University of Miami Law Review

Volume 48 | Number 3 Article 6

1-1-1994

# *Scheck v. Burger King Corp.*: Why Burger King Cannot Have Its Own Way with Its Franchisees

Adam B. Leichtling

# CASENOTE

# *Scheck v. Burger King Corp.*: Why Burger King Cannot Have Its Own Way with Its Franchisees



## I. INTRODUCTION

Courts have traditionally protected franchisors in their attempts to develop additional outlets when and where they see fit.[1] This protection was based upon the discretionary powers that franchisors had reserved for themselves in their franchise agreements.[2] The extent of the discretion retained by the franchisor has become the focus of "the long-fought war over market 'cannibalization,' pitting expansion-minded franchisors against their defensive franchisees."[3]

On July 6, 1992, in *Scheck v. Burger King*,[4] a federal district court in Florida made "devastatingly clear" its determination to protect franchisees in their battle against franchisors over territorial rights.[5] This Note analyzes the *Scheck* court's rationale for holding that Steven A. Scheck, the franchisee, could be protected from expansion by Burger King Corporation ("Burger King"), the franchisor, and, more impor-

1. *Franchise Furor Signals Need for Cooperation and Conciliation*, NATION'S RESTAURANT NEWS, September 28, 1992, at 37 [hereinafter *Franchise Furor*]. *See generally* David J. Kaufmann, *Franchising: Legislative and Judicial Update*, N.Y. L.J., Jan. 7, 1992, at 1 [hereinafter Kaufmann, *Update*]. Mr. Kaufmann is a partner of Kaufmann, Feiner, Yamin, Gildin & Robbins, which represents franchisors nationwide. *Id.*

2. *Id.*

3. Richard Martin, *Franchisee Gains Ground in BK 'Cannibalization' Suit*, NATION'S RESTAURANT NEWS, February 10, 1992, at 1.

4. 798 F. Supp. 692 (S.D. Fla. 1992) (denying a motion for reconsideration) (*Scheck II*).

5. *See* Martin, *supra* note 3, at 78 (quoting Harold Brown, the franchisee's Boston-based attorney in Scheck v. Burger King Corp., 756 F. Supp. 543 (S.D. Fla. 1991) (*Scheck I*)).

tantly, illustrates how this holding breaks from the court's traditional approach of protecting franchisors.

In their attacks on franchisors' expansionary tactics, franchisees are alleging unfair encroachment with increasing frequency and are "bringing lawsuits over their franchisors' purported breaches of the 'implied covenant of good faith and fair dealing.' "[6] Although "the covenant of good faith and fair dealing was applied to franchising and franchisors with a vengeance in the 1980's,"[7] courts were reluctant to create a zone of territorial protection for a franchisee where the operative franchise agreement clearly intended or expressly afforded none.[8] In those circumstances, the judiciary "forcibly rejected attempts to utilize the covenant [of good faith and fair dealing] to infer or imply territorial protection or exclusivity."[9] Even so, there has been a " 'growing effort by franchisees and their lawyers to use the doctrine of implied duty of good faith and fair dealing' to restrain franchisors."[10]

This Note analyzes the requirement of good faith in franchise contracts as it affects judicial protection of franchisees' territorial rights.[11] It focuses on the ability of the courts to force franchise contracts into an open, competitive market, which ensures that both parties are aware of and bargain for all contract terms. Central to this Note is the distinction between the denial of territorial exclusivity and the reservation of the franchisor's unlimited right to establish additional franchises. This Note concludes that the court has used the covenant of good faith to ensure that the parties to the franchise contract bargain for the territorial terms of the contract.

In *Scheck*,[12] the franchisee sued Burger King for damages caused by Burger King's establishment of a competing franchise.[13] Burger

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6. *Franchise Furor*, *supra* note 1.

7. David J. Kaufmann, *Franchise-Related Mergers, Acquisitions and LBO'S: Threshold Issues of Law*, *in* FRANCHISING 1992: BUSINESS AND LEGAL ISSUES, at 327 (PLI Comm. Law and Practice Course Handbook Series No. 603, 1992) [hereinafter Kaufmann, *Threshold Issues*]. Mr. Kaufmann is chairman of the Practicing Law Institute on Franchising.

8. *Id.* at 329.

9. *Id.*; *see* Kaufmann, *Update*, *supra* note 1, at 1.

10. Martin, *supra* note 3, at 78 (quoting Philip F. Zeidman, general counsel to the International Franchise Association).

11. In 1992, franchise outlets accounted for $717 billion in sales, which amounts to 34% of all domestic retail sales. David J. Kaufmann, *An Introduction to Franchising and Franchise Law*, *in* FRANCHISING 1992: BUSINESS AND LEGAL ISSUES, at 11 (PLI Comm. Law and Practice Course Handbook Series No. 603, 1992) [hereinafter Kaufmann, *Introduction*]. The number of franchise outlets has more than doubled in the last decade to over 533,000, and there are over 2,200 franchisors and 7.7 million franchise employees. *Id.*

12. Plaintiff, Steven A. Scheck operated a restaurant located in Lee, Massachusetts under a franchise agreement with Burger King. *Scheck I*, 756 F. Supp. 543, 545 (S.D. Fla. 1991).

13. *Id.* at 545. The Complaint filed on February 6, 1989, alleged that "Burger King's decision to sanction the Marriott Corporation's conversion of a Howard Johnson restaurant to a Burger

King moved for summary judgment[14] on the ground that because the Franchise Agreement specifically denied the franchisee "any area, market or territorial rights,"[15] Burger King's acts were explicitly authorized by the Franchise Agreement and could not constitute bad faith.[16] This Note considers Scheck's allegation of breach of the implied covenant of good faith and fair dealing (Count II of the Complaint), the only count which survived the motion for summary judgment.[17]

The court disagreed with Burger King's contention and found that "[t]he express denial of an exclusive territorial interest to Scheck does not necessarily imply a wholly different right to Burger King—the right to open other proximate franchises at will regardless of their effect on [Scheck's] operations."[18] Judge Hoeveler emphasized that Burger King's own policies and procedures were developed to protect against "cannibalization" and the potential ruin of neighboring franchises, which would weaken the Burger King chain.[19] Judge Hoeveler found that "while Scheck is not entitled to an exclusive territory, he is entitled to expect that Burger King will not act to destroy the right of the franchisee

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King franchise two miles away from Scheck's franchise in Lee, Massachusetts" damaged Scheck. *Id.* The case was originally filed in the United States District Court for the District of Massachusetts. *Id.* Burger King moved to dismiss and/or transfer the case pursuant to the forum selection provision of the Assignment Agreement. *Id.* Judge Frank H. Freedman, Chief United States District Judge for the District of Massachusetts, denied Burger King's motion to dismiss and transferred the case pursuant to 28 U.S.C. § 1404, in an order dated June 15, 1989. *Id.*

14. Burger King moved for summary judgment on all four counts of the complaint, which alleged breaches of (1) an implied non-competition agreement; (2) an implied covenant of good faith and fair dealing; (3) an implied contract created by promissory estoppel; and (4) the Massachusetts Consumer Protection Act, alleged to incorporate the previous claims. *Id.*

15. *Id.* at 549 (citing Franchise Agreement § 1). Burger King also argued that Scheck's claims were barred by the statute of frauds, or were released by two documents executed by Scheck in 1985 and 1986. *Id.* at 545.

16. *Id.* at 549.

17. *Id.* The court granted summary judgment as to the other counts of the complaint and ordered that they be dismissed. *Id.* at 548-50. For a complete discussion of the court's rulings as to Count I, which alleged breach of an implied non-competition agreement, see *id.* at 548; as to Count III, which alleged breach of an implied contract created by promissory estoppel, see *id.* at 549-50; and as to Count IV which alleged breach of the Massachusetts Consumer Protection Act claimed to incorporate the previous claims, see *id.* at 550. The court also denied and dismissed Burger King's affirmative defenses of release and statute of frauds. *Id.* at 546-48.

18. *Id.* at 549.

19. *Id.* (footnote omitted). The court noted the deposition testimony of Burger King Region Vice President Charles Olcott that a " 'Burger King site would not be approved for a franchisee where there would be an issue of large sales deterioration at a nearby existing Burger King, which would stem from the opening of the new store in question' . . . each site approval was made on a 'case by case basis.' " *Id.* at 549 n.12 (citing Olcott Dep., pp. 19-22).

In fact, Los Angeles attorney and franchise law specialist, Mitchell S. Shapiro, believes the court denied summary judgment "largely because of evidence that Burger King had internal policies aimed at preventing cannibalization. . . . [which] suggest that 'even Burger King didn't feel it had carte blanche to open units anywhere without regard for its franchisees.' " Martin, *supra* note 3, at 78.

to enjoy the fruits of the contract."[20]

Thereafter, Burger King moved for reconsideration, bringing the issue of good faith before the court again. While finding no "sound basis (either in law or policy) upon which to retreat from the above analysis,"[21] the court elaborated on the reasoning behind the decision. Significantly, the court analyzed the Franchise Agreement itself and concluded that the agreement lacked the explicit contractual language necessary to authorize Burger King's actions in this case.[22] The court found that, despite the express denial of an exclusive territorial interest to the franchisee in the Franchise Agreement, the principles of good faith and fair dealing precluded the franchisor's predatory actions.[23] The court's interpretation of the Franchise Agreement contradicted both Burger King's arguments[24] and other judicial interpretations of similar contracts.[25] By implying an obligation of good faith, the court has forced Burger King into an open, competitive market. That is, the court has required Burger King to bargain explicitly with franchisees for the right to establish competing franchises in the future.

## II. PERSPECTIVE: THE DEVELOPMENT OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

The implied covenant of good faith and fair dealing arises from the common law contract doctrine of implied promises or conditions.[26] Most jurisdictions require the performance of contractual obligations in good faith,[27] implying a covenant of good faith and fair dealing in every

20. *Scheck I*, 756 F. Supp. at 549 (citation omitted).

21. *Scheck II*, 798 F. Supp. 692, 694 (S.D. Fla. 1992). On the motion for reconsideration, the court considered "the pertinent portions of the record, the relevant case law, and the arguments presented by counsel" at the hearing on the motion. *Id.*

22. "[A]lthough the language of the Franchise Agreement states that the franchisee cannot expect an exclusive territory, such language does not even mention the franchisor, let alone does the language provide that Burger King retains the unlimited right to establish Burger King franchises at any location desired." *Id.*

23. *Id.* at 696.

24. Burger King relied on the provision in the Franchise Agreement specifying that " '[t]his license is for the described location only and does not in any way grant or imply any area, market or territorial rights proprietary to FRANCHISEE.' " *Id.* at 695 (citing Franchise Agreement, at 2) (footnote omitted). Burger King maintained that this language should have made the court's analysis simple and brief, because of the Florida rule precluding the implication of an obligation of good faith in "derogation of the express terms of a contract." *Id.*

25. Fickling v. Burger King Corp., [1987-1989 Transfer Binder] Bus. Franchise Guide (CCH) ¶ 9099, at 18,825 (4th Cir. 1988) (unpublished opinion) (applying Florida law). *See* discussion *infra* notes 76-80, 89, 115, 125-30 and accompanying text.

26. Robert T. Joseph, *Do Franchisors Owe a Duty of Competence?*, 46 BUS. LAW. 471, 483 (1991).

27. *See* Joseph W. Sheyka, *State Franchise and Dealer Protection Laws*, *in* 28TH ANNUAL

contract.[28] The implied covenant is contained in the Restatement of Contracts,[29] codified in the Uniform Commercial Code[30] and, more importantly, recognized by Florida law.[31]

The classic formulation of the implied covenant doctrine was articulated by the New York Court of Appeals in 1933, in *Kirke La Shelle Co. v. Paul Armstrong Co.*[32] The court stated that "in every contract there is an implied covenant 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."[33] Thus, the actions of the parties to a contract are limited and each party must substantially perform thereunder to accomplish the contract's purposes.[34]

According to the Restatement, every contract "imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[35] "Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party . . . ."[36] Even when a party believes its conduct to be justified, the common law obligation of good faith may be violated. Bad faith[37] may comprise action or inaction, including "subterfuges and evasions," and fair dealing "may require more than honesty."[38] Bad faith is conduct proscribed because it violates "community standards of decency, fairness or reasonable-

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ADVANCED ANTITRUST SEMINAR: DISTRIBUTION AND MARKETING, at 1015 (PLI Corp. Law and Practice Course Handbook Series No. 625, 1988).

28. *See id.*; Joseph, *supra* note 26, at 482. *But see* Monroe County Oil Co. v. Amoco Oil Co., 75 B.R. 158, 163 (S.D. Ind. 1987) (Indiana law does not recognize an implied covenant of good faith and fair dealing).

29. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979).

30. U.C.C. § 1-203 (1989).

31. *See* Johnson v. Davis, 480 So. 2d 625, 628 (Fla. 1985); Fernandez v. Vazquez, 397 So. 2d 1171, 1174 (Fla. 3d DCA 1981). *See also* First Nationwide Bank v. Florida Software Servs., Inc., 770 F. Supp. 1537, 1542 (M.D. Fla. 1991); East Bay Ltd. Partnership v. American Gen. Life & Accident Ins. Co., 744 F. Supp. 1118, 1122 (M.D. Fla. 1990), *aff'd*, 937 F.2d 619 (11th Cir. 1991); Green Cos. v. Kendall Racquetball Invs., Ltd., 560 So. 2d 1208, 1210 (Fla. 3d DCA 1990); Harrison Land Dev. Inc. v. R & H Holding Co., 518 So. 2d 353, 355 (Fla. 4th DCA 1987); Brickell Bay Club Condominium Ass'n v. Hernstadt, 512 So. 2d 994, 997 (Fla. 3d DCA 1987), *review denied*, 520 So. 2d 584 (Fla. 1988); Coira v. Florida Medical Ass'n, 429 So. 2d 23, 23 (Fla. 3d DCA 1983); Bowers v. Medina, 418 So. 2d 1068, 1069 (Fla. 3d DCA 1982).

32. 188 N.E. 163 (N.Y. 1933).

33. *Id.* at 167.

34. Kaufmann, *Threshold Issues*, *supra* note 7, at 327.

35. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979).

36. *Id.* cmt. a.

37. Logically, the opposite of good faith.

38. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. d (1979) ("subterfuges and evasions violate the [common law] obligation of good faith in performance even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty.").

ness."[39] Rather than providing a precise definition of bad faith, the Restatement offers guidance by means of illustration.[40]

Similarly, under the Uniform Commercial Code ("UCC"), every contract imposes an obligation of good faith in its performance and enforcement.[41] The UCC provides two definitions of good faith. According to Article 1, which applies throughout the UCC, good faith is "honesty in fact in the conduct or the transaction concerned."[42] Under Article 2, which applies only to the sale of goods,[43] the elements of good faith comprise "honesty in fact" and compliance with "reasonable commercial standards of fair dealing in the trade."[44] The Article 2 standard requires " 'a state of mind' in which '[a] party is advantaged only if [that party] acted with innocent ignorance or lack of suspicion.' "[45]

These formulations of good faith are phrased broadly in order to protect the reasonable expectations of the bargaining parties and to fulfill "the basic purpose of contract law."[46] Further, where the express promises of the contract do not adequately express the full intentions of the parties, the courts will imply a promise.[47] When a court implies a covenant of good faith and fair dealing, it is recognizing that the parties "occasionally have understandings or expectations that were so fundamental that they did not need to negotiate about those expectations."[48]

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39. *Id.* cmt. a.

40. Thus, bad faith includes "evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance." *Id.* cmt. d.

41. U.C.C. § 1-203 (1989) ("Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."). For a thorough discussion, see generally Steven J. Burton, *More on Good Faith Performance of a Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497 (1983); Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369 (1980); E. Allan Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666 (1963); B. J. Reiter, *Good Faith in Contracts*, 17 VAL. U. L. REV. 705 (1983); Robert S. Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810 (1982); Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968).

42. U.C.C. § 1-201(19) (1989).

43. *Id.* § 2-201.

44. *Id.* § 2-103(1)(b).

45. Jason D. Topp, Comment, International Minerals & Mining Corp. v. Citicorp N. Am., Inc.: *A Contractual Relationship Between Loan Applicant and Lender*, 76 MINN. L. REV. 131, 137 (1991). This standard is sometimes referred to as the "rule of 'the pure heart and the empty head.' " Robert Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 812 (1958).

46. 3A CORBIN ON CONTRACTS § 654A(A) (Supp. 1993); Joseph, *supra* note 26, at 483 (citing Corbin).

47. 3 CORBIN ON CONTRACTS § 561 (West 1960 & Supp. 1993). Corbin observes that "it has become more fashionable for courts to talk of 'good faith' than of 'implied covenants.' " *Id.*

48. *Id.* § 570; Joseph, *supra* note 26, at 484 (citing Corbin).

Of course, determining what understandings or expectations were so fundamental that they were not negotiated begs the question.

Because of the foregoing considerations, the application of an implied covenant of good faith and fair dealing to franchise contract controversies has been the subject of much debate.[49] In some respects, franchise contracts are "precisely the type of contract whose interpretation and enforcement can be assisted by appropriate use of the implied covenant."[50] Good faith and fair dealing typically limit the manner in which one party can exercise contractually-granted discretion, thereby protecting the reasonable expectations of the other party to the contract.[51] Thus, the implied covenant is an important limit on the amount of discretion traditionally afforded the franchisor.[52] Further, "[t]he terms of franchise agreements are often vague or ambiguous[, as] the contracting parties did not (and indeed could not) anticipate every contingency that might occur during the course of the often extended franchise relationship."[53] The implied covenant helps solve this problem by putting interpretative boundary lines in a contract where ambiguity lies. Accordingly, the "courts have consistently held that there is an implied covenant of good faith and fair dealing in any franchise agreement."[54]

Problems sometimes arise, however, because courts disagree about what constitutes good faith[55] and about the effects of implying good

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49. Joseph, *supra* note 26, at 481. For a general treatment, see Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369 (1980). Although there is a split among courts about whether the UCC itself or only its principles are applicable to a franchise relationship, courts have uniformly applied the implied covenant of good faith and fair dealing to these agreements. Kaufmann, *Threshold Issues*, *supra* note 7, at 328. Courts have often imposed a duty of good faith in non-UCC contexts. Gerard Mantese, *The U.C.C. and Keeping the (Good) Faith*, 70 MICH. B.J. 270 (March 1991). Additionally, the covenant of good faith and fair dealing has been imposed by statute into the franchise relationship, in one fashion or another, in Arkansas, Delaware, Hawaii, Indiana, South Dakota, Washington, and Wisconsin. Kaufmann, *Threshold Issues*, *supra* note 7, at 328.

50. Joseph, *supra* note 26, at 481.

51. *Id.*

52. *Id.*

53. *Id.*

54. Thomas M. Pitegoff, *Franchise Relationship Laws: A Minefield for Franchisors*, 45 BUS. LAW. 289, 308 (1989). *See, e.g.*, Davis v. Sears, Roebuck & Co., Bus. Franchise Guide (CCH) ¶ 9384 (6th Cir. 1989); Corenswet, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129 (5th Cir.), *cert. denied*, 444 U.S. 938 (1979); Tulsa Trailer & Body, Inc. v. Trailmobile, Inc., [1986-1987 Transfer Binder] Bus. Franchise Guide (CCH) ¶ 8615 (N.D. Okla. 1986).

55. Topp, *supra* note 45, at 135-36. The scope and meaning of the implied covenant has been addressed in cases concerning the establishment of new franchises adjacent to a plaintiff's existing location, and in cases involving the relocation of franchise sites and termination of franchise relationships. Joseph, *supra* note 26, at 481. For a general discussion of the implied covenant in the context of franchise terminations, see T. Mark McLaughlin and Caryn Jacobs,

faith.[56] The good faith obligation has become increasingly important in the franchising context as franchisees frequently attempt to "require action by their franchisors not specifically required by the terms of their franchise agreements or established by their courses of dealing."[57] In some cases, franchisees seek to revise or supplement the terms of their franchise agreements in order to prevent conduct which otherwise may be "expressly authorized by their franchise agreements."[58] In these situations, franchisees argue that they are only attempting to "preclude franchisors from dishonestly or unfairly usurping or denying them the benefits of their contracts."[59] Although courts may imply the covenant of good faith and fair dealing where the nature of the bargain is not changed, arguments to extend the implied covenant beyond its traditional limits[60] are typically rejected, and generally have been unsuccessful.[61]

Even though the covenant of good faith and fair dealing sometimes assists the court in interpreting the intention of the parties where the contract is silent or ambiguous, it will not be used to override express contractual provisions.[62] Courts are usually reluctant to rewrite contracts, especially commercial ones.[63] In addition, courts "demonstrably loathe to utilize the [implied] covenant . . . to disturb the express terms

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*Termination of Franchises: Application of the Implied Covenant of Good Faith and Fair Dealing*, 7 FRANCHISE L.J. 1 (Summer 1987).

56. As Judge Hoeveler notes, "the implied covenant of good faith and fair dealing involves an intricate and amorphous legal construct." *Scheck II*, 798 F. Supp. 692, 697 n.10 (S.D. Fla. 1982).

57. Sheyka, *supra* note 27, at 1069.

58. *Id.*

59. *Id.*

60. Joseph, *supra* note 26, at 483.

61. *Id.*

62. Pitegoff, *supra* note 54, at 308; *see, e.g.*, Domed Stadium Hotel v. Holiday Inns, 732 F.2d 480, 485 (5th Cir. 1984) ("The implied obligation to execute a contract in good faith usually modifies the express terms of the contract and should not be used to override or contradict them.") (citation omitted) (applying Louisiana law); Carlock v. Pillsbury Co., 719 F. Supp. 791, 819-20 (D. Minn. 1989) (action for breach of the implied covenant of good faith and fair dealing dismissed because plaintiff's claim that mass distribution of prepackaged pints of ice cream violated the agreement was contrary to the express language of the agreement which reserved the right for the franchisor and trademark owner to distribute products by any method); Patel v. Dunkin' Donuts of America, Inc., 496 N.E.2d 1159, 1161 (Ill. App. Ct. 1986) (holding the covenant of good faith did not bar the defendants from establishing a new franchise within one mile of plaintiffs' business because the franchise agreement expressly granted the defendants the unqualified right to establish a new business); Rado-Mat Holdings, U.S., Inc., v. Holiday Inns Franchising, Inc., No. 76747, slip op. at 5 (N.Y. Sup. Ct. Dec. 13, 1991) ("Under the facts in this case, [the] implied covenant of good faith cannot contradict or alter an explicit term set forth in a contract."); Super Valu Stores, Inc. v. D-Mart Food Stores, Inc., 431 N.W.2d 721, 726 (Wis. Ct. App. 1988) ("[I]t would be a contradiction in terms to characterize an act contemplated by the plain language of the parties' contract as a 'bad faith' breach of that contract.").

63. Joseph, *supra* note 26, at 483.

of a franchise agreement,"[64] because such a revision would "defeat rather than fulfill the parties' expectations."[65] Consequently, "the judiciary has forcibly rejected attempts to utilize the covenant to infer or imply territorial protection or exclusivity where the contract is clear that none was intended or expressly afforded."[66] Practice indicates that whether a franchisor's conduct breaches the implied covenant of good faith and fair dealing undeniably depends on the facts of a given case[67] and, quite logically, on the terms of the particular contract.[68]

Federal courts had already interpreted the pertinent language of the Burger King form contract. In *Fickling v. Burger King Corp.*,[69] the Fourth Circuit "interpreted the exact same language contained in the Franchise Agreement entered into between Scheck and Burger King and found that such contractual language barred a cause of action under Florida law for breach of the implied covenant of good faith."[70] The Fourth Circuit based its decision on the understanding that "the obligation of good faith will not be implied in derogation of the express terms of a contract."[71] Fickling's claim was disposed of because implying an obligation of good faith and fair dealing would have overridden the Fourth Circuit's reading of the express terms of the Franchise

64. Kaufmann, *Threshold Issues*, *supra* note 7, at 329; *see, e.g.* Fickling v. Burger King Corp., [1987-1989 Transfer Binder] Bus. Franchise Guide (CCH) ¶ 9099, at 18,825 (4th Cir. 1988) (unpublished opinion) (Under Florida law, the "obligation of good faith will not be implied in derogation of the express terms of a contract."); Puretest Ice Cream, Inc. v. Kraft, Inc., 806 F.2d 323, 325 (1st Cir. 1986) (holding that accepting a mere lack of good reason as a violation of the implied covenant of good faith would transform the indefinite term contract from one terminable at will into one terminable for cause); Grand Light & Supply Co. v. Honeywell, Inc., 771 F.2d 672, 679 (2d Cir. 1985) (holding that where a contract expressly provided for termination on 30 days notice, a good faith requirement would not be implied to override explicit contractual provisions); Cardinal Stone Co. v. Rival Mfg. Co., 669 F.2d 395, 396 (6th Cir. 1982) (holding that language in standardized purchase order allowing termination at any time meant without cause); Jack Rowe Assocs. v. Fisher Corp., 639 F. Supp. 564, 567-68 (C.D. Cal. 1986) (holding that where a contract expressly provided for termination on 30 days notice, a good faith requirement would not be implied to override explicit contractual provisions), *vacated on other grounds*, 833 F.2d 177 (9th Cir. 1987).

65. Joseph, *supra* note 26, at 483.

66. Kaufmann, *Threshold Issues*, *supra* note 7, at 329. *But see* Photovest Corp. v. Fotomat Corp., 606 F.2d 704, 728 (7th Cir. 1979), *cert. denied*, 445 U.S. 917 (1980). Kaufmann observes, however, that "most franchise agreements by their terms confer territorial exclusivity upon franchisees." Kaufmann, *Threshold Issues*, *supra* note 7, at 329.

67. Sheyka, *supra* note 27, at 1069. For a more comprehensive review of the ways in which franchisors' acts have been found to breach the covenant of good faith and fair dealing, see *id.*

68. *See* cases cited *supra* note 62.

69. Fickling v. Burger King Corp., [1987-1989 Transfer Binder] Bus. Franchise Guide (CCH) ¶ 9099, at 18,825 (4th Cir. 1988) (unpublished opinion).

70. *Scheck II*, at 798 F. Supp. 692, 699 (S.D. Fla. 1992). *See Fickling*, [1987-1989 Transfer Binder] Bus. Franchise Guide (CCH) at 18,824-25.

71. *Fickling*, [1987-1987 Transfer Binder] Bus. Franchise Guide (CCH) at 18,825.

Agreement.[72]

Burger King asserted that Judge Hoeveler would have to either grant its motion for summary judgment, or depart from a long line of precedent regarding implied covenants of good faith and fair dealing.[73] Burger King also contended that the Court would have to ignore the express terms of the contract between Scheck and Burger King in order to rule in favor of Scheck.[74]

In denying Burger King's motion for summary judgment, however, Judge Hoeveler did not disagree with the Fourth Circuit's understanding of the covenant of good faith and fair dealing. Rather, Judge Hoeveler refused to read the Franchise Agreement's denial of territorial exclusivity to the franchisee as a reservation of unlimited power to the franchisor that could be used to establish additional franchises.

## III. ANALYSIS

This part of the Note is divided into two distinct sections. The first section analyzes Judge Hoeveler's application of the covenant of good faith and fair dealing, and argues that the *Scheck* decision correctly makes use of that implied covenant. The second section analyzes the court's decision under the auspices of game theory and concludes that Judge Hoeveler's decision is also correct under that doctrine.

### A. *Implying a Covenant of Good Faith Does Not Depart From Precedent*

Arguably, Judge Hoeveler "appears to be rewriting the law governing territorial encroachment vis-a-vis the implied covenant of good faith and fair dealing.[75] For franchisors, the opinion is a "disturbing exception" to the rule against implying the covenant of good faith and fair dealing because it gives a franchisee an exclusive territory where the franchise agreement does not grant such a right.[76] Perhaps the impact of the *Scheck* opinion is a matter of perspective.

In fact, *Scheck's* significance does not lie in a radical departure from long standing precedent. Rather, it lies in the clarity with which Judge Hoeveler grasped the economic effects of Burger King's arguments and contracting strategies. The court clearly states that "the pre-

72. *Id.*

73. *See Scheck II*, 798 F. Supp. at 698-99.

74. *Id.*

75. Kaufmann, *Update*, *supra* note 1, at 7.

76. *Id.* at 7 ("Can the implied covenant of good faith and fair dealing be applied to create a zone of territorial protection for a franchisee when the operative franchise agreement confers none? Until recently, the answer would be an emphatic 'no.' ").

cedent-setting value of the Court's decision today is not nearly as immense as [Burger King] suggests; this Court is simply not issuing a decision contravening the rule expressed in the case law holding that the implied covenant cannot override an explicit contractual term."[77]

The line of authority typically cited for the proposition that the covenant of good faith and fair dealing will not be implied in contradiction of express contractual provisions[78] must be read carefully. In those cases, the contracts contained language denying exclusive territory, license, or distribution area to a franchisee or licensee,[79] as well as explicit language granting the franchisor or licensor the right to establish competing franchises, issue competing licenses, or pursue competing business opportunities.[80] Thus, the rule restated by Judge Hoeveler is that the covenant of good faith and fair dealing cannot be implied into a contract that not only disclaims an exclusive territory for the franchisee, but also gives the franchisor the right to establish competing franchises at will.[81] According to Judge Hoeveler, this rule did not control in *Scheck*, because Burger King did not unequivocally reserve for itself the right to establish competing franchises at will.[82]

Implying the covenant of good faith and fair dealing into a franchise contract is also encouraged by the relational theory of contracts.[83] In fact, relational contract theory is particularly suited to long

77. *Scheck II*, 798 F. Supp. at 698.

78. *See* cases cited *supra* note 62.

79. *Id.*

80. *Scheck II*, 798 F. Supp. at 698. *See* Hotel v. Holiday Inns, 732 F.2d 480, 483 n.1 (5th Cir. 1984) ("[T]he Licensor has, and shall continue to have during the life of this license agreement . . . the right to construct and operate one or more Holiday Inns at any place other than on the site licensed hereby."); Carlock v. Pillsburg Co., 719 F. Supp. 791, 819 (D. Minn. 1989) ("[T]he franchisor and its parent companies explicitly reserved the right to distribute Haagen-Dazs ice cream by any method."); Patel v. Dunkin' Donuts of Am., Inc., 496 N.E.2d 1159, 1159 (Ill. App. Ct. 1986) (The agreement provided that " 'DUNKIN' DONUTS, in its sole discretion, has the right to operate or franchise other DUNKIN' DONUTS SHOPS under, and to grant other licenses in, and to, any or all of the PROPRIETARY MARKS, in each case on such terms and conditions as DUNKIN' DONUTS deems acceptable.' "); Rado-Mat Holdings, U.S., Inc. v. Holiday Inns Franchising, Inc., No. 76747, slip op. at 4 (N.Y. Sup. Ct. Dec. 13, 1991) ("The Commitment Agreement and License Agreement contains precise language, reserving to itself the right to license any business activity at any location . . . ."); Super Valu Store, Inc. v. D-Mart Food Stores, Inc., 431 N.W.2d 721, 723 (Wis. Ct. App. 1988) ("Super Valu retained the 'right to choose and select its . . . retailers and to enter into Super Valu Retailer Agreements with other parties at Super Valu's sole choice and discretion.' ").

81. *Scheck II*, 798 F. Supp. at 699. Alternatively, Judge Hoeveler states that "these cases can be read as holding that irrespective of whether an exclusive territory is explicitly denied to the franchisee, a court simply cannot imply the covenant of good faith where the contract grants to the franchisor the right to establish additional franchises at any location desired." *Id.* at 699 n.12.

82. *Id.* at 699.

83. *Cf.* Henry H. Perritt, Jr., *Implied Covenant: Anachronism or Augur?*, 20 SETON HALL L. REV. 683, 718 (1990) (discussing employment contracts as opposed to franchise agreements). Ian Macneil largely developed the relational theory of contracts. *See generally* IAN R. MACNEIL, THE

term ongoing contractual relationships such as a franchise agreement.[84] While traditional contract theory focuses on the "discrete transaction," examining the parties' relationship only at the moment of contract formation,[85] relational contract theory contemplates a contractual regime where the parties intend to maintain an ongoing relationship.[86] In relational contract theory, "parties treat their contracts more like marriages than like one-night stands."[87]

In such a contract, it is impossible to "allocate optimally all the risks at the time of contracting" because of the intricacies or uncertainties of "future contingencies."[88] For relational contracts, the traditional contractual analysis is not a "feasible contracting mechanism" because it is impossible to perfectly allocate future risks into well-defined contractual promises.[89] Accordingly, relational contract theory focuses more on preserving the contractual relationship than on interpreting the specific language of the contract.

Under relational contract theory, "[o]bligations are not frozen in an initial bargain. They evolve over time as circumstances change. . . . The object of contracting is to establish and define a cooperative relationship, not merely to allocate risk."[90] Consequently, "parties are obligated to behave in a way that promoted the relationship, and in a way that is consistent with the needs and expectations of both parties."[91]

Thus, classic interpretive methods which focus on the discrete contractual agreement to determine the parties' intent constitute "fundamental error."[92] Relational contract theory recognizes that "wealth

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NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS (1980); Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law*, 72 NW. U. L. REV. 854, 886 (1978); Ian R. Macneil, *Values in Contract—Internal and External*, 78 NW. U. L. REV. 340 (1983); *see also* William C. Whitford, *Ian Macneil's Contribution to Contracts Scholarship*, 1985 WIS. L. REV. 545 (1985).

84. Patricia A. Tidwell & Peter Linzer, *The Flesh-Colored Band Aid—Contracts, Feminism, Dialogue, and Norms*, 28 HOUS. L. REV. 791, 795 (1991); *see also* Perritt, *supra* note 83, at 718 ("Relational contract theory is a way to reduce the artificiality of applying formal contract law doctrines to continuing legal relationships that are best thought about in contractual terms.").

85. John E. Murray, Jr., *The Chaos of the "Battle of the Forms": Solutions*, 39 VAND. L. REV. 1307, 1383 n.263 (1986).

86. Keith A. Palzer, *Relational Contract Theory and Sovereign Debt*, 8 NW. J. INT'L L. & BUS. 727, 728 (1988).

87. Robert W. Gordon, *Macauley, Macneil, and the Discovery of Solidarity and Power in Contract Law*, 1985 WIS. L. REV. 565, 569 (1985).

88. Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1090 (1981).

89. *See id.* at 1090.

90. Perritt, *supra* note 83, at 713.

91. *Id.* at 717. Perritt observes that this "central concept of the relational theory" virtually restates the idea of a covenant of good faith and fair dealing. *Id.*

92. Jay M. Feinman, *The Significance of Contract Theory*, 58 U. CIN. L. REV. 1283, 1303 (1990).

maximization is not the only important aspect of the bargain,"[93] particularly in a long-term contractual relationship.[94] In fact, if one party fails to perform in accordance with the contract, the other party's role is to cooperate and accommodate instead of rigidly requiring technical performance.[95]

Relational contract theory thus "legitimates the implied covenant" of good faith and fair dealing.[96] Moreover, relational contract theory helps clarify "the ways in which the covenant should be understood and applied in actual cases."[97] In emphasizing the preservation of the relationship, relational contract theory expands the traditional contract "norm of contractual solidarity."[98]

Likewise, relational contract theory makes broad use of extrinsic evidence in interpreting contract terms, expanding on the traditional notions of course-of-dealing and trade usage.[99] Relational contract theory requires courts to consider broadly the contractual relationship.[100] Although perhaps acting intuitively,[101] in accordance with the recent development of relational contract theory, courts have increasingly found rights and duties arising out of the parties' dealings with each other throughout the course of their relationship.[102]

Judge Hoeveler also recognized the importance of how Burger King has dealt with its franchisees. While examining Burger King's own policies, which were aimed at protecting franchisees from unlimited expansion, Judge Hoeveler observed that even Burger King dealt with the franchisees as if the Franchise Agreement did not reserve for Burger King the unlimited right to establish additional franchises. Burger King's policies prove that the *Fickling* court was too quick to grant a dismissal. That is, Burger King's policies recognize, at a minimum, that

93. *Id.* at 1302.

94. Tidwell & Linzer, *supra* note 84, at 796. Tidwell and Linzer observe that "a party to a long-term contractual relationship does not always simply seek to maximize her own wealth opportunities, but often also considers the needs and expectations of the other party, with whom she has dealt before and will deal again." *Id.*

95. Perritt, *supra* note 83, at 713.

96. *Id.* at 718.

97. *Id.*

98. Macneil, *Values in Contract-Internal and External*, *supra* note 83, at 362; Perritt, *supra* note 83, at 714.

99. Perritt, *supra* note 83, at 716-17.

100. *See* Feinman, *supra* note 92, at 1303. Of course, a flexible regime of contract interpretation may only lead parties to be more specific in their contracts, and may make long-term contracts more cumbersome in their provisions. Likewise, "imposing a norm of flexibility may cause parties to be more precise in specifying the terms of their contracts and therefore less flexible." *Id.* at 1303-04.

101. Peter Linzer, *Uncontracts: Context, Contorts and the Relational Approach*, 1988 ANN. SURV. AM. L. 139, 166.

102. Tidwell & Linzer, *supra* note 84, at 795 (citing cases as examples).

the parties would deal with the issue of encroachment of additional franchises at some point in the future. Burger King neither promised territorial rights, nor gave itself the right to do whatever it pleased. Consequently, granting a motion for summary judgment would render Burger King's own policies essentially meaningless.[103] Thus, if given effect, Burger King's policies support Judge Hoeveler's interpretation of the Franchise agreement.[104]

Judge Hoeveler's only departure from precedent is "from the *Fickling* court's reading of the language of the Franchise Agreement."[105] Under Judge Hoeveler's reading, the "absence of language in this contract of adhesion which would preserve unto [Burger King] the clear right" to grant competing franchises mandates factual inquiry and consideration of the implied covenant.[106] Thus, the central issue is not whether a covenant of good faith should be implied, but rather whether it applies to the specific provisions regarding territory under consideration.[107]

If Burger King wished to reserve the right to take predatory action, it should have done so clearly and explicitly in the Franchise Agreement.[108] Indeed, Judge Hoeveler suggested that Burger King's problem could easily be solved by clearly and unambiguously inserting into its franchise agreements the right to establish competing franchises.[109] Burger King's ability to rewrite the contract to reserve this right, however, is constrained by the economic consequences because such a contractual revision would reduce the value of a franchise.[110]

The key question under Judge Hoeveler's analysis is why a cove-

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103. Instead, the *Scheck* decision effectuates Burger King's own policies, at least to the extent that they may be considered by a jury.

104. Moreover, even if the contract is read as the *Fickling* court suggests, relational contract theory may suggest that Burger King's own policies ought to be given effect even over express terms to the contrary. *See* Perritt, *supra* note 83, at 716-17. Although, "[i]t is ironic to say that conduct 'interprets' terms when it practically rebuts express terms or dramatically changes them." *Id.* at 717.

105. *Scheck II*, 798 F. Supp. 692, 699 (S.D. Fla. 1992).

106. *Id.*

107. *Id.*

108. *Id.*

> If a franchise agreement gives the franchisor the right to build (or permit building) another store next door to the one earlier permitted, it had better say so in clear terms. If it does not—if the franchisor has not given unto itself the right to be predatory—then it should be prepared to defend its position on a good faith—that is, reasonable conduct—basis.

*Id.* at 699-700.

109. *Id.* at 700.

110. Because "there are very few companies that can do that without affecting the marketability of their concepts." Martin, *supra* note 3, at 78 (quoting general counsel to the International Franchise Association, Philip F. Zeidman).

nant of good faith and fair dealing should be implied, not whether the covenant should be implied.[111] In *Scheck*, implying a covenant of good faith and fair dealing would bring the franchise arrangement into an open competitive market. On the other hand, interpreting the contract as denying the franchisee an exclusive territory and granting Burger King the right to establish competing franchises at any location would permit the franchisor to receive more than fair market value for the sale of a franchise. Beyond implied covenant doctrine, an analysis of the Burger King Franchise Agreement under the concepts of game theory provides insight into how and why Judge Hoeveler's decision is correct.

### B. *Modern Game Theory as a Basis for Understanding the Court's Opinion*

Game theory[112] is a theory to predict the rational behavior by two or more interacting rational individuals, each determined to maximize his own interests as determined by individual utility or payoff.[113] These interests may include selfish and unselfish components.[114] The underlying assumptions of classic game theory[115] include the following: (1) each individual seeks to maximize individual utility; (2) the various possible outcomes of a particular situation are well-specified; (3) individuals have consistent preferences among outcomes; and (4) all individuals

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111. You can give any conclusion a logical form. You always can imply a condition in a contract. But why do you imply it? It is because of some belief as to the practice of the community or of a class, or because of some opinion as to policy, or, in short, because of some attitude of yours upon a matter not capable of exact quantitative measurement, and therefore not capable of founding exact logical conclusions.

Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 465-66 (1897).

112. Although the title is perhaps misleading, "game theory" is "the study of the basic elements of many person conscious conflict and cooperation. It deals, at a high level of abstraction, with the description and analysis of multiperson cross-purposes optimization." Martin Shubik, *Game Theory, Law, and the Concept of Competition*, 60 U. CIN. L. REV. 285, 285 (1991).

> The key elements in the development of the theory of games are (1) the formal description of the games; and (2) the proscription or description of how the game is or should be played. The former involves the formalization of the rules of the game. . . . The latter provides normative or behavioral solution theories dealing with how the game should be or is played.

*Id.* For an interesting review of Shubik's paper, see Ian Ayres, *Three Approaches to Modeling Corporate Games: Some Observations*, 60 U. CIN. L. REV. 419 (1991).

113. Harsanyi, *Advances in Understanding Rational Behavior*, *in* RATIONAL CHOICE 82, 89 (J. Elster ed. 1986) (emphasis omitted).

114. *Id.* That is, motives are not necessarily economic or short term, and sanctions are not always legal. *See* David Charny, *Nonlegal Sanctions in Commercial Relationships*, 104 HARV. L. REV. 373 (1990).

115. *See generally* THOMAS C. SCHELLING, THE STRATEGY OF CONFLICT 162-72 (1963) (describing classic game theory); R. DUNCAN LUCE & HOWARD RAIFFA, GAMES AND DECISIONS: INTRODUCTION AND CRITICAL SURVEY (1957) (same).

know the preference patterns of others.[116] Game theorists, however, concede that reality is not necessarily reflected in these assumptions.[117]

In fact, classic game theory's usefulness has been criticized for "deal[ing] with games so well defined that there is no room for bargaining."[118] More importantly, the classic models generally do not consider misinformation.[119] Accordingly, "[m]uch of the color of bargaining, and with it much of what makes a real difference to whether it goes one way or another, escapes such models."[120] Therefore, modern game theory focuses on noncooperative games involving individuals with asymmetric and imperfect information, and relaxes the assumptions of classic game theory.[121]

Modern game theory is a particularly useful tool for analyzing the formation of Burger King's "contract of adhesion"[122] Franchise Agreement because of asymmetric and imperfect information available to the parties.[123] In this agreement, information is particularly important because the agreement requires an initial allocation of the risks of long-term future contingencies.[124] The disparity of information available to Burger King and its franchisees, including the degree to which the contract grants protection from predatory acts by Burger King, illustrates the correctness of the court's decision.

As previously noted, Burger King's Franchise Agreement explicitly denies an exclusive territorial interest to the franchisee.[125] The contract is silent, however, regarding Burger King's right to establish franchises in close proximity to existing Burger King restaurants.[126] This silence is a windfall for Burger King if the contract offers no protection to a franchisee.

Without a specific clause in the Franchise Agreement granting Bur-

116. Elizabeth S. Scott, *Pluralism, Parental Preference, and Child Custody*, 80 CAL. L. REV. 615, 643-44 n.85 (1992) (citing LUCE & RAIFFA, *supra* note 115, at 4-5).

117. *See, e.g.*, SCHELLING, *supra* note 115, at 4; LUCE & RAIFFA, *supra* note 115, at 5.

118. David Braybrooke, *The Possibilities of Compromise*, 93 ETHICS 139, 144 (1982).

119. *Id.*

120. *Id.*

121. *See* Scott, *supra* note 116, at 643-44 n.85. For a thorough analysis of modern game theory, see ERIC RASMUSSEN, GAMES AND INFORMATION: AN INTRODUCTION TO GAME THEORY (1989).

122. *Scheck II*, 798 F. Supp. 692, 699 (S.D. Fla. 1992).

123. For a comprehensive treatment of an imperfect information model of standardized form contracts, see Avery Katz, *The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation*, 89 MICH. L. REV. 215, 272-93 (1990).

124. *See* Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CAL. L. REV. 2005 (1987) (providing a thorough analysis of the decisionmaking strategies of parties to long-term commercial contracts using the techniques of modern decision analysis and game theory).

125. *Scheck I*, 756 F. Supp. 543, 549 (S.D. Fla. 1991) (citing Franchise Agreement § 1).

126. *Scheck II*, 798 F. Supp. at 696.

ger King the right to establish Burger King restaurants at any location it selects, a franchisee may have expectations that some degree of protection from predatory acts by Burger King exists.[127] Courts should protect these expectations where they are reasonable. When a court does not find such expectations reasonable, the franchisee receives no protection and Burger King reaps the benefits of predatory action without giving consideration. In such circumstances, Burger King can charge a higher price for a franchise than it would have if the franchisee understood that its sizable investment could be attacked by the placement of a competitive Burger King anywhere and at any time.[128] A decision that did not imply a covenant of good faith and fair dealing, such as the *Fickling* decision,[129] would effectively grant Burger King the ability to receive the benefits of a specific clause, without bargaining for it and without a reduction in price to reflect the franchise's diminished value. In the instant case, if Judge Hoeveler had determined that the contract granted no protection to Scheck despite his expectations, then Scheck paid an unfairly high price for the franchise.

Judge Hoeveler's decision is economically correct because it unequivocally implies a covenant of good faith, establishes some protection from predatory acts, and forces franchisors to compensate franchisees for market intrusions. Thus, even if Burger King chooses not to rewrite the contract in any fashion, the *Scheck* decision forces Burger King to buy out its existing franchisees before it can establish franchises located in the same vicinity. Thus, the franchise will approach actual open competitive market value.

One side effect to the *Scheck* decision is that the franchisee will have increased bargaining power. Although, Burger King has the informational advantage in the macro-economy, the micro-economic advantage often belongs to the franchisee, particularly once the franchisee has been operating for some time. If there is imperfect information, Burger King will have an experience and expertise advantage over a new fran-

127. Even Burger King's own policies indicate that Burger King expected that a franchisee would have some protection from Burger King establishing additional franchises without limitation. Franchisees are justified in their expectations that Burger King had not reserved to itself the right to unconditionally grant additional franchises since Burger King's own policies expressly protect franchisees from the effects of such a reservation of power. *Scheck II*, 798 F. Supp. at 549, 549 n.12. Further, Scheck's complaint contained a pleading of fraud, alleging that Burger King continuously stated that it has a policy of protecting franchisees by not establishing additional franchises near existing franchises.

128. Scheck purchased the restaurant property for $690,000 and made $200,000 in renovations, according to his Miami attorney, Robert Zarco. John H. Kennedy, *Suit Argues Lee can't Support 2 Burger Kings*, BOSTON GLOBE, July 7, 1992, Economy Section, at 37.

129. [1987-1989 Transfer Binder] Bus. Franchise Guide (CCH) ¶ 9099, at 18,825 (4th Cir. 1988) (unpublished opinion).

chisee. If, however, Burger King is forced to purchase territorial rights from an established franchise, the franchisee will have the advantage in the bargaining process because the franchisee knows the profit margin of the franchise and has a greater understanding of its market value. Moreover, the franchisee knows that Burger King will pay nearly as much for these territorial rights as it would receive for the new franchise it wants to establish.[130] This is because Burger King can make its profit in a narrow margin, as long as it can sell a new franchise for slightly more than it needs to pay for the territorial rights.

On the other hand, if the contract includes an explicit clause granting exclusive territory to the franchisee or reserving the franchisor's right to establish additional franchises for Burger King, the parties have bargained for protection from predatory acts. In that scenario, the price of a Burger King franchise reflects an open competitive market, and includes the price of territorial exclusivity.[131] If *Scheck* forces Burger King to rewrite its form franchise agreement, then Burger King, the drafter of the contract of adhesion, will have the burden of creating a provision which explicitly grants itself territorial rights.[132]

Even though the Franchise Agreement is an adhesion contract in form,[133] it may be less of an adhesion contract in economic reality. Franchisees may be "little guys" relative to franchisors, but they do have the power to walk away from Burger King's offer. At the point of entry into a contract, at least, the franchisee has alternative investment options.

In future contracts, Burger King must decide whether to rewrite its franchise agreements to include a term of territorial exclusivity, reserve the unlimited right to establish additional franchises, or wait until it wants to develop additional franchises to purchase those rights from existing franchises. It is the position of this Note that it is in Burger King's interest to bargain for the buyout at the time of contract formation because Burger King is then favored by imperfect information. By forcing Burger King to choose between these options, the court has brought Burger King's Franchise Agreement into an open economic market.

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130. Burger King will receive the new franchise fee less transaction costs, yielding the smallest profit.

131. Of course, a franchisee may wish to pay for exclusivity, while a franchisor may wish to pay for "predatory" rights or for the reservation of the rights to establish additional franchises.

132. This Note does not address situations where there is a seller's market. If there are very few franchisors supplying franchises, *Scheck*'s impact is significantly decreased because the franchisees have substantially less bargaining power.

133. *Scheck II*, 798 F. Supp. 692, 699 (S.D. Fla. 1992).

## IV. CONCLUSION

*Scheck v. Burger King Corp.* is correct both from a legal perspective and from an economic standpoint. The traditional rights of franchisors to open additional franchises at will[134] have been protected by the courts.[135] Although most franchise agreements confer territorial exclusivity upon franchisees by their terms,[136] some franchisors seek to have their rights to expand restricted by nothing but their own discretion.[137]

The court in *Scheck* held that when franchisors do not specifically reserve the right to establish additional franchises at will, franchisors' discretion to expand must be exercised in good faith. There is no question that the Franchise Agreement expressly denies Scheck an exclusive territorial interest.[138] Yet, the court also found that the Franchise Agreement did not specifically reserve for Burger King the right to open franchises at will regardless of the effect on its other franchises.[139] The court, thus, quite correctly departed from the *Fickling* court's loose reading of both the contractual language and of precedent regarding the implied covenant of good faith.[140]

The *Fickling* court agreed with the franchisor's assertions. That court's interpretation of precedent rejected the use of the covenant of good faith and fair dealing "to infer or imply territorial protection or exclusivity."[141] Further, the *Fickling* court protected franchisor interests and sought to avoid creating "a zone of territorial protection for a franchisee when the operative franchise agreement confers none."[142] Thus, the *Fickling* court found itself compelled by the Florida rule that "the obligation of good faith will not be implied in derogation of the express terms of a contract."[143] The *Fickling* court's decision is troubling because it narrowly reads franchise case law[144] and ignores economic perspectives.[145]

The Burger King Franchise Agreement fails to preserve the clear

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134. *Franchise Furor*, *supra* note 1, at 37.

135. Kaufmann, *Update*, *supra* note 1, at 7.

136. Kaufmann, *Threshold Issues*, *supra* note 7, at 329.

137. Kaufman, *Update*, *supra* note 1, at 7.

138. *Scheck II*, 798 F. Supp. 692, 694 (S.D. Fla. 1992).

139. *Id.* at 694, 699.

140. *Id.* at 699-700.

141. Kaufmann, *Threshold Issues*, *supra* note 7, at 329; *see* Kaufmann, *Update*, *supra* note 1, at 7.

142. Kaufmann, *Update*, *supra* note 1, at 1.

143. *Scheck II*, 798 F. Supp. at 699.

144. *Id.* at 698-700.

145. *See* discussion of game theory *supra* part III.B.

right to establish Burger King restaurants at any location it selects.[146] In the absence of such clear language, to allow Burger King the unfettered right to open franchises defeats the open competitive market. Under the *Fickling* court's analysis, Burger King pays nothing for, and collects payment despite, the "unfettered" right.

After *Scheck*, Burger King will be forced to bargain for territorial rights. The *Scheck* opinion is more economically sound than the prior approach used by Florida courts, because it prevents Burger King from utilizing the term of the contract that denies a franchisee an exclusive territorial interest to destroy the fruits of the contract. *Scheck* validates the " 'growing effort by franchisees and their lawyers to use the doctrine of implied duty of good faith and fair dealing' to restrain franchisors."[147] Unquestionably, the *Scheck v. Burger King Corp.* decision will restrict Burger King's ability to expand at its own discretion, and will affect the battle for territorial rights between franchisors and their franchisees.

ADAM B. LEICHTLING

146. *Scheck II*, 798 F. Supp. at 699-700.

147. Martin, *supra* note 3, at 78 (quoting Philip F. Zeidman, general counsel to the International Franchise Association).