LOOKING THROUGH THE JUDICIAL LENS: THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING IN FRANCHISE RELATIONSHIPS

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INTRODUCTION

Oh frailty, thy name is contract, as the bard may have written in the Elizabethan times.[1] The law of contracts has undergone somewhat of a revolution, or evolution, in recent years and is continuing to evolve as it is shaped by the actions of legislators, the interpretations of courts, and most of all, the needs of the market place.[2] Law students enter into a labyrinth we call "Contracts I" and are generally given a historical perspective on the principles of contract. The students meet Rose the cow and are taught strict rules of how to form a contract and how to interpret a contract once it is formed.[3] As all first-year law students learn within the first few weeks of their law school careers, there needs to be an offer followed by acceptance, both supported by consideration, in order for there to be a valid contract.[4] This simple equation is the emphasis of nearly all of the early contract cases taught in law schools today.

It would also be fair to say, however, that many contract cases involve not just a single transaction between parties, but multiple transactions over an extended period of time. In such instances, the contracting parties often form a relationship that is not easily adjudicated under the most basic principles of contract law and is thereby subject to legal rules, presumptions, and equitable principles—such as the implied covenant of good faith and fair dealing—that are not always present in the express terms

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1 *Cf.* WILLIAM SHAKESPEARE, HAMLET act. 1, sc. 2 (a play on Shakespeare's oft quoted "[f]raility, thy name is woman").

2 Danielle Kie Hart, *Contract Law Now – Reality Meets Legal Fictions*, 41 U. BALT. L. REV. 1, 45 (2011).

3 Sherwood v. Walker, 33 N.W. 919, 920 (Mich. 1887).

4 1 RICHARD A. LORD, WILLISTON ON CONTRACTS §§ 4:3, 6:1, 7:2 (4th ed. 2011).

of the contract and which are still being developed today.[5] In modern times, a common form of such long-term contractual relationships arises in franchise agreements. As such, this article will critically examine recent developments by the courts of the implied covenant of good faith and fair dealing as applied to the franchise relationship, specifically the continuing debate regarding what principles govern the interpretation of a franchise agreement that is terminated before the contracted end date, and make recommendations as to the application of the implied covenant of good faith and fair dealing to the contractual relationship between franchisors and franchisees.

I. THE REALISTS ADDRESS THE PROBLEM OF HAL AND MARGE

The twentieth century saw a major movement in the interpretation of contracts, exemplified by the so-called "realist."[6] Karl Llewlyn and Soia Mentschikoff, the primary drafters of the Article II sales provision of the Uniform Commercial Code ("UCC"), were major proponents of the realist movement.[7] The realists began by examining the real world of commercial law and commercial relationships and, based upon their observations, proposed the novel idea that, in addition to embodying a single or series of transactions, contracts can be viewed as a relationship that parties enter into in order to effectuate a mutual benefit.[8] Among other endeavors, the realist sought to draft a code that would amend—or bend, depending upon your point of view—traditional contract concepts to be more user-friendly to the real world of commercial relations and thus provide a unified set of principles to govern commercial transactions.[9] From such endeavor, the Uniform Commercial Code was born.[10]

The sales contract formation issues in Article II of the Uniform Commercial Code are a good illustration of the shift in contractual relations that was implemented by the realists.[11] Prior to the advent of the UCC, a sales contract required an offer from the prospective buyer and an

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[5] *See* Carmen D. Caruso, *Franchising's Enlightened Compromise: The Implied Covenant of Good Faith and Fair Dealing*, 26 FRANCHISE L.J. 207, 207–08 (2007).

[6] Hart, *supra* note 2, at 30; *see generally* Karl N. Llewellyn, *What Price Contract? – An Essay in Perspective*, 40 YALE. L.J. 704, 710 (1931).

[7] John M. Breen, *Statutory Interpretation and the Lessons of Llewellyn*, 33 LOY. L.A. L. REV. 263, 268 (2000).

[8] *See* Llewellyn, *supra* note 6, at 717.

[9] *See* Breen, *supra* note 7, at 443.

[10] *Id.*

[11] *Id.*; *see* Hart, *supra* note 2, at 30.

acceptance by the seller, both supported by consideration.[12] The seller's acceptance had to mirror the buyer's offer in all respects, meaning that the terms of the offer and acceptance had to be the same terms—colloquially called the "Mirror Image Rule."[13] If the seller's acceptance contained additional terms or terms that were inconsistent with the buyer's, then there was simply no contract, and the parties had to start over.[14] The adoption of the UCC changed these long held principles in important ways so that the law better comported to the way that commercial transactions work in the real world.[15]

A simple hypothetical starring Hal and Marge exemplifies the real world of commercial transactions as observed by Llewellyn and Mentschikoff. In this hypothetical, Hal is the senior buyer for Acme Construction Company, and Marge is the purchasing agent for Smith Lumber Company. Hal and Marge have done business over the phone for twenty years with Hal purchasing all of his lumber needs for the construction company through Marge's lumber supply company. In a typical deal, Hal would telephone Marge and order a truck-load of lumber for a construction project. After exchanging pleasantries and asking about each others' families, Marge would say, "Yes, we have the lumber in stock, and the lumber can be delivered at this price, on this date, subject to these terms." Hal would then mail (or, more recently, fax) a ten page purchase order to Marge, containing the terms discussed on the telephone on the first page and boiler plate language prepared by lawyers he had never met and which he would never read on the remaining nine pages. Buried on page seven would be a boilerplate provision stating that Hal's company, the buyer, would be entitled to any consequential damages that might arise as a result of faulty lumber. This meant that, in the future, if there was a personal injury that could be traced back to the lumber, Hal's company could seek compensation from the lumber supply company for any associated damages that exceeded the cost of the lumber.

Upon receiving Hal's purchase order, Marge would typically respond by sending a ten-page acknowledgement, with page one containing the terms discussed on the phone and the remaining nine pages containing boilerplate language that she has never read. Buried on page eight of Marge's acknowledgment was a provision stating that Marge's lumber

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12 LORD, *supra* note 4, at §§ 4:3, 6:1, 7:2.

13 *See e.g.*, Livingstone v. Evans, [1925] 4 D.L.R. 769, 770–71 (Can. Alta. S.C.).

14 *See* LORD, *supra* note 4, at § 5:3; *see also Livingstone*, [1925] 4 D.L.R. at 770–71.

15 Russell A. Hakes, *Focusing on the Realities of the Contracting Process: An Essential Step to Achieve Justice in Contract Enforcement*, 12 DEL. L. REV. 95,112–13 (2011); *see also* U.C.C. § 2-207 (2011).

supply company would not be liable for any consequential damages as a result of the sale, and, if any personal injury occurred due to faulty lumber, Marge's company would be liable only for replacing the lumber.

Therefore, in a typical transaction between Hal and Marge, Hal's purchase order would contain an express consequential damages provision and Marge's acknowledgment would contain a directly conflicting waiver of consequential damages. As such, under the traditional principles of contract law, Hal and Marge were never parties to a contract because the offer (the purchase order) was not a mirror image of the acceptance (the acknowledgement),[16] and, upon discovering this, Hal and Marge would have to completely start over in their business dealings.[17]

However, Llewellyn and Mentschikoff, who observed that such strict contract interpretation is not consistent with the commercial realities of the twentieth century, stepped in with the more lenient provisions of Article II of the UCC.[18] For example, Llewellyn and Mentschikoff drafted UCC § 2-207 in order to address these commercial realities and crafted it to provide that, under certain conditions, a contract would exist and be enforceable in spite of inconsistent or additional terms in the offer and acceptance.[19] Assuming that § 2-207 governed Hal and Marge's transaction —since Article II is applicable where both parties are merchants—[20]then Hal and Marge would have a valid and enforceable contract that comports to their understanding of their transaction.[21]

The purpose of this hypothetical is to illustrate that the realists looked at commercial transactions as a relationship and sought to fashion contract law to better fit that perspective and to be more consistent with the economic realities of the twentieth century.[22] In the above hypothetical, the business transactions between Hal and Marge were essentially a series of single transactions represented by individual contracts over a period of time. However, each specific transaction (such as the single transaction outlined above) although short in duration, could in fact be characterized as a relationship. But what if the business transactions between Hal and Marge were more than a series of individual contracts over a period of time? What if the transaction was a single contract governing a continuing relationship in which the parties contemplated doing business with each other over an

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[16] *Livingstone*, [1925] 4 D.L.R. at 770–71; LORD, *supra* note 4, at § 6:3.

[17] *Livingstone*, [1925] 4 D.L.R. at 770–71; LORD, *supra* note 4, at § 6:3.

[18] Llewellyn, *supra* note 6, at 737, 750.

[19] U.C.C. § 2-207(3) (2011); *see* Breen, *supra* note 7, at 393.

[20] § 2-104(1).

[21] § 2-207(1).

[22] *See* Hart, *supra* note 2, at 80.

extended period of twenty or more years? Apparently, Llewellyn and Mentschikoff foresaw this possibility, and built into the UCC a standard that was intended to govern the manner in which two parties entering into a business transaction would deal with one another when undertaking a long-term transactional relationship.[23] As such, the UCC instills within every Article II business transaction an implied covenant that each party would act in good faith, which is defined by the UCC, and honed by judicial interpretation, as "honesty in fact."[24] This implied covenant of good faith and fair dealing, however, cannot generally be used as an independent basis for a cause of action for breach of contract. Rather, the implied covenant must be brought as a derivative, or dependent, claim arising out of a breach of an express contractual provision.[25] As discussed below, this can have drastic consequences in the real world of the franchise relationship, due in part to the longevity of the relationship undertaken by franchisors and franchisees.

II. THE FRANCHISE RELATIONSHIP

At first glance, the concept of the franchise relationship may seem overwhelming and difficult to a practitioner who is unfamiliar with its nature. In its simplest form, the franchise relationship is a contractual one, whereby a franchisor licenses to a franchisee the right to distribute a specific product or service using a prescribed business format under the franchisor's trade or service mark.[26] This concept of the modern franchise system has its origins in the early 1890's, when Martha Melina Harper developed a new business model, which she used to open a network of 500 Harper Beauty Shops throughout the United States, Canada, and Europe.[27] In the 1950s and 1960s, franchising began to take off when chains such as McDonald's and Burger King began marketing their successful business concepts to individuals in return for individuals paying for the right to use the successful business's name and good will.[28] During this period, franchising was a "virtually unchecked" practice that developed rapidly in a

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23. U.C.C. § 1-203 (2011); Breen, *supra* note 7, at 288.
24. § 1-203.
25. Caruso, *supra* note 5, at, 207–08 (2007); § 1-203.
26. *See* 16 C.F.R. § 436.1(h) (2012).
27. Francine Lafontaine & Roger D. Blair, *The Evolution of Franchising and Franchise Contracts: Evidence from the United States*, 3 ENTREPRENEURIAL BUS. L.J. 381, 385 (2009).
28. *Id.* at 386; Bus. Franchise Guide ¶ 105 (CCH).

"*laissez-faire* legal environment."[29] In 1970, however, California enacted the Franchise Investment Law,[30] the first piece of legislation aimed at regulating franchise systems. The law was passed in response to complaints over franchise sales practices, which had a reputation for touting "rags to riches" stories aimed at inducing "an easily influenced and relatively unsophisticated audience to make investments in franchise opportunities."[31] Today, franchising is regulated, in part, by the Federal Trade Commission ("FTC") under the FTC Rule with state law playing a major role in regulating the franchise system.[32]

One of the hallmarks of the franchise relationship is that it is a long-term business relationship, similar to the on-going relationship between Hal and Marge described in Part I. However, where the Hal and Marge hypothetical involved a series of single transactions that spanned several years, the franchise relationship involves a single, unified business relationship between two parties that extends over a period of time, perhaps as long as twenty or thirty years. In the hypothetical described above, Hal and Marge are under no obligation to continue their business arrangement; it is a simple supplier/buyer relationship, in which either party can elect to discontinue doing business with the other at any time. In contrast, the participants in a franchise relationship, the franchisor and franchisee, are obligated to continue the business relationship they established at the founding of the contractual relationship. Furthermore, Hal and Marge have no agreement in place that will govern how they will interact with one another once each single transaction is complete. In the franchise

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[29] Rochelle B. Spandorf & Mark B. Forseth, *Franchise Registration*, *in* FUNDAMENTALS OF FRANCHISING 125, 126 (Rupert M. Barkoff & Andrew C. Selden eds., 3d ed. 2008) (footnote omitted).

[30] CAL. CORP. CODE §§ 31000–31516 (West 2012) (effective Jan. 1, 1971).

[31] Spandorf & Forseth, *supra* note 29, at 127.

[32] 16 C.F.R. § 436 (2012). The FTC Rule, 16 C.F.R. § 436, states the minimum standards franchisors must meet in disclosure documents which franchisors must provide to prospective franchisees. *See* Spandorf & Forseth, *supra* note 29 at 132. However, the FTC Rule does not require these documents to be filed or reviewed by any federal regulatory body and registration of the franchise is not required. *Id.* at 131. States, on the other hand, play a major role in the regulation of franchises. *Id.* at 129-31. States are not preempted from establishing more stringent disclosure requirements, and may require the franchise to be registered or the disclosure documents to be filed with the appropriate state agency. *Id.* at 129-32. For a more detailed discussion of the franchise disclosure document see Judith M. Bailey & Dennis E. Weiczorek, *Franchise Disclosure Issues*, *in* FUNDAMENTALS OF FRANCHISING 95, 95–123 (Rupert M. Barkoff & Andrew C. Selden eds., 3d ed. 2008). For a more detailed discussion of franchise regulation and registration see Spandorf & Forseth, *supra* note 29, at 125–81.

relationship, however, the parties explicitly undertake a continuing relationship, which will hopefully be mutually beneficial.

The benefits of a franchise relationship can be easily illustrated in the simple example of a person wishing to open a restaurant. He or she essentially has the following two options: (1) open the restaurant from scratch or (2) "rent" an existing restaurant concept that has been developed by others. In the first option, starting a restaurant from scratch, he or she would have to form a business entity (i.e., a corporation), purchase or lease a suitable property upon which to operate the restaurant, and purchase or lease restaurant equipment. Additionally, he or she would be required to develop menus and a business plan, taking into consideration important factors such as food/cost ratios— a concept that he or she may have no experience in—and coming up with a clever restaurant name. The entrepreneur would then have to take steps, at both the state and federal level, to protect his or her right to be the exclusive owner of that name. This would be a crucial step in starting the restaurant because, if the restaurant eventually became successful and the owner wanted to operate other restaurants under the same name in other areas, he or she would want to ensure that competitors could not appropriate the name of his or her established and profitable restaurant.

There are, of course, many other complex steps necessary to establish a restaurant business, and, as a result, the person desiring to do so may believe that they do not possess the necessary qualifications or experience to implement such a business concept successfully. However, the second option of "renting" a restaurant concept eliminates some of the daunting complexities and provides an alternative route for an aspiring restaurateur to realize his or her dream of starting a restaurant.

Let us assume that a prospective restaurateur, whom we will call Harry, partially got his idea of starting a restaurant from frequenting one of his favorite eating establishments, "Burger King." Harry discovered that, in exchange for "franchise fees," he could run and have partial ownership of a Burger King business by acquiring or licensing from the owner, Burger King Corporation ("BKC"), the right to operate a restaurant under the name "Burger King," and use the same concept which he found appealing, thereby avoiding many of the issues associated with opening a restaurant from scratch. Essentially, Harry would be acquiring the right to operate the Burger King Restaurant concept by paying an initial franchise fee to the owner, BKC. For this fee, Harry would obtain the right to use the name Burger King, as well as all of the signs and logos associated with a Burger King, which we refer to as "trade dress." After paying his franchise fee and being accepted or approved by BKC as a potential franchisee, Harry would sign a franchise agreement, establishing a long-term relationship between himself and BKC. After the agreement is signed, Harry would undergo an extensive training program conducted by the franchisor, during which he would learn, among other things: how to buy the raw materials for the food, how to make the food, how to acquire the necessary restaurant equipment, and how to follow the business and accounting principles established by BKC. Additionally, BKC would assist him in obtaining a location for his restaurant and buying or leasing necessary property. Harry would be guided through each step of this process by the franchisor, BKC, in lieu of undertaking every step by himself. More importantly, Harry would obtain the license or right to hold himself out as a Burger King restaurant and to use the Burger King name, which is of value to him because of its widespread name recognition.

After signing the franchise agreement and undergoing the above-mentioned training process, Harry would be a party to a *hopefully* long-term relationship with BKC, in which he would have continued authorization to use their name and logos and would rely upon Burger King's continued assistance and limited supervision in running his restaurant. In exchange for the training and assistance described above, Harry would pay periodic (generally monthly) royalties to BKC, at a rate defined as a percentage of his gross or net income as set forth in the franchise agreement. To run a Burger King restaurant, Harry would be relying on the expertise of others to literally set him up in the business. Harry would not own the Burger King name, nor would he own what is commonly called the "good will" of the business. Should the franchise relationship be terminated, Harry would have to cease doing business as a Burger King restaurant and give up all rights to many aspects of the Burger King business, including use of the Burger King name. Generally, Harry would also be required to sign an agreement not to compete with the franchisor Burger King in the event of a termination, which would preclude him from continuing in the restaurant business in a specific area and for a reasonable period of time after termination of the franchise agreement.

One could think of a franchise agreement as being similar to a prenuptial agreement entered into before marriage. While the dissimilarities are obvious, the similarities between the two agreements are intriguing. Both agreements envision a long-term relationship, whereby each party seeks to enter into a mutually beneficial relationship in order for each party to feel the relationship is successful. As such, the parties attempt to structure the agreement in such a way that both benefit by entering the agreement, while concurrently protecting their varied interests. Applying this principle in the context of a franchise agreement, the franchisor has the challenge of structuring the franchise business format so that the franchisee is able to run a successful franchise and, therefore, is able to pay royalties to the franchisor. If the franchise agreement is well-structured, both the franchisor and franchisee will receive monetary benefits, and both parties will feel that the relationship is successful.

The challenge, however, arises when a franchise relationship sours and disputes arise within the context of the long-term franchise relationship. In such cases, the question becomes, "by what principles is the contract to be interpreted?" This question is being actively litigated in courts around the country without a coherent set of principles to guide the courts, not to mention franchisors or franchisees.[33] From the franchisor's perspective, they have successfully negotiated a very tightly controlled franchise agreement over the years, which they have entered into with multiple franchisees. Therefore, they are primarily interested in a strict interpretation of contractual principles, without regard to the nature of the continuing relationship between the parties. Franchisees, on the other hand, in an effort to continue what has been a beneficial relationship, are looking more toward the long-term relational aspects between themselves and the franchisor. From this perspective, and because the franchisee historically comes from a weaker bargaining position than the franchisor, the franchisee has a desire for the courts to apply principles such as good faith on the part of the larger franchisor corporation.[34]

With this background in mind, we now turn to an interesting pair of cases that were initiated by BKC in the U.S. District Court for the Southern District of Florida against several franchisees.[35] In these two cases, the court grappled with the issues of how to interpret and apply the concept of good faith and the implied covenant of good faith and fair dealing to a long-term franchise agreement.[36] Both cases centered around BKC's imposition of a so-called "Value Menu" on its franchisees, under which the franchisees were required to sell a double cheeseburger for $1.00, even though the cost

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33 *See, e.g.*, Wendy's Int'l Inc. v. Saverin, 337 F. App'x 471 (6th Cir. 2009); Juarez v. Jani-King of Cal., Inc., 273 F.R.D. 571 (N.D. Cal. 2011); JM Vidal, Inc. v. Texdis USA, Inc., 764 F. Supp. 2d 599 (S.D.N.Y. 2011); Dunkin' Donuts Franchised Rests. LLC v. Grand Cent. Donuts, Inc., No. CV 2007 4027(ENV)(MDG), 2009 WL 1750348 (E.D.N.Y. June 19, 2009).

34 *See* Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN. L. REV. 927, 991–92 (1990) (arguing that because of the unequal bargaining power of franchisors and franchisees, courts should apply a "relational approach to the interpretation of franchise contracts and the resolution of franchise disputes" instead of strict contract principles).

35 Burger King Corp. v. E-Z Eating, 41 Corp., 572 F.3d 1306 (11th Cir. 2009); Nat'l Franchisee Ass'n v. Burger King Corp., No. 09-23435-CIV, 2010 WL 4811912 (S.D. Fla. Nov. 19, 2010).

36 *E-Z Eating, 41 Corp.*, 572 F.3d at 1308, 1312 n.8, 1313 n.10; *Nat'l Franchisee Ass'n*, 2010 WL 4811912, at *3–4, *6.

of producing the double cheeseburger was alleged to be $1.29.[37] Essentially, the franchisees in both cases, among many other alleged causes of action, pled that BKC failed to act in good faith by requiring that its franchisees take a loss on the double cheeseburger.[38] The next part of this article will discuss the Burger King cases, which, although ultimately settled out of court, set forth important legal principles during the litigation. Then, this article will discuss recent and active pending litigation concerning the issue of franchise agreement interpretation based on contract law, in particular, as it applies to the covenant of good faith.

III. THE BURGER KING CASES: ANALYSIS UNDER A MICROSCOPE

A. *Burger King v. E-Z Eating*

Luan and Elizabeth Sadik (the "Sadiks") were owners of five "in-line" Burger King restaurants in New York City, New York, which they operated under the corporate entity E-Z Eating Corporation ("E-Z Eating").[39] In 2007, BKC filed a complaint against the Sadiks in the U.S. District Court for the Southern District of Florida, alleging that the Sadiks, through their corporate entity E-Z Eating, breached their franchise agreements (the "Franchise Agreements") by ceasing to operate one of their restaurants, an act which constituted "abandonment" under the Franchise Agreements' terms.[40] Additionally, BKC alleged that the Sadiks individually breached a personal guaranty (the "Guaranty") that they had signed in exchange for financial assistance from BKC.[41] In their answer, the Sadiks claimed, among other affirmative defenses, that BKC breached the Franchise

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37 *Nat'l Franchisee Ass'n*, 2010 WL 4811912, at *1; *see E-Z Eating, 41 Corp.*, 572 F.3d at 1309–10.

38 *E-Z Eating, 41 Corp.*, 572 F.3d at 1311; *Nat'l Franchisee Ass'n*, 2010 WL 4811912, at *1.

39 Defendants' Answer and Affirmative Defenses to Plaintiff's Complaint and Counterclaims at 9, Burger King Corp. v. E-Z Eating 8th Corp., No. 07-20181-CIV (S.D. Fla. July 25, 2008), [hereinafter Defendant's Answer], *aff'd* 572 F.3d 1306 (11th Cir. 2009). An "in-line" restaurant is defined in the Franchise Agreement: Non-Traditional Facility Addendum as a "[r]estaurant food service system having a limited seating capacity authorized and approved by BKC to be developed at selectively approved malls, food courts, strip shopping centers or other retail locations to serve a limited menu of Burger King products." Defendants' Answer, Composite Exhibit "B," Non-Traditional Facility Addendum at 1.

40 Complaint ¶¶ 27–31, Burger King Corp. v. E-Z Eating 8th Corp., No. 07-20181-CIV (S.D. Fla. July 25, 2008), 2007 WL 605235 ¶¶ 27–31, [hereinafter E-Z Eating 8th Corp. Complaint], *aff'd* 572 F.3d 1306 (11th Cir. 2009).

41 *Id.* at ¶ 34.

Agreements by acting in bad faith in a manner that was contrary to the Sadiks's well-being. [42]

1. Background

The Sadiks began operating Burger King franchises in 1996.[43] In 1999, the Sadiks opened their third and fourth franchises in New York City; and, in 2001, they opened another. [44] By 2001, "it was obvious to both [the Sadiks] and BKC that the BKC brand of restaurants was beginning to show failures in its product line," allegedly due to, *inter alia*, BKC's lack of marketing efforts and poor marking strategy compared to other national chain restaurants.[45] In 2005, the Sadiks entered into an assistance agreement (the "Assistance Agreement") with BKC, resulting in the above-mentioned Guaranty, due to financial difficulties allegedly sustained because the franchised restaurants were not producing sufficient business and the Sadiks had begun to fall behind on royalty and advertisement payments owed to BKC under the Franchise Agreements.[46]

During the four-year period leading up to the signing of the Assistance Agreement, BKC apparently made representations to the Sadiks that it had selected the E-Z Eating restaurants as among those they deemed valuable and would assist the Sadiks by providing them with operational "and/or" financial assistance, so that the restaurants would be able to better compete in their market.[47] This decision was supposedly based upon information gathered through BKC programs intended to streamline BKC's corporate and franchise operations by consolidating franchisees BKC deemed valuable.[48] The Sadiks argued that the representations made during this period caused them to forgo closing or selling their restaurants, as BKC had allowed similarly situated restaurants to do so without penalty.[49] In fact, in 2005, the Sadiks had initially sought permission to close or sell their restaurants, as required under the Franchise Agreements, believing BKC would grant permission since the Sadiks "forewent their opportunity previously to close or sell immediately the [r]estaurants based on BKC's

42 Defendants' Answer, *supra* note 39.

43 *Id.* at 10.

44 *Id.* at 9.

45 *Id.* at 10.

46 *Id.* at 11–12.

47 *Id.* at 10.

48 Defendants' Answer, *supra* note 39, at 10.

49 *Id.* at 11.

representations." [50] However, BKC denied the Sadiks' request and, instead, extended credit to relieve the Sadiks' indebtedness.[51] According to the Sadiks, BKC promised that it would support the restaurants.[52] This provision, however, was not explicitly included in the writing of the Assistance Agreement, which was executed on May 1, 2005.[53] Just before entering into the Assistance Agreement, BKC published guidelines concerning the implementation of the "Value Menu" it was seeking to eventually implement system-wide.[54] Among the provisions of the guidelines was a recommendation that any Burger King restaurant that was unable to overcome the negative financial impact of the Value Menu would be exempt from its requirements.[55] Because their restaurants were performing poorly, were in a location that would purportedly be exempt from the Value Menu, and they did not have enough financial resources to implement the proposed Value Menu, the Sadiks believed that their restaurants fell within the category of Burger Kings that would be exempt from implementing the Value Menu. It was around this time that BKC extended credit assistance to the Sadiks.[56]

In February 2006, BKC implemented a nation-wide "Value Menu" with items to be sold at maximum price points established by BKC and required that the menu be sold at all U.S. restaurants, unless the franchisee applied in writing for and was granted an exception to the policy.[57] The Sadiks did not expect these exemption requirements.[58] The policy was distributed in a system-wide memorandum describing the new Value Menu, explaining the associated policies, and establishing how to apply for exemption from its implementation.[59] Among the exceptions to implementing the Value Menu outlined in the memorandum was a provision for in-line restaurants, which stated that a franchisee wishing to apply for such exception must do so in writing to the Division Vice

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[50] *Id.*

[51] *Id.* at 12.

[52] *Id.*

[53] *See* Defendants' Answer, Exhibit "C," Assistance Agreement at 1, Burger King Corp. v. E-Z Eating 8th Corp., No. 07-20181-CIV (S.D. Fla. Feb. 11July 25, 2008), *aff'd* 572 F.3d 1306 (11th Cir. 2009), 2008 WL 384554.

[54] Defendants' Answer, *supra* note 39, at 12–13.

[55] *Id.* at 14.

[56] *Id.*

[57] Burger King Corp. v. E-Z Eating, 41 Corp., 572 F.3d 1306, 1309–10 (11th Cir. 2009).

[58] *Id.* at 1315.

[59] *Id.* at 1309–10.

President.[60] The Sadiks did not apply in writing for an exception.[61] Instead, they relied upon the previous representations of BKC that they would not be subject to implementing the Value Menu.[62] As a result, they did not implement the Value Menu in their restaurants.[63] BKC sent a demand for compliance letter stating, in substance, that, if the Sadiks/E-Z Eating did not implement the Value Menu within 48 hours, BKC would declare the Sadiks/E-Z Eating in default of the Franchise Agreements and that the Sadiks could not rely on the oral representations of BKC.[64] The Sadiks responded to the demand letter, stating that they had complied with the demand letter but believed they were eligible for the Value Menu exceptions.[65] Furthermore, the response letter outlined the Sadiks's understanding that the franchisees must initiate a BKC investigation by making a formal application for the Value Menu exception, remarked that the policy did not make sense, and requested a telephone call to discuss the matter.[66] It also noted that BKC had requested a meeting with the Sadiks/E-Z Eating and requested information regarding the agenda for such a meeting.[67] In April 2006, the Sadiks sent another letter to BKC asserting that they qualified for an exception from the Value Menu program, "yet for reasons that are unclear, BKC will not agree to the exemption."[68] BKC's attorney replied that she had not discussed the matter with BKC, but that if the defendants had submitted the requisite written request and back-up data for an exemption and had not received the exemption, then those restaurants did not qualify.[69]

In January 2007, the Sadiks ceased operation of Burger King restaurant #12287 (referred to as "E-Z Eating 8th Corp." in litigation).[70] Then, in March 2007, the Sadiks ceased operation of Burger King restaurant #12288 (referred to as "E-Z Eating 46th Corp." in litigation).[71] The following year, in a letter dated January 17, 2008, and after commencement of the action presently discussed, BKC formally declared the remaining

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[60] *Id.*

[61] *Id.* at 1315.

[62] Defendants' Answer, *supra* note 39, at 14.

[63] *E-Z Eating 41 Corp.*, 572 F.3d at 1310.

[64] *Id.*

[65] *Id.*

[66] *Id.*

[67] *Id.*

[68] Burger King Corp. v. E-Z Eating, 41 Corp., 572 F.3d 1306, 1310 (11th Cir. 2009).

[69] *Id.*

[70] *Id.* at 1311.

[71] *Id.*

franchise agreements terminated and directed the Sadiks to cease operation of the subject Burger King restaurants, #11100 (referred to as "E-Z Eating 41st Corp." in litigation) and #13447 (referred to as "E-Z Eating 47th Corp. in litigation).[72]

2. Relevant Procedural History

i. Prior Litigation

Litigation concerning the issues in this case arose in an earlier proceeding initiated by E-Z Eating and the Sadiks in August 2006, in the U.S. District Court for the Southern District of New York.[73] Burger King restaurants #12287 ("E-Z Eating 8th Corp."), #11100 ("E-Z Eating 41st Corp."), #12288 ("E-Z Eating 46th Corp."), and #13447 ("E-Z Eating 47th Corp."), as well as the Sadiks, were named as plaintiffs.[74] Arguing essentially the same facts as the 2007 case, E-Z Eating alleged: (1) common law fraud, based on representations made by BKC before the signing of the Assistance Agreement; (2) deceptive actions and practices under New York statute N.Y. GBL § 349; and (3) promissory estoppel.[75] Of notable difference, however, were allegations that BKC had an "ulterior motive" in seeking to have E-Z Eating keep their franchise restaurants operating despite financial difficulties.[76] BKC was preparing an initial public offering ("IPO") of its stock to become a publicly traded company,[77] which was eventually made on February 16, 2006.[78] E-Z Eating alleged that, in anticipation of this IPO, BKC was attempting to promote its financial health by having franchisees participate in the "Value Menu," thus triggering more interest from potential investors, regardless of the negative financial impact the "Value Menu" would have on the franchisees.[79] The Sadiks' entire New York complaint, however, was dismissed without prejudice in deference to a forum selection clause in the Franchise Agreements, which stipulated that the parties agreed to litigate all grievances in the U.S. District Court for the

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72 *Id.*

73 Complaint ¶ 1, E-Z Eating 47 Corp. v. Burger King Corp., No. 06cv5990 (JES) (S.D.N.Y. Dec. 6, 2006), 2006 WL 2582087 ¶¶ 2, 8 [hereinafter E-Z Eating 47 Corp. Complaint].

74 *Id.* ¶¶ 2, 8.

75 *Id.* ¶¶ 42–61.

76 *Id.* ¶¶ 32–36.

77 *Id.* ¶¶ 32–33.

78 *Id.* ¶ 32.

79 E-Z Eating 47 Corp. Complaint, *supra* note 73, ¶¶ 37–41.

Southern District of Florida.[80] The allegations made by E-Z Eating as a defendant in Florida were essentially the same as those it made as a plaintiff in New York.[81]

ii. Present Procedural History

The procedural history of the present case involves a tedious exchange of claims, counterclaims, and motions to dismiss between BKC and the Sadiks. In early 2007, BKC filed an action in Florida for breach of contract against the Sadiks' Burger King restaurant #12287 ("E-Z Eating 8th Corp."),[82] which E-Z Eating responded to with an answer and counterclaims. Eventually, BKC filed a motion to dismiss E-Z Eating's counterclaims, arguing, in substance, that:

(1) the defendants lacked standing to assert the counterclaims because they were "attempting to assert claims for relief based on the legal rights or interests of multiple entities that are not parties" to the case [83]

(2) the counterclaim of common law fraud was not allowed because (a) the Assistance Agreement's integration clause barred the defendants from arguing that they detrimentally relied upon BKC's representations when entering into the Assistance Agreement, since that provision incorporated all prior negotiations and discussions between the parties and stating that the parties are not bound by any other agreement—there was no mention of the representations in the assistance agreement—and, as such, E-Z Eating could not rely to their detriment on extraneous representations in support of their allegations of fraud; and (b) the allegation of common law fraud was not plead with particularity as required by Rule 9(b) of the Federal Rules of Civil Procedure; [84]

(3) the Sadiks/E-Z Eating failed to allege a breach of a contractual duty, since the provision they relied upon left the amount of support it would provide under § 6-I of the Franchise Agreement up to BKC's discretion; and [85]

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[80] E-Z Eating 47 Corp. v. Burger King Corp., No. 06cv5990 (JES) (S.D.N.Y. Dec. 6, 2006).

[81] *See* E-Z Eating 47 Corp. Complaint, *supra* note 73.

[82] Burger King Corp. v. E-Z Eating, 41 Corp., 572 F.3d 1306, 1311 (11th Cir. 2009).

[83] Plaintiff Burger King Corporation's Motion to Dismiss, or, Alternatively, Strike Counterclaim at 3, Burger King Corp. v. E-Z Eating 41 Corp., No. 07-20181-CIV (S.D. Fla. July 25, 2008) [hereinafter BKC's Motion to Dismiss], *aff'd* 572 F.3d 1306 (11th Cir. 2009).

[84] *Id.* at 5–11.

[85] *Id.* at 11.

(4) the defendants' claim for breach of implied duty of good faith and fair dealing fails because it cannot be maintained "(a) in derogation of the express terms of the underlying contract or (b) in the absence of breach of an express term of the underlying contract."[86]

Additionally, BKC alleged that E-Z Eating's counterclaim was a "shotgun" pleading as it incorporated, by reference, each of its predecessor allegations to support the current allegation.[87] When BKC became aware that the Sadiks had closed a second restaurant (E-Z Eating 46th Corp.), thereby breaching the Franchise Agreement associated with that restaurant, BKC withdrew its motion to dismiss and filed an amended complaint naming EZ-Eating 46th Corp. as a third defendant, leaving the substance of the claims primarily unchanged.[88] The defendants—now E-Z Eating 8th Corp., E-Z Eating 46th Corp., and the Sadiks—filed their answer and affirmative defenses against BKC's amended complaint, alleging the same substantive set of facts, claims, and circumstances as their original answer and counterclaim.[89]

BKC once again moved to dismiss the defendants' counterclaims, alleging the same grounds for dismissal, less the lack of standing argument.[90] In response, the defendants clarified that the basis for their counterclaims was not that BKC had induced the defendants to sign the assistance agreement, but that BKC had made representations that "induced the Defendants to stay in business" in a "calculated plan to retain Defendants as franchisees… in preparation of its impending [IPO]."[91] The Sadiks/E-Z Eating further argued that, if this was the case, BKC "used its better leverage and empty promises of financial and operational assistance to entice the Defendants to sign the Assistance Agreement."[92] Moreover, BKC's "unexpected" implementation of the "Value Menu" three days before its IPO demonstrated that BKC "never intended to permit Defendants to avoid the harsh financial effects of the [Value Menu], and the imposition was merely a strategic move on BKC's part." [93]

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86 *Id.* at 13 (quoting Burger King Corp. v. Weaver, 169 F. 3d 1310, 1317–18 (11th Cir. 1999)).

87 BKC's Motion to Dismiss, *supra* note 83, at 14.

88 Burger King Corp. v. E-Z Eating, 41 Corp., 572 F.3d 1306, 1311 (11th Cir. 2009).

89 *Id.*

90 BKC's Motion to Dismiss, *supra* note 83, at 1.

91 Defendants' Response in Opposition to Plaintiff's Motion to Dismiss, or, Alternatively, Strike Defendants' Counterclaims to Amended Complaint at 6–7, Burger King Corp. v. E-Z Eating 41 Corp., No. 07-20181-CIV (S.D. Fla. July 25, 2008) [hereinafter Defendant's Response], *aff'd* 572 F.3d 1306 (11th Cir. 2009).

92 *Id*. at 6.

93 *Id.* at 7.

As to their claims of breach of contract and breach of implied duty of good faith and fair dealing, the defendants argued that (1) they had set out factual averments that BKC would "surely dispute," (2) BKC was attempting to make undetermined factual allegations on a record that had yet to be significantly developed, and (3) the defendants should have a right to attempt to meet their burden of proof on the elements of a breach of contract.[94] Furthermore, the defendants asserted that because they had set out a valid breach of contract claim and *then* brought their breach of implied covenant of good faith and fair dealing claim by incorporating the facts set forth in the former claim, they had properly plead a claim for the latter.[95]

In response, BKC argued that the Sadiks'/E-Z Eating's fraud claim was barred by the Assistance Agreement's integration clause, as well as the release contained in the Assistance Agreement. Furthermore, BKC argued that the breach of contract claim also failed because the Sadiks'/E-Z Eating's position was based on allegations that BKC breached a general obligation of support, yet, under Florida law, "there is no cause of action for breach of a general obligation of support of BKC's Franchise Agreement."[96] BKC then extended that reasoning and asserted that the claim for breach of implied covenant of good faith and fair dealing should also fail.

BKC eventually filed a motion for summary judgment asserting that there was no genuine issue of material fact for a trier of facts to decide.[97] In support, BKC cited that the Sadiks/E-Z Eating admittedly closed their restaurants prior to the termination date established by the Franchise Agreement and without BKC's consent, which constitutes a material breach of the Franchise Agreement.[98] Additionally, BKC pointed out that the defendants' counterclaims did not purport to defeat their motion for summary judgment and that each counterclaim failed as a matter of law because the defendants waived their right to make such claims in the Assistance Agreement.[99] Pertinent to a discussion of the implied covenant

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94 *Id.* at 13.

95 *Id.* at 14.

96 Burger King Corp.'s Reply Memorandum in Support of Its Motion to Dismiss, or, Alternatively, Strike Defendants' Counterclaims to Amend Complaint at 8, Burger King Corp. v. E-Z Eating 41 Corp., No. 07-20181-CIV (S.D. Fla. July 25, 2008), *aff'd* 572 F.3d 1306 (11th Cir. 2009) (citing Burger King Corp. v. Hinton, 203 F. Supp. 2d 1357 (S.D. Fla. 2002)).

97 Plaintiff/Counter-Defendant Burger King Corp.'s Dispositive Motion For Summary Judgment Against Defendants and Incorporated Memorandum of Law at 1, Burger King Corp. v. E-Z Eating 41 Corp., No. 07-20181-CIV (S.D. Fla. July 25, 2008) [hereinafter BKC's Dispositive Motion for Summary Judgment], *aff'd* 572 F.3d 1306 (11th Cir. 2009).

98 *Id.* at 2.

99 *Id.*

of good faith and fair dealing, BKC argued that, "Defendants simply broadly charge the BKC's actions somehow breach the implied duty… without citation to any particular contractual duty that BKC allegedly breached," and that the breach relied upon was further insufficient as a matter of law because "the fact that BKC maintained the sole reasonable discretion to determine the way in which it provides the enumerated services in the Franchise Agreement bars Defendants' breach of contract claim."[100] Conceding to some of BKC's arguments, the defendants voluntarily withdrew their claims for common law fraud and promissory estoppel.[101]

Regarding their other claims, however, the Sadiks/E-Z Eating filed a response to BKC's motion for summary judgment arguing impossibility of performance as to BKC's claim of breach of contract under the franchise agreement, citing that BKC had actual knowledge that the Value Menu was causing extreme loss to defendants and a previous failed attempt at a "99 Cent Menu" program some years earlier.[102] Additionally, the defendants argued that if there was a breach, BKC would be unable to demonstrate that a breach was the "proximate cause of BKC's lost future royalties."[103] The defendants further argued that implementation of the Value Menu was a *"de facto* or constructive termination of defendant's franchises," which, in effect, proximately caused BKC's lost royalties.[104] BKC countered that it was authorized under the Franchise Agreement to implement the Value Menu and that, as a result, E-Z Eating's impossibility defense and its claims for breach of contract and breach of implied covenant of good faith claim all fail because there was no breach of the Franchise Agreement.[105] BKC asserted that the defendants misinterpreted the law (specifically *Burger King v. Hinton*[106]) in support of their proposition that a franchisee's breach

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[100] *Id.* at 18–19.

[101] Memorandum of Law in Response to Plaintiff Burger King Corp.'s Motion for Summary Judgment Against Defendant/Counterclaim Plaintiff's E-Z Eating 8th Corp., E-Z Eating 46th Corp., Luan Sadik and Elizabeth Sadik at 2, n. 1,Burger King Corp. v. E-Z Eating 41 Corp., No. 07-20181-CIV (S.D. Fla. July 25, 2008) [hereinafter Memorandum of Response to BKC], *aff'd* 572 F.3d 1306 (11th Cir. 2009).

[102] *Id.* at 9.

[103] *Id.* (citing Burger King v. Hinton, Inc., 203 F. Supp. 2d 1357, 1366–67 (S.D. Fla. 2002), holding a franchisee's breach is not proximately connected to lost future royalties when the franchisor's actions bring about the loss of future royalties).

[104] *Id.*

[105] Burger King Corporation's Reply Memorandum in Support of Its Dispositive Motion for Summary Judgment Against Defendants at 4–5, Burger King Corp. v. E-Z Eating 41 Corp., No. 07-20181-CIV (S.D. Fla. July 25, 2008) [hereinafter BKC Reply Memorandum], *aff'd* 572 F.3d 1306 (11th Cir. 2009).

[106] 203 F. Supp. 2d 1357 (S.D. Fla. 2002).

is not proximately connected to lost future royalties when the franchisor's actions bring about the loss of future royalties.[107] BKC distinguished *Hinton* based on the fact that it was BKC's decision to terminate that franchise agreement due to Hinton's breach of the Franchise Agreement.[108] As such, BKC argued that the governing principle was located in *Burger King v. Barnes*,[109] which held, *inter alia*, that the franchisee's abandonment of the restaurant in was the proximate cause of BKC's damages, and, as such, that Florida law entitled BKC to lost profits.[110]

The court ordered that all three pending cases be consolidated for pretrial procedures on interrelated claims between BKC and the Sadiks/E-Z Eating, and the cases were termed the "Cooke Action" (*Burger King v. E-Z Eating 8th Corp & E-Z Eating 46th Corp.*), the "Jordan Action" (*Burger King v. E-Z Eating 41st Corp. & E-Z Eating 47th Corp.*), and the "Ungaro Action" (*E-Z Eating 41st Corp. & E-Z Eating 47th Corp. v. Burger King*).[111] In the Cooke Action, BKC claimed that E-Z Eating had breached their contract and sought lost profits due under the Franchise Agreement.[112] BKC filed a motion for summary judgment, which the court granted.[113] In the Jordan Action, BKC's claims alleged unfair competition, trademark infringement, and breach of franchise agreement.[114] In the Ungaro Action—the only action in which E-Z Eating was the plaintiff—E-Z Eating sought declaratory relief for BKC's breaches of contract and the implied covenant of good faith and fair dealing, a counterclaim they raised in answer to the Cooke Action and the Jordan Action.[115]

The judge then ordered consolidation of all three actions for trial and denied BKC's previous motion to dismiss.[116] BKC's motion for summary judgment in the Cooke Action, however, was granted in part, only finding, as to liability, that the defendants defaulted on the Franchise Agreement by

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[107] BKC Reply Memorandum, *supra* note 105, at 10–11.

[108] *Id.*

[109] 1 F. Supp. 2d 1367 (S.D. Fla. 1998).

[110] BKC Reply Memorandum, *supra* note 105, at 10–12; *see Hinton Inc.*, 203 F. Supp. 2d at 1366–67.

[111] Burger King Corp. v. E-Z Eating 41 Corp., 572 F.3d 1306, 1311–12 (11th Cir. 2009).

[112] E-Z Eating 8th Corp. Complaint, *supra* note 40, ¶¶ 28–31.

[113] *E-Z Eating 41st Corp.*, 572 F.3d at 1312.

[114] *Id.* at 1311.

[115] *Id.* at 1312.

[116] *Id.*

abandoning and closing the restaurants prior to expiration of their term and by failing to address BKC's claims and defenses.[117]

BKC's motion for summary judgment in the Cooke Action[118] had been filed prior to initiation of the Ungaro and Jordan Actions and before the three actions were consolidated.[119] Thus, the court's order granting BKC's motion for summary judgment, in part, was applied only to the Cooke Action and not the Ungaro or Jordan Actions. The court did not address the issue of damages in the Cooke Action order.[120]

BKC filed a subsequent motion for summary judgment on the remaining claims, arguing that the defendants' affirmative defenses in the Jordan Action were identical to those which the court had already ruled on in the Cooke Action and which, according to BKC, were determined to be meritless by the same order.[121] BKC also argued that E-Z Eating's counter-claims in the Jordan Action and claims in the Ungaro Action for breach of contract and breach of implied duty of good faith and fair dealing were duplicative causes of action.[122] The court rejected this argument in its order partially granting BKC's motion for summary judgment, leaving the request for injunctive relief in the Ungaro Action the only remaining distinct cause of action, which the court had already refused by denying E-Z Eating's earlier motion for a preliminary injunction.[123]

On July 25, 2008, the court granted BKC's motion for summary judgment on remaining issues in the Jordan Action and the Ungaro Action and awarded damages in the amount of $770,547.55 for past due royalties, outstanding payments on a promissory note, and lost profits in the Cooke Action.[124]

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[117] *Id.*

[118] *Id.*

[119] *E-Z Eating 41st Corp.*, 572 F.3d at 1312.

[120] *Id.* at 1312.

[121] Plaintiff Burger King Corp's Motion for Summary Judgment Against Defendants on Remaining Claims and Incorporated Memorandum of Law at 2, Burger King Corp. v. E-Z Eating 8th Corp., No. 07-20181-CIV (S.D. Fla. July 25, 2008), *aff'd* 572 F.3d 1306 (11th Cir. 2009).

[122] *Id.* at 2.

[123] Burger King Corp. v. E-Z Eating 8th Corp., No. 07-20181-CIV (S.D. Fla. July 25, 2008), *aff'd* 572 F.3d 1306 (11th Cir. 2008)

[124] Burger King Corp. v. E-Z Eating 8th Corp., 572 F.3d 1306, 1312 (11th Cir. 2009).

B. *National Franchise Association v. Burger King Corporation*

1. Background

The National Franchise Association ("NFA"), on behalf of all BKC franchisees, brought action against BKC regarding the implementation of a policy requiring franchisees to sell the "Double Cheese Burger" and "Buck Double" hamburgers at a price of no more than $1.00.[125] NFA brought claims for breach of contract and breach of implied covenant of good faith and fair dealing, and also sought declaratory relief that BKC's Franchise Agreement does not obligate franchisees to comply with the price points set by BKC for products sold by the franchisees, including, but not limited to the Double Cheese Burger and Buck Double hamburgers.[126]

The suit was premised upon BKC's obligation under the franchise agreements to "establish, and cause approved suppliers to the BKC system to *reasonably comply* with, product, service and equipment specifications."[127] NFA argued that nothing in the franchise agreement stated BKC has a right to impose mandatory price points for products sold by the franchisees.[128] Citing "decades" of practice to the contrary, NFA argued that BKC's assertion of this right was unfounded and offered as evidence a 2002 memorandum, in which BKC acknowledged that "it has been BKC's longstanding policy to allow each franchisee unfettered discretion to set all prices for products sold in the franchisee's Burger King Restaurants as it sees fit."[129] NFA observed that BKC had never unilaterally imposed price points for products sold by franchisees.[130] In addition, NFA pointed out that, in past practice, BKC had obtained a super-majority consent in a "show of support" vote among franchisees before introducing price points and that BKC's proposal for introducing the Double Cheese Burger to sell at a price of $1.00 had twice been rejected by the franchisees,

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[125] Nat'l Franchisee Ass'n v. Burger King Corp., No. 09-23435-CIV, 2010 WL 4811912, at *1 (S.D. Fla. Nov. 19, 2010).

[126] *Id.* at *2.

[127] Class Action Complaint for Declaratory Relief; Jury Demand at ¶ 18, Nat'l Franchisee Ass'n v. Burger King Corp., No. 09-23435-CIV (S.D. Fla. Nov. 19, 2010) (emphasis added), 2010 WL 4811912 ¶ 18.

[128] *Nat'l Franchisee Ass'n*, 2010 WL 4811912 at *5.

[129] Amended Consolidated Class Action Complaint ¶¶ 35–36, Nat'l Franchisee Ass'n v. Burger King Corp., No. 09-23435-CIV (S.D. Fla. Nov. 19, 2010), 2011 WL 1186547 ¶¶ 35–36.

[130] *Id.* ¶ 35.

in large part because it was not economically feasible, as production costs exceeded this price point.[131]

2. Relevant Facts

The genesis of this dispute can be traced to October 15, 2002, when BKC issued a memorandum stating: "Recent changes in the law now allow BKC to establish a maximum price a franchisee can charge for certain products in certain situations."[132] NFA, however, argued that, despite changes in the law, each franchisee's relationship with BKC is controlled by the law in effect at the time their individual franchise agreement with BKC was drafted, as that law is incorporated into each agreement as a matter of law when it is executed.[133]

In 2005, BKC sought to introduce the $1.00 Value Menu, as discussed above, and began the "show of support" process, stating that if the proposed Value Menu received positive support from 67.7% of the voting franchisees, then the Value Menu items would be required to be sold for no more than $1.00.[134] This proposal passed and was implemented soon thereafter. In 2008, BKC sought to introduce the Double Cheese Burger to the Value Menu.[135] At that time, the NFA and franchisees objected to both BKC's contention that it had the unilateral right to add items, and to BKC's specific proposal to add the Double Cheese Burger to the Value Menu. BKC abandoned the proposal at that time due to the objections.[136] In 2009, BKC again attempted to introduce the Double Cheese Burger to the Value Menu through the "show of support" process, but this proposal was once again rejected, this time because it was not cost effective to franchisees.[137] Despite its failure through the "show of support" process, BKC announced that, starting October 19, 2009, it would require all franchisees to offer the Double Cheese Burger on the Value Menu for $1.00.[138] NFA argues this is the first time BKC had ever attempted to impose a price point without majority consent though the "show of support" process.[139]

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[131] *Id.* ¶¶ 43, 44, 58–64.

[132] *Id.* ¶ 38.

[133] Nat'l Franchisee Ass'n v. Burger King Corp., 715 F.Supp. 2d 1232, 1244 (S.D. Fla. 2010).

[134] Amended Consolidated Class Action Complaint, *supra* note 129, ¶ 39.

[135] *Nat'l Franchisee Ass'n*, 715 F.Supp. 2d at 1236.

[136] *Id.*

[137] Amended Consolidated Class Action Complaint, *supra* note 129, ¶¶ 59–61.

[138] *Id.* ¶ 62.

[139] *Id.* ¶ 81.

3. Relevant Procedural History

Soon after BKC's announcement, NFA filed an action for declaratory relief, seeking a declaration that the franchise agreements did not obligate the franchisees to comply with price points set by BKC for products sold by the franchisees, including the Double Cheese Burger.[140] BKC responded with a motion to dismiss, arguing that the court's decision in *BKC v. E-Z Eating*, holding that "there is simply no question that BKC had the power and authority under the Franchise Agreement to impose the Value Menu on its Franchisees," [141] resolved the dispute.[142] BKC also argued that the claim should be dismissed because it was time barred by the statute of limitations and NFA lacked standing to bring the suit.[143] The court ruled that the franchise agreements granted BKC the right to set maximum price points for items and, therefore, that NFA's breach of the express contract claim failed.[144] However, the court further held that there was a material issue of fact concerning whether BKC breached the implied covenant of good faith and fair dealing.[145]

Soon after, the court ordered NFA to file a motion for class certification relating to the implied covenant of good faith and fair dealing claim,[146] which NFA promptly complied with, as there were issues of law and fact common to all franchisees in a sufficiently numerous class.[147] Among the issues common to the class were: (1) whether the identical or materially similar contracts at issue were breached, (2) whether BKC requiring franchisees to sell the Double Cheese Burger and Buck Double for $1.00 breached the franchise agreement, (3) whether BKC's history of dealing with the franchisees concerning the voting approval process created a reasonable expectation that the process would be followed, (4) whether BKC's "business care" test marketing of the Double Cheese Burger shows it acted in good faith, (5) whether the minimum cost at which a franchisee class could sell the Double Cheese Burger or Buck Double is less than

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140 *See id.* ¶ 79.

141 Defendant's Motion to Dismiss Class Action Complaint for Declaratory Relief at 2, Nat'l Franchisee Ass'n v. Burger King Corp., No. 09-23435-CIV (S.D. Fla. Nov. 19, 2010) [hereinafter Defendant's Motion to Dismiss Relief].

142 *Id.* at 2.

143 *Id.*

144 Nat'l Franchisee Ass'n v. Burger King Corp., 2010 WL 4811912, at *3 (S.D. Fla. Nov. 19, 2010).

145 *Id.*

146 *Id.*

147 Plaintiff Nat'l Franchisee Ass'n's Motion for Class Certification at 9, Nat'l Franchisee Ass'n v. Burger King Corp., No. 09-23435-CIV (S.D. Fla. Nov. 19, 2010).

$1.00, and (6) what the overall financial impact was on the class from the $1.00 price point set for the Double Cheese Burger and Buck Double.[148]

In response to NFA's motion for class certification, BKC argued that potential class members were, or potentially could be, in conflict with one another because many franchisees had reported they benefitted from the implementation of the $1.00 Double Cheese Burger program and/or opposed filing the suit.[149] BKC also contended that NFA failed to meet the procedural requirements for class certification arguing that: (1) the facts set out by NFA differed fundamentally from the positions of many class members, so the typicality required under Rule 23(a) of the Federal Rules Of Civil Procedure was absent;[150] (2) NFA's conflict with other members of the class precluded NFA from meeting the requirements of Rule 23(b)(2) of the Federal Rules of Civil Procedure because some franchisees would be involuntarily added to the class despite their objections to the case, effectively forcing them to take a position against the $1.00 Double Cheese Burger program that was contributing to the success of their business; and (3) NFA did not establish predominance under Rule 23(b)(3) because proof of each member's invididualized circumstances would be necessary to adjudicate the class claims or defenses because historical performance and highly individualized issues regarding each restaurant would have to be introduced to show BKC breached their contract with each franchisee.[151]

In reply to BKC's response to class certification, NFA pointed out that disproval by some class members does not preclude class certification because some divergence of opinion is inherent in any class action and BKC's assertions were based upon eighteen franchisees expressing support for the year-old $1.00 Double Cheese Burger program.[152] Furthermore, BKC's argument that some franchisees' positions in favor of selling Double Cheese Burgers at the $1.00 price point were adverse to others in the class opposed to the price point was unfounded because any franchisee that wished to continue to sell the Double Cheese Burger at the price point would still be able to do so if NFA prevailed.[153] The relief sought was the ability to sell the Double Cheese Burger at any price the franchisee wishes,

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[148] *Id.*

[149] Defendant Burger King Corp.'s Opposition to Plaintiff's Motion for Class Certification at 14, Nat'l Franchisee Ass'n v. Burger King Corp., No. 09-23435-CIV (S.D. Fla. Nov. 19, 2010) [hereinafter BKC Opposition to Certification].

[150] *Id.* at 16.

[151] *Id.* at 17–18.

[152] Plaintiff Nat'l Franchisee Ass'n's Reply Brief in Support of its Motion for Class Certification at 1–2, Nat'l Franchisee Ass'n v. Burger King Corp., 09-23435-CIV (S.D. Fla. Nov. 19, 2010) [hereinafter Nat'l Franchisee Ass'n's Reply].

[153] *Id.* at 6.

which was not inconsistent with any franchisee continuing to sell the items at the price point.[154] Additionally, the court would be able to redefine the class as it so chooses, for example, by excluding some purported members and including others.[155]

In response to BKC's contentions that procedural requirements had not been met, NFA argued that it had satisfied the requirements of Rule 23(b)(2) because NFA sought primarily injunctive relief, and the rule authorizes "a remedy that, as a practical matter, affords injunctive relief or may serve as a later basis for injunctive relief."[156] NFA also asserted that it satisfied the requirements of Rule 23(b)(3) because the case fits a common fact pattern where predominance exists because the BKC's liability-creating actions toward the franchisees are uniform and controlling. NFA cited *Klay v. Humana*,[157] which states that common issues of fact or law predominate if they "have a direct impact on every class member's efforts to establish liability," which, in this case, would be BKC's imposition of the $1.00 Double Cheese Burger on franchisees in violation of its normal procedures.[158]

In August 2010, the court ordered that the NFA case be consolidated with another pending action, known as the "Family Dining" case, and denied NFA's motion for class certification, with the ability to renew the motion after a consolidated complaint had been filed.[159] NFA promptly filed its amended consolidated class action complaint and renewed motion, making the same allegations as originally set forth and seeking declaratory judgment and damages for breach of contract and express duty of good faith, breach of implied covenant of good faith and fair dealing, and violation of the Florida Deceptive and Unlawful Trade Practices Act.[160] BKC moved to dismiss, arguing, among other things, that NFA's action for declaratory judgment, which alleged that BKC lacked authority under its franchise agreements to set maximum price points was barred by the court's prior ruling on that issue and that NFA could only bring a claim for the

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[154] *Id.* at 4–5.

[155] *Id.* at 7.

[156] *Id.* at 8 (quoting Adv. Comm. Note, 39 F.R.D. 69, 102 (1966)).

[157] 382 F.3d 1241 (11th Cir. 2004) ; *see id.* at 1255 (quoting Ingram v. Coca-Cola Co., 200 F.R.D. 685, 699 (N.D. Ga. 2001)); *see also* Allapattah Servs., Inc. v. Exxon Corp., 333 F.3d 1248, 1260-61 (11th Cir. 2003).

[158] Nat'l Franchisee Ass'n Reply, *supra* note 152, at 8.

[159] Consol. Class Action Complaint ¶ 2, Nat'l Franchisee Ass'n v. Burger King Corp., No. 09-23435-CIV (S.D. Fla. Nov. 19, 2010), 2010 WL 3900717 ¶ 2.

[160] *Id.* ¶¶ 62, 81.

breach of implied covenant of good faith and fair dealing.[161] BKC further argued that NFA failed to sufficiently raise its factual claim that BKC acted in bad faith under its express contractual duty of good faith because NFA only alleged that the franchisees would have losses on a single product line.[162] As to the claim for breach of implied covenant of good faith and fair dealing, BKC sought dismissal on the grounds that the duty of good faith was expressly set forth in the contract and the implied common law duty was therefore inapplicable.[163] The court granted BKC's motion to dismiss, ruling that NFA had failed to allege facts sufficient to support a claim for bad faith.[164] Subsequently, NFA successfully moved to have the order amended.[165]

IV. GOOD FAITH VARIATIONS

As commentators have noted, the covenant of good faith and fair dealing has emerged in recent years as a "reasonable compromise" for many of the problems associated with the relational aspect of the franchise relationship.[166] The preceding cases, *Burger King v. E-Z Eating* and *National Franchise Association v. Burger King* (collectively the "Burger King cases"), illustrate what the majority of courts around the country have held with regards to application of the covenant of good faith and fair dealing, namely, that it may not serve as an independent cause of action for a breach of the franchise agreement.

The Burger King cases also illustrate many of the issues and hurdles associated with the concept of good faith in the franchise relationship in the context of the undefined aspects of the franchisor's ability to exercise discretion.[167] In many cases, a breach of the covenant of good faith is

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[161] Defendant Burger King Corp.'s Corrected Motion to Dismiss Plaintiff's Consol. Class Action Complaint, Motion to Strike Under Rule 12(f) and Supporting Memorandum of Law at 2, Nat'l Franchisee Ass'n. v. Burger King Corp., No. 09-23435-CIV, 2010 WL 4811912 (S.D. Fla. Nov. 19, 2010) [hereinafter BKC's Corrected Motion and Memorandum].

[162] *Id.* at 8.

[163] *Id.* at 13.

[164] Nat'l Franchisee Assoc. v. Burger King Corp., No. 09-23435-CIV, 2010 WL 4811912 at *4 (S.D. Fla. Nov. 19, 2010).

[165] Plaintiffs' Motion to Alter or Amend, or to Vacate, the Court's Order Dismissing Their Case With Prejudice and for Leave to File an Amended Consol. Class Action Compliant and Supporting Memorandum of Law at 16, Nat'l Franchisee Assoc. v. Burger King Corp., No. 09 -23435-CV, 2010 WL 5881908 (S.D. Fla. Nov. 19, 2010); Nat'l Franchisee Assoc. v. Burger King Corp., No. 09-23435-CV (S.D. Fla. Feb. 10, 2011).

[166] *See, e.g.*, Caruso, *supra* note 5, at 213.

[167] Hadfield, *supra* note 34, at 992.

asserted as a counterclaim by defendants after the franchise relationship has soured and the franchisor is either seeking to recover monies due under the franchise agreement or to terminate the franchise relationship.[168] One of the problems alluded to above is that the franchise agreement is an incomplete contract at the time the franchise relationship is formed.[169] This also encompasses situations in which a franchisee is not allowed to view the franchise operating manual, which is part of the contract, at the time the relationship is formed due to the proprietary nature of the information contained in the manual.[170] Additionally, in many cases "there will be no language in the written document to assist a court in determining whether a particular franchisor demand is legitimate and whether the franchisee's behavior is in compliance or in violation of that demand."[171]

In the majority of franchise agreements, the franchisor drafts the agreement in such as way as to leave open many aspects of the agreement in order to exercise substantial discretion in implementing certain provisions, such as setting menus, changing the trade dress, or setting prices.[172] Additionally, the franchisee is usually not allowed to see the operating manual even though it forms a substantial part of the contract.[173] In these situations, commentators have noted that the covenant of good faith is intended to act as a gap filler by which neither party will undertake to do anything which would frustrate the purpose underlying contract,[174] but the way this gap filler is applied by the courts differs substantially from state to state.[175] In many jurisdictions, the covenant of good faith and fair dealing may not be pled as an independent cause of action for breach of contract,[176] much less as the tort of bad faith, despite its intended purpose of protecting the bargained-for interests of the parties.[177] While this may hold true for most jurisdictions, others have taken varied positions as to how the covenant of good faith and fair dealing operates in franchise agreements.

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[168] *See, e.g.*, Dunkin' Donuts Franchised Rests. LLC v. Grand Cent. Donuts, No. CV 2007-4027(ENV)(MDG), 2009 WL 1750348, at *2 (E.D.N.Y. June 19, 2009).

[169] Hadfield, *supra* note 34, at 928.

[170] *Cf. id.* at 944; 16 C.F.R. § 436.2 (2012).

[171] Hadfield, *supra* note 34, at 947.

[172] *Id.* at 943–46.

[173] *See id.* at 947.

[174] *See, e.g.*, Nicholas R. Weiskopf, *Wood* v. *Lucy: The Overlap Between Interpretation and Gap-Filling to Achieve Minimum Decencies*, 28 PACE L. REV. 219, 222 (2008).

[175] *See* Hadfield, *supra* note 34, at 984.

[176] *See, e.g.*, Caruso, *supra* note 5, at 207.

[177] *See, e.g.*,*id.* at 208.

In sampling many of the recent cases that have come down regarding the covenant of good faith in the franchise relationship, it appears that application of the covenant centers around three prominent theories of how the provision operates. In this section, I propose a new idea of how to deal with the interpretation of the covenant of good faith and fair dealing in the franchise agreement

A. *The Majority Rule*

In many jurisdictions around the United States, the prevailing view regarding the covenant of good faith is that, despite its intended purpose of protecting the parties' interests, it is not an independent cause of action for a breach of the franchise agreement.[178] Instead, there can be no cause of action for a breach of the implied covenant absent an allegation that an express term of the contract has been breached."[179] Accordingly, a franchisee must plead the covenant of good faith in relation to a breach of an express term of the contract.[180]

Furthermore, such jurisdictions hold that the covenant serves only to "animate those express terms and supports a claim for breach of the express contract."[181] Under this view of the implied covenant of good faith and fair dealing, the covenant acts as a redundancy since it does not hold parties to any independent obligation except those expressed in the terms of the contract.[182] In effect, the covenant does not impose an obligation on the party to act in a way consistent with the underlying contract; it only obligates the party to perform the provisions that are expressed in the contract in a manner consistent with good faith.

Take for instance, *Hardee's Food Systems v. Hallbeck*.[183] In that case, the defendant, Hallbeck, filed a counterclaim against Hardee's Food Systems ("Hardee's"), alleging that Hardee's breached the covenant of good faith and fair dealing by failing "to deliver to [the Hallbecks] a viable

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[178] *E.g.*, Tidmore Oil Co. v. BP Oil Co., 932 F.2d 1384, 1391 (11th Cir. 1991).

[179] Payless Car Rental Sys., Inc. v. Elkik, 702 S.E.2d 697, 700 (Ga. App. 2010) (quoting Snow v. Ruden, McClosky, Smith, Schuster & Russell, P.A., 896 So. 2d 787, 792 (Fla. Dist. Ct. App. 2005); *see also* Caruso, *supra* note 5, at 208.

[180] *See* Caruso, *supra* note 5, at 208.

[181] Caruso, *supra* note 5, at 208; *see also, e.g.*, *Tidmore Oil Co.*, 932 F.2d at 1391.

[182] Dunkin' Donuts Franchised Rests. LLC v. Grand Cent. Donuts, No. CV 2007 4027(ENV)(MDG), 2009 WL 1750348, at *3 (E.D.N.Y. June 19, 2009).

[183] 776 F. Supp. 2d 949 (E.D. Mo. 2011).

franchise concept and a reasonable opportunity to succeed."[184] The court held that, although Missouri law imposes an implied covenant of good faith and fair dealing in every contract as related to the "manner in which a party employs discretion conferred by a contract," the covenant "cannot give rise to new obligations not otherwise contained in the contract's express terms."[185] The implied covenant simply prohibits one party from "depriving the other party of its expected benefit under the contract."[186] Similarly, in *Teng Moua v. Jani-King of Minnesota*, [187] the U.S. District Court for the District of Minnesota stated that the implied covenant "serves only to enforce existing contractual duties, and not to create new ones."[188] In both of these cases, the franchisee parties, Hallbeck and Teng Moua, failed to provide sufficient evidence to support a breach of contract claim and thus failed to allege a sufficient derivative cause of action for breach of the implied covenant of good faith and fair dealing by the franchisors, Hardee's and Jani-King, respectively.[189]

The U.S. District Court for the Western District of Pennsylvania has recognized three potential limitations of the scope of the implied duty of good faith and fair dealing under this majority view: (1) it may only be applied in limited circumstances, (2) it may not give rise to an independent cause of action, and (3) the implied duty may not override express contractual terms.[190]

B. *The Minority Position*

Though the prevailing view described above is what has been favored in recent judicial decisions, courts in various jurisdictions around the country are opening up to the idea of treating the implied covenant of good faith and fair dealing as a gap-filling mechanism, due in part to the covenant's malleable nature, as well as uncertainties inherent in the

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[184] Defendant's First Amended Answer, Defenses, Affirmative Defenses and Counterclaims ¶ 19, Hardee's Food Sys., Inc. v. Hallbeck, 776 F. Supp. 2d 949 (E.D. Mo. 2011) (No. 4:09-cv-00664).

[185] *Hardee's Food Sys., Inc.*, 776 F. Supp. 2d at 952–53 (quoting BJC Health Sys. v. Columbia Cas. Co., 478 F.3d 908, 914 (8th Cir. 2007)).

[186] *Id.* at 953 (quoting Morton v. Hearst Corp., 779 S.W.2d 268, 273 (Mo. App. 1989)).

[187] 810 F. Supp. 2d 882 (D. Minn. 2011).

[188] Teng Moua v. Jani-King of Minnesota, 810 F. Supp. 2d at 899 (quoting Allen v. Thom, No. A07-2088, 2008 WL 2732218, at *5 (Minn. Ct. App. July 15, 2008)).

[189] *See Hardee's Food Sys. Inc.,* 776 F. Supp. 2d at 953; Teng Moua, 810 F. Supp. 2d at 904.

[190] Martrano v. Quizno's, No. 08-0932, 2009 WL 1704469, at *18–19 (W.D. Pa. June 15, 2009).

franchise relationship.[191] Pursuant to this view of the covenant of good faith and fair dealing, a party vested with the ability to exercise discretion under the franchise agreement must do so in good faith.[192] If a franchisor exercises such discretion in a way as to frustrate the reasonable expectations of the franchisee, such exercise of discretion may constitute a breach of the underlying contract, even though no express term of the franchise agreement was breached. Pursuant to this view, then, the covenant acts to protect the bargained-for benefit of the parties by providing a cause of action for breach of the contract without breach of an express term because the exercise of discretion was such as to frustrate the parties' agreement.[193]

New York, as well as Massachusetts, has adopted a version of this view within the franchise context. In *Coca Cola North America v. Crawley Juice, Inc.*,[194] the court alluded to the contours of the implied covenant in a dispute over a distribution agreement.[195] The court held that Coca Cola North America ("Coca Cola") had not breached the implied covenant of good faith and fair dealing because they had not acted in a way that would deprive the other party of the fruits of the bargained for contract.[196] Instead, Coca Cola had performed according to the express terms of the contract.[197] However, the court's analysis summarized New York's position by stating that the "scope of the potential liability for breach of the covenant is quite narrow: such a breach cannot give rise to liability if it merely replicates the liability for breach of the underlying contract, nor can it create new contractual rights or impose additional duties."[198] Yet, the New York court went on to expand on the implied covenant of good faith and fair dealing by stating that a breach of the covenant may occur "where the contract is not technically breached, but one party has acted to destroy or injure the right of the other party to receive the benefit of he contract."[199] This is an important departure from the majority rule as stated above. Instead of requiring that a

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[191] Fleetwood v. Stanley Steemer Int'l., 725 F. Supp. 2d 1258, 1274 (E.D. Wash. 2010).

[192] *See, e.g.*, Warren Distrib. Co. v. InBev USA L.L.C., No. 07-1053, 2010 WL 2326168, at *4 (D.N.J. June 7, 2010); Coldwell Banker Real Estate, LLC, v. Plummer & Assocs., No. 09-1313, 2009 WL 3230840, at *3 (D.N.J. Oct. 2, 2009).

[193] *See Fleetwood,* 725 F.Supp. 2d at 1274; Doyle v. Nutrilawn U.S., Inc., No. C09-0942JLR, 2010 WL 1980280, at *8 (W.D. Wash. May 17, 2010).

[194] Nos. 09-CV-3259, 09-CV-3260, 09-CV-3279, 2011 WL 1882845 (E.D.N.Y. May 17, 2011).

[195] *See* Coca-Cola N. Am. v. Crawley Juice, Inc., 2011 WL 1882845, at *9.

[196] *See id.* at *9.

[197] *Id.* at *10.

[198] *Id.* at *9.

[199] *Id.* at *9 (quoting Witherspoon v. Rappaport, 65 F. App'x 356, 359 (2d Cir. 2003)).

breach of an express provision occur in order to have a valid claim for breach of the implied covenant of good faith and fair dealing, the covenant may give rise to an independent cause of action if a party has destroyed the right of the other party to receive the bargained-for fruits of the contract.

New Jersey courts have followed a formulation similar to that of New York and have interpreted the implied covenant of good faith and fair dealing as "having the effect of a commitment that 'neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.'"[200] Again, due to the covenant's ability to be brought as an independent cause of action against the alleged wrong-doer, this is an important departure point from the majority rule. The New Jersey Court went on to state that, "though a party may not have breached a contract's express terms, it may be liable under this theory for engaging in conduct that frustrates the other party's receipt of the bargained for benefit."[201] Additionally, the New Jersey Supreme Court articulated a substantial test for determining whether the implied covenant has been breached:

> [A] party exercising its right to use discretion in setting price under a contract breaches the duty of good faith and fair dealing if that party exercises its discretionary authority arbitrarily, unreasonably, or capriciously, with the objective of preventing the other party from receiving its reasonably expected fruits *under the contract*. Such risk clearly would be beyond the reasonable expectations of the parties at the formulation of a contract when parties reasonably intend their business relationship to be mutually beneficial. They do not reasonably intend that one party would use the powers bestowed on it to destroy unilaterally the other's expectations without legitimate purpose. [202]

This articulated test is important for a variety of reasons, including its fundamental adherence to the principle that the implied covenant of good faith and fair dealing is intended to protect the bargained-for interest of the

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[200] Coldwell Banker Real Estate, LLC. v. Plummer & Assocs., Inc., No. 09-1313, 2009 WL 3230840 at *3 (quoting Sons of Thunder, Inc. v. Borden, Inc., 690 A.2d 575, 587 (N.J. 1997).

[201] *Id.* at *3 (quoting Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Ctr. Assocs., 864 A.2d 387, 396 (N. J. 2005)).

[202] JOC, Inc. v. Exxonmobil Oil Corp., No. 08-5344, 2010 WL 1380750, at *5 (D.N.J. Apr. 1, 2010) (citing Wilson v. Amerada Hess Corp. 773 A.2d 1121, 1126 (N.J. 2001)) (emphasis in original).

parties. Here, despite what the express terms of the contract state, notions of a mutually beneficial relationship and the reasonable expectations of the parties are forced to the forefront and the realist perspective of how the relationship is intended to operate at its founding are considered. Additionally, the New Jersey Supreme Court's opinion sets forth a workable standard of arbitrariness, unreasonableness, and capriciousness, which has long been used elsewhere in law.[203] The opinion also sets forth the concept of discretion, which forms an important part of the parties' franchise agreement. If one party exercises its vested discretion in such a way that the court finds its exercise arbitrary, unreasonable or capricious, then such a person could be held to violate the covenant of good faith.[204] Indeed, in *JOC v. Exxonmobil Oil Corp.*,[205] the U.S. District Court for the District of New Jersey found that the plaintiffs had alleged sufficient facts to proceed on a claim of breach of the implied covenant of good faith and fair dealing when they alleged that the defendant exercised discretion over pricing, rental rates, and other such discretionary decisions which the defendant allegedly knew would prevent the plaintiff from receiving the benefit of he bargained for contract. [206]

One must be careful, however, not to be subsumed by the covenant of good faith, as it does have its limits. In the New York case of *Yonaty v. Amerada Hess Corp*.,[207] the court articulated one of the limits of the implied covenant of good faith and fair dealing by stating that "no obligation can be implied that would be inconsistent with other terms of the contractual relationship."[208] Additionally, the court stated that "[t]o show a breach of the covenant… a plaintiff must show '(1) fraud, (2) malice, (3) bad faith, (4)

[203] *JOC, Inc.*, 2010 WL 1380750, at *5; *see, e.g.*, Rabb v. State Bd. Of Certified Pub. Accountants of La., 893 So. 2d 904, 906 (La. Ct. App. 2004) (stating the standard of appellate review of administrative agency decisions is that of arbitrary, capricious and "clearly unreasonable" in the context of certificate revocation of an accountant); Citizens Alliance to Protect Our Wetlands v. Wynn, 908 F. Supp. 825, 830 (W.D. Wash. 1995) (stating that, under the Administrative Procedures Act in the context of the issuance of a permit under the Clean Water Act by the Army Corp of Engineers to build a horseracing facility, a court may not set aside agency action unless it is arbitrary or capricious and there is no rational basis for the action); Kiester v. Humana Hosp. Alaska, Inc., 843 P.2d 1219, 1223 (Alaska 1992) (explaining that a court reviews a hospital's denial of privileges to a doctor according to both procedural and substantive due process which requires that "procedures employed by the hospital are fair, that the standards set by the hospital are reasonable, and that they have been applied without arbitrariness and capriciousness").

[204] *JOC, Inc.*, 2010 WL 1380750, at *5.

[205] No. 08-5344, 2010 WL 1380750 (D.N.J. Apr. 1, 2010).

[206] *Id.* at *6.

[207] No. 3:04-CV-605, 2009 WL 2824733 (N.D.N.Y. Aug. 31, 2009).

[208] *Id.* at *2.

other intentional wrongdoing, or (5) reckless indifference to the right of others such as gross negligence.'"[209] This imparts the very important limitation of bad motive into the equation of good faith, but still, there must be some affirmative action by the allegedly breaching party that injures the aggrieved party.

The Washington courts have also recognized similar contours to the covenant of good faith. For example, in *Fleetwood v. Stanley Steemer International, Inc.*,[210] the court described the doctrine of good faith as having a "malleable nature," used in litigation to combat the "uncertainties inherent in franchise relationships," with the covenant being most often applied to "the party assuming discretionary control in the agreement."[211] While the Washington Court declined to hold that Stanley Steemer breached the covenant of good faith, it did recognize the importance of the covenant's role in the relationship between the franchisor and franchisee.[212] The court stated that the covenant is designed to protect the parties' reasonable expectations, but was reluctant to use the covenant "as a basis for redefining the parties' relationship or for imposing unanticipated burdens or limitations on one of the parties."[213] However, it is important to note that the court did not state that the covenant did not impose burdens on the parties.[214] Instead, it stated that the burden imposed on the parties is to exercise discretion in a reasonable manner and in good faith.[215] This is illustrated by the court's recognition that "[a]t the outset of a franchise relationship there is undoubtedly an expectation on the part of all concerned that the system will grow and prosper."[216] Additionally, the court observed that courts must look past what is stated in the franchise agreement because "[r]easonable expectations obviously cannot be judged solely on the basis of the gains anticipated by the contracting parties."[217]

C. *No Covenant of Good Faith*

While most of the country follows the above-mentioned philosophies regarding the covenant of good faith and fair dealing, there are several

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[209] *Id.*
[210] 725 F. Supp. 2d 1258 (E.D. Wash. 2010).
[211] Fleetwood v. Stanley Steemer Int'l., 725 F. Supp. 2d at 1274.
[212] *Id.*
[213] *Id.*
[214] *See Id.* at 1274.
[215] *Id.*
[216] *Id.*
[217] *Fleetwood*, 725 F. Supp. 2d at 1274.

states which do not recognize the covenant of good faith. Furthermore, a few states allow parties to waive the covenant of good faith in franchise agreements. For instance, in *Tri-County Retreading v. Bandag*,[218] the Missouri Court of Appeals held that, under Iowa law, there is no implied covenant of good faith and fair dealing in fully integrated agreements.[219] In essence, the integration of the contract dictates that the parties have reached the full agreement and nothing outside the agreement may be considered as part of the agreement. The problem with this formulation is that it ignores the relational aspect of the parties within the franchise relationship and therefore fails to see all possible contingencies in a ten year, or longer, business relationship. This is untenable since economic conditions, as well as public preference toward a particular product, are liable to change during the course of the relationship. Additionally, such a standard ignores the realities of the operation of the franchise relationship and the reason why the relationship was entered into in the first place: commencement of a mutually beneficial long-term relationship intended to afford a degree of independence as well as dependence upon each of the parties.

The United States District Court for the Southern District of Indiana held that the courts rarely impose a common law duty of good faith and fair dealing where the terms of the agreement are clear and unambiguous.[220] While this formulation is more based in the realities of the franchise agreement, it too ignores the idea that a contract which clearly vests discretion in a party may be breached due to that discretion being operated in such a way as to deprive the other party of the benefit of the contract and in essence destroy the relationship as it existed at the time the franchise agreement was entered into. In another vein, the Arkansas courts have allowed the parties to be able to waive the implied covenant of good faith and fair dealing in the franchise agreement by express term.[221] While freedom of contract is a cornerstone of modern contract theory, the ability to license the other party to act in bad faith seems be an unconscionable exercise of the freedom of contract.

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[218] 851 S.W.2d 780 (Mo. Ct. App. 1993).

[219] *Id.* at 784.

[220] Craig & Landreth, Inc. v. Mazda Motor of Am., Inc., 744 F. Supp. 2d 818, 826 (S.D. Ind. 2010); *see also* Ennes v. H & R Block E. Tax Servs., Inc., No. 3:01CV-447, 2002 WL 226345, at *3 (W.D. Ky. Jan. 11, 2002) (holding that Kentucky does not recognize the implied covenant of good faith and fair dealing as giving rise to a separate tort action outside the context of insurance contracts even though franchisor could take unfair advantage of a franchisee).

[221] Gunn v. Farmers Ins. Exch., 372 S.W.3d. 346, 351–52 (Ark. 2010).

CONCLUSION

There has been an evolution in the law of contracts that has been motivated by agreements that set forth long-term relations between the parties. We began with an examination of the changes brought about by the realists in the middle of the twentieth century, when they drafted Article II of the UCC. Article II's changes to contract law were dictated by the commercial realities of that time as evidenced by our illustration in the introduction of the commercial relationship between Hal and Marge.

During the 1970s the franchise relationship came to fruition and, as professor Hadfield noted in his above-quoted article, there was a need for more elasticity in construing the long-term franchise relationship.[222] A dichotomy developed between the franchisors who favored a more strict construction of the franchise agreement and the franchisees who desired more elastic standards of interpreting contractual provisions embodied by the implied covenant of good faith and fair dealing.

In examining the court decisions through the date of this article's publication, it is apparent that neither franchisors nor franchisees get everything they desire in contract interpretation. On one hand, the franchisors have not been able to convince the courts to adopt strict construction of the franchise contracts and, on the other hand, the courts have refused to pronounce a fiduciary relationship between franchisors and franchisees. In describing the tension between two parties to a business transaction that is governed by Article II principles, the authors of the textbook *Commercial Transactions: A Systems Approach* note, "unfortunately the Article II drafters were better at identifying the tension between freedom of contract and anti-oppression than they were at outlining specific factors to resolve it."[223] The same observation can be made of regulatory efforts and judicial interpretation of franchise agreements. As Professor Hadfield aptly observed, the elasticity provided by the implied covenant of good faith and fair dealing appears to be a fair standard.[224]

Even though it may be difficult to enunciate factors that would apply in all franchise contract interpretation cases, there is a need for more uniformity in interpreting the implied covenant of good faith and fair

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[222] *See* Hadfield, *supra* note 34, at 985 n.262; *see* Caruso, *supra* note 6, at 209.

[223] LYNN M. LOPUCKI, ELIZABETH WARREN, DANIEL KEATING, & RONALD J. MANN, COMMERCIAL TRANSACTIONS: A SYSTEMS APPROACH (Aspen Publishers, 2009).

[224] *See* Hadfield, *supra* note 34, at 984 (arguing that the covenant of good faith is a crucial means of aligning franchise contract dispute resolution with the reality of underlying franchise relationships).

dealing, due in large part to the national and international nature of franchises. This author would suggest the following:

- Courts should not interpret the franchise contract to change the deal, nor should they change express provisions upon which the parties have agreed.
- A waiver of the principle of good faith in interpreting a franchise agreement should be invalid *per se*.
- The only way a franchise relationship is going to be profitable or successful for both parties is that a win-win situation is created through the contractual relationship and judicial interpretation, focusing on the concept of discretion.

It is the opinion of this author that where discretion is authorized by express contract provisions, an operations manual, or any other document apart from the franchise agreement, that the implied covenant of good faith and fair dealing should be actively used as a standard by the court to produce a favorable and profitable relationship for both parties. At this point, it appears that the Washington and New York cases come close to these suggestions. This author encourages future courts to favor the position of those states in lieu of the majority rule, as set forth in the Burger King cases discussed in this article.