From the Benevolence of the Butcher: Motive and Contractual Right to Terminate

By Benjamin W. Clements, TroyGould PC

What is the relationship between a party's motive for terminating a franchise and its contractual right to terminate? Can a "bad" motive defeat such a right? Like so many other questions, the most accurate, if unhelpful, answer seems to be, "It depends." Case law offers a few accepted principles that help shape the analysis, most notably the general rule that one party's material breach of contract renders legally irrelevant the other party's true motive for terminating, all other things being equal. But from that rule there are exceptions, including: (a) where the alleged breach that gives rise to the termination is not material; (b) where the contract calls for an exercise of discretion by the terminating party; and (c) where statutory franchise law alters the common law analysis. As set forth below, the motive may be relevant, and even defeat a contractual right to terminate, in these situations.

A Contractual Right to Terminate

The rule that motive is irrelevant where a contractual right to terminate exists looks to the objective manifestations of the party's intent, not whether a party has an unspoken motive for ending the relationship. As one court recently explained, by citing Adam Smith no less, the law of contracts presumes parties act in their own self-interest and is therefore largely unconcerned with motive: "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages." *D2E Holdings, LLC v. Corp. for Urb. Home Ownership of New Haven*, No. CV 176075593, 2021 WL 1699282, at *1 (Conn. Super. Ct. Apr. 6, 2021) (*quoting* 1 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* 22–23 (1776)).

Modern decisions often cite one of two cases for this rule. In *McDonald's Corp. v. Robertson*, 147 F.3d 1301 (11th Cir. 1998), McDonald's terminated a franchisee for failing to meet quality, safety, and cleanliness standards. Think "undercooked meat patties," "freezer burn," and cold McNuggets. *Id.* at 1305–06. Affirming a preliminary injunction enjoining the franchise from continuing to operate, the Eleventh Circuit rejected the franchisee's argument that the alleged safety violations were a pretext for McDonald's true motive: moving the restaurant to a more profitable location. The court held that the franchisee's "failure to comply with McDonald's QSC and food safety standards constituted a material breach of the franchise agreement sufficient to justify termination, and thus, it does not matter whether McDonald's also possessed an ulterior, improper motive for terminating the . . . franchise agreement." *Id.* at 1309.

In the other case, *Tuf Racing Prods., Inc. v. Am. Suzuki Motor Corp.*, 223 F.3d 585 (7th Cir. 2000), the Seventh Circuit stated the rule this way: "If a party has a legal right to terminate the contract . . . , its motive for exercising that right is irrelevant. The party can seize on a ground for termination given it by the contract to terminate the contract for an unrelated reason." *Id.* at 589 (citations omitted). While endorsing that rule, the court affirmed a verdict in favor of a motorcycle dealer against Suzuki for wrongfully terminating the franchise, holding that the evidence supported the dealer's argument that Suzuki did not have a contractual basis for terminating and so procured a breach of contract to justify the termination. *Id.* at 588–90. Its "tactics" included "denying standard credit terms and then accusing [the dealer] of failing to maintain a regular plan for sales on credit, as required by the franchise agreement." *Id.* at 589.

Courts have recently held that this rule applies with equal force to claims for breach of the implied covenant of good faith and fair dealing. If one party has a contractual right to terminate, the other party cannot use the implied covenant to revitalize the argument that the contract was terminated unlawfully because it was based on an improper motive. *See, e.g., Chong v. 7-Eleven, Inc.*, No. 18-1542, 2020 WL 1069456, at *9 (E.D. Pa. Mar. 4, 2020) (granting 7-Eleven summary judgment on the franchisee's claim for breach of the implied covenant where the franchisee underreported sales and profits, and the contract gave 7-Eleven the

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right to terminate for such conduct, "even if . . . 7-Eleven . . . terminated the franchises . . . because of an ulterior motive"); *Little Caesar Enters., Inc. v. Miramar Quick Serv. Rest. Corp.*, No. 19-1860, 2020 WL 4516289, at *2 (6th Cir. June 25, 2020) (affirming a preliminary injunction in favor of Little Caesars where the franchisees stopped reporting gross sales and paying the required royalty and advertising fees, and the contracts gave Little Caesars the right to terminate for such conduct, even if motivated by retaliation or discrimination).

By contrast, in *Jack in the Box Inc. v. San-Tex Rests., Inc.*, No. SA-20-CV-00328-XR, 2021 WL 148058 (W.D. Tex. Jan. 14, 2021), the court denied Jack in the Box's motion to dismiss a franchisee's counterclaim for breach of the implied covenant. *Id.* at *6–7. According to the claim, Jack in the Box induced the franchisee to invest millions of dollars to renovate and improve its restaurants only to deny the franchisee an opportunity to recoup and earn a return on its investment. *Id.* at *7. The franchisee alleged that Jack in the Box had "a fraudulent pretext designed to permit [it] to terminate the Franchise Agreement with cause," including that Jack in the Box's CEO threatened retaliation in response to the franchise owner's involvement in a vote of no confidence. *Id.* The court held that these allegations permitted the inference that Jack in the Box acted in "bad faith" by creating a pretext to terminate the franchise. *Id.* Notably, the court did not discuss whether Jack in the Box had a contractual right to terminate.

Thus, in the absence of a contractual right to terminate, the motive may well be relevant to the question of whether termination is legally valid. *See Charter Practices Int'l, LLC v. Goldberg*, Case No. 12-62407-cv, 2013 WL 12064551, at *6 n.2 (S.D. Fla. Feb. 8, 2013) ("Motivation is only irrelevant if there was a legal right to terminate the contract. Here, arguably there was no legal right to terminate, so motivation can be considered.").

Materiality

The materiality of a breach may be critical to both the validity and consequences of termination. *See Reuter v. Jax Ltd.*, 711 F.3d 918, 921 (8th Cir. 2013) (under Minnesota law, "[t]o justify termination, the breach must be material"); *Postal Instant Press, Inc. v. Sealy*, 51 Cal. Rptr. 2d 365, 373–75 & n. 7 & 9 (Cal. Ct. App. 1996) (analyzing under California law the potential "draconian" consequences of a franchise agreement that authorized termination for a "material breach," which was a defined term of the contract).

And because not all cases present a clear-cut answer to the materiality question, whether a breach is material may provide fertile ground for arguments about motive. For instance, what if one party seizes upon the conduct of the other party that, though technically a breach of contract, does not impact the heart of the parties' relationship? Or what if a party holds up a series of relatively minor defaults as a material breach? In these circumstances, there is at least some authority finding that motive may be relevant to the validity of the termination.

In *Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.*, 970 F.2d 273 (7th Cir. 1992), the parties sued each other, the franchisor arguing that it lawfully terminated the franchise, and the franchisees arguing that the termination violated the contract. The evidence showed that the franchisees committed a number of "material breaches," a term that the contract defined, ranging from "undercooked and misshapen cookies" to underreporting gross sales by nearly three times the allowed margin of error. *Id.* at 278. Despite these breaches, the district court entered a preliminary injunction in favor of the franchisees to restore the franchise, holding that the terms of the contract were "commercially unreasonable." *Id.* at 279.

Reversing, the Seventh Circuit held that commercial unreasonableness was not a basis for refusing to enforce the contract. *Id.* at 279–80. It also rejected the franchisees' argument that the termination arose out of "spitefulness" or "personal nastiness." *Id.* at 280. But in so doing, the court recognized that improper motive could underlie a finding of commercial bad faith in certain circumstances. These include, for example, where franchisees had built "an immensely successful franchise and the [franchisor] had tried to appropriate the value they had created by canceling the franchise on a pretext: three (or four, or five, or a dozen for that matter) utterly trivial violations of the contract that the company would have overlooked but for its desire to take advantage of the [franchisees'] vulnerable position." *Id.* Although the franchisees failed to prove such a case, the court nevertheless recognized that a termination based on trivial, non-material breaches might provide an opening for arguing improper motives.

Discretion

The exercise of discretion may offer another avenue to argue improper motives. In *Interim Health Care of Northern Illinois, Inc. v. Interim Health Care, Inc.*,

225 F.3d 876 (7th Cir. 2000), a franchisee of temporary medical services alleged that in terminating its franchise, the franchisor violated the implied covenant, which, under Illinois law, obligates parties "vested with contractual discretion" to exercise such discretion "with proper motive." *Id.* at 884. At issue was the franchisor's promise to "furnish national account leads." *Id.* at 883. The contract was vague about what accounts and related information the franchisor was obligated to furnish, meaning the franchisor had the discretion to decide what to withhold and, therefore, "was not permitted to withhold . . . for improper motives." *Id.* at 884–85. The evidence suggested the franchisor may have "forced the franchisee into default" by withholding certain account information to lure away two of the franchisee's largest clients as part of a broader effort to usurp the franchisee's territory, and then held up the default as the reason for termination. *Id.* at 885–86. The Seventh Circuit reversed the district court's entry of summary judgment, holding that the franchisor may have "dishonestly" invoked the discretionary obligation to furnish account information such that an issue of fact existed regarding "the genuine reason" for the termination. *Id.*

Franchise Law

Franchise legislation may alter the common law analysis. A general purpose of most state franchise laws is to remedy an imbalance of power between franchisor and franchisee. To that end, many state franchise laws define the circumstances in which a franchisor may terminate a franchise, usually by requiring "good cause," among other criteria.

Some definitions of "good cause" are unlikely to make motive a relevant consideration. In *Century 21 Real Estate LLC v. All Professional Realty, Inc.*, 889 F. Supp. 2d 1198 (E.D. Cal. 2012), *aff'd*, 600 F. App'x 502 (9th Cir. 2015), a franchisee of real estate brokerage services argued that the franchisor's termination violated the California Franchise Relations Act ("CFRA") because its stated reasons for termination (*e.g.*, non-payment of franchise fees) were pretext for ulterior motives. *Id.* at 1224. The court rejected the argument because the CFRA defined "good cause" as merely the franchisee's failure to comply with the contract after receiving notice and an opportunity to cure, without any "mention of a 'good faith' requirement." *Id.* at 1225. Because the franchisor properly conducted the termination under the contract, the court found that the motive was "irrelevant." *Id.*

Two recent decisions involving 7-Eleven reached similar results. In one, the court held that 7-Eleven's alleged racial bias was irrelevant under the New Jersey Franchise Practices Act because 7-Eleven had "good cause" to terminate based on the franchisee's failure to pay payroll taxes, provide workers' compensation insurance, and withhold and pay Social Security taxes. *7-Eleven, Inc. v. Sodhi*, No. 13-3715 (MAS) (JS), 2016 WL 3085897, at *5 (D.N.J. May 31, 2016), *aff'd sub nom. 7-Eleven, Inc. v. Sodhi*, 706 F. App'x 777 (3d Cir. 2017). In the other, the court held that whether 7-Eleven disliked a franchisee's participation in an advocacy group or public criticism of 7-Eleven's business practices was irrelevant under the Illinois Franchise Disclosure Act because 7-Eleven had "good cause" to terminate based on the franchisee's failure to comply with wage-and-hour laws and submit accurate payroll information. *7-Eleven, Inc. v. Shakti Chicago, Inc.*, No. 18-cv-5269, 2019 WL 3387001, at *2 (N.D. Ill. July 26, 2019).

By contrast, some laws require not just "good cause" but also "good faith" to terminate. *See* Young & Dressler, *Pure Hearts & Franchise Terminations: The Role of Good Faith Under State Relationship Laws*, The Franchise Lawyer, Spring 2018, at 14–18. Depending on the jurisdiction, these laws may provide a statutory hook to argue improper motives.

For example, Ohio's Alcoholic Beverages Franchise Act ("OABFA") requires manufacturers to act "in good faith" and with "just cause" in "cancelling . . . a franchise." Ohio Rev. Code § 1333.84(A). The OABFA defines "good faith" as "the duty . . . to act in a fair and equitable manner toward each other so as to guarantee each party freedom from coercion or intimidation." *Id.* § 1333.82(D). Courts construing the OABFA have held that it "confin[es] violations of good faith to coercion or intimidation," and that, in turn, "[t]he existence of coercion or intimidation is determined by whether the act was undertaken 'simply for some business motive' or there was 'an ulterior or intimidating motive.'" *Dayton Heidelberg Distrib. Co. v. Vineyard Brands Inc.*, 74 F. App'x 509, 514 (6th Cir. 2003). Thus, "[i]f there is independent evidence that the manufacturer used intimidation or coercion," such as for an improper motive, "the existence of just cause for termination will not save the manufacturer." *Id.* at 515.

Even so, there is a patchwork of such laws around the country, and courts do not uniformly construe concepts like "good faith." While a statutory "good faith" requirement may defeat a contractual right to terminate in some jurisdictions,

others construe the concept more narrowly. *Compare Central Sports, Inc. v. Yamaha Motor Corp.*, U.S.A., 477 F. Supp. 2d 503, 509 (D. Conn. 2007) (reasoning that the Connecticut Franchise Act's "good faith" requirement necessitated consideration of an alleged "improper motive" for termination, but holding that the franchisee failed to prove "[b]ad faith termination"), *and Williston Farm Equip., Inc. v. Steiger Tractor, Inc.*, 504 N.W.2d 545, 549 (N.D. 1993) (holding that "a manufacturer's treatment of other similarly situated dealerships may have some probative value to establish 'good cause' and 'good faith' for the termination of a dealership agreement" under North Dakota's Dealer Law), *with Tuf Racing*, 223 F.3d at 589 (while acknowledging that the Illinois Motor Vehicle Franchise Act "requires franchisors to deal with their franchisees in good faith," rejecting the franchisee's argument that "the good-faith provision entitles it to complain about a pretextual termination even if there is good cause for termination").

The lesson is this: Where state franchise law incorporates a concept like good faith, it is critical to analyze the applicable statutory language and interpretive case law to determine whether the motive may be relevant. Although it is generally not from the benevolence of the butcher that we should expect our dinner, statutory franchise law may obligate the butcher to act with a motive more savory than raw, uncured self-interest. ■

Message from the Chair

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thanks to Brian and Martine for their leadership, which was particularly challenging due to the pandemic and its impact on travel and personal interaction, and look forward to the contributions of Kerry and Nicola in these roles.

The Forum's Nominating Committee completed its work this summer under the leadership of Immediate Past Chair Will Woods. I want to thank Will and committee members Annie Caiola, Kerry Green, Elliot Ginsburg, and Steve Goldman for their efforts to ensure that the Forum leadership remains in capable hands. I am very pleased to congratulate Elizabeth Weldon who was nominated to be the next Forum Chair for a two-year term starting in August 2023. Jason Adler, Nicole Micklich, and Ben Reed each were nominated to serve a second three-year term on the GC. Dan Oates was nominated for a three-year term on the GC beginning in August 2023, and Mark Forseth was nominated for a one-year term beginning in August 2023 to serve the balance of Elizabeth's unexpired GC term. We will vote on these nominations at the Forum's business meeting on Friday, November 4.

In addition to these GC and senior leadership roles, the Forum depends on the efforts of many more people who serve as committee members supporting our officer and division positions, as editors and authors for our Forum periodicals and books, and as Annual Meeting and webinar speakers. On behalf of the Forum, I want to thank everyone who has served in any of these capacities. If you are interested in getting more involved in the Forum generally or in serving in a specific area, please contact me or any member of the GC or senior leadership and we will get you involved.

You can reach me at rcoleman@phrd.com or 404.420.1144. I look forward to seeing you in San Diego! ■

Message from the Editor-in-Chief

By Erin C. Johnsen, Garner, Ginsburg & Johnsen, P.A.

As Ron noted in his Chair's message, September marks the beginning of a new ABA year and various changes in forum leadership positions. Here at *The Franchise Lawyer*, there aren't any changes to our editorial board. However, I want to thank Justin Sallis for agreeing to continue as an editor and begin his second term with *The Franchise Lawyer* this September. Without the diligent work of Justin and the rest of our editors, we would not be able to create this publication.

If you're interested in writing for *The Franchise Lawyer* in a future issue or have a topic idea that you'd like to see covered, please reach out to me directly at ecjohnsen@yourfranchiselawyer.com or 612-259-4807. ■