructive termination statutes are extremely critical of changes that result in a loss of territory rights or unfair competition for franchisees.

States with statutes that may impose challenges for franchisors trying to impose changes on their franchisees include California[79], Connecticut,[80] Delaware[81], Hawaii,[82] Indiana,[83] Iowa,[84] Michigan,[85] Minnesota,[86] Mississippi,[87] Missouri,[88] Nebraska,[89] New Jersey,[90] South Dakota,[91] Virginia,[92] and Washington.[93] Many of these statutes prohibit franchisors from terminating except for "good cause" but they vary in defining what constitutes good cause. For some states, good cause is narrowly defined as a material breach of the franchise agreement.[94] In other states, good cause may be based on a franchisor's legitimate business reasons. On the other hand, a court in Connecticut held that "the meaning of good cause is broader than franchisee breach ... If the Connecticut legislature intended good cause to result only from franchisee breach," it failed to state so.

Like other franchise relationship statutes, the New Jersey Act Franchise Practices Act was codified to "rule out arbitrary and capricious cancellation of franchises while preserving the right of franchisors to safeguard their interests through the application of clear and nondiscriminatory standards."[95] Franchisees in New Jersey have attempted to stop franchisors from enacting systemic change with mixed results.

In *Maintainco, Inc. v. Mitsubishi Caterpillar Forklift America, Inc.*, the plaintiff was a dealer selling forklifts pursuant to a dealership agreement with Mitsubishi. The dealership agreement allowed Mitsubishi to change the dealer's territory from time to time, or to appoint more than one dealer to share in the territory, or to sell products directly to customers who were designated as national accounts. Notwithstanding the contract terms, Mitsubishi's officers testified that the industry custom was for territories to be exclusive to each dealer, and that Mitsubishi verbally confirmed this exclusivity to all dealers for years. The dealer was not required to exclusively sell Mitsubishi products, so when Mitsubishi partnered with another manufacturer and began offering marketing advantages to its new partner, plaintiff began selling Toyota forklifts. After several years of tension, Mitsubishi appointed a new dealer in plaintiff's territory and gave that new dealer additional terms that put it at a substantial advantage over plaintiff. The court held

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[79] CAL. BUS. & PROF. CODE § 20020.
[80] CONN. GEN. STAT. § 42-133.
[81] DEL. CODE ANN. tit. 6, §§ 2551-2556.
[82] HAW. REV. STAT. § 482E-6(1).
[83] IND. CODE § 23-2-2.7-1(7).
[84] IOWA CODE § 523H.1–H.17.
[85] MICH. COMP. LAWS § 445.1527(c).
[86] MINN. STAT. § 80C.14 subdiv. 3.
[87] MISS. CODE ANN. § 75-24-51 to -63.
[88] MO. REV. STAT. § 407.401–.420.
[89] NEB. REV. STAT. § 87-401 to -414.
[90] N.J. STAT. ANN. § 56:10-1 to -29.
[91] S.D. CODIFIED LAWS § 37-5A-1 to -87.
[92] VA. CODE ANN. § 13.1-557 to -574.
[93] WASH. REV. CODE. § 19.100.180(1).
[94] See e.g. CAL. BUS. & PROF. CODE § 20020.
[95] *Carlos v. Philips Business Systems, Inc.*, 556 F.Supp. 769, 775–76 (D.C.N.Y.,1983) citing *Assembly Bill* 2063 (1971).

this conduct was a breach of the agreement and constituted an attempt to terminate the contract, all of which violated the N.J. Act.[96]

In *Carlos v. Philips Business Systems, Inc.*, a franchisor of dictation equipment decided to make a wholesale change to the structure of its franchise system, which it termed a "major marketing change." The franchisor offered a new agreement to all of its franchisees and to a number of new businesses, which caused the franchisees to lose their territorial rights as well as their competitive pricing, terms and advertising advantages.[97] One franchisee brought a claim under the N.J. Act to obtain injunctive relief, arguing the franchisor "terminated, cancelled or failed to renew the franchise without complying with statutory requirements."[98] The franchisor argued that it had not terminated the franchisee, and was merely trying to streamline its marketing system in order to improve its own profitability.[99] The court disagreed with the franchisor, holding that the "clear intent" behind the new arrangement was to eliminate exclusive dealers, like the franchisee in that case, in order to make more profits and the insinuation that this was a mere change was "in the court's opinion, nothing more than a poorly disguised euphemism for what is essentially a termination or failure to renew this distributorship agreement…"[100] The court enjoined the franchisor's attempted change.[101]

In *Fabbro v. DRX Urgent Care, LLC*, however, the Appellate Division of the Superior Court of New Jersey rejected a constructive termination claim, holding that, even where the franchisor had made material changes that harmed, rather than helped, franchisees, and even where the franchisor's changes were, allegedly, "a material re-write of the parties' original agreement" and business operations, where there are no allegations that the franchisor wants to terminate the franchises, there was no constructive termination.[102]

The U.S. Court of Appeals for the Ninth Circuit turned the good cause requirement on its head in *American Mart Corp. v. Joseph E. Seagram & Sons, Inc.*, holding that, under Nevada's Alcoholic Beverage Franchise Act, where termination was undertaken "in good faith and for good cause," meaning there was a sufficient business justification for its actions that was not undertaken with an improper motive, then a franchisor had a "complete defense."[103] There, the franchisor decided to change from a system under which it authorized several distributors to do business in a particular area to a system of exclusive distributorships and, accordingly, terminated certain

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[96] *Maintainco, Inc. v. Mitsubishi Caterpillar Forklift America, Inc.*, 975 A.2d 510, 512, 408 N.J.Super. 461, 465 (N.J.Super.A.D.,2009); *see also Beilowitz v. General Motors Corp.,* 233 F. Supp. 2d 631, 643-44 (D.N.J., 2002) (holding that it is a violation of the N.J. Franchise Practices Act for a franchisor to impose an unreasonable sales quota and/or to require a franchisee to operate at a loss while the franchisor implements a new marketing strategy, and additionally holding that there was no "good cause" where a franchisee had successfully operated for years and merely failed to implement a new, unproven marketing strategy, which the franchisor used as a basis to refuse to renew the franchise agreement).

[97] Id. at 772.

[98] Id. at 775.

[99] Id.

[100] Id. at 776.

[101] Id.

[102] *Fabbro v. DRX Urgent Care, LLC*, 616 Fed.Appx. 485, 490 (C.A.3 (N.J.), 2015) (holding franchisees were "in good standing" and, thus, not in danger of termination).

[103] *American Mart Corp. v. Joseph E. Seagram & Sons, Inc.*, 824 F.2d 733 (9th Cir. (Nev.), 1987).

distributors.[104] Notwithstanding the fact that the terminated distributors had not breached their agreements, the court held that the decision to terminate did not violate the good cause provision of the Nevada statute because the nationwide plan was warranted by compelling business considerations and constituted a valid business judgement.[105]

The caselaw interpreting good cause statutes maintains a common theme: While courts may agree that franchisors can make significant changes to their businesses, when those changes result in a loss of a franchisee's territory rights or business, franchisors can expect a legal fight, and one they may not win.

b. Bad Faith.

A number of states have enacted laws requiring franchisors to act in good faith. One example of such a statute is Washington State's Franchise Investment Protection Act ("FIPA"), which requires parties to a franchise agreement to deal with each other "in good faith."[106]

In *JDS Group Ltd. v. Metal Supermarkets Franchising America, Inc.*, a Washington state franchisee sued its franchisor for seeking to impose onerous software requirements in violation of, among other things, the good faith obligation of FIPA.[107] It appears that challenges to software requirements are generally met with quite a bit of resistance by courts in Washington and other states, and this case is no exception.[108] The United States District Court for the Western District of New York, interpreting Washington law, held that good faith cannot overcome the express terms of a contract and, moreover, "embraces more than bad judgment or negligence and imports dishonest purpose, moral obliquity, conscious wrongdoing, breach of known duty through some ulterior motive or ill will partaking of the nature of fraud, and embraces actual intent to mislead or deceive another."[109] In that case, because the express terms of the franchise agreements allowed the franchisor to develop or designate computer software programs and other software for franchisees to use, and because there was no evidence of bad faith or improper purpose or motivation, there was no violation of the bad faith provisions of FIPA.[110] Critically, the court was persuaded by evidence showing that the franchisor had devoted significant time and resources to developing its new software, including efforts to resolve flaws identified by franchisees.[111]

FIPA also prohibits franchisors from requiring franchisees to purchase or lease goods or services from approved sources of supply unless and to the extent that the franchisor satisfies the burden of proving that such restrictive purchasing agreements are reasonably necessary for a lawful purpose justified on business grounds, and do not substantially affect competition. FIPA

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[104] Id. at 734-35.
[105] Id.
[106] RCW §§ 19.100.180 (1)
[107] *JDS Group Ltd. v. Metal Supermarkets Franchising America, Inc.*, 2017 WL 2643667, at *1 (W.D.N.Y. 2017)
[108] *See, e.g., La Quinta Corp. v. Heartland Properties LLC,* 603 F.3d 327, 336 (6th Cir. 2010)*; Bores v. Domino's Pizza, LLC*, 530 F.3d 671, 676 (8th Cir. 2008).
[109] *JDS Group Ltd.* 2017 WL 2643667 at *7 *citing Hamilton v. State Farm Mut. Auto. Ins. Co.*, 9 Wash. App. 180, 189, 511 P.2d 1020, 1025 (Wash. Ct. of Appeals Div. 1 1973).
[110] *Id.*
[111] *Id. citing Doyle v. Nutrilawn U.S., Inc.*, 2010 WL 1980280, at *8 (W.D. Wash. May 17, 2010) (granting summary judgment on claim for violation of § 19.100.180(1) where plaintiff failed to show that franchisor failed to act in good faith in connection with the terms of the franchise agreement).

further states it is unfair or deceptive for franchisors to impose any rule or standard unless it is reasonable or necessary.[112] The *JDS Group Ltd.* court rejected the franchisee's claim that the software requirement was a violation of FIPA, holding that the franchisee happily utilized an older version of a proprietary software program developed by the franchisor for the past ten years, stating that the statute should not be interpreted "to undercut a franchisor's business judgment in establishing standards for its franchise system."[113]

FIPA's comprehensive framework for regulating the franchisor-franchisee relationship creates a number of practical compliance obligations for franchisors seeking to implement system changes in Washington. First, franchisors should ensure that their FDDs and franchise agreements clearly and broadly reserve the right to make system changes, including changes to technology requirements, supplier arrangements, fee structures, and operational standards, so that the adequacy of initial disclosures cannot be challenged as a basis for resisting those changes.[114] Second, franchisors should evaluate any proposed new fees or charges against the FIS-09 Interpretive Statement to determine whether those fees were adequately disclosed in the FDD and whether a formal amendment is required before they can be imposed on Washington franchisees.[115] Third, franchisors should document the business rationale for all system changes, maintaining records that can be used to demonstrate that each change meets the WFIPA's "reasonable and necessary" standard if challenged. Fourth, franchisors should maintain consistency in the enforcement of system standards across all Washington franchisees, as discriminatory enforcement is independently prohibited by the WFIPA and can undermine the franchisor's ability to defend the reasonableness of its standards. Finally, franchisors should engage proactively with Washington franchisees when implementing significant system changes, providing clear communication about the rationale for the changes and offering appropriate support to facilitate compliance, as this approach not only reduces the risk of disputes but also demonstrates the good faith that the WFIPA requires.

c. Discrimination

Some state statutes specifically prohibit discriminatory enforcement of franchise agreements,[116] so franchisors should be wary of imposing changes arbitrarily or inequitably across its system.

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[112] RCW §§ 19.100.180 (2)(B) and (H).

[113] *JDS Group Ltd.* 2017 WL 2643667 at *8 *citing* Douglas C. Berry et al., *State Regulation of Franchising: The Washington Experience Revisited*, 32 Seattle U. L. Rev. 811, 890 (2009) *and citing Corp v. Atl. Richfield Co.*, 122 Wash. 2d 574, 585-87 (1993) ("[C]ourts generally give considerable deference to franchisors' efforts to restructure, retrench, or wind down their franchise systems.")

[114] Einhorn & Linderman, supra note 1, at 23-24; Kathryn Kotel, Doug Luther & Stephanie Russ, "No General Counsel, No Problem: Best Compliance Practices for Small-System Franchisors," ABA 48th Annual Forum on Franchising W-17, at 33-34 (2025).

[115] Washington Department of Financial Institutions, Franchise Act Interpretive Statement - FIS-09, supra note 9; Einhorn & Linderman, supra note 1, at 23.

[116] *See e.g.* ARK. CODE ANN. § 4-72-204(1)(defining "good cause," as the "failure by a franchisee to comply substantially with the [franchisor's] [requirements. . . which requirements are not discriminatory as compared with the requirements imposed on other similarly situated franchisees, either by their terms or in the manner of their enforcement…"); 815 ILL. COMP. STAT. § 705/18 (stating it is an unfair franchise practice for a franchisor to "unreasonably and materially discriminate between franchisees operating a franchised business located in this State in the charges offered or made for franchise fees, royalties, goods, services, equipment, rentals, or advertising services, if such discrimination will cause competitive harm to a franchisee who competes with a franchisee that received the benefit of the discrimination . . .); IND. CODE ANN. § 23-2-2.7-2(5)

In Wisconsin, for example, courts have held that where there is possible discrimination, there is no good cause to terminate a franchise agreement.[117] The U.S. District Court for the Eastern District of Wisconsin enjoined a franchisor from imposing a distribution system only on certain of its franchisee, because it violated the Wisconsin Fair Dealership Act.[118] Typically, to prove discrimination, franchisees must show that other "similarly situated" franchisees were treated differently in factually-similar scenarios. Franchisees may challenge changes imposed on only particular franchisees or particular types of franchisees as discriminatory and franchisors may then face a protracted legal battle to prove the changes are fairly imposed.

d. DISCLOSURE CHALLENGES TO FRANCHISOR'S ABILITY TO ENACT CHANGES.

The Federal Trade Commission's Trade Regulation Rule on Franchising (the "Franchise Rule") requires franchisors to provide prospective franchisees with a Franchise Disclosure Document ("FDD") containing specific disclosures about the franchise system before any sale is made. While the Franchise Rule was designed to ensure transparency in the franchise relationship, it was finalized in 2007 when the technology landscape and business environment were vastly different from today.[119] As franchise systems evolve and franchisors seek to implement system-wide changes, the disclosure obligations embedded in the Franchise Rule present both a compliance challenge and a potential legal vulnerability. Franchisors must carefully evaluate whether proposed system changes trigger disclosure obligations, require amendments to existing FDDs, or necessitate updated state registrations before implementation can proceed. Franchisors should note that while there is no private right of action under the Franchise Rule, state statutes may incorporate the Franchise Rule by reference, or may simply require compliance with all federal statutes or other laws.

a. Items of Disclosure

1. Item 1 - The Franchisor and Any Parents, Predecessors, and Affiliates

Item 1 of the FDD requires disclosure of the franchisor's name, principal business address, any parents, predecessors, and affiliates that offer franchises in any line of business or provide products or services to franchisees.[120] When a franchisor undergoes a merger, acquisition, or other structural change as part of its growth or change agenda, Item 1 must be carefully reviewed and updated to reflect any new entities that have been added to the overall corporate structure. Transactions frequently result in the addition of new affiliate entities to the franchisor's corporate structure, and those affiliates may provide

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[117] *See, e.g.*, *Keen Edge Co. v. Wright Mfg., Inc.*, No. 19-CV-1673-JPS, 2020 WL 4926664, at *7 (E.D. Wis. Aug. 21, 2020) (finding "no evidence of good cause" where "not all of these requirements" imposed on the plaintiff "were imposed on other dealers").

[118] WISC. STAT. § 135.02(4)(a) (defining good cause, as required for termination, to be a failure to comply with material requirements which shall not be discriminatory as compared with those imposed on other franchisees.)

[119] Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities; Final Rule, 72 Fed. Reg. 15444, 15445 (Mar. 30, 2007), codified at 16 C.F.R. Part 436; Kerry Renker Green, Manal Zakhary Hall & Keri McWilliams, "Implementing Challenging Technologies in Franchise Systems," ABA 46th Annual Forum on Franchising W-16, at 29 (2023).

[120] 16 C.F.R. § 436.5(a).

products or services to franchisees or offer franchises in their own right.[121] The FTC Rule defines an "affiliate" as "an entity controlled by, controlling, or under common control with, another entity," and any such entity that provides products or services to franchisees must be disclosed.[122] Failure to update Item 1 to reflect new affiliates arising from a system change or acquisition can constitute a material omission in the FDD, exposing the franchisor to regulatory scrutiny and franchisee claims.

2. Item 6 – Other Fees

Item 6 of the FDD requires disclosure of all fees (other than initial fees, which must be disclosed in Item 5)[123], that the franchisee must pay to the franchisor or its affiliates, or that the franchisor or its affiliates impose or collect in whole or in part for a third party.[124] This section must include the type of fee, the amount of the fee, due date, remarks that elaborate on this information, whether fees are payable only to the franchisor and/or collected by the franchisor or third parties, and whether they are non-refundable and uniformly-imposed, among other things.

Franchisors that enact changes in their system resulting in the imposition of additional fees may face disclosure claims from franchisees. In *Bird Hotel Corp. v. Super 8 Motels, Inc.*, the Court ruled for a franchisee after the franchisor's parent corporation increased a fee on a loyalty program, holding the additional fee was capped by the specific language in the contract, and the franchise agreement did not permit the franchisor to add new recurring charges, even if the franchisor did retain the right to revise system standards and operational rules.[125] Franchisors should be extremely wary of imposing fees that run contrary to any specific language in the franchise agreement.

3. Item 7 - Estimated Initial Investment

Item 7 requires franchisors to disclose the estimated initial investment a franchisee will need to make to establish and begin operating the franchised business.[126] When franchisors implement system changes that alter the cost structure of opening or operating a franchise - such as requiring new technology platforms, updated point-of-sale systems, remodeling or refresh requirements, or new equipment mandates - the estimated initial investment figures disclosed in Item 7 may no longer be accurate. Courts have recognized that franchisees may bring claims based on misrepresentations in the FDD where actual costs materially exceed disclosed estimates. For example, in *Devayatan, LLC v. Travelodge Hotels, Inc.*, a court found that a franchisor's broad range of possible initial investment costs in its FDD, combined with a disclosure that a punch list of required improvements was only a "random sample inspection" and not exhaustive, was sufficient to defeat a franchisee's negligent misrepresentation claim.[127] However, that outcome turned on the adequacy of the original disclosure. Where a franchisor implements a system change that significantly increases the cost of entry or operation without updating Item 7, the franchisor risks both regulatory action and franchisee claims for rescission or damages. Claims based in fraud will generally be based on misrepresentations or omissions of facts known at the time of the sale – accordingly, Franchisors should also take care to document when they determine they will implement changes that will result in

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[121] Jarina D. Duffy, David J. Kaufmann & Melanie Parker, "Challenges After Acquiring and Managing a New Brand," IFA 55th Annual Legal Symposium, at 11 (2023).
[122] 16 C.F.R. § 436.1(a); Duffy, Kaufmann & Parker, supra note 3, at 11.
[123] 16 C.F.R. §436.5(e).
[124] 16 C.F.R. §436.5(f).
[125] *Bird Hotel Corp. v. Super 8 Motels, Inc.*, No. CIV 06-4073, 2010 WL 572741 (D.S.D. Feb. 16, 2010).
[126] 16 C.F.R. § 436.5(g)
[127] *Devayatan, LLC v. Travelodge Hotels, Inc.*, No. 6:14-cv-561-Orl-41TBS, 2016 WL 3477205, at *6-7 (M.D. Fla. June 24, 2016), discussed in Robert M. Einhorn & Lauren Wright Linderman, "Implementing Systemwide Changes to Maximize Compliance and Minimize Conflict," ABA 47th Annual Forum on Franchising W-20, at 19 (2024)

significant increases to build-out costs, and ensure that their FDD is amended *promptly*. Franchisors should treat any system change that materially affects the cost of establishing or operating the franchise as a potential trigger for an FDD amendment.

4. Item 8 - Restrictions on Sources of Products and Services

Item 8 requires franchisors to disclose franchisee obligations to purchase or lease goods, services, supplies, fixtures, equipment, inventory, computer hardware and software, real estate, or comparable items from the franchisor, its designees, or approved suppliers.[128] It also requires franchisors to disclose whether it or its affiliates are approved suppliers or the only approved suppliers of any good or service, whether any officer of the franchisor owns an interest in any supplier, and whether the franchisor or its affiliates will derive revenue from required purchases or leases by franchisees. As franchise systems evolve and franchisors introduce new technology platforms, delivery service partnerships, or revised supply chain arrangements, Item 8 disclosures can quickly become outdated. The introduction of third-party delivery service providers such as DoorDash, Grubhub, or UberEats into a franchise system, for example, creates new supplier relationships that may require disclosure under Item 8, particularly where franchisees are required to use such platforms and the franchisor or its affiliates derive revenue from those arrangements.[129]

Similarly, when a franchisor acquires another brand and new affiliate entities become suppliers to franchisees, Item 8 must be updated to reflect those new relationships and any revenue the franchisor or its affiliates will derive from franchisee purchases.[9] The FTC has specifically signaled its concern in this area, with FTC staff releasing guidance noting that a franchisor's failure to disclose fees in the FDD - including fees imposed through changes to the operations manual - "is a violation of the Franchise Rule and Section 5 of the FTC Act."[130]

5. Item 11 - Franchisor's Assistance, Advertising, Computer Systems, and Training

Item 11 requires franchisors to disclose the assistance they will provide to franchisees before and after opening, including advertising programs, computer systems, and training.[131] As franchise systems undergo change - whether driven by new technology, shifting consumer preferences, or post-acquisition integration - the representations made in Item 11 can become a source of significant legal exposure. Franchisors who have represented in Item 11 that they will provide certain levels of support, training, or advertising assistance must ensure that those representations remain accurate as the system evolves. Where a franchisor reduces support services, changes its advertising fund administration, or transitions to new technology platforms without updating Item 11, franchisees may argue that the franchisor failed to deliver on its disclosed obligations. The administration of advertising funds is a particular area of sensitivity, as Item 11 requires specific disclosures about how advertising funds are collected and used, and disputes regarding the franchisor's use of those funds can arise in any franchise system. With respect to technology, the Franchise Rule's current requirement to disclose requirements regarding the use of "electronic cash registers or computer systems" has been noted as inadequate to address the modern technology landscape, and the FTC has received public comments calling for updated disclosure requirements that account for

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[128] 16 C.F.R. § 436.5(h).
[129] Julie Lusthaus & Michelle Murray-Bertrand, "Hitting Refresh: Updating Your Franchise Agreement to Reflect the Times," ABA 45th Annual Forum on Franchising W-17, at 17-20 (2022)
[130] Federal Trade Commission, Staff Guidance on the Unlawfulness of Undisclosed Fees Imposed on Franchisees (July 12, 2024), at 1, discussed in Einhorn & Linderman, supra note 6, at 21.
[131] 16 C.F.R. § 436.5(k).

cloud computing, data breach risks, the value of customer data, and the potential for franchisors to sell or share franchisee-generated data.[132]

b. The Material Change Standard and the Obligation to Amend

In addition to the specific required disclosures discussed above, franchisors implementing system changes must be attentive to the Franchise Rule's requirement to amend the FDD to reflect any "material change" - defined as any change to the franchisor or the franchise itself that is likely to have a significant financial impact on, or which is likely to influence the decision-making process of, a franchisee or prospective franchisee.[133] The FTC Rule requires franchisors to revise the FDD within a reasonable time after the close of each fiscal quarter to reflect any material change.[134] Several states impose more stringent requirements, with some states requiring amendment "promptly" upon the occurrence of a material change, and others requiring amendment within thirty (30) days.[135] States including Hawaii, Indiana, Maryland, Minnesota, New York, and Wisconsin have enacted their own definitions of "material change" that may capture system changes not otherwise covered by the federal standard.[136] For example, changes in control, corporate reorganizations, the commencement of new product or service lines requiring additional franchisee investment, and significant changes to franchisee obligations to purchase items from the franchisor or its designated sources are all specifically identified as material changes under various state statutes.[137] Franchisors who implement system changes without evaluating whether those changes constitute a material change requiring FDD amendment do so at their peril, as failure to amend can expose the franchisor to regulatory action, franchisee rescission claims, and potential liability for disclosure violations.

The material change obligation has significant practical implications for franchisors seeking to implement system changes efficiently. Because the obligation to amend may arise at any point during the year - not merely at the time of annual renewal - franchisors must build a compliance process that continuously monitors proposed and implemented system changes against the material change standard. Outside franchise counsel can play a critical role in this process by helping franchisors create a "trigger events" checklist that identifies categories of changes requiring amendment, implementing quarterly review protocols to catch undisclosed changes, and establishing procedures for promptly addressing material changes as they arise.[138] Franchisors should also be aware that continuing to offer and sell franchises after a material change has occurred but before an amendment has been filed and declared effective in registration states can constitute an unregistered offer or sale, exposing the franchisor to regulatory penalties and franchisee rescission rights.[139] The cost of proactive compliance - including the preparation and filing of interim amendments - is almost invariably far less than the cost of defending against franchisee claims or regulatory investigations arising from undisclosed material changes.

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[132] Green, Hall & McWilliams, supra note 1, at 30; Letter from the North American Securities Administrators Association, Inc. to the Federal Trade Commission re: Franchise Rule Regulatory Review, 16 CFR Part 436, Matter No. R511003, at 6 (May 13, 2019), discussed in Green, Hall & McWilliams, supra note 1, at 30

[133] 16 C.F.R. § 436.7(d).

[134] 16 C.F.R. § 436.7(b).

[135] Duffy, Kaufmann & Parker, supra note 3, at 16-17.

[136] Duffy, Kaufmann & Parker, supra note 3, at 14-16 (citing Haw. Code Regulations § 16-31-1; I.C. § 23-2-2.5-13.1(b); Md. Code Regs. § 02.02.08.01; Minn. Code Regs. § 2860.2400; N.Y. Gen. Bus. Laws. Regs. § 200.5; Wis. Admin. Code s. DFI-Sec. 31.01(2)(a)-(e)).

[137] Duffy, Kaufmann & Parker, supra note 3, at 14-16.

[138] Ramsey, Mortensen & DiBlassio, supra note 18, at 16.

[139] Kotel, Luther & Russ, supra note 17, at 33; Einhorn & Linderman, supra note 4, at 20-21.

c. FTC Staff Guidance on Unlawfulness of Undisclosed Fees Imposed on Franchisees

On July 12, 2024, the Federal Trade Commission took what many franchise practitioners viewed as a significant step in signaling heightened federal scrutiny of franchisor practices by releasing a suite of actions directed at what the FTC characterized as "unfair and deceptive practices by franchisors."[140] Among these actions was the release of FTC Staff Guidance on the Unlawfulness of Undisclosed Fees Imposed on Franchisees (the "Staff Guidance"), which directly addressed the practice of franchisors imposing fees on franchisees that were not disclosed in the FDD.[141] The Staff Guidance, while not binding on the Commission itself, represents an important statement of FTC staff's views on the application of the Franchise Rule and Section 5 of the FTC Act to undisclosed fee practices, and franchisors would be unwise to dismiss it as merely advisory. For franchisors seeking to implement system changes that involve new or increased fees - whether through amendments to the operations manual, new technology mandates, revised supplier arrangements, or other mechanisms - the Staff Guidance creates a meaningful compliance framework that must be carefully considered.

i. The Substance of the Staff Guidance

The Staff Guidance focuses on the Franchise Rule's prohibition on deceptive and unfair acts or practices in connection with the offer and sale of franchises. The Staff Guidance identifies two primary legal bases for the unlawfulness of undisclosed fees. First, the Staff Guidance notes that the Franchise Rule requires franchisors to disclose all fees that franchisees must pay to the franchisor or its affiliates in Items 5 and 6 of the FDD, and that a franchisor's failure to disclose fees in the FDD "is a violation of the Franchise Rule and Section 5 of the FTC Act."[142] Second, the Staff Guidance notes that the imposition of undisclosed fees may also constitute an unfair act or practice in violation of Section 5 of the FTC Act, independent of the Franchise Rule, where the practice causes or is likely to cause substantial consumer injury that is not reasonably avoidable by the franchisees themselves and is not outweighed by countervailing benefits.[143]

Of particular significance for franchisors implementing system changes, the Staff Guidance specifically identifies the operations manual as one mechanism through which franchisors may improperly impose previously undisclosed fees. The Staff Guidance states that "one way franchisors may impose previously undisclosed fees is by making changes to the Operating Manual," and makes clear that this practice is subject to the same legal analysis as any other form of undisclosed fee imposition. This directly implicates the common franchisor practice of using broad operations manual amendment provisions in franchise agreements as a vehicle for implementing new fees - such as technology fees, delivery platform fees, data management fees, or training fees - without formally amending the FDD or seeking updated state registrations. The Staff Guidance signals that FTC staff views this practice as potentially unlawful, at least where the fees were not adequately disclosed in the original FDD.[144]

ii. Implications for the Franchisor's Change Agenda

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[140] Federal Trade Commission, Press Release, "FTC Takes Action to Ensure Franchisees' Complaints are Heard and to Protect Against Illegal Fees" (July 12, 2024), discussed in Robert M. Einhorn & Lauren Wright Linderman, "Implementing Systemwide Changes to Maximize Compliance and Minimize Conflict," ABA 47th Annual Forum on Franchising W-20, at 20-21 (2024).

[141] Federal Trade Commission, Staff Guidance on the Unlawfulness of Undisclosed Fees Imposed on Franchisees (July 12, 2024), at 1 [hereinafter "Staff Guidance"], discussed in Einhorn & Linderman, supra note 1, at 21.

[142] Staff Guidance, supra note 2, at 1; 16 C.F.R. §§ 436.5(e)-(f); Einhorn & Linderman, supra note 1, at 21.

[143] Staff Guidance, supra note 2, at 1; 15 U.S.C. § 45(a); *FTC v. Wyndham Worldwide Corp.*, 799 F.3d 236, 240 (3d Cir. 2015), discussed in Kerry Renker Green, Manal Zakhary Hall & Keri McWilliams, "Implementing Challenging Technologies in Franchise Systems," ABA 46th Annual Forum on Franchising W-16, at 8-9 (2023).

[144] Einhorn & Linderman, supra note 1, at 21.

The Staff Guidance has significant practical implications for franchisors seeking to implement system changes that involve new or increased fees. The most direct implication is that franchisors can no longer rely solely on broad operations manual amendment provisions in their franchise agreements as legal authority for imposing new fees on franchisees. While such provisions may be contractually sufficient to require franchisee compliance - and courts have generally upheld franchisors' rights to implement system changes through operations manual amendments where the franchise agreement expressly reserves that right - the Staff Guidance makes clear that contractual authority alone does not insulate a franchisor from FTC scrutiny if the fees were not disclosed in the FDD.

This creates a tension between the contractual framework of franchising - which typically gives franchisors broad discretion to modify system standards through operations manual amendments - and the disclosure framework of the Franchise Rule - which requires franchisors to disclose all fees to prospective franchisees before the franchise is sold. Franchisors must navigate this tension carefully, recognizing that the contractual right to impose a fee and the legal obligation to disclose that fee are separate and independent requirements, both of which must be satisfied.[145]

For franchisors contemplating system changes that will result in new or increased fees, the Staff Guidance suggests the following compliance framework. First, franchisors should evaluate whether the proposed fee was adequately disclosed in the FDD at the time the affected franchisees purchased their franchises. If the fee was disclosed - either as a specific fee or as a category of fees that the franchisor reserved the right to impose - the franchisor is in a stronger position to argue that the disclosure obligation has been satisfied. Second, if the fee was not adequately disclosed, franchisors should consider whether a formal FDD amendment is required before the fee can be imposed, and should consult with franchise counsel to evaluate the amendment and registration implications in each state where the franchisor operates.[146] Third, franchisors should review their existing FDDs to ensure that Items 5, 6, and 11 adequately disclose not only current fees but also the franchisor's right to impose new or additional fees in the future, so that future system changes involving new fees can be implemented on a stronger disclosure foundation.

iii. Limitations of the Staff Guidance

Notwithstanding its significance, the Staff Guidance has important limitations that franchisors and their counsel should understand. The Staff Guidance expressly states that it "represents the views of FTC staff and is not binding on the Commission." This means that the Staff Guidance does not have the force of law and cannot be directly enforced against franchisors as a regulatory matter. However, FTC staff guidance is generally viewed as a reliable indicator of the agency's enforcement priorities and the legal theories it is likely to pursue in enforcement actions, and franchisors who disregard the Staff Guidance do so at their own risk.[147]

Moreover, the Staff Guidance's focus on the Franchise Rule and Section 5 of the FTC Act does not preclude franchisees from pursuing private claims based on the same underlying conduct. Franchisees who have been subjected to undisclosed fees may have claims for breach of contract, breach of the implied covenant of good faith and fair dealing, violation of state franchise relationship laws, and violation of state consumer protection statutes, all of which may provide independent bases for recovery regardless of whether the FTC takes enforcement action.[148] The Staff Guidance therefore serves as a reminder that the

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[145] Einhorn & Linderman, supra note 1, at 21; Kathryn Kotel, Doug Luther & Stephanie Russ, "No General Counsel, No Problem: Best Compliance Practices for Small-System Franchisors," ABA 48th Annual Forum on Franchising W-17, at 33-34 (2025).

[146] Kotel, Luther & Russ, supra note 17, at 33-34; Jarina D. Duffy, David J. Kaufmann & Melanie Parker, "Challenges After Acquiring and Managing a New Brand," IFA 55th Annual Legal Symposium, at 16-17 (2023).

[147] Einhorn & Linderman, supra note 1, at 21; Kotel, Luther & Russ, supra note 17, at 38.

[148] J. Mark Dady & James M. Susag, "Now is the Winter of Our Discontent: Dealing with Wide-Spread Franchise System Unrest," ABA 48th Annual Forum on Franchising W-6, at 16-17 (2025); Einhorn & Linderman, supra note 1, at 14-18

legal risks associated with undisclosed fees extend well beyond the risk of FTC enforcement and encompass a broad range of potential franchisee claims.

iv. Proactive Compliance Strategies

In light of the Staff Guidance, franchisors should take proactive steps to evaluate and strengthen their disclosure practices with respect to fees. Outside franchise counsel can play a critical role in this process by helping franchisors conduct a comprehensive audit of their existing FDDs to identify any fees that are currently being imposed on franchisees but were not adequately disclosed, developing a remediation plan for addressing any disclosure gaps identified in the audit, and revising FDD disclosure language to ensure that all current and anticipated future fees are adequately disclosed.[149] Franchisors should also review their franchise agreements and operations manuals to ensure that the contractual authority for imposing fees is clearly stated and consistent with the disclosures made in the FDD, so that the contractual and disclosure frameworks are aligned rather than in tension. Finally, franchisors should establish internal compliance processes that require any proposed new fee to be evaluated against the FDD disclosure framework before it is implemented, ensuring that the disclosure obligation is considered at the outset of the change management process rather than as an afterthought.

e. CONTRACT-BASED CHALLENGES TO SYSTEM-WIDE CHANGE.

As set forth above, franchisors may be prohibited from making certain changes by their contracts. Courts have recognized two principal constraints: (i) system-wide directives may not override express contractual rights, and (ii) even where discretion exists, it must be exercised in good faith.

a. System-Wide Changes That Conflict with Express Contractual Rights

A franchisor's authority to impose system-wide standards does not extend to altering or contradicting specific rights allocated by the franchise agreement. Where a system-wide directive conflicts with the parties' express contractual terms, courts have treated such conduct as giving rise to a viable breach of contract claim.

In *Stuller, Inc. v. Steak N Shake Enterprises, Inc,.*[150] the franchisor implemented mandatory pricing and promotional policies across its system, which franchisees challenged as inconsistent with their agreements. The court rejected the franchisor's position that its system authority unambiguously permitted those directives, finding instead that the agreements were ambiguous as to pricing control and that the franchisor was not entitled to summary judgment on that basis. The court further granted relief to the franchisee on its contract-based declaratory claim after considering extrinsic evidence bearing on the parties' intent. Critically, the court drew a distinction between permissible operational standard-setting and impermissible interference with bargained-for rights, emphasizing that system-level authority cannot be used to effectively rewrite specific contractual provisions.

b. Implied Covenant of Good Faith and Fair Dealing as a Constraint on System-Wide Authority

Even where a franchise agreement grants a franchisor broad discretion over system standards or operations, as they often do, that discretion is constrained by the implied covenant of good faith and fair dealing. Courts have consistently held that contractual discretion must be exercised reasonably and not in a manner that frustrates the other party's ability to perform or receive the benefit of the bargain.

In *Carvel Corp. v. Diversified Management Group, Inc.,* [151] the Second Circuit reaffirmed that "every contract contains an implied covenant of good faith and fair dealing" and that a party may not "intentionally and purposely do anything to prevent the other party from carrying out the agreement on his

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[149] Kotel, Luther & Russ, supra note 17, at 33-34, 38.
[150] *Stuller, Inc. v. Steak N Shake Enterprises, Inc.*, 877 F. Supp. 2d 674 (C.D. Ill. 2012).
[151] *Carvel Corp. v. Diversified Management Group, Inc.*, 930 F.2d 228 (2d Cir. 1991).

part." The court further explained that even where a contract grants "considerable discretion" over matters such as advertising, sales, and operations, that discretion does not relieve a party of its obligation to act in good faith, and remains "bounded by the parties' mutual obligation to act in good faith."

Because the franchisee introduced evidence that the franchisor exercised its discretion in a manner that frustrated performance, including reversals of operational and advertising policies, the court held that the jury was entitled to be instructed on the implied covenant and ordered a new trial. This holding underscores that the exercise of system-level authority, even where facially permitted, is subject to scrutiny where it is alleged to be arbitrary or undertaken in bad faith.

Similarly, in *Dayan v. McDonald's Corp.,*[152] the court articulated the governing standard for evaluating discretionary authority in franchise relationships. The court explained that where one party is vested with contractual discretion, that party "must exercise that discretion reasonably and with proper motive, and may not do so arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties." Although the franchisor ultimately prevailed on the facts in *Dayan*, the decision makes clear that the existence of broad system authority does not permit arbitrary or opportunistic conduct, whether in the form of system-wide directives or otherwise.[153]

Consistent with these principles, courts have permitted claims to proceed where a franchisor's exercise of operational or system-wide authority is alleged to have been undertaken in bad faith or in a manner that undermines the franchisee's reasonable contractual expectations.

V. CONCLUSION AND RECOMMENDED BEST PRACTICES.

a. Franchisors.

i. Preparation

Of all the principles that should guide a franchisor's approach to system changes, preparation is perhaps the most fundamental. The legal and practical challenges to a franchisor's change agenda that have been examined throughout this paper - from disclosure obligations and material change standards to franchisee association resistance and regulatory scrutiny - are all significantly more manageable when the franchisor has invested the time and resources necessary to prepare thoroughly before implementation begins. Preparation in this context encompasses several distinct but interrelated activities.

First, franchisors should conduct a comprehensive legal audit of any proposed system change before implementation, evaluating the change against the full range of applicable legal requirements. This audit should address, at a minimum, whether the proposed change is authorized by the existing franchise agreement and operations manual, whether the change triggers a material change obligation requiring FDD amendment under the federal Franchise Rule or applicable state standards, whether the change involves new or increased fees that must be disclosed in the FDD before they can be imposed, whether the change implicates state franchise relationship laws - including Washington's WFIPA "reasonable and necessary" standard - and whether the change affects any representations made in the FDD that must be updated to remain accurate.[154] Franchisors who skip this legal audit and proceed directly to implementation risk

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[152] *Dayan v. McDonald's Corp.*, 125 Ill. App. 3d 972, 466 N.E.2d 958 (1984).

[153] The authorities relied upon in *Carvel* and *Dayan* reinforce this limitation. *See, e.g.*, *Gelder Med. Grp. v. Webber*, 41 N.Y.2d 680, 684 (1977) (recognizing implied covenant in every contract); *Van Valkenburgh, Nooger & Neville, Inc. v. Hayden Publ'g Co.*, 30 N.Y.2d 34, 45 (1972) (same); *Cross & Cross Props., Ltd. v. Everett Allied Co.*, 886 F.2d 497, 502 (2d Cir. 1989) (contractual discretion is limited by obligation of good faith), each cited in *Carvel*; and *Foster Enters., Inc. v. Germania Fed. Sav. & Loan Ass'n*, 97 Ill. App. 3d 22, 30–31 (1981), cited in *Dayan* for the proposition that discretionary authority must be exercised reasonably and not arbitrarily.

[154] Einhorn & Linderman, supra note 1, at 30-31; Kathryn Kotel, Doug Luther & Stephanie Russ, "No General Counsel, No Problem: Best Compliance Practices for Small-System Franchisors," ABA 48th Annual Forum on Franchising W-17, at 33-34 (2025).

discovering compliance problems after the fact, when the cost of remediation is far greater than the cost of proactive review would have been.

Second, franchisors should conduct a thorough operational and financial analysis of the proposed change before implementation, evaluating the impact of the change on franchisee operations and economics with the same rigor applied to the franchisor's own business case for the change. This analysis should include a realistic assessment of the costs franchisees will incur in implementing the change, the timeline required for franchisee compliance, the operational disruption the change may cause, and the financial impact on franchisee unit economics.[155]

Third, franchisors should develop a comprehensive implementation plan that addresses the sequencing of legal compliance steps, the timing and content of franchisee communications, the support resources that will be made available to franchisees during the transition, and the metrics by which the success of the implementation will be evaluated. A well-developed implementation plan not only reduces the risk of compliance failures and franchisee disputes but also demonstrates the good faith and organizational competence that courts and regulators look for when evaluating a franchisor's conduct in implementing system changes.[156] Franchisors should also identify in advance the internal and external resources - including franchise counsel, operations support staff, training personnel, and technology support - that will be needed to execute the implementation plan effectively, and should ensure that those resources are committed and available before the implementation process begins.[5]

Fourth, franchisors should anticipate the legal and practical objections that franchisees are likely to raise in response to the proposed change and develop well-reasoned responses to those objections before they are raised.[157] This preparation should include a review of the franchise agreement and FDD to identify any provisions that franchisees may invoke in resisting the change, an assessment of the strength of those arguments and the franchisor's responses, and a review of relevant case law and regulatory guidance to ensure that the franchisor's legal position is well-grounded.

ii. Communication

Even the most legally sound and operationally well-designed system change can generate significant franchisee resistance if it is communicated poorly. Franchisees who learn about system changes through rumor, incomplete information, or last-minute announcements are far more likely to react with suspicion and resistance than those who receive clear, timely, and comprehensive communication from the franchisor about the nature, rationale, and implications of the proposed change. Effective communication is therefore not merely a courtesy to franchisees - it is a strategic imperative for franchisors seeking to implement system changes successfully.[158]

Franchisors who involve franchisees early on – when first considering changes, and communicate the motivation for the change, the various options the franchisor is considering, and the various methods to potentially implement the change, will likely fare better than franchisors who simply impose changes without involving franchisees in the process in meaningful ways.

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[155] Einhorn & Linderman, supra note 1, at 5-6; Julie Lusthaus & Michelle Murray-Bertrand, "Hitting Refresh: Updating Your Franchise Agreement to Reflect the Times," ABA 45th Annual Forum on Franchising W-17, at 3-5 (2022).
[156] Einhorn & Linderman, supra note 1, at 31-32; Kotel, Luther & Russ, supra note 2, at 30.
[157] Einhorn & Linderman, supra note 1, at 31; Dady & Susag, supra note 1, at 22-24.
[158] Dady & Susag, supra note 1, at 22-24; Einhorn & Linderman, supra note 1, at 30-31

iii. Transparency

Transparency is closely related to communication but deserves separate treatment because it addresses a distinct and equally important dimension of the franchisor-franchisee relationship during system changes. While communication focuses on the content and timing of information shared with franchisees, transparency focuses on the franchisor's willingness to be open and honest about the full range of considerations - including the franchisor's own interests and limitations - that are driving the proposed change. Franchisors who are transparent with franchisees about the rationale for system changes, the anticipated costs and benefits, the uncertainties involved, and the franchisor's own role in the change build the kind of trust that is essential for a healthy and productive franchise relationship.[159]

iv. Internal Support

The final and in some respects most operationally critical element of a successful franchisor change strategy is the commitment of adequate internal support resources to assist franchisees in implementing system changes. Even franchisees who accept the legitimacy of a system change and are committed to compliance may struggle to implement the change effectively without adequate support from the franchisor, and franchisees who struggle with implementation are more likely to become dissatisfied, non-compliant, and ultimately litigious. The franchisor's obligation to provide adequate support during system changes derives not only from the practical imperative of successful implementation but also from the legal framework governing the franchise relationship, including the representations made in Item 11 of the FDD regarding the assistance the franchisor will provide and the implied covenant of good faith and fair dealing.[160]

b. Franchisees.

i. Advocacy.

Franchisees may feel as though they are at the mercy of the whims of their franchisor – and oftentimes not even the franchisor they initially put their faith into when first investing into the system. Oftentimes franchise systems change hands, are restructured, and new investors join, frequently bringing agendas that have more to do with recouping their investment than in improving the system.

In the face of unfamiliar leadership, and with agreements growing increasingly one-sided and operational mandates coming from all angles, franchisees may feel powerless. But there is always power in numbers. Franchisee groups, whether formal associations or otherwise, that collectively advocate for system changes and proactively engage with franchisors, may be surprised to find that their organization can actually beget real results within the system.

ii. Communications.

Franchisee groups can collectively hire counsel to draft letters to the franchisor on a number of issues, collectively bargaining on a number of fronts simultaneously. The group may decide, instead, to focus their efforts on a particular issue, and prioritize negotiating on that point over all else.

Franchisees should first seek to understand the change the franchisor is seeking to implement – oftentimes the system is rife with rumors about the change that bear little or no resemblance to the reality envisioned by the franchisor. Franchisee advocacy groups can bridge the communication gap between the

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[159] Dady & Susag, supra note 1, at 22-24; Einhorn & Linderman, supra note 1, at 32-33.

[160] 16 C.F.R. § 436.5(k); Einhorn & Linderman, supra note 1, at 32; Kotel, Luther & Russ, supra note 2, at 27-28.

franchisor's initiative (and intentions) and franchisees' misapprehensions and fears. This initial outreach to the franchisor can often be non-confrontational, information-gathering and may be effective in starting a dialogue without ever resorting to more aggressive tactics.

Where franchisees are adamant about fighting a system change, franchisee groups are best served by understanding their potential leverage at the outset. Because so many states provide critical statutory protections for franchisees, an audit of the location of franchisees within the system (and group) is critical to understand what laws the franchisor's proposed changes may violate (and, thus, what potential claims the franchisees collectively have). Additionally, a survey of all franchise disclosure documents and franchise agreements is critical to understanding where key provisions have changed over the years and the implication of those changes on franchisee rights and remedies and any potential claims.

Most franchisees hope that their initial outreach results in a dialogue. A great number of issues that plague franchise systems could be resolved by a productive two-sided dialogue between the franchisor and franchisees. Where these discussions fail, or, worse, when the franchisor refuses to engage, the franchisees may be forced to take a more aggressive route.

While most franchise agreements prohibit class action lawsuits, franchisees can collectively strategize and fund a number of individual lawsuits against the franchisor to address truly problematic issues within the system. This "death by a thousand cuts" strategy can be very effective. Franchisee groups should identify franchisees in states with favorable statutes to address issues – hopefully franchisees with unblemished operating histories, who would not be subject to counterclaims by the franchisors. Franchisee groups can use the threat of these litigations to force a more productive dialogue.