THE DEMISE OF NOTICE AND CURE RIGHTS FOR FRANCHISEES, AND POSSIBLY FRANCHISORS

Rupert M. Barkoff
Partner
Kilpatrick Stockton LLP
Atlanta, Georgia, United States 30309-4530
Tel: 404.815.6366; Fax: 404.541.3122
Email: rbarkoff@kilpatrickstockton.com

Presented at the 25th Annual
International Society of Franchising Conference
Boston University
Boston, Massachusetts, U.S.A.
June 16-18, 2011

25th Anniversary
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by

Rupert M. Barkoff*

I. INTRODUCTION

Based on a recent review of certain cases involving cure rights when franchise agreements have been breached, I have the sense that the law of contracts, as it relates to this particular subject, is being interpreted by Lewis Carroll characters, rather than learned judges with years of experience. I have always found Alice in Wonderland a frustrating book, and certain of its characters, especially the mad and elusive Cheshire Cat, as mysterious. Logic, as we know it, seems to be foreign to the philosophy preached by this animal, or at least twisted when applied to reality. Moreover, the consequences of his advice are unpredictable. The same now holds true when a franchisor, and possibly a franchisee, ignores a provision in a franchise agreement that requires the giving of notice and an opportunity to cure a default before terminating a franchise agreement.

Contract law, especially in a commercial setting, is predicated on the principle of certainty. When two parties get together to make a deal, they should with particularity delineate the terms of their agreement, and then each should perform the obligations he (or she) has assumed, and each should be entitled to the anticipated benefits bargained for in the agreement.

* Mr. Barkoff is a partner in the law firm of Kilpatrick Stockton LLP, and Chair of the firm’s Franchise Practice Group. He is a former Chair of the American Bar Association’s Forum on Franchising, Co-Editor of Fundamentals of Franchising, and Chair of the State Bar of Georgia’s Franchise Law Section. He has published over 200 pieces on franchising and franchise law. Mr. Barkoff would like to thank Ms. Lauren Sullins Ralls, an associate with Kilpatrick Stockton LLP, for her research assistance on this paper.

1 Says Alice: “Would you tell me, please which way I ought to go from here?”
The Cheshire Cat: “That depends a good deal on where you want to get to.”
Alice: “I don’t much care where –”
The Cheshire Cat: “Then it doesn’t matter which way you go.”
Of course, life has never been that simple, and there have always been exceptions to this goal of certainty.

For example, public policy will often trump an agreement between parties. A contract of slavery without doubt is certainly illegal and unenforceable. Similarly, an overly broad non-competition agreement may be unenforceable on the theory that society does not want people bargaining away their right to earn a living. And the introduction of the concept of unconscionability in the 20th century has even further shattered the sanctity of contract, although for the most part unconscionability is generally successfully invoked only in cases involving true consumers.2

There are other examples where the courts will not enforce a definitive agreement between the parties. If the contract contains a mutual mistake, the contract will not be enforced as written. If it is impossible to perform the contract, a court may decide not to give full rights of enforcement as well. Equitable principles, such as estoppel, clean hands and the like, are often used to avoid contract enforcement.

Also, since time in memoriam, contract law has been fighting a constant battle with the concept of fraud. Fraud claims are usually based on representations made orally or in collateral documents that induce one party to claim that he was duped into entering into the arrangement. Proving fraud is burdensome in that the plaintiff must clear several hurdles to succeed. He must show convincingly: (1) a representation; (2) its falsity; (3) its materiality; (4) the speaker's knowledge of its falsity or reckless disregard for its truth; (5) his or her intent that it should be acted upon by the person to whom it is made and in the manner reasonably contemplated; (6) the hearer's ignorance of its falsity; (7) his or her reliance upon its truth; (8) his or her right to rely on

2 But see Postal Instant Press, Inc. v. Sealy, 51 Cal. Rptr. 2d 365 (Ct. App. 1996). In other countries—Australia, for example, the reach of the concept of unconscionability may be far greater than in the United States. See Australian Trade Practices Act, §51AC.
it; and (9) consequent and proximate injury.³ Where a plaintiff can clear all these hurdles, he will typically ask that a contract be rescinded, and often—but not always—his fraud claim will trump the defendant’s claim that the contract should be enforced.⁴ The defendant, of course, will argue in these circumstances (assuming the contract contained an integration clause)⁵ that reliance by the plaintiff was unreasonable given that the contract expressly warned the other side not to rely on any extraneous representations.

And finally, even when a contract is fairly clear, a court may decide that its language simply does not correctly reflect the expectations of the parties. Consider, for example, the following language:

In the event [individual] ceases to be an employee of [company] or any subsidiary thereof for any reason, whether voluntarily, involuntarily, or by death, any option or unexpired portion thereof granted to him which is otherwise exercisable shall thereupon terminate.⁶ Could the language have been any clearer? Yet, back in the 1960s and 1970s, reviewing this or similar language, three courts held that a terminated employee was entitled to exercise his rights to acquire options after he was terminated.⁷

This paper will explore a similar situation in the context of a franchise arrangements governed by the common law in various jurisdictions within the United States—specifically, the

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⁴ The plaintiff may also affirm the contract and sue for damages.
⁵ An integration clause states that the written contract constitutes the entire agreement between the parties and that there are no other representations or agreements between the parties.
⁷ See id.; see also *Hilgenberg v. Iowa Beef Packers, Inc.*, 175 N.W.2d 353 (1970); and *Gaines v. Monroe Calculating Mach. Co., Inc.*, 78 N.J. Super 168, 188 A.2d 179 (1963). Finding case law to support an employee’s position that he should be entitled to exercise his options after being terminated was my first project in private practice. The language quoted above was similar to the language of the contract I was analyzing. I feared that my legal career was getting off to a very bad start. The cases I have cited restored my faith in justice, but not in the sanctity of contracts.
conflict between default provisions that grant notice and cure rights to a defaulting party, presumably to give it protection from surprise terminations, and language that specifies that the delineation of defaults and the grant of cure rights is not intended to eliminate the possibility that the non-defaulting party has the option to declare a “material” breach and thereby avoid the procedural rights of notice and cure, notwithstanding clear, agreed upon contractual language that ostensibly protects the defaulting party from such a surprise. While this paper focuses almost exclusively on United States law, that is not to say that this issue might not arise in other jurisdictions, especially those that follow the common law.