

PUBLICATION

Franchisees Must Carefully Consider Renewal Provisions

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Do franchise transaction participants usually pay much attention to renewal provisions in the franchise agreement? They should. Not all renewal provisions are created equally. A California appellate court recently construed a renewal provision in a Mail Boxes Etc. (MBE) franchise agreement in a decision yielding surprising results. The unreported opinion is styled *G.I. McDougal, Inc. v. Mail Boxes Etc., Inc. et al.*, Cal. Rptr. 3d, 2012 WL 90083 (CA. App. 2012).

McDougal, the franchisee plaintiff, entered into a franchise agreement with MBE on February 5, 1994. In 2001, UPS acquired MBE, which became a wholly-owned subsidiary of UPS. UPS and MBE offered certain financial incentives to MBE franchisees who re-branded from “Mail Boxes Etc.” to “The UPS Store” and undertook certain other obligations. More than 90 percent of the MBE franchisees accepted the UPS brand and associated obligations/benefits. McDougal did not.

At the time McDougal signed the franchise agreement in 1994, the relevant part of the renewal provision stated:

Such renewal shall be effected by the execution of an appropriate document extending the term of this Agreement on the same terms and conditions as are contained in the then current Franchise Agreement for the sale of new MBE Centers.

By the time McDougal's MBE franchise came up for renewal, McDougal was required to execute an agreement for The UPS Store as a condition of renewal. He refused and alleged that UPS and MBE breached the MBE franchise agreement by refusing to renew the MBE agreement. McDougal claimed the franchise agreement had to be renewed without change.

The court honed in on the words italicized above to reject McDougal's claims. The court first stated that if the italicized language was interpreted literally, McDougal would have no right to renewal because the franchisor no longer offered a franchise agreement for new MBE centers. The court then noted that the franchise agreement allowed MBE to change proprietary marks under certain circumstances. Consequently, MBE did not have to renew the franchise “intact and without change.” Next, the court noted that in connection with the change in proprietary marks, the franchisor no longer offered MBE franchises and instead only offered “The UPS Store” franchises, which is what was offered to McDougal.

McDougal also argued that the 1994 franchise agreement did not allow modification unless by mutual consent. That argument was quickly dispatched by the court because the mutual consent language addressed the 1994 franchise agreement, not the offered agreement, and the offered agreement was “on the same terms and conditions as are contained in the then current Franchise Agreement for the sale of new MBE Centers.” Similarly, the 1994 franchise agreement acknowledged that MBE may evolve, develop and change and that is exactly what happened through the acquisition by UPS.

McDougal's last stab was to argue that the renewal provision violated the implied covenant of good faith and fair dealing because it did not expressly reserve to MBE the right to condition renewal upon McDougal's acceptance of a materially different agreement. This argument also fell short because any implied covenant

grows out of express terms and the renewal provision expressly allowed renewal “on the same terms and conditions as are contained in the then current Franchise Agreement,” which is exactly what was offered to McDougal.

So what is the big takeaway from this case? Both franchisees and franchisors must seriously consider the renewal provision when drafting or negotiating agreements and not view the provision as “boilerplate.” Franchisors need the flexibility to present renewing franchisees with franchise agreements that reflect the dynamically evolved franchise system, which will necessarily be different than those signed years earlier. The evolved brand franchise agreements may even offer different parties, products and business method requirements. Franchisees need to understand that the initial term may be the only term it receives a license to use and operate under a certain brand at the time of signing, and that at renewal, they may not have a chance to select the same terms for the same brand as they enjoyed at the inception, or the new offering. Material changes may be required to maintain and continue with the franchise affiliation, and their choice is to renew or cease operation.