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BUSINESS LAW
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The Moving Target: System Standards and the Franchisor's "Sole Discretion" to change Franchisee Obligations

Let's make a deal: For the next 10 years, we'll let you use our "Widgets-R-Us" name and trademark and allow you to sell "Widgets-R-Us"-brand widgets. Our company, WRU, will even provide you with pre-opening assistance, and to the extent that the company deems appropriate, advise you on marketing and operations.

We don't ask for much in return. In addition to making prompt payment of certain specified royalties and other fees— and honoring all other terms expressly stated in the contracts prepared by our in-house counsel — you simply agree to abide by **whatever** standards WRU happens to put in place at any particular time. It doesn't matter whether our rules turn out to be necessary, rational, or even fair. For all we know, following those yet-unannounced standards could destroy any chance you have of realizing a profit. We **can** promise, however, that your failure to abide by them would put you in default, entitle WRU to terminate your franchise and possibly make you liable to us for future fees that we would have received had you remained part of our system. (That reminds us: Don't even **think** about trying to terminate the agreement yourself. The contracts were prepared by our in-house counsel and overwhelmingly favor us. Break your contract, and you **will** suffer consequences.) Oh, and you'll also have to reimburse us for any and all attorneys' fees and costs that we incur demanding payment from you, suing you, and collecting from you.

Just trust us, though. We know what we're doing. (**DISCLAIMER: THE PRIOR TWO SENTENCES ARE NOT TO BE CONSIDERED A WARRANTY OF ANY KIND. FURTHER, BY ACCEPTING OUR OFFER, YOU ACKNOWLEDGE THAT YOUR DEGREE OF SUCCESS OR FAILURE WILL LARGELY BE DETERMINED BY YOUR OWN EFFORTS AND LEVEL OF COMPETENCE.**)

Now, do you think we're delusional in believing you might accept our deal? Well, we're really not suggesting any terms that one wouldn't see in a typical franchise agreement. The difference is that we're **emphasizing** the virtually unfettered discretion that you'd be giving us, whereas the typical franchise agreement is not as obvious. That's not to suggest that the typical franchisor has duplicitous or sinister motives (although some franchisors do). Rather, it's just that the issue is difficult to spot with an untrained eye — particularly when that eye has been reading page after page of legalese.

In short, the franchisor needs to create and maintain certain “system standards” for its franchisees to follow, and it usually will want the flexibility to change them how and when it sees fit. The desire for maximum flexibility, while understandable when one considers the franchisor’s goals and challenges, is not always consistent with the franchisee’s interests.

I. System Standards: What They Are and How They’re Imposed

“System standards” is a catch-all phrase to describe the franchisor’s internal set of rules, regulations, and operating procedures. They can cover issues as mundane as how to answer the telephone and issues as significant as a requirement to renovate and refurbish your facility at your own expense. Although some of specific standards might be directly stated in the franchise agreement, most are not. Instead, the franchise agreement probably will require you to abide by an unseen set of “confidential “ standards set forth in a separate Operations Manual (sometimes going by a different name, such as “Standards Manual”) and/or in other written documents. Often, the franchisor will present the manual to you only after you’ve signed the franchise agreement and entered the franchise system. Moreover, even those franchisors who allow you to borrow and review current Operations Manuals before signing are providing only a limited benefit, as the franchisor probably reserves the right to periodically change those standards during the franchise term.

There are some legitimate reasons for franchisor secrecy and the right to change standards over time. A franchisor’s system standards are (or should be) what creates much of the value in purchasing the franchise in the first place, and franchisors who carelessly expose such “trade secrets” to the public risk losing value and competitive advantages. Similarly, franchisors wish to modify standards from time to time in order to adapt to market changes and technological changes. On at least some level, secrecy and the ability to modify standards are intended to benefit franchisees by improving their chances for success.

II. The Franchisor’s “Sole Discretion” to Choose and Change System Standards

Typically, the franchise agreement will not guarantee that the unseen system standards will be reasonable toward, or beneficial to, the individual franchisee. Further, the franchise agreement will usually state that the franchisor may revise the standards “from time to time, **in its sole discretion.**”

“Sole discretion” has a special meaning in the law, and, for all intents and purposes, gives the franchisor who reserves it the virtually unlimited right to make otherwise lawful decisions without hearing questions or challenges from its franchisees. In fact, it even prevents judges and juries from second-guessing the franchisor in the role of business strategist or striking down an action or standard on the grounds that it is objectively “unreasonable” or unfair. As a result, the words “sole discretion” effectively limit the remedies available to the franchisee, who is deemed to have “agreed” to the then-unknown standards when signing the franchise agreement.

The downsides to the franchisee are severe. First, if the franchisor can change the rules

as it goes along, the franchise might turn out to be much different (and much worse) than the one the franchisee originally purchased. Second, when given such power, an unscrupulous franchisor – perhaps one who wishes to replace an existing franchisee with a wealthier one who might purchase more units – could “move the goalposts” in an effort to hold the existing franchisee in default and ultimately terminate the franchise.

III. What You Can Do as a Potential Franchisee

So, as a prospective franchisee, what can you do to protect yourself from overly-burdensome compliance obligations when you do not yet know what these obligations are going to be?

The first thing is to ask the franchisor to replace franchise agreement clauses allowing for “sole” discretion with those permitting the exercise of “reasonable” discretion. Many (if not most) franchisors will be unwilling to make such a concession with regard to system-wide operating standards, but it is definitely worth a try. Second, you could ask the franchisor to add provisions giving you the option to terminate the franchise without penalty on certain anniversaries or upon the happening of certain events (such as a “system standards” change requiring you to undertake a major renovation or fundamentally changing your obligations under the franchise agreement). A third strategy is to seek a “cap” on the amount of monies you’ll be required to spend to comply with new standards. A fourth option, if you’re willingness to take risks and delegate an enormous amount of power to a franchisor is limited, is to simply walk away.

These ideas are just that, and the list of options we’re presenting is by no means exclusive. Indeed, we do **not** recommend that you review and negotiate the terms of a franchise agreement on your own, without competent counsel. The franchisor is represented by a franchise lawyer, and in order to truly protect yourself, you should be as well. Regardless, before committing the next 10-15 years of your life to a franchise relationship, you at least need to understand that some of your most important obligations might not even be in the franchise agreement.

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