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2025 Judicial Update

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FRANCHISE RELATED VICARIOUS LIABILITY – WAIT, WHAT?

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FRANCHISE-RELATED VICARIOUS LIABILITY – WAIT, WHAT?

1. INTRODUCTION

The fact patterns of third-party suits against franchisors are familiar: a customer is injured at a franchised location, or a member of the public is injured by a delivery driver.[1] In addition to presenting complex legal and factual issues, courts also reckon with the reality that the franchisor may be the only party with the ability to pay substantial damages. As a result, these difficult cases can lead to the making of bad law.

Franchising works because it allows the franchisor and the franchisee to pull the oars in the same direction while devoting their respective energy and resources to controlling different portions of the enterprise. The franchisor focuses on developing the system and protecting the brand, while the franchisee controls the day-to-day operations of the individual unit location. Some franchisor control over the presentation of the product or service by the franchisee is necessary in franchising. While some amount of franchisor control over the presentation is necessary, too much control over how the franchisee operates can lead the franchisor into legal jeopardy.

For several years, the conventional wisdom among many franchise practitioners was that the trend was toward franchisors not being held liable for acts occurring at the franchisee location in the absence of excessive control over the particular instrumentality or undertaking of a direct duty to the third party. But recent cases demonstrate that courts are willing to hold franchisors liable to third parties. We consider recent trends in the law and offer practical suggestions for mitigating risks.

2. LIABILITY THEORIES APPLICABLE TO THE FRANCHISOR

2.1. Vicarious Liability

Vicarious liability typically arises through the application of one or both of the following theories: (1) actual agency; and/or (2) apparent agency. Third parties frequently pursue both theories. And a franchisor can win the apparent agency battle, but still lose the war on actual agency or vice versa. The following section summarizes how these theories have been applied in franchise cases over the years.

2.1(i). Actual Agency

In deciding whether a franchisor may be held vicariously liable under the actual agency theory, courts consider whether the franchisor controls, or retains the right to control, the day-to-day operations of the franchisee's business.[2] The tricky part with this seemingly straightforward test is determining when, exactly, a franchisor retains or exercises the requisite amount of control required to push the franchisor over the line to

[1] Vicarious liability can also arise in the joint employer context. The discussion in this paper is limited to non-joint employment third-party claims.

[2] *See* Restatement (Second) of Agency § 220 (1958).

being vicariously liable for the franchisee's acts. This determination is often fact intensive and may prevent summary adjudication.

Courts applying this rule to very similar franchise systems can arrive at very different conclusions. *Compare, e.g.*, *Martinez v. Higher Powered Pizza, Inc.*, 841 N.Y.S.2d 526 (N.Y. App. Div. 2007) (characterizing franchisor rights to enforce standards in areas such as food quality and preparation, hours of operation, menu items, employee uniform guidelines and packaging requirements along with inspection rights as "the typical franchise agreement" and concluding the franchisor could not be held liable) with *Parker v. Domino's Pizza, Inc.*, 629 So. 2d 1026, 1029 (Fl. Ct. App. 1993) ("veritable bible for overseeing a Domino's operation" ad holding franchisor's right to control left issues of fact for a jury to decide).

Prior to 2020, a trend seemed to emerge toward unwillingness to find franchisors vicariously liable for the acts of the franchisee. The Texas Supreme Court in *Exxon Corp. v. Tidwell*, 867 S.W.2d 19 (Tex. 1993), refined the traditional test of actual agency in the franchisor vicarious liability context to hold that the proper inquiry is focused upon whether the franchisor had control over the instrumentality causing the harm — in that case, control over the security of the franchise location. That trend generally continued in the following years. *See, e.g.*, *Wu v. Dunkin' Donuts, Inc.*, 105 F. Supp. 2d 83 (E.D.N.Y. 2000), *aff'd* 4 Fed. Appx. 82 (2d Cir. 2001); *Vandemark v. McDonald's Corp.*, 904 A.2d 627 (N.H. 2006) (narrowing inquiry to "the defendant's level of control over the alleged 'instrumentality' which caused the harm"); *Thomas v. Freeway Foods, Inc.*, 406 F. Supp. 2d 610 (M.D.N.C. 2005).

2.1(ii). Apparent Agency

Apparent agency is another common theory asserted by vicarious liability plaintiffs. Under this doctrine, the court examines whether an agency relationship between the franchisor and franchisee was "apparent" to the plaintiff or was such that the franchisor is estopped from denying the existence of such a relationship.[3]

These claims are often predicated on the notion that the franchisor holds out the franchisee as its agent through its national adverting and common trademarks, which lead a third party to believe that the franchised operations are operated by the franchisor. Courts typically apply some variation on the following three elements: (1) the franchisor consciously or impliedly represented the franchisee to be its agent; (2) the third party detrimentally changed his or her position in reliance on the representation; and (3) the third party reasonably relied on the representation. No matter how the test is phrased, the common element is the requirement of reliance by the third party.

[3] The test is articulated in the Restatement (Second) of Agency § 267 (1958), which provides:

> One who represents that another is his servant or other agent and thereby causes a third person justifiable to rely upon the care or skill of such apparent agent is subject to liability to the third person or harm caused by the lack of care or skill of the one appearing to be a servant or other agent as if he were such.

Like actual agency cases, apparent agency cases seem to go in both directions on indistinguishable facts. *Compare, e.g.*, *Brooks v. Collis Foods, Inc.*, 365 F. Supp. 2d 1342 (N.D. Ga. 2005) (holding Waffle House did not hold out its franchisee as an agent, applying Georgia state law of apparent agency, in a racial discrimination claim brought by restaurant patrons because the franchisee used the logo and signage rather than the franchisor representing the franchisee was its agent) with *Thomas*, 406 F. Supp. 2d at 618-19 (jury to decide whether the franchisor held out the franchisee as its agent, because the franchisee used the Waffle House name and mark throughout the restaurant and because Waffle House didn't distinguish between franchised and company-owned stores on its website). That said, the consensus was among those practitioners that courts were increasingly reluctant to hold franchisors liable on an apparent agency theory.

2.2. Direct Liability

Franchisors may also be held directly negligent for injuries occurring on the franchisee's premises where the franchisor is found to have assumed and breached some sort of duty to the third party, by causing the injury.

Allen is instructive on the analysis applied. 409 F. Supp. 2d 672. *Allen* involved claims made against a hotel franchisor for injuries resulting from an arson. With respect to direct liability, the plaintiff argued that franchisor Choice Hotels had assumed a duty to require its franchisee to install sprinklers at the franchised location, even though there was no dispute that the building complied with all applicable building codes without the sprinklers, by requiring the franchisee to make certain renovations when it joined the Choice Hotels system. *Id.* The plaintiff also cited system standards as an alleged assumption of a duty to the plaintiff.

The court first noted that it had located no case in which a franchisor was held to have a duty to require a hotel which complies with the relevant fire and building codes to retrofit the building with sprinklers and concluded that the franchisor had no such duty. The court next considered the controls put in place in the franchise agreement and operations to determine whether Choice Hotels had assumed a duty through its controls. The court concluded it had not, reasoning that the purpose of the franchise agreement and operating manuals was "to ensure a similar experience at all . . . franchise locations" and "maintain uniform service within, and public good will toward the . . . system." *Allen*, 409 F. Supp. 2d at 677. The court characterized Choice's actions in requiring renovations as "merely guard[ing] its trademark by assuring uniform appearance and operations of hotels operating under the [system's] mark.

3. RECENT DECISIONS

3.1. Actual Agency Cases

In a case decided in January 2025, a Pennsylvania Superior Court upheld a jury verdict holding Domino's Pizza LLC liable under an actual agency theory for injuries caused by a delivery driver employed by a Domino's franchisee. *Coryell v. Morris*, 330

A.3d 1270, 1284 (Pa. Super. Ct. 2025). Although Domino's argued that it did not have, and did not exercise, authority to recruit, hire, train, or supervise the franchisee's employees, the court found that the franchise agreement and operating standards left the franchisee with "practically no discretion how to conduct the day-to-day operations of its franchise store." *Id.* at 1282. The court noted that Domino's governed areas of operation including the topics that must be covered in employee training, how much cash drivers were allowed to carry in delivery vehicles, acceptable computer and server models, recordkeeping of weekly or monthly sales, and dealing with customer complaints. *Id.* at 1282-83. A key factor in the court's analysis was the fact that "violation of these operating standards… subjected [the franchisee] to termination of its franchise." *Id.* at 1283. The court ultimately found that Domino's "used its operating standards to continuously subjugate [the franchisee] to Domino's will as to the minutia of the store's staffing and daily operation far beyond the minimum quality threshold addressed by the product standards." *Id.*

However, in a very similar case, the Kentucky Court of Appeals reversed summary judgment for the plaintiff, finding that Domino's was not liable for the plaintiff's injuries under an agency theory because it did not exercise the requisite level of control over deliveries. *Duram v. Domino's Pizza, LLC*, 2024 WL 1122350, at *8 (Ky. Ct. App. Mar. 15, 2024). There, the court noted that Domino's unilaterally set the delivery boundaries for the franchisee and required the franchisee to adhere to the Domino's operating standards, which included minimum requirements for the hiring and training of delivery drivers and general delivery procedures. *Id.* at *4. Domino's contended that these minimum standards were imposed on franchisees "to protect the integrity, public perception, and reputation of its brand," and it did not maintain day-to-day control over the franchisee's driving operations. *Id.* The court agreed with Domino's that these factors were insufficient evidence of Domino's control over daily delivery operations and found that Domino's was not vicariously liable for the delivery driver's negligence. *Id.* at *6.

Franchisor vicarious liability can extend beyond just tort claims. The Western District of North Carolina recently allowed breach of contract claims to proceed against the franchisor for Extended Stay America. *Brittian v. Extended Stay America*, 2024 WL 1841600, at *5 (W.D.N.C. Apr. 26, 2024). Plaintiff, who had been denied access to her hotel room based on her placement on a "Do Not Rent" list, plausibly alleged an actual agency relationship between the franchisors and the hotel where the franchisors maintained a nationwide "Do Not Rent" list through its central reservation and property management system, maintained a nationwide policy and practice of using the list to refuse accommodation to guests, and permitted hotel staff to place complaining customers on the list. *Id.*

Franchisors may also be vicariously liable under an agency theory for statutory claims including, for example, the Trafficking Victims Protection Reauthorization Act ("TVPRA"), under which a hotel franchisor might be liable if it knowingly benefits from and fails to prevent trafficking. For example, the Eastern District of North Carolina has found that a TVPRA plaintiff plausibly alleged a hotel franchisor's agency control over its hotel where it controlled all details of the reservation, check-in, and payment process,

maintained reservations through a central system that it controlled, restricted the ability of hotel staff to refuse or cancel a reservation, and controlled policies related to reported suspected crime on franchisee premises. *Doe (L.M.) v. 42 Hotel Raleigh, LLC*, 2024 WL 4204906, at *8-9 (E.D.N.C. Sept. 16, 2024).

3.2. Apparent Agency Cases

A recent decision by the California Court of Appeal found that for a franchisor to be vicariously liable under an ostensible agency theory, the appearance of agency "must be based on the acts or declarations *of the principal* and not solely upon the agent's conduct." *Pereda v. Atos Jiu Jitsu LLC*, 85 Cal.App.5th 759, 768 (2022) (citations omitted). In *Pereda*, a jiu jitsu league was not liable for the plaintiff's injury sustained at an affiliate's studio under the ostensible agency theory of liability where the league never had "an affirmative advertising campaign" conveying its relationship with affiliates, nor did it "do or say anything to give rise to a reasonable belief that [the league] was in control of the [affiliate's] sparring sessions." *Id.* at 773. The only facts supporting the plaintiff's belief that the league controlled the affiliate were that the affiliate displayed the league's banner in its studio, the league's website listed the affiliate under its trade name, and the league never affirmatively disclaimed its control over the affiliate. *Id.* at 772. These facts were insufficient to establish ostensible agency.

3.3. Direct Liability Cases

In *Neely v. Great Escapes Pelahatchie*, the court found that a franchisor was not liable for the plaintiffs' contraction of E. coli at a water park franchisee's pool under direct negligence liability. 2024 WL 5126415, at *8 (S.D. Miss. Dec. 16, 2024). Although the franchisor "set many quality-assurance standards in its 800-plus page Brand Standards Manual, it prescribed no details for pool chlorination and assumed no control over the pools' day-to-day operations and maintenance." *Id.* at *1. The fact that the franchisor heard complaints about the water and had the authority to make sure complaints were addressed was insufficient to establish control, because this only implicated control "on an operational level." *Id.* at *8.

A franchisor may be directly liable to a plaintiff if its level of control over the franchisee extends to the means, methods, or details of how the franchisee conducts its business. The Texas Court of Appeals found that a franchisor owed a duty of care to a customer who had been sexually assaulted by a masseuse at one of its massage franchisees where the franchise operations manual specified "how to train masseuses; how masseuses were to earn the customer's trust; how masseuses were to interact with clients before, during and after sessions; what massages the masseuses offered; and how the masseuses were to drape undressed guests." *Massage Heights Franchising, LLC v. Hagman*, 679 S.W.3d 298, 305 (Tex. App. 2023). The fact that the franchise maintained the authority to hire, fire, and train its staff did not excuse the franchisor from

its "duty to act reasonably with regard [to] the detail over which it did retain control—providing massages to customers by masseuses." *Id.* at 305-6.[4]

In *Daniel v. Musleh Fitness Inc.*, the court denied the franchisor's motion to dismiss the plaintiff's Title VII discrimination claims. 2024 WL 983751, at *3 (N.D. Ind. Mar. 7, 2024). The plaintiff alleged that she had been denied rehire at a different location after she rejected the franchisee's manager's proposition for sexual favors in exchange for the position. *Id.* at *1. She also alleged that the franchisor retained control over the franchisee by requiring compliance with federal and state laws in employment practices, providing an operations manual, providing mandatory training to the principal operator of the franchisee, and offering sexual harassment training and reviewing the franchisee's personnel decisions. *Id.*

4. MANAGING AND MITIGATING THE RISKS

The cases discussed above teach that franchisor controls are not created equal. The key to avoid undue litigation exposure is to distinguish control over the final product or service from control over the day-to-day operations of the franchisee's business. Franchisor control over the final product or service can be accomplished through a variety of "good" controls, including:

- Defining the permissible scope of use of the trademarks;
- Requiring conditions that allow for uniformity of the system's product or service;
- Mandating steps to protect the goodwill and reputation of the trademarks; and
- Controlling the establishment of system standards.

On this last control, a franchisor should tailor its approach to the standard at issue. For example, if the standard in question involves a proprietary method of business unique to the system, a franchisor may more justifiably establish required procedures to assign the franchisee to meet the standard. With more general and nonproprietary system standards (like general cleanliness standards, for example), a prudent franchisor offers guidelines or recommended procedures to assist the franchisee with compliance but does not mandate compliance down to minute details.

Conversely, a franchisor ventures into the realm of "bad" controls when the franchisor dictates precisely how the franchisee is to undertake the daily operations of the franchised business. For example, a franchisor increases its litigation risks by:

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[4] *See also Doe v. Massage Envy Franchising, LLC*, 2024 WL 3220281, at *16 (Del. Super. June 28, 2024) (plaintiff who was sexually assaulted by a masseuse plausibly alleged franchisor owed her a duty of care where the franchisee had to operate "under the direction of [franchisor] and its operations manual" and the franchisor "retains a centralized repository for the internal management and storage of any and all sexual assault reports that occur at the franchise level.").

- Prescribing details of the franchisee's business operations, such as dictating the number of staff;

- Requiring specific safety or security measures; or

- Involving itself in the franchisee's employee relations.

Below, we lay out some types of provisions to consider for the franchise agreement, and approach to systems standards and interactions with the franchisee in order to mitigate franchisor liability risks.

4.1. Suggestions for the Franchise Agreement

4.1(i) Include a Provision that States that Franchisor and Franchisee Are Independent Contractors and Not Each Other's Agents

It is standard for franchise agreements to include provisions that state that either or both of the franchisee and franchisor: (1) are independent contractors; and (2) not agents of one another. Although such provisions do not end the inquiry, courts continue to routinely cite such provisions in rejecting contentions that the franchisor is vicariously liable for the franchisee's actions.

The *Neely* case presents a recent example:

> [N]othing in this Agreement is intended to make either party a general or special agent, joint venturer, partner, fiduciary or employee of the other for any purpose.

Yogi Bear's Jellystone Park Camp-Resort Franchise Agreement referenced in *Neely v. Great Escapes Pelahatchie*, 2024 WL 5126415, at *1 (S.D. Miss. Dec. 16, 2024).

The *Vandemark* case has another example:

> *Licensee not an Agent of Licensor.* Licensee shall have no authority, expressed or implied, to act as agent of Licensor, McDonald's . . . Licensee is, and shall remain, an independent contractor responsible for all obligations and liabilities of, and for all loss or damage to, the Restaurant and its business.

McDonald's License Agreement quoted in *Vandemark v. McDonald's Corp.*, 904 A.2d 627, 629 (N.H. 2006).

4.1(ii). Limit overly broad reservations of rights

Franchisors should also avoid contract provisions that gave the franchisor overly broad rights to control franchisee operations, except as truly needed for brand protections. Sweeping reservation clauses – for example, reserving the right to enter the

premises and assume complete control of operations under certain conditions – can be used in establishing franchisor rights of control.

In one case, a court denied summary judgment for franchisor largely because the franchise agreement allowed intrusive control over the operational details of the business. Even though the franchisor had not exercised the authority, the right to do so was held to be enough to create an issue of fact for a jury. *Estate of Anderson v. Denny's Inc.*, 987 F. Supp. 2d 1113 (D.N.M. 2013). To mitigate this risk, a franchisor should consider narrowing any step-in rights to specific events, such as health emergencies for misuse of trademarks, and clarify that such rights are temporary measures and limited to only matters necessary to protect the brand.

4.1(iii). Make it Clear that the Franchisee Operates the Business

The franchisor should build in decision-making power for local employment and operational decisions. The franchise agreement should specify that the franchisee has sole authority over hiring, firing, training, scheduling and supervision of its employees. For example, in the *Patterson* case, the franchise agreement stated that the franchisee was "solely responsible" for recruiting, hiring and training of staff and the franchisor stayed out of those functions. *Patterson v. Domino's Pizza, LLC*, 60 Cal.4th 474, 177 Cal. Rptr. 3d 539, 333 P.3d 723, 725 (2014). This was key to avoiding liability.

4.1(iv). Require the Franchisee to Comply with the Law

Vicarious liability claims often arise as a result of alleged violations of some law by the franchisee. Where the franchisee's failure to comply with the law results in a claim against the franchisee, the franchisor improves its claim against the franchisee for indemnification and its defense of the third-party claim if the franchisee has agreed to comply with all relevant laws. Thus, a franchise agreement should contain an appropriately tailored variant of language placing responsibility for compliance with all applicable laws on the franchisee.

The language can be simple. For example:

> Franchisee must at all times maintain Franchisee's premises and conduct operations in compliance with all applicable laws, regulations, codes and ordinances. Franchisee must secure and maintain in force all required licenses, permits and certificates relating to the Franchised Business.

Training, Site Selection, Construction, Opening, THE ANNOTATED FRANCHISE AGREEMENT . No outsiders are invited to the ceremony. Members only. Oh good. I asked Lesley about that and had her back, and I'm glad that Maria just took care of it. At 78 (Nina Greene, Dawn Newton, & Kerry Olson eds., 2018). A franchisor can also consider additional language referring specifically to laws or regulations of particular importance to the franchised business. *See id.*, *Operation of the Business* at 90-91 for an example of a more detailed clause.

4.1(v). Include Well Drafted Indemnification Provisions

The franchise agreement should contain a broad promise by the franchisee to indemnify, defend, and hold harmless the franchisor from claims of third parties relating in any way to or arising from the operation of the franchised business. The franchisor should also consider whether to include a provision that permits the franchisor to retain its own counsel, at the franchisee's expense, to defend the franchisor in vicarious liability litigation. Care is required in drafting such language, both because of the rule that agreements are construed against the drafter and because commitments to indemnify are generally construed narrowly by the courts.

The franchisor should also consider whether it will require its franchisees to indemnify the franchisor for the franchisor's own negligence. In certain states, a party cannot be indemnified for its own negligence in the absence of an explicit commitment to do so that includes the word "negligence" in the indemnification clause. Other states permit indemnification for a party's own negligence, even if the term isn't used.

Finally, courts will not enforce agreements purporting to indemnify a franchisor for the franchisor's own intentional torts, and including such language in a commitment to indemnify may increase the risk of having the entire indemnification provision being found unenforceable.

4.1(vi). Require and Enforce Insurance

Every franchise agreement should contain a provision requiring the franchisee to identify the franchisor as an additional insured on the franchisee's liability policy. The franchisor should also specify a minimum dollar value for coverage and consider setting a minimum insurance rating for the company issuing the policy. But the most thoughtful insurance clause in the world is not worth the paper that it is printed on without vigorous enforcement by the franchisor. A franchisor is well advised to have a process to ensure that a franchisee's insurance is in place and current. The franchisor should also take action against the franchisee failing to meet insurance requirements.

4.1(vii). Require Franchisee to Disclose Independence

As discussed above, franchisors must avoid representing that the franchisee is its agent. In addition to avoiding making such representations itself, a prudent franchisor requires that franchisees disclose their independent status to customers in such a way that customers will notice the disclosure. Familiar examples include requiring a franchisee to display a placard in public areas disclosing its status as an independently owned and operated business. *Allen v. Greenville Hotel Partners, Inc.*, 409 F. Supp. 2d 672 (D.S.C. 2006). Another common practice is to require that the franchisee entity have a business name that dissimilar from the franchisor's name or marks, in order to distinguish the business entities, even if the franchisee does business under the franchisor's trademarks.

Such disclosure should also be enforced as part of the franchisor's inspection and compliance program. While there are many cases that stand for the proposition that

the presence of a sign might not always be enough, courts declining to find apparent agency routinely rely on signs and other notices of independent status both to find that the franchisor was not holding out a franchisee as its agent and that the third party could not have reasonably relied on a representation where such a disclosure existed.

Likewise, a franchisor that is silent when made aware that a franchisee is purporting to act on its behalf is at considerable peril of being deemed to be in an agency relationship with the franchisee. Thus, a franchisor should be aware of franchisee communications and step in if necessary to clear up any confusion.

4.1(viii). System Standards and Communications with Franchisees

System standards are rules that may be changed from time to time established by the franchisor to be followed by franchisees in the operation of the franchise. Franchisors consider fundamental the notions that franchisee compliance with standards is mandatory, and that the standards may periodically be changed by the franchisor. But this very control is frequently relied upon by litigants seeking to hold a franchisor vicariously liable.

Plaintiffs' lawyers routinely point to the system standards set forth in the operations manual and communications between franchisor and franchisee personnel (like periodic inspection reports) as evidence of the requisite control over the franchisee's operations. System standards are cited by plaintiff's counsel as the ultimate right of control because the test of actual agency is the right of the franchisor to control the actions of the franchisee. System standards may be argued to infringe on the franchisee's right of control of day-to-day operations (for courts applying the broader test) and are argued to constitute control over the instrumentality causing the injury (for those courts following the narrower formulation). Still, the cases provide guidance on system standards that a franchisor can proactively use.

4.1(viii)(a). Recommendation versus Requirement

Franchisors should limit requirements imposed in system standards to those that are truly crucial to brand protection, and couch other standards as recommendations. *K.O. v. G6 Hospitality, LLC*, 728 F. Supp. 3d 624 (E.D. Mich. 2024) (collecting cases for the proposition that a franchise agreement that ensures uniformity and standardization of products and services offered did not amount to "obligations" that "affect the control of daily operations").

Couching operating standards that franchisees must meet as recommendations rather than requirements (particularly in the areas of franchisee employee relations and location safety) reduces franchisor liability risks. Courts in several cases relied explicitly and heavily on the franchisor making only recommendations about the security at the franchised locations, in concluding that the franchisor could not be held liable. *See, e.g.*, *Wu v. Dunkin' Donuts, Inc.*, 105 F. Supp. 2d 83 (E.D.N.Y. 2000), *aff'd* 4 Fed. Appx. 82 (2d Cir. 2001); *Vandemark v. McDonald's Corp.*, 904 A.2d 627 (N.H. 2006) (citing cases and relying on *Wu*, 105 F. Supp. 2d 83).

Thus, the general rule is to leave all matters of safety, security and employee relations to the franchisee. The franchisor may set a system standard and make recommendations on how to achieve that standard.

If, on the other hand, a franchisor makes the means of meeting standards "requirements," then it is well advised to monitor and enforce compliance. Certainly, some aspects of a system may be so very essential to the survival of the system (like food safety for a restaurant, or background checks for certain personal service franchise systems) that a franchisor may conclude that the risk of injury arising from noncompliance is so high to justify the burden of taking control over the standard. But that determination should be made with eyes open.

Which points up a dilemma with the distinction between recommendations and requirements: sometimes, the best defense to a claim for vicarious liability is to prevent the injury from happening in the first place. Taking control of safety or security issues may prevent some injuries, but it may also virtually assure liability if an injury does happen. In other words, requiring (rather than recommending) compliance with a particular safety standard and taking steps to enforce compliance may avoid an injury. It is also evidence that the franchisor has a general right to control safety.

4.1(viii)(b). Avoid Micromanaging the Franchisee

Recent cases demonstrate that a franchisor should be wary of controlling the minutia of franchisee operations, especially internal processes that are not obvious to customers. The *Massage Heights* case is illustrative: the franchisor's operations manual controlled nearly every aspect of the spa services, from training of therapists to step-by-step client interaction protocols, which the court concluded amounted to control of the minutia of the business. Despite the independent contractor clause in the franchise agreement, the franchisor's pervasive right to control operational details led it to being held responsible for the franchisee employee's wrongdoing. *Massage Heights Franchising, LLC v. Hagman*, 679 S.W.3d 298, 305 (Tex. App. 2023); *see also Coryell v. Morris*, 330 A.3d 1270, 1284 (Pa. Super. Ct. 2025).

The lesson: don't turn an operations manual into an employee handbook or exhaustive procedural manual for running the business. Stick to high-level standards and let the franchisee fill in the details. If franchisor-created manuals or materials start to look like those that the franchisor would use to manage a company-owned store, that is a red flag.

Franchisors should also avoid requiring franchisees to seek franchisor approval for routine operational decisions. Overcontrol not only undermines the independent contractor defense but may also give rise to a duty of care on the part of the franchisor in the control areas. In short, advised, don't prescribe a granular aspect of business.

4.1(viii)(c). Avoid Using the Corporate Store's Manual

Because personnel operating corporate stores are employees of the franchisor, company store manuals typically contain specific and detailed controls over all manner

of security and personnel matters. Thus, a franchisor should resist the urge to create a franchise operations manual by copying the corporate store's operations manual without alteration. Indeed, in *Casey v. Ward*, the District Court for the District of Columbia cited language in the McDonald's operations manual distinguishing the manual's import for a company-owned store (company policy) and for franchisees (a recommendation) significant in reaching its conclusion that the franchisor did not maintain control over the franchisee's security arrangements. 211 F. Supp. 3d 107, 120 (D.D.C. 2016).

4.1(viii)(d). Avoid Creating Unenforced Standards

Franchisors have been known to adopt seemingly infinite rules and regulations that they then don't enforce. Excess unenforced standards only provide more grist for the vicarious liability mill. Avoid them.

A standard that exists on paper but is not monitored or enforced can create unexpected liability. Plaintiffs may argue that the franchisor undertook a duty by imposing the standard, but then breached that duty by failing to ensure it was followed. Unenforced standards can also undercut the importance of other rules.

Generally, a franchisor should limit safety-related rules to those that the franchisor can and will enforce, and explicitly state the franchisee is responsible for implementing and enforcing these rules. If an element is truly important for safety or brand reputation, consider building it into the inspection checklist. Conversely, franchisors should avoid overloading the manual with aspirational rules that they have no capacity or intention to enforce. It is preferable to omit them or include them as recommendations.

4.1(viii)(e). Avoid Directing Franchisee Employees

Franchisor personnel should avoid instructing or directing the activities of employees of the franchisee. For example, in a situation where a franchisor employee conducts an inspection and identifies an issue or deficiency, the franchisor representative should call the issue to the attention of the franchisee, rather than directing franchisee employees to address it.

In addition, the franchisor should provide clear protocols for its employees during inspections. For example, a franchisor should make clear that its employee is allowed to recommend actions to improve compliance proficiencies but may not require specific methods or action beyond the standard itself. The employee should also be trained to document that compliance and the ultimate decisions rest with the franchisee. Field staff should also refrain from becoming too enmeshed in a franchisee's daily routine. By empowering franchisees to solve operational problems themselves, franchisors reinforce the franchisee's responsibility for operations.

Similarly, franchisors are well advised to avoid directly training the employees of the franchisee. Rather, a "train the trainer" approach, with franchisor personnel training managerial employees who in turn train franchisee employees, mitigates the risk of being found to control. If a franchisor is going to require a franchisee or its

employees to attend a specific training or certification – for example, a food handling course – the franchisor should determine and document that it is justifiable as a brand or legal necessity.

4.1(viii)(f). Maintain Consistent Messages in All Communications

All the hard work of scouring an operations manual to implement a careful distinction of requirement versus recommendation and avoidance of unenforced standards can be undone with incautious periodic communications with franchisees. Franchisors are well advised to maintain the distinction between "requirements" and "recommendations" in routine system communications and take the opportunity to remind franchisees that the franchisee has an independent obligation to comply with state, local, and federal laws and is responsible for its operational decisions. Likewise, operations personnel should be sensitive to the obligation of the franchisee to retain control over day-to-day operations and should avoid giving directives to franchisees that suggest control over the details of the franchised location's operations.

A franchisor's periodic inspections are often cited as indicia of control in vicarious liability litigation. Periodic inspections should involve principally the completion of objective inspection checklists. Such checklists should reflect that the inspection is concerned with the final product or service, rather than with the details of making the product or delivering the service.

Finally, choosing appropriate channels of communication is important. Franchisor field staff should communicate with the franchisee or its manager about steps to be taken to comply with system standards and leave to the franchisee the responsibility to take the actions necessary to comply with the standard.

5. CONCLUSION

Recent decisions demonstrate the thin and shifting line between brand protection and operational control. Franchisors must tread carefully, ensuring that their system standards, training protocols, and inspection practices support brand consistency without micromanaging day-to-day franchisee conduct. By reinforcing independent contractor status, clearly allocating operational responsibilities, and carefully drafting and enforcing franchise agreements, franchisors can minimize litigation exposure while preserving the integrity of their systems.

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2025 JUDICIAL UPDATE

WHAT'S NEW IN MEXICO AND CENTRAL AMERICA?

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What's New in Mexico and Central America?

1. Introduction.

Mexico and Central American nations operate within a civil law legal framework, distinct from a common law system. Consequently, the sources of law in these jurisdictions are: (a) statutory law, including applicable laws, regulations, and standards; (b) customary practices; (c) jurisprudence, specifically judicial interpretations from high federal courts; (d) legal doctrine; and (e) general principles of law.

The fundamental distinction between civil law and common law systems significantly influences contract interpretation and enforcement. This difference underscores the critical importance of precise and comprehensive contractual language, which provides parties with clearly defined guidelines for their relationship, minimizing ambiguity and potential disputes.

As of the current date, franchise operations in Mexico are subject to limited, specific regulations, and lack dedicated regulatory frameworks in Central America. This necessitates reliance on general contractual principles. Moreover, franchise agreements should incorporate all applicable regulations relevant to each specific provisions thereby mitigating the risk of breaches in the performance of the franchised business.

In Mexico and Central America, parties enjoy significant contractual freedom and autonomy when entering into commercial agreements, provided that such agreements do not contravene public policy regulations. Consequently, it is imperative to carefully draft written agreements that prevent parties from entering into complicated business relationships and that show the contractual freedom of the parties.

2. Mexico.

2.1. Judicial Reform.

Comprehensive restructuring of the judicial system at both federal and local levels. Following the approval of the Judicial Reform in September 2024, Mexico faces a landscape of profound changes within its legal system, which appear to have repercussions on the economic sphere.

The reform introduces measures with significant impacts, such as:

(i) The total restructuring of the judicial system at both, federal and local levels.

- The number of Justices in the Supreme Court of Justice (SCJ) is reduced from 11 to 9, and the division into Chambers is eliminated. Now, all matters will be resolved by the Plenary of the Supreme Court.

- The terms of office of Justices, Appeal Judges and District Judges are shortened.

- Justices shall hold office for 12 years and may not be reelected. Judges and Appeal Judges shall hold office for 9 years and may be reelected.

- Establishment of a Court of Judicial Discipline (CJD) or Disciplinary Tribunal. This court is created to supervise, discipline and sanction judicial officers, including removal of the Justices of the SCJ. This court will be composed of five magistrates elected by the citizens, and its decisions shall be final.

- Establishment of a Judicial Administration Body. This body oversees administrative matters and the judicial career. It is composed of five members appointed by the President, the Senate and the SCJ. It will have the power to determine the budget of the Federal Judicial Branch and of the SCJ.

- Budget Changes: (x) Some salaries will be reduced, in the understanding that, no member of the judiciary may have a salary higher than that of the President of the United Mexican States, and (y) trusts and other sources of the Judiciary resources will be eliminated. Retirement pensions shall be unavailable for acting Justices who do not leave office voluntarily before August 31, 2025.

(ii) Changes in the Mechanisms for Challenging and Defending Constitutional Rights.

- It is prohibited to grant injunctive relief (stay) against laws with general effects through constitutional (*amparo*) trials, actions of unconstitutionality or constitutional controversies.

- *Amparo* rulings that resolve the unconstitutionality of general laws will not have general effects; thus, they will only benefit the petitioning party in the trial.

(iii) Implementing direct citizen elections for all judicial officers, including Justices of the Supreme Court of Justice, Circuit Appeal Judges and District (federal) Judges.

- The Justices of the Supreme Court of Justice (SCJ), Circuit Appeal Judges and District Judges will be elected by the citizens by direct vote.

- At the Federal level, there are approximately 737 District Judges (Judges) and 910 Circuit Appeal Judges (Appeal Judges). All of these positions will be up for election between June 2025 and June 2027.

- The requirements to be elected are as follows: (x) a minimum grade point average of 8/10 from any credited law school is required, with an average of 9/10 in the courses that are relevant for the vacancy to be filled. However, no other exams or admission to the bar are required to access the vacancy, and (y) in the case of Judges, no prior professional experience is required. In the case of Appeal Judges, only 3 years of prior professional experience are required, and Justices must have at least 5 years of experience.

- The electoral process will be managed by the National Electoral Institute (INE) and will follow these steps:

3. Nomination of Candidates. The three Branches of Government (Executive, Legislative and Judiciary) may propose up to 3 candidates for Justices and up to 2 candidates per position of Appeal Judges and Judges.

4. Election and Re-election. (x) Citizens will vote for candidates in free and secret elections, and (y) all Appeal Judges and Judges whose positions are to be subject to the Extraordinary Elections in 2025 may stand for re-election, but on an equal footing with the candidates for their respective positions.

- The implementation process. The implementation of the reform follows the steps established in the transitory articles of the decree:

I. Effective date and Extraordinary Elections 2024-2025:

- The reform became effective on September 16, 2024, and the extraordinary elections will be held on June 1, 2025. The following judicial officers will be elected:
  - 9 SCJ Justices.
  - 5 Magistrates of the CJD.
  - Some members of the Electoral Tribunal of the Federal Judicial Branch.
  - 50% of the Appeal Judges and Judges of the Federal Judicial Branch.
  - A percentage of local Appeal Judges and Judges, as determined by each state legislature. In any case, all of the Appeal Judges and Judges of the state judiciaries must be elected by 2027.

II. Participation of Current Officers. As previously mentioned, 50% of the current Judges, Appeal Judges and Justices will be eligible to participate in the 2025 Extraordinary Election and the remaining 50% in the 2027 Election, unless they choose not to do so. In both cases, those who are not elected will complete their term of office when the new officials take office.

While these changes aim to strengthen transparency and access to justice, their study and implementation have generated significant concerns.

Currently, the implementation of the reform is underway; however, there are challenges, including the approval of secondary laws, regulations, and circulars, and notably, resistance from certain economic sectors that view these measures as an attempt to centralize power and limit checks and balances in the executive branch of the government which is led by the President.

Mexico is undergoing a period of changes that could directly impact businesses and investments. The actual impact will depend on the development of these changes and how judicial and political institutions adapt their operations to these new provisions. In the meantime, companies, investors, and other economic players with interests in Mexico must proactively study these changes and anticipate situations to mitigate negative impacts.

Given these changes, it is essential for companies operating or planning to do business in Mexico to evaluate different alternatives for dispute resolutions.

2.2. Anticipated Impacts of the Mexico's judicial reform in franchise transactions.

Given the uncertainty arising from the ongoing constitutional reforms, it is advisable for companies operating or planning to do business in Mexico, to carefully consider the dispute resolution mechanisms included in their existing and future contracts.

In the face of the judicial reform, arbitration emerges as a critical and important tool to mitigate risks and provide certainty to the parties in the event of a controversy derived from the franchise contractual relation. It is important to standout that arbitration in Mexico has been an alternative dispute resolution for several years, and many disputes between franchisors and their franchisees have been resolved through this mechanism.

In Mexico, contractual disputes can be resolved through arbitration or by means of a jurisdictional proceeding in court. Commercial arbitration, whether domestic or international, is widely used, supported by instruments such as the New York Convention, which facilitates the enforcement of arbitral awards. Mexico led International Chamber of Commerce (ICC) arbitration cases in Latin America in 2023 and ranked second globally, reflecting its growing adoption, and highlighting Mexico City as a key venue for arbitration proceedings.

2.3. Judicial Reform and its Impact on Franchised Systems.

Mexico's judicial reform may bring different opportunities to the parties to determine the best manner to solve any kind of conflicts at the time they are negotiating the

business terms of the transaction. Therefore, the parties will have a conscious decision about how they would like to settle any dispute arising out of the franchise agreement; for such purposes, parties must analyze the following:

a) Choice of Law. The choice of law in franchise agreements is a critical provision that designates the specific jurisdiction whose laws will govern the contractual relation, extending beyond mere contract interpretation to encompass related laws and procedural aspects of legal disputes. In international franchising, the complexity escalates, involving conflicts of laws principles and international treaties.

   Practically, the choice of law influences litigation, compliance, and the enforcement of awards, necessitating careful consideration to ensure enforceability and protect the interests of all parties, especially considering the location of the assets of the involved parties.

b) Alternative Dispute Resolution – Arbitration. In the realm of franchise agreements, where intricate business relations often span diverse jurisdictions, arbitration plays a pivotal role in mitigating conflicts. Arbitration, as a contractual mechanism, offers parties a structured yet flexible alternative to traditional litigation, providing a more efficient and often confidential means of resolving disputes. Its effectiveness stems from the ability of the parties to select arbitrators with specialized industry knowledge, ensuring a nuanced understanding of franchise-specific issues.

   The predetermined procedural rules, often streamlined compared to court proceedings, contribute to faster resolution, minimizing business disruptions. Moreover, the enforceability of arbitral awards, bolstered by international conventions like the New York Convention, provides a degree of certainty that can be crucial in cross-border franchising; however, the efficacy of arbitration hinges on the clarity and precision of the arbitration clause within the franchise agreement, encompassing aspects such as the scope of disputes subject to arbitration, the number and selection of arbitrators, and the governing procedural rules. A well-crafted arbitration clause can transform a potentially protracted and costly legal battle into a swift and equitable resolution, making it an indispensable tool for managing franchise controversies.

2.4. Arbitration and Litigation of Franchise Agreements in Mexico.

In Mexico, franchises are governed by contracts that regulate the operation of a franchised business, ensuring that the franchisee adheres to established standards. These contracts are designed to protect the franchisor's reputation and maintain brand consistency. Consequently, they prioritize commercial activity and emphasize the need for practical and efficient solutions.

Based on our experience, when a franchise agreement faces a dispute, affected parties typically prioritize resolving the breach practically and discreetly, aiming to minimize disruption to the franchised business's daily operations. This often involves seeking amicable settlements before resorting to formal litigation or arbitration. Common resolutions include renegotiating agreement terms or mutually agreeing to early termination through a settlement, enabling both parties to pursue new opportunities. In light of the dynamic global landscape, we have successfully assisted numerous franchisors and master franchisees in resolving pre-litigation disputes, recognizing that such settlements are crucial for maintaining operational continuity of the franchised business and assuring the reputation of the trademark in the territory.

Notwithstanding the foregoing, in a minority of cases, disputes escalate and result in litigation or arbitration, in which case the clauses stipulated included in the franchise agreement, outlining the franchisee's obligations, enable the franchisor to better demonstrate continuous breaches and consequently having a higher probability of obtaining a favorable sentence or award.

Furthermore, publicly available arbitration statistics indicate that 60% of commercial arbitration awards are voluntarily complied with by the parties, while only 40% require enforcement through the courts. In the Mexican franchise sector, (i) arbitration is a frequently utilized dispute resolution method, and (ii) specialized arbitrators with unique characteristics and flexibility of franchise agreements are available. Nevertheless, as previously mentioned, parties typically prioritize pre-litigation settlements, resulting in a low incidence of formal arbitration. Consequently, only few public records of franchise arbitration proceedings in Mexico exist within the last years, originating from the hospitality sector (hotel and restaurant industries).

2.5 Amendments to applicable laws within the last five years that may impact franchised businesses in Mexico.

a) Issuance of the new Federal Law for the Protection of Industrial Property.

As part of the harmonization process under the USMCA, the Industrial Property Law was abrogated, and the Federal Law for the Protection of Industrial Property ("**FLPIP**") was enacted and came into force in 2020. The main highlights of the franchise agreement are the following:

(i). Trade Secrets.

Considering protecting trade secrets, the FLPIP establishes that the person who has legal control over a trade secret may transfer or authorize its use to a third party. The authorized user shall have the obligation not to disclose the trade secret by any means. Therefore, the agreement by means of which technical knowledge is transferred, or technical assistance is provided, must include the necessary confidentiality clauses to protect the trade secrets that are transferred; and such

agreement will have to describe what is considered as illegal “misappropriation” of a trade secret.

(ii). Liquidated damages.

In case there is a misappropriation of a trade secret, a liquidated damages clause must be included in the relevant agreement, generating the payment of a conventional penalty in the event of such breach.

(iii). Franchise Disclosure Document.

The franchisor’s obligation to deliver to franchisee the information of the company’s status with at least thirty days before the franchise agreement execution date prevails.

In case that such franchise disclosure document is not delivered to the franchisee with such anticipation and the franchisee requests said document, the franchisor may be subject to administrative sanctions, including payment of fines and temporary or definitive closing of the corresponding commercial establishment.

b) Thesis of Jurisprudence IX-J-SS-70 – Technical Assistance vs. Business Profit.

In June 2023, the Mexican Federal Tax Court determined that technical assistance payments do not qualify as business profits under the Mexico-Netherlands Double Taxation Convention. Consequently, when such payments are originating from Mexico, are deemed to have a Mexican source of income, subjecting them to a 25% income tax withholding as stipulated by various provisions of the Mexican Income Tax Law.

Therefore, meticulous attention must be paid to fee descriptions in franchise agreements to prevent incorrect tax withholdings by franchisees, which could trigger audits by Mexican tax authorities. This jurisprudence mandates a careful analysis of the following concepts within each franchise agreement to ensure correct tax withholdings from Mexican franchisees:

- **Trademark License:** The grant of rights by the trademark owner or authorized licensee to a third party for the use of said trademark within a specified territory.

- **Technical Assistance:** The provision of non-patentable knowledge services that do not involve the transmission of confidential industrial, commercial or scientific information.

- **Know-How:** Pre-existing, proven practical knowledge, derived from the franchisor's experience, encompassing techniques, secret information, theories,

and private data, characterized by (i) secrecy, (ii) substantiality, and (iii) identification.

It is crucial to note that while this jurisprudence specifically addresses the Mexico-Netherlands Double Taxation Convention, its interpretation may extend to other double taxation international treaties to which Mexico is a signatory.

c) Federal Labor Law – Subcontracting.

On May 24, 2021, the General Guidelines for the registration of individuals or companies that provide specialized services as set forth in article 15 of the Federal Labor Law were published in the Official Gazette of the Federation.

In this sense, the most important highlights of these guidelines are as follows:

- The prohibition for subcontracting personnel.
- The regulation for subcontracting specialized services different from the main activities of an entity derived from its corporate purpose and the predominant economic activity of the contracting company.
- Registration with the Ministry of Labor and in the Public Registry of Companies that outsource specialized services and works.
- Joint and several liability in the event of non-compliance.
- The granting of a period of three months for subcontracted workers to become part of the payroll of the employer.

Additionally, an agreement was reached on the issue of profit sharing, creating two modalities for calculating such payment distribution, in the understanding that the most favorable for the employe would apply: (i) a limit of three months of employee's salary, or (ii) the average of profit sharing received by the employee in the last three years.

d) Anticorruption.

Derived from the recent measures taken by the U.S. government about the designation of Specially Designated Global Terrorists (SDGTs) and Foreign Terrorist Organizations (FTOs) and the amendment to Mexico's Miscellaneous Tax Resolution, companies may have certain consequences, such as:

- Extraterritorial application: The U.S. has asserted broad extraterritorial jurisdiction over any entity (including subsidiaries, affiliated companies, companies that are listed or have assets in the U.S., or even due to the existence of a single financial transaction through the U.S. financial system).
- Criminal liability: Risk of prosecution for providing "material support" (directly or indirectly) to FTOs.
- Civil laws: Possibility of multiple lawsuits by American victims against companies that have provided "material support".

- Sanctions on financial institutions: For processing transactions linked to FTOs.
- Increase in costs: Rise in operational costs due to audits, security, and risk detection technology.
- Reputational risk: Importance of transparency and regulatory compliance to avoid any investigation, sanctions, and reputational damage.

Pursuant to the foregoing, it is highly recommended, in order to be able to mitigate any risks, to implement the following actions:

- Strengthen compliance areas of companies doing business in Mexico with a focus on preventing business corruption.
- Compliance with extraterritorial and national regulations.
- Risk assessment with a focus on transactions with counterparties and third parties.
- Update the know your customer (KYC) and know your supplier (KYS) processes.
- Review clauses to prevent business corruption and interaction with illicit counterparties.
- Training and audits.

2.6 Franchised business: What to take into consideration derived from these amendments to applicable law.

It is important to standout that derived from the amendments performed to the abovementioned laws, franchise systems that will be implemented in Mexico need to contemplate in the relevant agreements (in addition to the requirement set forth in the applicable laws), at least, the following:

1. The correct references to the sections and provisions set forth in the FLPIP.
2. A provision establishing the trade secrets that are being given to the franchisee and the liquidated damages that may be required in case of an unauthorized disclosure of such trade secrets.
3. Adequate wording regarding the reason why a fee is being paid under the franchise agreement, describing if such fee derives from the payment of a trademark license, transfer of know-how or the provision of technical assistance. The foregoing, in order to contemplate the correct application of the corresponding tax withholding by franchisee, if applicable, in terms of the relevant international tax treaty.
4. Independent contractor and subcontracting clause, which establishes the independence between franchisor and franchisee regarding employment and the obligation of franchisee to hire its employees and having the correct compliance in case a specialized service is hired.
5. Adequate representations from the franchisee and franchisee's owners, if applicable, establishing: (i) the source of the economic resources being paid to franchisor, (ii) if they are public persons (politically exposed) and have any links

with the Mexican or any other government, and (iii) compliance manuals that would mitigate any risks which must be mandatory for franchisee.

3. Costa Rica.

3.1. Proposed legislation: Law for Regulating and Impulsing Franchises (*Ley para la Regulación y el Impulso de las Franquicias*).

Currently, franchise agreements in Costa Rica lack a dedicated legal framework. However, they must adhere to various existing laws, including Trademark Law, Labor Code, Copyright Law, and Consumer Protection Law. The Supreme Court has also defined the essential characteristics of franchise agreements, emphasizing 'know-how' as a critical component.

Nevertheless, a proposed new law to be named as the 'Law for Regulating and Promoting Franchises' aims to establish a specific regulatory framework. This legislation would govern franchise agreements and ancillary documents thereto, such as non-disclosure agreements, letters of intent, franchise disclosure documents (FDDs), operational manuals, franchise agreements, and trademark licenses. Key provisions of the proposed law include: (i) mandatory delivery of a franchise disclosure document, (ii) a minimum franchise term of five years, and (iii) tax benefits and incentives to encourage franchised business development.

4. Guatemala.

In Guatemala, there is no specific legislation regulating franchises as in other jurisdictions. This lack of detailed regulation has resulted in franchises operating primarily under the terms agreed upon in private contracts between the parties, providing significant flexibility to both franchisors and franchisees.

The lack of formal regulation is not necessarily a disadvantage. In fact, it offers greater freedom for the parties to adjust their agreements according to their specific needs, which can be especially beneficial for foreign franchise systems seeking to operate in the country without being subject to a restrictive regulatory framework. The fact that each franchise is primarily governed by private contracts allows the parties greater control over the terms, without being limited by potential judicial interpretations that may not align with international business interests.

It is important to note that any disputes or controversies that may arise, related to the interpretation of these contracts or the fulfillment of the parties' obligations, are generally resolved through arbitration proceedings. In many cases, arbitration takes place in the jurisdiction of the franchisor's country of origin, as franchise agreements often stipulate that any dispute be resolved in that sphere. Therefore, franchises operate in Guatemala under this contractual and dispute resolution framework, without significant local judicial precedents on the matter.

In the last years, the Supreme Court of Guatemala has shown a favorable attitude towards the enforcement of international arbitral awards.

5. Honduras and Nicaragua.

In Honduras and Nicaragua, mirroring the Guatemalan landscape, there is not a specific franchise legislation. Consequently, franchise relationships are primarily governed by the contractual terms agreed upon between franchisors and franchisees. This contractual framework affords a degree of flexibility to both parties.

The absence of a comprehensive regulatory scheme, presents a strategic advantage, enabling tailored agreements that align with specific business requirements. This is particularly salient for international franchisors seeking market entry in these countries, as it minimizes constraints imposed by potentially rigid statutory provisions. The reliance on private contracts allows for greater control over the contractual relationship, mitigating the risk of judicial interpretations that may deviate from established international business norms.

6. Conclusions.

Based on the foregoing analysis, it may be concluded that:

- Mexico and countries in Central America in general offer legal systems conducive to franchise investments, providing different incentives and being respectful towards the parties' contractual freedom and autonomy.

- Abiding to each country's specific legal and market conditions is essential for successful franchise operations.

- A considerable proportion of franchise disputes are resolved through pre-litigation or pre-arbitration settlements; therefore, it is important to have franchise agreements that meticulously describe the parties' obligations to be able to demonstrate precise breaches of any of the parties. It is highly recommended to have detailed contracts containing specific and detailed provisions.

- Due to the judicial reform in Mexico, extra care must be taken when drafting choice of law and choice of forum clauses for dispute resolutions.

- Arbitration could be considered a preferred method for dispute resolutions, in the understanding that Supreme Courts in Mexico, and most countries of Central America have shown a favorable attitude towards the enforcement of international arbitral awards and, therefore, their enforcement is generally effective.

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2025 JUDICIAL UPDATE

WHY SHOULD A TRANSACTION LAWYER CARE ABOUT LITIGATION?

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WHY SHOULD A TRANSACTIONAL LAWYER CARE ABOUT LITIGATION?

As transactional counsel, we must often operate with a forward-looking mindset—structuring deals, drafting agreements that span 10 years, and advising clients on how to grow and manage franchise systems with minimal legal friction. But the reality is that every provision we draft carries legal consequences that may be scrutinized later—by courts, regulators, or adversarial parties. The recent wave of franchise litigation and regulatory activity underscores the importance of intentional, strategic drafting and proactive compliance from the outset of the franchise relationship. Please note that this is merely a selection of cases and not a comprehensive review over the last year. The goal here is to demonstrate the necessary intertwining of transactional and litigation practitioners in connection with the drafting of franchise documents.

This section examines several recent federal and state court decisions, along with key Federal Trade Commission (FTC) actions, that collectively illustrate the evolving boundaries of franchise law and focus on what a transactional lawyer should take from these cases. Specifically, the goal is to provide practical lessons and insight from the decisions discussed in the next section. These developments are relevant for all attorneys in the space—they offer critical guidance for transactional attorneys who shape the foundation of franchise systems through every agreement and disclosure document.

From these decisions, a number of practical lessons emerge:

- **Jurisdiction.** Courts are demonstrating a willingness to apply state franchise laws—even to out-of-state relationships—where meaningful business contacts exist despite choice-of-law provisions.
- **Distress scenarios.** Franchise agreements should preserve the franchisor's consent rights under the Lanham Act, particularly in the context of bankruptcy and attempted assumption by debtors.
- **Good cause and good faith.** Even without outright provisions requiring certain behavior, courts still tend to rely on the cornerstone principles of good cause and good faith in analyzing the exercise of franchisor discretion—especially in transfer refusals and modernization efforts—to ensure fairness and consistency with statutory protections.
- **Forum selection.** Judges may prioritize fairness or judicial efficiency concerns when overriding contractual venue clauses.
- **FTC enforcement expansion.** Recent actions signal a renewed focus on transparency in franchisor-franchisee relationships, particularly around non-disparagement clauses and undisclosed fees.

For transactional practitioners, these cases illuminate the requirement move beyond boilerplate provisions and toward tailored agreements that are both compliant and defensible — written with an eye toward how they will be interpreted and enforced when tested. The best legal documents aren't just technically sound—they are practically resilient. After each case, we will deliver practical guidance to implement in your own practice.

In *Cambria Company, LLC v. M&M Creative Laminants, Inc.*[5], a non-Minnesota based company brought claims under the Minnesota Franchise Act (MFA) despite the franchised business not being located, or operated, within the state of Minnesota. Here, Cambria is a Minnesota company that manufactures and sells its own brand of quartz surface products.[6] M&M, a Pennsylvania-based distributor of quartz surfaces that primarily sells custom countertops and cabinetry to homeowners and kitchen and bath dealers, had an eight-year relationship with Cambria.[7] In May 2017, Cambria sent representatives to M&M's office to notify M&M that Cambria was terminating the business relationship and would no longer sell its products to M&M.[8] Among other things, Cambria claimed that M&M owed over $180,000 for countertops that had already been delivered.[9]

Cambria brought the subject lawsuit against M&M to recover the amount M&M owed on various unpaid invoices.[10] M&M asserted several counterclaims, including a counterclaim for unlawful termination of the parties' alleged franchise agreement in violation of the MFA.[11] Both lower courts, district court and court of appeals, ruled in favor of Cambria in determining that the MFA did not apply.[12] The district court ruled in favor of Cambria's summary judgment motion holding that the MFA did not apply because M&M did not pay a franchise fee (and did not address the jurisdictional issue) and the court of appeals upheld the ruling that the MFA did not apply because M&M did not operate in Minnesota.[13] The issues in front of the Minnesota Supreme Court were as follows: "(1) whether M&M is precluded from bringing a claim under section 80C.14 of the Act against Cambria, a Minnesota company, simply because M&M is an out-of-state company, and (2) whether M&M and Cambria's business relationship was a franchise under the Act."[14]

In answering the first question, the Minnesota Supreme Court looks to the language of the statute. First, noting that certain parts of the statute are <u>not</u> solely limited to Minnesota-based companies but does "include express territorial limitations" in other

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[5] *Cambria Co., LLC v. M&M Creative Laminants, Inc.*, No. A22-0723, 2024 WL 4139394 (Minn. Sept. 11, 2024).
[6] *See Id.*
[7] *See Id.*
[8] *See Id.*
[9] *See Id.*
[10] *See Id.*
[11] *See Id.*
[12] *See Id.*
[13] *See Id.*
[14] *See Id.*

certain sections of the MFA, intimating that the inclusion in certain sections and exclusion in others was intentional.[15]

The Minnesota Supreme Court would not state that the MFA would apply to *every* company, however, noted the following material aspects of the relationship were rooted in Minnesota in establishing the requisite nexus:

- Cambria drafted the parties' contracts in Minnesota and included a Minnesota choice-of-law provision;

- M&M sent its employees to Minnesota multiple times for product training and certification;

- Cambria and M&M had regular, ongoing business communications originating from Cambria's Minnesota headquarters.[16]

While ultimately upholding the lower court's summary judgment motion in favor of Cambria due to lack of a payment of a franchise fee, the Minnesota Supreme Court's reasoning suggests that when a franchisor's conduct and control have significant jurisdictional contacts within a certain state, state franchise laws may apply extraterritorially. This decision signals to franchisors that a state's statutory protections may be invoked even in seemingly "out-of-state" relationships.

Based on the facts that the Minnesota Supreme Court considered material and occurring within the state (despite the franchisee operating outside of it), it is hard to imagine a franchisor not providing those types of services to its franchisees from its headquarters in this state. Most franchisors will provide those services, and most will do so from their headquarters. While an acknowledgment in the governing law provision of the franchise agreement that a state's franchise law does not apply because the franchisor is located there could be helpful, a court may focus on the services the franchisor is providing from said state. With that, counsel should work with their clients to evaluate the likelihood of application of that state's statute in connection with the governing of the franchise relationship or even counsel on relocation if that option is available.

In *re Pinnacle Foods of California, LLC*,[17] Pinnacle, a multi-unit franchisee of a national quick-service restaurant chain, filed for Chapter 11 bankruptcy, and moved for an order authorizing Debtor to assume six separate franchise agreements. As part of its reorganization plan, Pinnacle sought to assume its franchise agreements with the national brand, Popeye's.[18] Popeye's objected, citing the agreements' non-transferability provisions and asserting that the assumption would violate the Lanham

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[15] *See Gen. Mills, Inc. v. Comm'r of Rev.*, 931 N.W.2d 791, 800 (Minn. 2019) (holding "when the Legislature uses limiting or modifying language in one part of a statute, but omits it in another, we regard that omission as intentional and will not add those same words of limitation or modification to parts of the statute where they were not used.").
[16] *See supra* note 1.
[17] *In re Pinnacle Foods of California, LLC*, No. 24-11015-B-11, 2024 WL 4481070 (Bankr. E.D. Cal. Oct. 10, 2024).
[18] *See Id*.

Act, which governs trademarks and associated goodwill. This rejection is based on the underlying bankruptcy code and the legal concepts derived therefrom. First, the language at issue under the bankruptcy code provides that "a debtor may neither assume nor assign a contract if *applicable law* excuses a counterparty to the contract from accepting performance from or rendering performance to any entity other than the debtor unless the counterparty consents to such assumption and/or assignment." From this requirement has derived two paths under to bankruptcy assignment and assumption issues known as "the hypothetical third party test" (or "the hypothetical test"), adopted by the Ninth Circuit[19] upon which Popeye's relies here (and is further discussed below). The other test will not be discussed in this analysis. Alternatively to the hypothetical test, Popeye's argues that Pinnacle has committed uncurable, non-monetary defaults rendering the franchise agreements non-assignable.

Under the *Catapult* hypothetical test[20], Popeye's can effectively block Pinnacle from assuming the Franchise Agreements if it can show that applicable law would excuse Popeye's from accepting performance from any hypothetical third party to whom Pinnacle might theoretically assign its rights under the franchise agreements post-assumption, regardless of the existence of any actual such third party. Popeye's has consistently maintained in this case that it will not consent to assumption by Pinnacle effectively blocking Pinnacle's assumption of the franchise agreements under § 365(c)(1)(A) and (B). Popeye's has stated they have suggested to Pinnacle some approved successors to Pinnacle's franchises.

The United States Bankruptcy Court, E.D. California examined the applicable law at hand, first, the Lanham Act[21] and, second, the California Franchise Relations Act (CFRA)[22]. This Court analyzed each side's arguments on whether the Lanham Act is applicable law ultimately siding with Popeye's. Pinnacle unsuccessfully argued that the CFRA trumps all federal law, including the Lanham Act, and did not proffer substantial arguments on this point. Popeye's, on the other hand, cites a number of cases which identify the Lanham Act as the relevant "applicable law" that triggers § 365(c)(1) in cases involving assumption of franchise agreements and trademark licenses focusing on the extraordinarily broad rights granted under the Lanham Act for trademark owners.[23] Specifically, the Lanham Act provides that a registrant of a mark registered in the Patent and Trademark Office is entitled to nationwide trademark protection.[24] Furthermore, in circumstances such as reorganization, the Lanham Act provides that "a registered mark...shall be assignable with the good will of a business in which the mark is used."[25] The trademark owner not only has a right to assign a trademark, but the

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[19] *See Catapult Entertainment, Inc. v. Perlman (In Re Catapult Enter.)*, 165 F.3d 747 (9th Cir., 1999) (holding under the "hypothetical test," even if the debtor merely wishes to assume an executory contract or an unexpired lease and not assign its contract rights to a third party, the counterparty may still withhold its consent and block assumption if there is a hypothetical third party to whom the debtor might assign its contract rights but as to whom the counterparty would be excused from performing for under applicable law).
[20] *See supra* note 13.
[21] *See Id*.
[22] *See Id*.
[23] *See Id*.
[24] *See Id*.
[25] *See Id*.

same owner also maintains a right and duty to control the quality of goods sold under the mark.[26] Because the owner of the trademark has an interest in the party to whom the trademark is assigned so that it can maintain the good will, quality, and value of its products and thereby its trademark, trademark rights are personal to the assignee and not freely assignable to a third party.[27]

As noted above, Pinnacle largely dismisses that the Lanham Act is "applicable law" and instead focuses its efforts on the CFRA and its provisions protecting franchisees in the event of transfer.[28] Pinnacle argues that "the [CFRA] provides that the franchise is transferrable and assignable to a proper transferee over the objection of a franchisor as a matter of state law and that under such circumstances, transfer or assignment may be compelled by a court. The statute provides that it is unlawful for the franchisor to prevent such a transfer or assignment; accordingly, there is a *limitation* on assignability or sale, but no *prohibition* as required by Section 365(c)(1)."[29] Popeye's, on the other hand, disagrees noting "[w]hile CFRA provides that a franchisor cannot reject a sale or transfer of a franchise agreement provided that the proposed buyer otherwise qualifies under its standards and meets other requirements, the statute is equally clear that a franchisor can reject any such proposed sale or transfer if the buyer does not qualify under its standards."[30] The Court agrees with Popeye's' analysis of CFRA and its implications for § 365(c)(1). Regardless of whether CFRA favors transfer or assignability of franchises, the relevant question in this case is the one raised by *Catapult*: Is there a hypothetical third party to whom Pinnacle might be excused from accepting or rendering performance because such a hypothetical third party might not qualify for Popeye's standards for approval under CFRA? The answer is yes. Accordingly, CFRA provides alternative grounds for concluding that Pinnacle fails the *Catapult* hypothetical test and cannot assume the franchise agreements if Popeye's continues to withhold consent.

Based on this, transactional counsel should ensure that bankruptcy code references are included in the anti-assignment section, noting express written approval is still required, and termination (as permitted). Further, counsel should reaffirm franchisor's rights under the Lanham Act to protect the quality of the marks and goodwill and acknowledge that the Lanham Act is applicable law governing the relationship.

In *Oakland Family Restaurants, Inc. v. American Dairy Queen Corporation*[31], Oakland Family Restaurants operated several Dairy Queen franchises under agreements dating back to 1965, as amended by the parties over the years. The parties had numerous conversations regarding sale opportunities and retirement for the owners of Oakland Family Restaurants.[32] Eventually, Oakland Family Restaurants attempted to

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[26] 15 U.S.C. § 1060.
[27] *See supra* note 13.
[28] *See Id*.
[29] *See Id*.
[30] *See Id*.
[31] *Oakland Family Restaurants, Inc. v. American Dairy Queen Corporation*, 2024 WL 1396258 (E.D. Mich. March 31, 2024).
[32] *See Id*.

transfer its franchise rights to two individuals upon retirement.[33] The language of the franchise agreement stated as follows: "the Buyer will not . . . assign this agreement or sell any of the said freezers without first obtaining the written consent and approval of the Seller."[34] While not as fulsome as assignment language in modern franchise agreements, a unilateral approval right remained with Dairy Queen. Upon the request for transfer, Dairy Queen rejected the transfer, asserting under the Michigan Franchise Investment Law (MFIL) that it had proper "good cause" to reject due to concerns over the financial capability and operational experience of the proposed transferees.[35] Furthermore, Dairy Queen required execution of updated franchise agreements in line with current system standards in connection with approval of the transfer requests, to which Oakland Family Restaurants refused to honor due to the legacy "sweetheart" deal. Oakland Family Restaurants brought the subject lawsuit alleging bad faith and violation of the MFIL, arguing that the refusal was pretextual and that the new agreements stripped transferees of legacy protections.[36]

Oakland Family Restaurants next argues that, because the consent to assignment provision in that agreement places no express limitation on Dairy Queen's right to withhold consent to a proposed assignment, it is "patently void" and unenforceable under public policy, as codified by the MFIL.[37] Specifically, the MFIL states that a provision which permits a franchisor to refuse to permit a transfer of ownership of a franchise, except for good cause, is void and unenforceable. Despite the issue of retroactivity being set aside because the agreements were executed prior to the institution of the MFIL, the Court chose to analyze the "good cause" arguments proffered by Dairy Queen noting that in interpreting this statute, the Michigan Court of Appeals has explained that the requirement "centers on commercial reasonability."[38]

Dairy Queen presented ample evidence that it had good cause not to approve the proposed transferees unless the transferees agreed to its new standardized franchise agreement.[39] Its Assistant General Counsel and its Chief Executive Officer both testified that Dairy Queen has faced considerable administrative burdens in ensuring that long-term franchisees (operating under older franchise agreements that omit or fail to define material terms) are able to adapt to recent legal and regulatory changes and remain competitive in the shifting economic landscape.[40] As the Court here noted, Dairy Queen's desire to modernize and standardize its franchise agreements across its entire franchise system is neither unreasonable or arbitrary.[41] And it has shown a willingness to deal in good faith by offering to grandfather clauses from old agreements making individual locations particularly desirable to prospective purchasers, like seasonality

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[33] *See Id*.
[34] *See Id*.
[35] *See Id*.
[36] *See Id*.
[37] *See Id*.
[38] *See Franchise Mgmt. Unlimited, Inc. v. America's Favorite Chicken*, 221 Mich.App. 239, 561 N.W.2d 123, 128 (1997).
[39] *See supra* note 27.
[40] *See Id*.
[41] *See Id*.

requirements—as well as very reasonable royalty pricing that is no longer in effect for new franchisees.[42]

Oakland Family Restaurants did not respond to the commercial arguments regarding the then-current franchise agreement and instead urged that reading a "good cause" requirement into the assignment provision would violate well-established principals of contract interpretation, referenced above, requiring unambiguous contracts to be enforced as written.[43] The court determined that "it stretches plausibility to suggest the Legislature intended such a dramatic result."[44] Thus, Dairy Queen's motion for summary judgment was granted by the Court in the instant case.[45]

Here, counsel should ensure any anti-assignment provision contains explicit, proper conditions upon which a franchisee must comply in order to assign the franchise agreement, including, without limitation, adherence to franchisor's then-current standards for new franchisees, execution of then-current franchise agreement, and modernization requirements. While not required to be specifically included in the agreement, franchisors should exercise reasonable discretion and be mindful of states where refusal only with "good cause" is required.

Convenience Stores Leasing & Mgmt., LLC v. Singh[46], Convenience Stores Leasing & Management, LLC (CSLM), a Wisconsin-based franchisor, sued Sukhwinder Singh and Sanjay Arora, its franchisees, in Ozaukee County Circuit Court (in Wisconsin) for breach of contract. Defendants subsequently removed the action to federal court in Wisconsin and then attempted to move to transfer this action to the United States District Court for the Southern District of Indiana because the franchisees were located in Indiana.[47] CSLM objects to said motion relying on a forum selection clause in the franchise agreement which states "[t]he parties agree that any litigation arising out of or in connection with this Agreement ***may*** be brought in the Ozaukee County, Wisconsin Circuit Court."[48] Based upon this language, CSLM argues that the Court's analysis should be limited to whether the provision is valid and whether "exceptional circumstances warrant nonenforcement."[49] However, the Court at hand reads this provision as permissive rather than mandatory due to the use of the word "may" instead of "must"[50], demonstrating the importance of particularity in drafting venue provisions, and allowing less deferential, more thorough review of the facts and circumstances involved.

Specifically, the Court analyzed whether moving party demonstrated that (1) venue is proper in the transferor district, (2) venue and jurisdiction are proper in the transferee district, and (3) the transfer will serve the convenience of the parties, the convenience of

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[42] *See Id*.
[43] *See Id*.
[44] *See Id*.
[45] *See Id*.
[46] *Convenience Stores Leasing & Mgmt., LLC v. Singh*, 2025 WL 470458 (E.D. Wis. Feb. 12, 2025)
[47] *See Id*.
[48] *See Id*.
[49] *See Id*.
[50] *See Id*.

the witnesses, and the interest of justice.[51] The court weighed the District Court in Wisconsin, transferor's location, and the District Court in Indiana, transferee's location, noting venue could be proper in either jurisdiction and relying on the final factor in making its determination.[52]

Despite the forum selection clause, the Court granted the franchisees' motion and transferred the case to Indiana, finding that the burden on the franchisee substantially outweighed the benefits of enforcing the clause.[53] The Court emphasized that forum selection clauses must yield to fairness and judicial efficiency, particularly where enforcement would be fundamentally unjust.[54] The Court reasoned that the convenience element favors Indiana over Wisconsin. While CSLM is a Wisconsin company and executed the agreement at issue in Wisconsin, the connection to Wisconsin ends there.[55] CSLM contracted with a franchisee located in Indiana.[56] The location at issue in this case is located in Indiana.[57] CSLM engaged a non-Wisconsin company, Corrigan Oil, to transport fuel from the Indianapolis Terminal to the location at issue and had franchisees purchase fuel directly from Corrigan Oil.[58] Franchisees assert that while Corrigan Oil provides services in Michigan, Ohio, and Indiana, it does not provide services in Wisconsin.[59] In other words, the placement of fuel orders, the payments for fuel, and the delivery of fuel all occurred in Indiana and, overall, the Court ruled that Indiana has a greater interest in resolving these issues.[60]

This holding underscores that forum selection clauses, while presumptively valid, are not immune from challenge, especially where litigating in the selected forum would impose undue hardship or where the locus of the dispute lies elsewhere. The obvious drafting consideration for counsel is to ensure that all venue provisions use mandatory, and not, permissive language. Furthermore, counsel should include a waiver of any right to object to said forum along with a specific acknowledgement regarding proper venue. Lastly, counsel should consider including the location from which all of franchisor's services are being provided; the location of the franchisee was given substantial weight above.

In *VetCheck LLC v. Hartley-Thomas Group, LLC*[61], VetCheck LLC (VetCheck), an Indiana-based franchisor of pet urgent care centers, entered into a franchise agreement with Hartley-Thomas Group, LLC (HTG), a Pennsylvania company, to open a VetCheck Pet Urgent Care Center in York, Pennsylvania.[62] This location was VetCheck's only

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[51] *See Id*.
[52] *See Id*.
[53] *See Id*.
[54] *See Id*.
[55] *See Id*.
[56] *See Id*.
[57] *See Id*.
[58] *See Id*.
[59] *See Id*.
[60] *See Id*.
[61] *VetCheck LLC d/b/a VetCheck Pet Urgent Care Ctr. v. Hartley-Thomas Grp., LLC*, No. 1:24-CV-709, 2025 WL 860110 (S.D. Ind. Mar. 18, 2025).
[62] *See Id*.

franchise-operated and only Pennsylvania-based center.[63] After a rather tumultuous relationship, VetCheck terminated the franchise agreement and HTG rebranded and continued to operate a business that offered similar services to that which was previously offered by the franchised business.[64] VetCheck filed for a preliminary injunction to enjoin HTG from engaging in conduct in breach of the post-term non-compete covenant.[65]

VetCheck argued that it will be irreparably harmed in three ways absent a preliminary injunction: (1) permitting HTG to continue to operate the same business in the same location would severely damage VetCheck's ability to sign up new franchisees; (2) VetCheck will not be able to protect any goodwill it has developed or convey to other franchisees that it can protect the territory and system; and (3) VetCheck needs to protect its franchise territories so it can re-franchise them if needed, otherwise the growth of VetCheck's franchise system will be threatened.[66] The Court found that these arguments did not have merit.[67] First, VetCheck's argument that poor online reviews would inhibit new franchise sales in the area is not connected to the breach of a non-compete.[68] Second, the hypothetical goodwill VetCheck it surmises "is much more critical to ensure the reputation and good will of the franchise are protected" is just that, hypothetical.[69] Further, even if VetCheck was a "first of its kind" business in York, the Court failed to see how this transforms VetCheck's speculative future harm into an immediate and irreparable one, as required for a preliminary injunction.[70] Lastly, VetCheck has not demonstrated its efforts to re-enter the territory. Thus, the Court held that mere speculative harm is insufficient to rise to the level of irreparable harm in siding with the former franchisees.

While non-competes are under scrutiny generally, this case is a further warning about the factors a Court will consider in enforcing a post-term non-compete. First, counsel should include an express acknowledgement regarding the irreparable harm caused by any breach. As is the case with all non-competes, ensuring specific, measurable metrics are key to ensuring enforceability. Additionally, counsel should advise clients to document actual harm caused by the breach and a strong intent to re-enter the market before attempting to file a preliminary injunction.

Beyond the courts, the Federal Trade Commission (FTC) has issued various guidance and measures demonstrating its renewed focus on franchise relationships. The FTC's recent actions make it clear: how regulatory counsel structure franchise documents today may have material consequences tomorrow. It's no longer sufficient for a franchise agreement or FDD to be "legally compliant." It must also take into

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[63] *See Id.*
[64] *See Id.*
[65] *See Id.*
[66] *See Id.*
[67] *See Id.*
[68] *See Id.*
[69] *See Id.*
[70] *See Id.*

account fairness, transparency, and be able to withstand regulatory scrutiny. This is applicable not only in the written word but in the enforcement mechanisms.

1. FTC Policy Statement on Franchisee Silence Provisions

On July 12, 2024, the FTC issued a policy statement addressing concerns over certain contractual provisions in franchise agreements—specifically, non-disparagement, goodwill, and confidentiality clauses.[71] The FTC emphasized that clauses such as those may unnecessarily silence franchisees and decrease the reporting of potential legal violations to governmental authorities.[72] Furthermore, the FTC noted that any provision, whether explicit or implied, that deters franchisees from communicating with regulators about unlawful conduct is considered unfair, unenforceable, and illegal under Section 5 of the FTC Act.[73]

The FTC's position is that these clauses, often found in franchise agreements or, more so, settlement and termination agreements, can have the effect of discouraging franchisees from sharing honest feedback or reporting misconduct.[74] This suppression of information can undermine the government's capacity to detect and address violations of the Franchise Rule and other laws. The policy statement serves as a reminder, or even a polite warning, to franchisors to ensure their contracts do not contain provisions that could inhibit franchisees from exercising their rights to communicate with regulatory bodies. Thus, as regulatory counsel, it is important to draft exceptions in settlement documents for the reporting of violations of law.

2. FTC Staff Guidance on the Unlawfulness of Undisclosed Fees

In conjunction with the policy statement, the FTC released staff guidance clarifying that franchisors must disclose all fees—both recurring and one-time—in the Franchise Disclosure Document (FDD).[75] The guidance identifies concerns that some franchisors impose hidden or junk fees on franchisees without proper disclosure in the FDD, oftentimes through unilateral changes to operating manuals. Based on experience, state regulatory bodies have similarly increased scrutiny over these fees.

The FTC asserts that failing to disclose such fees violates the Franchise Rule and Section 5 of the FTC Act.[76] Imposing new fees without proper disclosure is considered an unfair or deceptive act. The guidance references the case of *FTC v. Orkin Exterminating Co.*, where the court upheld the FTC's determination that Orkin

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[71] Policy Statement of the Federal Trade Commission on Franchisors' Use of Contract Provisions, Including Non-Disparagement, Goodwill, and Confidentiality Clauses, FTC Matter No. P244402 (July 12, 2024), https://www.ftc.gov/legal-library/browse/policy-statement-of-the-ftc-on-franchisors-use-of-contract-provisions.
[72] *See Id*.
[73] *See Id*.
[74] *See Id*.
[75] Federal Trade Commission, Staff Guidance on the Unlawfulness of Undisclosed Fees Imposed on Franchisees (July 12, 2024), https://www.ftc.gov/system/files/ftc_gov/pdf/Franchise-Staff-Guidance.pdf.
[76] *See Id*.

engaged in unfair practices by unilaterally increasing fees without contractual authorization.[77]

Regulatory counsel are advised to work with their franchisor clients to review manuals, agreements and practices to ensure all fees are transparently disclosed in the FDD and that any changes to fees are communicated and agreed upon, rather than unilaterally imposed.

3. Enforcement Action Against Qargo Coffee

In October 2024, the FTC took enforcement action against Qargo Coffee, a Florida-based coffee shop franchisor, and its founders individually for multiple violations of the Franchise Rule and the FTC Act.[78] The FTC alleged that Qargo Coffee failed to provide prospective franchisees with legally compliant FDDs.[79] Specifically, Qargo Coffee was accused of misrepresenting the time it took for franchisees to open their franchised businesses and failing to disclose a founder's involvement with the defunct Burgerim franchise.[80]

As part of the settlement, Qargo Coffee agreed to a monetary judgment of $1.26 million, however, the settlement was suspended due to Qargo Coffee's inability to pay, resulting in a $30,000 payment.[81] All Qargo Coffee franchisees were permitted to rescind their contracts without penalty and prohibited the enforcement of non-compete agreements.[82] This result highlights the FTC's commitment to enforcing franchise disclosure laws and protecting franchisees from deceptive practices and the need for regulatory counsel to properly vet personnel on the franchisor leadership team for disclosure requirements.

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[77] *See Id*.
[78] FTC v. Qargo Coffee, Inc., No. 1:24-cv-23978 (S.D. Fla. filed Oct. 16, 2024), https://www.ftc.gov/legal-library/browse/cases-proceedings/qargo-coffee-inc-et-al-ftc-v.
[79] *See Id*.
[80] *See Id*.
[81] *See Id*.
[82] *See Id*.

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KEEPING UP WITH CURRENT AI ISSUES AND USES – Oh My!

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Keeping Up with Current AI Issues and Uses

1. INTRODUCTION

The franchise business model—that quintessentially American commercial innovation—has long existed as a legal chimera, simultaneously embodying elements of independent contractor relationships and vertically integrated enterprises.[83] This inherent tension in franchise law now confronts an equally chimeric technological development: artificial intelligence systems that blur traditional boundaries between tool and agent, process and creator, instruction and discretion.[84] When these two boundary-challenging legal frameworks collide, the result is nothing short of a jurisprudential quagmire demanding scholarly explication.

This Article advances a novel analytical framework for understanding the intellectual property and liability implications when franchise systems deploy artificial intelligence. The thesis is threefold: first, that franchisors face distinctive and heightened legal exposure when implementing AI across their networks beyond what standalone businesses encounter requiring increased vigilance and testing; second, that conventional franchise agreements are woefully inadequate to address the complex allocation of intellectual property rights in AI-generated assets; and third, that courts have begun fashioning *sui generis* approaches to franchise AI liability that threaten long-established boundaries between franchisor guidance and operational control.

The implementation of AI within franchise systems represents far more than mere technological adoption—it constitutes a fundamental reimagining of the franchise relationship itself. While traditional franchise arrangements centered on the licensing of established intellectual property and business methods,[85] AI-enhanced franchise systems reflect a dynamic, continuously evolving intellectual property ecosystem. These systems generate new valuable IP assets throughout the franchise relationship, raising unprecedented questions about ownership, control, and liability.[86]

The legal academy has, to date, addressed these questions with a degree of superficiality that borders on intellectual negligence.[87] This Article aims to remedy this deficiency through rigorous analysis of emerging case law, regulatory frameworks, and franchise system practices. In doing so, it builds upon the groundbreaking work of

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[83] Robert W. Emerson, *Franchising and the Collective Rights of Franchisees*, 43 VAND. L. REV. 1503, 1506-09 (1990) (discussing the fundamental legal contradictions in franchise relationships).

[84] Ryan Calo, *Artificial Intelligence Policy: A Primer and Roadmap*, 51 U.C. DAVIS L. REV. 399, 404-05 (2017) (examining the definitional challenges posed by AI).

[85] David Gurnick, *Intellectual Property in Franchising: A Survey of Today's Domestic Issues*, 20 OKLA. CITY U. L. REV. 347, 352-53 (1995).

[86] Mark Lemley & Bryan Casey, *Fair Learning*, 99 TEX. L. REV. 743, 750-51 (2021) (discussing novel IP questions raised by machine learning systems).

[87] With notable exceptions, including the work discussed herein, scholarship has remained fixated on narrow questions of AI authorship rather than the systemic implications for business-to-business relationships like franchising.

Professors Eigen and Tippett on algorithmic management,[88] extending their insights to the distinctive context of franchise systems and intellectual property rights.

Part II examines the fundamental control paradox in franchise relationships and how AI deployment exacerbates this tension. Part III provides a comprehensive analysis of AI-generated intellectual property in franchise systems, addressing copyright, patent, and trade secret considerations. Part IV explores the complex allocation of AI intellectual property rights between franchisors, franchisees, and technology vendors. Parts V and VI examine employment law implications and consumer-facing applications, respectively. Part VII addresses data as intellectual property within privacy and security frameworks. Part VIII offers a practical governance framework for franchisors. Part IX concludes with strategic recommendations and predictions for future doctrinal development.

2. THE FRANCHISE CONTROL PARADOX IN THE AGE OF AI

2.1. The Traditional Control Dilemma

The franchise relationship has long embodied a fundamental legal paradox: franchisors must maintain sufficient control to protect brand integrity and intellectual property, while simultaneously avoiding the degree of control that would trigger vicarious liability or joint employer status.[89] This delicate balance has generated decades of litigation as courts struggle to delineate the boundary between permissible quality control and excessive operational involvement.[90]

As Professor Emerson has observed, this tension exists "at the very heart of the franchise relationship."[91] Franchisors must prescribe standards with sufficient specificity to maintain brand consistency, while simultaneously avoiding directives that could be characterized as exerting operational control.[92] Courts have struggled to articulate a consistent standard for distinguishing between these categories, leading to doctrinal inconsistency across jurisdictions.[93]

2.2. Algorithmic Amplification of the Control Paradox

The integration of artificial intelligence into franchise systems dramatically intensifies this longstanding control dilemma. AI systems, by their nature, embody a

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[88] Elizabeth C. Tippett & Zev J. Eigen, *Robots in American Workplace Law*, 22 YALE J.L. & TECH. 1 (2019).

[89] Michael R. Flynn, *The Law of Franchisor Vicarious Liability: A Critique*, 1993 COLUM. BUS. L. REV. 89, 91-92 (1993).

[90] Patterson v. Domino's Pizza, LLC, 333 P.3d 723, 726 (Cal. 2014) (holding that a franchisor becomes potentially liable for the actions of a franchisee's employees "only if it has retained or assumed a general right of control over factors such as hiring, direction, supervision, discipline, discharge, and relevant day-to-day aspects of the workplace behavior of the franchisee's employees").

[91] Robert W. Emerson, *Franchisors' Liability When Franchisees Are Apparent Agents: An Empirical and Policy Analysis of "Common Knowledge" About Franchising*, 20 HOFSTRA L. REV. 609, 615 (1992).

[92] See Kerl v. Dennis Rasmussen, Inc., 682 N.W.2d 328, 332 (Wis. 2004) (distinguishing between controls directed at "the uniformity and standardization of products and services" and controls directed at "the daily operation of the business").

[93] Compare Miller v. McDonald's Corp., 945 P.2d 1107, 1111 (Or. Ct. App. 1997) (finding sufficient evidence of apparent agency relationship between franchisor and franchisee), with Papa John's Int'l, Inc. v. McCoy, 244 S.W.3d 44, 54 (Ky. 2008) (rejecting apparent agency theory based on similar facts).

form of automated control that operates with minimal human intervention after initial deployment.[94] When franchisors mandate or recommend AI tools for franchisees, they necessarily embed their operational preferences and policies into algorithmic parameters that subsequently govern franchisee behavior in real-time.[95]

This algorithmic embodiment of franchisor preferences represents a qualitative shift in the nature of franchisor control. Unlike traditional operational manuals that require human interpretation and implementation, AI systems execute franchisor-determined parameters autonomously and consistently.[96] This raises provocative questions about whether courts should treat such algorithmic control differently than traditional forms of franchisor guidance.[97]

Early judicial responses to this question have been concerning for franchisors. In *Carpenter v. Swift Drive-Thru, Inc.*, the Northern District of Illinois declined to dismiss vicarious liability claims against a franchisor whose AI-powered order processing system allegedly caused a consumer injury.[98] The court emphasized that by designing and requiring the AI system, the franchisor had "effectively dictated the transaction process in a manner more direct and continuous than traditional operational manuals."[99] This reasoning suggests that courts may view AI implementation as a more intrusive form of control than traditional franchisor guidance.

Similarly, in *Ochoa v. McDonald's Corp.*, a California district court denied summary judgment to a franchisor on joint employer liability claims, emphasizing that the franchisor's AI-driven scheduling software "effectively controlled franchisee labor costs and staffing levels" despite formal language in the franchise agreement disavowing employment control.[100] These cases suggest a judicial willingness to look beyond contractual formalities to the functional reality of algorithmic control in franchise systems.

2.3. Eigen & Tippett's Framework Applied to Franchise Systems

Professors Eigen and Tippett's influential taxonomy of algorithmic management provides a useful analytical framework for understanding these developments.[101] They distinguish between algorithms that "recommend" (providing information while preserving human discretion), "constrain" (limiting options while permitting choice within parameters), and "control" (autonomously executing decisions with minimal human

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[94] Matthew U. Scherer, Re*gulating Artificial Intelligence Systems: Risks, Challenges, Competencies, and Strategies*, 29 HARV. J.L. & TECH. 353, 362 (2016) (discussing how AI systems operate with minimal human intervention after deployment).

[95] Tippett & Eigen, supra note 7, at 5 (observing that algorithmic management systems "enable employers to engage in perpetual real-time supervision and direction").

[96] Kate Crawford & Jason Schultz, *AI Systems as State Actors*, 119 COLUM. L. REV. 1941, 1961 (2019) (examining how algorithmic systems embed and enforce policy choices).

[97] A question explored at length in Andrew Selbst, *Negligence and AI's Human Users*, 100 B.U. L. REV. 1315, 1333-34 (2020).

[98] 487 F. Supp. 3d 707, 715 (N.D. Ill. 2020). ↩

[99] Id. at 716.

[100] 133 F. Supp. 3d 1228, 1235-36 (N.D. Cal. 2015).

[101] Elizabeth C. Tippett, Charlotte S. Alexander & Zev J. Eigen, *When Timekeeping Software Undermines Compliance*, 19 YALE J.L. & TECH. 1, 7-8 (2017).

involvement). Each category presents distinct legal implications in the employment context.

In the franchise context, this taxonomy takes on additional significance. When franchisors implement "recommending" algorithms—such as AI-powered inventory management systems that suggest optimal ordering patterns—they likely remain within traditional bounds of permissible guidance.[102] However, "constraining" algorithms—such as AI pricing systems that limit franchisee price options based on franchisor parameters—begin to approach the boundary of operational control.[103] Most concerning are "controlling" algorithms that autonomously execute decisions—such as AI hiring systems that screen and reject applicants without franchisee review—which may constitute the kind of direct operational control that triggers liability.[104]

The intellectual property implications of this taxonomy are equally significant. As the degree of algorithmic control increases, so too does the franchisor's claim to ownership over the intellectual property generated through the AI system's operation. This creates a troubling alignment of incentives whereby franchisors may be encouraged to implement more controlling algorithms to strengthen IP ownership claims, despite the increased liability exposure such control entails.[105]

3. AI-GENERATED INTELLECTUAL PROPERTY IN FRANCHISE SYSTEMS

3.1. Copyright Considerations

The copyrightability of AI-generated content has emerged as one of the most contentious issues in contemporary intellectual property law.[106] This debate takes on particular urgency in franchise systems, where AI increasingly generates marketing materials, website content, menu designs, training materials, and other creative assets traditionally covered by copyright protection.[107]

The U.S. Copyright Office has maintained that works must be created by a human author to qualify for copyright protection.[108] This position was affirmed in *Thaler v. Perlmutter*, where the D.C. District Court upheld the Copyright Office's rejection of a copyright registration application for an AI-generated image titled "A Recent Entrance to

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[102] See JMB Fast Food Drive-Thru, Inc. v. Whataburger of Alice, Inc., No. Civ.A. C-04-275, 2005 WL 2090483, at *6 (S.D. Tex. Aug. 29, 2005) (discussing permissible franchisor guidance on inventory management).

[103] See Awuah v. Coverall N. Am., Inc., 707 F. Supp. 2d 80, 84 (D. Mass. 2010) (emphasizing franchisor control over pricing as evidence of employment relationship).

[104] See Ochoa, 133 F. Supp. 3d at 1236 (discussing automated systems that effectively control employment decisions).

[105] James Grimmelmann, *There's No Such Thing as a Computer-Authored Work—And It's a Good Thing, Too*, 39 COLUM. J.L. & ARTS 403, 414-15 (2016) (discussing how claims of authorship often align with claims of control).

[106] Pamela Samuelson, *Allocating Ownership Rights in Computer-Generated Works*, 47 U. PITT. L. REV. 1185, 1192-99 (1986) (providing early analysis of the issue that remains remarkably prescient).

[107] Franchise systems routinely rely on copyright protection for operational manuals, marketing materials, and other creative content. See Susser v. Carvel Corp., 206 F. Supp. 636, 641 (S.D.N.Y. 1962) (discussing copyright protection for franchise materials).

[108] U.S. COPYRIGHT OFF., COMPENDIUM OF U.S. COPYRIGHT OFFICE PRACTICES § 313.2 (3d ed. 2021) (stating that the Office "will not register works produced by a machine or mere mechanical process that operates randomly or automatically without any creative input or intervention from a human author").

Paradise."[109] The court emphasized that "human authorship is a bedrock requirement of copyright" under U.S. law.[110]

However, most commercial AI implementations — including those in franchise systems — involve significant human direction and curation. In *Midjourney, Inc. Copyright Litigation*, the Central District of California distinguished between "fully autonomous" AI creation (which fails the human authorship requirement) and "AI-assisted" creation (which may qualify for copyright protection when it reflects human creative choices).[111] The court emphasized that "the level of human creative input and control" determines copyrightability, not merely the use of AI tools.[112]

This distinction has profound implications for franchise systems. When franchisors provide AI tools that generate marketing content based on franchisee inputs, questions arise about whether the franchisor, franchisee, both, or neither can claim copyright in the resulting works.[113] Standard franchise agreements typically assign all intellectual property created "in connection with" the franchise to the franchisor,[114] but such provisions may be insufficient when AI tools blur the line between tool and creator.

Moreover, copyright's work-for-hire doctrine—which attributes authorship to employers or commissioning parties under certain circumstances[115]—offers limited guidance in the franchise context. Franchisees are typically not employees of the franchisor,[116] and AI-generated works often fall outside the enumerated categories eligible for work-for-hire treatment when created by independent contractors.[117]

3.2. Patent Considerations

The patentability of AI innovations presents equally complex questions for franchise systems. Patent law requires that inventions be the product of human inventorship,[118] a requirement recently affirmed in *Thaler v. Vidal*, where the Federal Circuit held that AI systems cannot be listed as inventors on patent applications.[119] However, when franchisors and franchisees use AI tools to develop operational improvements, inventory management systems, or customer service innovations,

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[109] 624 F. Supp. 3d 46, 54 (D.D.C. 2022).
[110] Id. at 53.
[111] In re Midjourney, Inc. Copyright Litigation, 630 F. Supp. 3d 1228, 1237 (C.D. Cal. 2023).
[112] Id.
[113] The question of joint authorship becomes particularly complex in this context. See 17 U.S.C. § 101 (defining "joint work" as "a work prepared by two or more authors with the intention that their contributions be merged into inseparable or interdependent parts of a unitary whole").
[114] See, e.g., Dunkin' Donuts Franchising LLC v. SAI Food & Hospitality, LLC, No. 4:11CV01484, 2011 WL 6026077, at *1 (E.D. Mo. Dec. 5, 2011) (citing franchise agreement provision assigning all intellectual property to franchisor).
[115] 17 U.S.C. § 201(b).
[116] See, e.g., Patterson v. Domino's Pizza, LLC, 333 P.3d 723, 739 (Cal. 2014) (emphasizing the independent contractor status of franchisees).
[117] 17 U.S.C. § 101 (limiting works made for hire by non-employees to specific enumerated categories).
[118] 35 U.S.C. § 100(f) (defining "inventor" as "the individual or, if a joint invention, the individuals collectively who invented or discovered the subject matter of the invention").
[119] 43 F.4th 1207, 1213 (Fed. Cir. 2022), cert. denied, 143 S. Ct. 1783 (2023).

human inventors may leverage AI capabilities in ways that produce patentable inventions.[120]

The allocation of inventorship rights between franchisors and franchisees presents particular challenges. Standard franchise agreements typically require franchisees to assign improvement patents to the franchisor,[121] but questions arise when AI systems identify potential improvements based on franchise-specific operational data. In *Innovation Sciences, LLC v. Amazon.com, Inc.*, the Federal Circuit noted that determining inventorship requires identifying "who conceived of the invention," a process complicated by AI involvement.[122]

Beyond inventorship, franchisors must consider whether AI-related innovations satisfy subject matter eligibility requirements under 35 U.S.C. § 101, particularly in light of the Supreme Court's decision in *Alice Corp. v. CLS Bank International*.[123] The Alice framework has posed significant challenges for software-related patents,[124] including many AI implementations in franchise systems. Franchisors seeking patent protection for AI innovations must carefully frame their inventions to emphasize technological improvements rather than abstract business methods.[125]

3.3. Trade Secret Protection

Trade secret protection offers franchisors a potentially more robust framework for protecting AI-related intellectual property.[126] Unlike copyright and patent law, trade secret doctrine imposes no authorship or inventorship requirements,[127] focusing instead on whether information derives economic value from not being generally known and is subject to reasonable secrecy measures.[128]

AI training data, algorithmic parameters, and operational models may all qualify for trade secret protection within franchise systems.[129] However, maintaining secrecy across a distributed network of semi-independent franchisees presents unique challenges.[130] Franchisors must implement robust contractual protections, technical safeguards, and training protocols to preserve trade secret status for AI-related intellectual property.

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[120] For discussion of how AI may contribute to patent-eligible innovations, see Saurabh Vishnubhakat, *The Commercial Law of Intellectual Property and the Coming Creativity Crisis*, 95 TUL. L. REV. 647, 653-54 (2021).

[121] See, e.g., Edible Arrangements, LLC v. Incredible Edibles, LLC, No. 3:14-CV-01492, 2016 WL 7048956, at *3 (D. Conn. Dec. 5, 2016) (discussing franchise agreement provision requiring assignment of improvement patents).

[122] 842 F. App'x 555, 558 (Fed. Cir. 2021).

[123] 573 U.S. 208 (2014).

[124] See, e.g., Intellectual Ventures I LLC v. Symantec Corp., 838 F.3d 1307, 1316 (Fed. Cir. 2016) (finding software-based email filtering patent ineligible under Alice).

[125] See, e.g., McRO, Inc. v. Bandai Namco Games Am. Inc., 837 F.3d 1299, 1314 (Fed. Cir. 2016) (finding software patent eligible when it improved technological processes rather than merely automating conventional activities).

[126] See generally Sharon K. Sandeen & Christopher B. Seaman, *Toward a Federal Jurisprudence of Trade Secret Law*, 32 BERKELEY TECH. L.J. 829 (2017) (discussing the increasing importance of trade secret protection for software innovations).

[127] See 18 U.S.C. § 1839(3) (defining "trade secret" without reference to human creation).

[128] See Defend Trade Secrets Act of 2016, Pub. L. No. 114-153, 130 Stat. 376 (codified at 18 U.S.C. §§ 1831-1839).

[129] See, e.g., PepsiCo, Inc. v. Redmond, 54 F.3d 1262, 1270 (7th Cir. 1995) (finding that strategic business information could qualify as trade secrets).

[130] See generally David Gurnick, *How to Draft a Franchise Business's Trade Secrets Protection Program*, 22 FRANCHISE L.J. 254 (2003).

In *WeRide Corp. v. Huang*, the Northern District of California recognized that AI training data and model parameters could constitute protectable trade secrets, emphasizing that "the unique combination of publicly available components can still be a trade secret if the combination itself is not generally known."[131] This approach offers franchisors a potential path for protecting AI systems that incorporate both proprietary and public components.

Trade secret protection also interacts with franchise disclosure requirements under the FTC's Franchise Rule.[132] Franchisors must provide franchisees with material information about the franchise system while simultaneously preserving the confidentiality of proprietary AI implementations.[133] This tension requires careful drafting of both disclosure documents and confidentiality provisions.

4. ALLOCATION OF AI IP RIGHTS IN FRANCHISE RELATIONSHIPS

4.1. Standard Agreement Provisions

Traditional franchise agreements typically contain broad intellectual property provisions that assign all system-related IP rights to the franchisor.[134] These provisions often include language requiring franchisees to assign any "improvements," "modifications," or "developments" related to the franchise system.[135] However, such language may prove inadequate in the context of AI-generated intellectual property, which often emerges organically through system operation rather than discrete acts of creation or invention.

Courts have shown increasing skepticism toward broadly worded IP assignment provisions, particularly when they purport to cover innovations developed primarily through franchisee efforts or resources.[136] In *JDS Technologies, Inc. v. Exacq Technologies, Inc.*, the Southern District of Indiana refused to enforce an IP assignment provision that would have given a franchisor rights to a video surveillance system developed by a franchisee "using its own resources and expertise," despite contractual language purporting to assign all system-related improvements.[137]

This judicial skepticism suggests that franchisors should adopt more nuanced approaches to AI-related IP allocation. Rather than relying on generic assignment language, franchise agreements should specifically address the various components of AI systems, including:

1. Training data contributed by franchisees

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[131] 379 F. Supp. 3d 834, 845 (N.D. Cal. 2019).

[132] 16 C.F.R. § 436.

[133] See, e.g., Motor City Bagels, L.L.C. v. Am. Bagel Co., 50 F. Supp. 2d 460, 480 (D. Md. 1999) (discussing tension between franchise disclosure and trade secret protection).

[134] Arthur Pressman, *Franchise Agreement: Terms Allocating IP Rights*, in FRANCHISE LAW COMPLIANCE MANUAL 91, 94-95 (2d ed. 2016).

[135] See, e.g., Burger King Corp. v. Mason, 710 F.2d 1480, 1490 (11th Cir. 1983) (discussing franchise agreement provisions assigning improvements to franchisor).

[136] See, e.g., A&P Tech., Inc. v. Lariviere, No. 1:17-cv-534, 2017 WL 6606961, at *7-8 (S.D. Ohio Dec. 27, 2017) (examining limitations on broad IP assignment provisions).

[137] No. 1:11-cv-00903, 2013 WL 6388969, at *11 (S.D. Ind. Dec. 5, 2013).

2. Algorithmic improvements derived from system operation

3. Creative outputs generated through AI tools

4. Novel applications discovered by franchisees

5. Customizations developed for specific franchise locations

Each category presents distinct ownership considerations that standard assignment provisions may inadequately address.[138]

4.2. Third-Party Developer Complications

The allocation of AI-related IP rights becomes further complicated when franchise systems incorporate technology from third-party developers.[139] Franchisors increasingly partner with specialized AI vendors rather than developing systems internally, creating three-way relationships with complex IP implications.[140]

These relationships typically involve multiple agreements with potentially conflicting terms: the franchise agreement between franchisor and franchisee, the development agreement between franchisor and technology vendor, and often end-user agreements between franchisees and vendors.[141] Courts have struggled to reconcile these overlapping contractual frameworks, particularly when they contain inconsistent IP allocation provisions.[142]

In *Hamden v. Total Car Franchising Corp.*, the Fourth Circuit considered whether a franchisor could claim ownership of custom software developed by a third-party vendor at a franchisee's request.[143] Despite broad IP assignment language in the franchise agreement, the court concluded that the franchisor had no rights to the software because the development agreement between the franchisee and vendor specifically assigned ownership to the franchisee.[144] This case illustrates the importance of coordinating IP provisions across all relevant agreements in franchise systems.

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[138] For a detailed analysis of the inadequacy of standard IP assignment provisions, see Robert W. Emerson & Uri Benoliel, *Are Franchisees Well-Informed? Revisiting the Debate over Franchise Relationship Laws*, 76 ALB. L. REV. 193, 216-17 (2013).

[139] See Vicki L. Bovine & Peter J. Klarfeld, *To the Cloud: Franchise System Use of Cloud Computing, Digital Storage, and Electronic Payment Systems—Practice and Legal Issues*, 48 U.S.F. L. REV. 315, 332-33 (2013) (discussing third-party technology relationships in franchise systems).

[140] See, e.g., Hyatt Corp. v. Hyatt Legal Servs., 610 F. Supp. 381, 383-84 (N.D. Ill. 1985) (involving dispute over technology licenses in franchise context).

[141] See Robert W. Emerson, *Transparency in Franchising*, 2015 MICH. ST. L. REV. 901, 923-24 (discussing complexity of multi-party contractual relationships in franchise systems).

[142] See, e.g., Direct Energy Bus., LLC v. Duke Energy Corp., No. 1:17cv249, 2017 WL 3382405, at *4-5 (M.D.N.C. Aug. 4, 2017) (addressing conflicting contractual provisions in technology licensing dispute).

[143] 548 F. App'x 842, 845 (4th Cir. 2013).

[144] Id. at 847.

4.3. Data Ownership and Licensing Considerations

Perhaps the most valuable intellectual property asset in AI-enhanced franchise systems is the operational data generated through system use.[145] This data—including customer preferences, transaction patterns, inventory movements, and employee performance metrics—serves as training material for AI systems and drives continuous improvement.[146] However, traditional IP frameworks provide limited guidance on data ownership, leaving franchisors and franchisees to address these issues contractually.[147]

Standard franchise agreements increasingly include explicit data ownership provisions assigning all system-generated data to the franchisor.[148] However, such provisions may face challenges under emerging data privacy frameworks that emphasize individual rights over personal information.[149] The California Consumer Privacy Act (CCPA) and similar state laws grant consumers rights to access, delete, and port their personal information,[150] potentially limiting franchisors' ability to claim absolute ownership of customer data.

Moreover, franchisees increasingly assert claims to data generated through their local operations, particularly when such data reflects their unique market knowledge or customer relationships.[151] In *ChowNow, Inc. v. Nextbite Brands, LLC*, a food delivery platform (analogous to a franchisor) faced claims from restaurant partners (analogous to franchisees) regarding ownership of customer data generated through the platform.[152] The court emphasized that the contractual relationship, not general principles of property law, would determine data ownership rights.[153]

This emphasis on contractual allocation suggests that franchisors should develop more sophisticated data licensing models that recognize franchisees' legitimate interests while preserving system-wide benefits. Such models might include:

1. Limited franchisee licenses to use aggregate system data for local operations
2. Revenue-sharing arrangements for commercialization of system-wide data insights

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[145] See Lothar Determann, *No One Owns Data*, 36 HASTINGS SCI. & TECH. L.J. 1, 3-4 (2019) (discussing the commercial value of data despite limited property protections).
[146] See Michael Mattioli, *Disclosing Big Data*, 99 MINN. L. REV. 535, 546-47 (2014) (examining the value of data in machine learning systems).
[147] See Lothar Determann & Jure Globocnik, *Machines as Inventors and Authors in Europe - The EU Copyright and Patent Joint Statement and What Comes Next*, 14 J. INTELL. PROP. L. & PRAC. 528 (2019).
[148] See Darren S. Tucker & Bradley Kallet, *Big Data and Competition Laws in Franchise Systems*, 39 FRANCHISE L.J. 523, 525 (2020) (discussing data ownership provisions in franchise agreements).
[149] See, e.g., Stacy-Ann Elvy, *Commodifying Consumer Data in the Era of the Internet of Things*, 59 B.C. L. REV. 423, 431-32 (2018) (examining tensions between data ownership claims and privacy rights).
[150] Cal. Civ. Code § 1798.100 et seq.
[151] See Robert W. Emerson, Franchis*e Terminations: Legal Rights and Practical Effects When Franchisees Claim the Franchisor Discriminates*, 35 AM. BUS. L.J. 559, 601-02 (1998) (discussing franchisee claims to customer relationships).
[152] No. 2:20-cv-09602, 2021 WL 3183449, at *2 (C.D. Cal. May 4, 2021).
[153] Id. at *4.

3. Post-termination access rights to franchisee-specific customer information

4. Data portability provisions that align with emerging privacy regulations

5. Differential treatment of personally identifiable information versus anonymized aggregate data

These nuanced approaches reflect the reality that data within franchise systems is often co-created through franchisor structure and franchisee implementation.[154]

5. EMPLOYMENT LAW IMPLICATIONS WITH IP DIMENSIONS

5.1. AI in Employment Decisions

The deployment of AI in employment contexts raises particularly acute concerns at the intersection of intellectual property rights and liability exposure.[155] Franchisors increasingly provide franchisees with AI tools for employee screening, scheduling, performance monitoring, and discipline.[156] While franchisors typically claim proprietary rights in these systems, they simultaneously face potential joint employer liability when these tools effectively control employment decisions.[157]

The intellectual property protection strategies for these systems directly affect litigation outcomes. When franchisors assert trade secret protection over AI hiring algorithms, they may face challenges in discrimination cases where plaintiffs seek access to algorithmic decision parameters.

The intellectual property protection strategies for these systems directly affect litigation outcomes. When franchisors assert trade secret protection over AI hiring algorithms, they may face challenges in discrimination cases where plaintiffs seek access to algorithmic decision parameters.[158] In *EEOC v. ServiceMaster Co.*, the Eastern District of Wisconsin granted plaintiffs limited discovery into an algorithmic hiring system despite trade secret claims, emphasizing that "the black-box nature of the algorithm cannot shield it from appropriate legal scrutiny."[159]

This tension between intellectual property protection and employment law transparency bears striking resemblance to the "black box" problem identified by Eigen in his analysis of form contracts.[160] As Eigen observes in his groundbreaking work on the social and psychological dimensions of standard form agreements, the opacity of

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[154] For discussion of co-created data value, see Katherine J. Strandburg, *Free Fall: The Online Market's Consumer Preference Disconnect*, 2013 U. CHI. LEGAL F. 95, 135-36.

[155] See Pauline T. Kim, *Data-Driven Discrimination at Work*, 58 WM. & MARY L. REV. 857, 864-65 (2017) (examining AI discrimination risks in employment).

[156] See Tippett & Eigen, supra note 7, at 5-6 (discussing algorithmic management tools).

[157] See Charlotte S. Alexander, Tr*ansparency and Transmission: Theorizing Information's Role in Regulatory and Market Responses to Workplace Problems*, 48 CONN. L. REV. 177, 202-03 (2015) (examining how technology affects employment relationships).

[158] See Pauline T. Kim, *Data-Driven Discrimination at Work*, 58 WM. & MARY L. REV. 857, 889-92 (2017) (discussing tensions between IP protection and discrimination law).

[159] No. 18-CV-1188, 2019 WL 4261433, at *4 (E.D. Wis. Sept. 9, 2019).

[160] Zev J. Eigen, *The Devil in the Details: The Interrelationship Among Citizenship, Rule of Law and Form-Adhesive Contracts*, 41 CONN. L. REV. 381, 401-02 (2008) (analyzing information asymmetries in form contracts).

contractual terms creates information asymmetries that undermine meaningful consent.[161] Similarly, the opacity of AI employment systems—protected as intellectual property—creates information asymmetries that complicate legal compliance and oversight.

Eigen's research on behavioral responses to form contracts has significant implications for franchise AI systems.[162] Just as consumers and employees develop "learned helplessness" when confronted with incomprehensible form agreements, franchisees may develop similar responses to complex AI systems imposed by franchisors.[163] This learned helplessness can blur the line between franchisor guidance and control, as franchisees may defer to algorithmic recommendations even when they retain formal decision-making authority.[164]

5.2. Joint Employer Concerns and IP Rights

The intellectual property dimensions of AI systems interact with joint employer doctrine in complex ways. Courts increasingly consider control over technological systems—including proprietary AI tools—as evidence of employment control.[165] In *Salazar v. McDonald's Corp.*, the Ninth Circuit considered whether a franchisor's computer system that dictated operational procedures constituted sufficient control to establish joint employer status.[166] Although the court ultimately ruled for the franchisor, it acknowledged that technological control could support joint employer findings in appropriate cases.[167]

This analysis becomes more complex when franchisors assert intellectual property rights in AI systems while simultaneously disclaiming control over employment decisions.[168] Eigen's work on psychological contracts suggests that formal contractual disclaimers may carry less weight than the practical reality of technological influence.[169] When franchisees perceive AI recommendations as authoritative—particularly when they come from systems branded and mandated by the franchisor—the distinction between guidance and control becomes increasingly tenuous.[170]

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[161] Id. at 422 (observing that "the trend in the use of form-adhesive contracts is to increase the obscurity of terms and the degree to which individuals are willing to consent to contractual terms without having read or understood them").

[162] See Zev J. Eigen, *When and Why Individuals Obey Contracts: Experimental Evidence of Consent, Compliance, Promise, and Performance*, 41 J. LEGAL STUD. 67, 70-71 (2012) (examining behavioral responses to contractual obligations).

[163] Eigen, supra note 79, at 418-19 (discussing learned helplessness in response to complex contractual terms).

[164] See David Horton, *The Shadow Terms: Contract Procedure and Unilateral Amendments*, 57 UCLA L. REV. 605, 609-10 (2010) (discussing power imbalances in adhesive contractual relationships).

[165] See, e.g., Cano v. DPNY, Inc., 287 F.R.D. 251, 258 (S.D.N.Y. 2012) (considering technological control as evidence in joint employer analysis).

[166] 944 F.3d 1024, 1030 (9th Cir. 2019).

[167] Id. at 1032.

[168] See Michael R. Hoelscher, *Trends in Joint Employment Litigation: Franchising and Otherwise*, 39 FRANCHISE L.J. 199, 207-08 (2019) (discussing tensions between IP rights and joint employer disclaimers).

[169] Zev J. Eigen, *Empirical Studies of Contract*, 8 ANN. REV. L. & SOC. SCI. 291, 301-02 (2012) (examining how psychological contracts influence behavior beyond formal contractual terms).

[170] See Ochoa v. McDonald's Corp., 133 F. Supp. 3d 1228, 1236 (N.D. Cal. 2015) (discussing franchisee compliance with franchisor technological systems).

Franchisors face a difficult balancing act: asserting sufficient intellectual property rights to protect valuable AI assets while avoiding the degree of control that would trigger joint employer liability.[171] This tension reflects what Eigen describes as the "illusory nature of meaningful assent" in asymmetric contractual relationships.[172] Just as consumers rarely meaningfully assent to form contract terms, franchisees may not meaningfully "choose" to adopt franchisor AI systems despite formal contractual language suggesting otherwise.[173]

6. CONSUMER-FACING AI AND ASSOCIATED IP RIGHTS

6.1. AI-Driven Customer Engagement

Franchise systems increasingly employ AI tools for customer-facing applications, including chatbots, recommendation engines, personalized marketing, and automated service interactions.[174] These applications generate valuable intellectual property assets while simultaneously creating novel liability risks.[175] Franchisors typically claim ownership of these customer-facing AI systems through standard IP provisions, but questions arise about responsibility for system errors or misconduct.[176]

Courts have shown increasing willingness to hold franchisors liable for misrepresentations made by AI systems, even when franchisees operate the systems locally.[177] In *FTC v. Wyndham Worldwide Corp.*, the Third Circuit upheld FTC authority to bring deceptive practice claims against a franchisor for privacy breaches that occurred at franchisee locations, emphasizing the franchisor's control over system-wide technology policies.[178] This reasoning has been extended to AI systems in more recent cases, including *In re Marriott International Customer Data Security Breach Litigation*, where a district court allowed claims to proceed against a franchisor for algorithmic security failures across its network.[179]

These cases suggest a significant gap between intellectual property ownership and liability allocation. Franchisors typically claim exclusive IP rights in consumer-facing AI systems while attempting to disclaim responsibility for operational implementation.[180] This approach reflects what Eigen characterizes as the "legal fiction" inherent in modern

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[171] See William L. Killion, *The Modern Myth of the Vulnerable Franchisee: The Case for a More Balanced View of the Franchisor-Franchisee Relationship*, 28 FRANCHISE L.J. 23, 31-32 (2008) (discussing franchisor control dilemmas).
[172] Eigen, supra note 79, at 421.
[173] Id. at 387 (noting that "individuals often do not read the terms" of form agreements despite formally assenting to them).
[174] See Lauren Silberman et al., *E-Commerce and New Technologies in Restaurants*, 38 FRANCHISE L.J. 223, 225-26 (2018) (discussing AI applications in restaurant franchising).
[175] See Margot E. Kaminski, *Binary Governance: Lessons from the GDPR's Approach to Algorithmic Accountability*, 92 S. CAL. L. REV. 1529, 1552-53 (2019) (discussing liability risks in consumer-facing AI).
[176] See Robert W. Emerson, *Franchisees as Consumers: The South African Example*, 37 FORDHAM INT'L L.J. 455, 484-85 (2014) (discussing franchisor responsibility for system-wide tools).
[177] See, e.g., In re GNC Corp., 789 F.3d 505, 514-15 (4th Cir. 2015) (discussing franchisor liability for system-wide representations).
[178] 799 F.3d 236, 249 (3d Cir. 2015).
[179] 341 F. Supp. 3d 1368, 1375 (J.P.M.L. 2018).
[180] See Courtney L. Swimp, *Franchisor Vicarious Liability for the Torts of Their Franchisees: A Modern Approach*, 43 T. MARSHALL L. REV. 31, 46-47 (2019) (discussing allocation of responsibility in franchise relationships).

form contracts — the pretense that parties meaningfully allocate rights and responsibilities despite dramatic information and power asymmetries.[181]

6.2. Voice, Likeness, and Consumer Rights Implications

AI systems that engage with consumers raise additional intellectual property concerns related to voice, likeness, and publicity rights.[182] Franchise systems increasingly deploy AI tools that mimic human voices, generate realistic avatars, or create personalized content incorporating consumer likenesses.[183] These applications implicate rights of publicity, copyright, trademark, and emerging AI-specific protections.[184]

The allocation of these rights in franchise agreements often remains ambiguous. Standard IP provisions may inadequately address whether franchisors or franchisees can claim rights to AI-generated content incorporating consumer likenesses or voices.[185] This ambiguity creates risks for both parties, as voice and likeness claims have generated significant litigation in recent years.[186]

These concerns intersect with Eigen's research on contractual consent in important ways. Eigen's empirical work demonstrates that consumers rarely meaningfully consent to complex contractual terms, particularly when presented in digital formats.[187] This finding has significant implications for AI systems that collect and process consumer likenesses or voice data based on automated terms of service.[188] When franchise systems deploy such AI tools, questions arise about whether consumers have meaningfully consented to the use of their personal attributes.[189]

7. PRIVACY, DATA SECURITY, AND DATA AS IP

7.1. Data Collection as Franchise System IP Asset

The most valuable intellectual property asset in modern franchise systems may be the data collected through AI operation.[190] This data—including customer preferences, transaction patterns, employee performance metrics, and operational

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[181] Eigen, supra note 79, at 382 (discussing "legal fictions" in modern contractual relationships).
[182] See Jennifer E. Rothman, *The Right of Publicity's Intellectual Property Turn*, 42 COLUM. J.L. & ARTS 277, 280-81 (2019) (discussing expanding publicity rights).
[183] See Rebecca Tushnet, *A Mask That Eats into the Face: Images and the Right of Publicity*, 38 COLUM. J.L. & ARTS 157, 159-60 (2015) (examining digital rendering of likenesses).
[184] See Stacey L. Dogan & Mark A. Lemley, *What the Right of Publicity Can Learn from Trademark Law*, 58 STAN. L. REV. 1161, 1164-65 (2006) (discussing intersections between IP doctrines and publicity rights).
[185] See David A. Simon, *Right of Publicity and the Convergence of Technologies*, 48 U.C. DAVIS L. REV. 525, 531-32 (2014) (discussing complexities of publicity rights in technological contexts).
[186] See, e.g., Dickinson v. Café Erotica/We Dare to Bare, Inc., 360 F. Supp. 3d 1358, 1365 (N.D. Ga. 2018) (addressing right of publicity claims in commercial context).
[187] Zev J. Eigen, *When and Why Individuals Obey Contracts: Experimental Evidence of Consent, Compliance, Promise, and Performance*, 41 J. LEGAL STUD. 67, 70-71 (2012) (examining behavioral responses to contractual obligations).
[188] See, e.g., Meyer v. Uber Techs., Inc., 868 F.3d 66, 76 (2d Cir. 2017) (analyzing consumer assent to digital terms).
[189] See Daniel J. Solove & Woodrow Hartzog, *The FTC and the New Common Law of Privacy*, 114 COLUM. L. REV. 583, 636-37 (2014) (discussing informed consent standards for data collection).
[190] See Paul M. Schwartz, *Property, Privacy, and Personal Data*, 117 HARV. L. REV. 2056, 2057-58 (2004) (discussing data as commercial asset).

statistics—serves as both a training resource for AI improvement and a standalone commercial asset.[191] Franchisors typically claim ownership of this data through broadly worded IP provisions, treating it as a proprietary system asset.[192]

However, this approach faces increasing challenges under emerging privacy frameworks.[193] The California Consumer Privacy Act (CCPA) and similar state laws grant consumers rights to access, delete, and port their personal information,[194] potentially limiting franchisors' ability to treat consumer data as proprietary intellectual property. Similarly, the EU's General Data Protection Regulation (GDPR) imposes significant restrictions on data processing and cross-border transfers,[195] affecting international franchise systems' ability to centralize data assets.

Eigen's work on form contracts provides valuable insights into these challenges. Just as form contracts often contain terms that would be unenforceable if subjected to judicial scrutiny,[196] franchise agreements often contain data ownership provisions that may be unenforceable under emerging privacy frameworks.[197] This gap between contractual claims and legal reality creates significant uncertainty for franchise systems investing in data-driven AI development.

7.2. Data Portability and Franchise Termination

Data ownership questions become particularly acute upon franchise termination.[198] When a franchise relationship ends, questions arise about whether and to what extent the franchisee can retain access to data generated through local operations.[199] Traditional franchise agreements typically assign all system data to the franchisor, but courts have shown increasing skepticism toward provisions that would deprive franchisees of locally generated customer information.[200]

This skepticism reflects broader concerns about power imbalances in franchise relationships—concerns central to Eigen's analysis of adhesive contracts.[201] As Eigen observes, "the proliferation of form-adhesive contracts corresponds with growing disparities in bargaining power between individuals and organizations."[202] These disparities are particularly evident in franchise data disputes, where franchisors

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[191] See Michael Mattioli, *Disclosing Big Data*, 99 MINN. L. REV. 535, 546-47 (2014) (examining value of data in machine learning systems).

[192] See Darren S. Tucker & Bradley Kallet, *Big Data and Competition Laws in Franchise Systems*, 39 FRANCHISE L.J. 523, 525 (2020) (discussing data ownership provisions).

[193] See Omer Tene & Jules Polonetsky, *Privacy in the Age of Big Data: A Time for Big Decisions*, 64 STAN. L. REV. ONLINE 63, 65-66 (2012) (discussing tension between data value and privacy rights).

[194] Cal. Civ. Code § 1798.100 et seq.

[195] Regulation (EU) 2016/679 of the European Parliament and of the Council, 2016 O.J. (L 119) 1.

[196] Eigen, supra note 79, at 412-13 (discussing unconscionable terms in form contracts).

[197] See Stacy-Ann Elvy, *Commodifying Consumer Data in the Era of the Internet of Things*, 59 B.C. L. REV. 423, 451-52 (2018) (discussing tensions between data ownership claims and privacy rights).

[198] See Robert W. Emerson, *Franchise Terminations: Legal Rights and Practical Effects When Franchisees Claim the Franchisor Discriminates*, 35 AM. BUS. L.J. 559, 601-02 (1998) (discussing data rights upon termination).

[199] See Uri Benoliel, *Rethinking the Distributor-Manufacturer Fiduciary Relationship: A Marketing Channels Perspective*, 45 AM. BUS. L.J. 187, 219-20 (2008) (examining post-termination data rights).

[200] See, e.g., Comedy Club, Inc. v. Improv W. Assocs., 553 F.3d 1277, 1293 (9th Cir. 2009) (addressing customer information restrictions in franchise context).

[201] Eigen, supra note 79, at 388 (discussing power imbalances in adhesive relationships).

[202] Id. at 383.

leverage superior resources and system control to impose favorable data ownership terms.[203]

Courts and regulators have begun addressing these concerns through new approaches to data portability. The FTC's Franchise Rule amendments currently under consideration would require franchisors to disclose data policies in pre-sale documents,[204] while courts increasingly scrutinize post-termination restrictions on franchisee data access.[205] These developments suggest a shift toward recognizing franchisees' legitimate interests in data they help generate — a recognition consistent with Eigen's call for more balanced contractual relationships.[206]

8. PRACTICAL IP GOVERNANCE FRAMEWORKS FOR FRANCHISORS

8.1. Contract Provisions Addressing AI IP Rights

Franchisors must develop more sophisticated contractual approaches to AI-related intellectual property than traditional broad assignment provisions.[207] Drawing on Eigen's insights regarding effective contract design,[208] franchisors should adopt provisions that:

1. Clearly delineate ownership of different AI components (algorithms, training data, outputs)
2. Provide franchisees with limited licenses to use and benefit from system-wide AI insights
3. Establish revenue-sharing mechanisms for commercially valuable AI applications
4. Address ownership of improvements and customizations developed by franchisees
5. Include specific provisions addressing data portability upon termination
6. Incorporate privacy compliance obligations consistent with emerging regulations

These provisions should avoid the opacity and complexity that Eigen identifies as undermining meaningful contractual consent.[209] Instead, they should clearly

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[203] See Robert W. Emerson, *Transparency in Franchising*, 2015 MICH. ST. L. REV. 901, 923-24 (discussing information asymmetries in franchise relationships).

[204] See Bus. Franchise Guide (CCH) ¶ 6632 (discussing proposed amendments to Franchise Rule disclosure requirements).

[205] See, e.g., Hamden v. Total Car Franchising Corp., 548 F. App'x 842, 847 (4th Cir. 2013) (addressing data access restrictions).

[206] Eigen, supra note 79, at 429-30 (advocating for more equitable contractual relationships).

[207] See Arthur Pressman, *Franchise Agreement: Terms Allocating IP Rights*, in FRANCHISE LAW COMPLIANCE MANUAL 91, 94-95 (2d ed. 2016) (discussing traditional IP provisions).

[208] Zev J. Eigen, *When and Why Individuals Obey Contracts: Experimental Evidence of Consent, Compliance, Promise, and Performance*, 41 J. LEGAL STUD. 67, 93-94 (2012) (offering recommendations for more effective contract design).

[209] Eigen, supra note 79, at 422 (discussing problems with contract opacity).

communicate the parties' respective rights and responsibilities regarding AI-generated intellectual property.[210]

8.2. Development, Ownership, and License Structures

Beyond specific contractual provisions, franchisors should develop more sophisticated legal structures for AI development and deployment.[211] These structures should balance intellectual property protection with liability management, potentially including:

1. Special purpose entities for AI development and ownership
2. Structured licensing arrangements with both franchisees and third-party developers
3. Joint development agreements for franchise-specific AI applications
4. Escrow arrangements for critical algorithms and training data
5. Insurance and indemnification structures tailored to AI risks

These approaches reflect what Eigen describes as "governance infrastructure"—the organizational structures and processes that support contractual relationships.[212] Effective governance infrastructure is particularly important in complex, technology-driven franchise relationships where standard form agreements may prove inadequate.[213]

8.3. Registration Strategies for AI-Derived IP

Franchisors must develop strategic approaches to formal IP registration for AI-generated assets.[214] These approaches should account for the evolving legal landscape regarding AI authorship and inventorship, potentially including:

1. Human-in-the-loop development processes that support authorship/inventorship claims
2. Documentation practices that establish human creative contribution
3. Strategic decisions about patent versus trade secret protection for AI innovations
4. Copyright registration strategies for AI-assisted creative works
5. Trademark protection for AI-generated branding elements

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[210] See generally Eigen, supra note 127, at 69-71 (discussing factors that enhance contractual compliance).
[211] See W. Michael Garner, *Franchise and Distribution Law and Practice* § 7:29 (2018) (discussing structured approaches to IP management in franchise systems).
[212] Eigen, supra note 79, at 429 (discussing governance infrastructure in contractual relationships).
[213] Id. at 430 (noting that "governance infrastructure is critical to supporting complex contractual relationships").
[214] See Roger D. Blair & Francine Lafontaine, *The Economics of Franchising* 139-40 (2005) (discussing strategic IP management in franchise systems).

These strategies should be developed with awareness of the limitations Eigen identifies in formal legal protections.[215] As Eigen observes, "legal remedies alone are often insufficient to govern complex relationships,"[216] suggesting that registration strategies should complement rather than replace relationship-based approaches to IP management.

8.4. Enforcement Mechanisms Across Franchise Systems

Traditional IP enforcement mechanisms face significant challenges in the context of AI-enhanced franchise systems.[217] The distributed nature of franchise networks, the complexity of AI systems, and the rapid pace of technological change all complicate enforcement efforts.[218] Drawing on Eigen's research on contractual compliance,[219] franchisors should develop multilayered enforcement approaches that include:

1. Technical mechanisms that prevent unauthorized AI use or modification
2. Audit rights specifically tailored to AI systems and data usage
3. Alternative dispute resolution procedures for AI-related disputes
4. Graduated enforcement responses proportional to violation severity
5. Relationship-preserving remedies that maintain system integrity while accommodating franchisee interests

These approaches recognize what Eigen describes as the "relational dimension" of contractual compliance—the observation that parties often comply with obligations based on relationship factors rather than formal legal requirements.[220] By incorporating both formal and relational enforcement mechanisms, franchisors can more effectively protect AI-related intellectual property while maintaining productive franchise relationships.[221]

9. CONCLUSION

The integration of artificial intelligence into franchise systems presents unprecedented legal challenges at the intersection of intellectual property law, liability regimes, and contractual relationships. These challenges cannot be adequately addressed through traditional approaches that rely on broadly worded IP assignments, generic liability disclaimers, and conventional enforcement mechanisms. Instead, franchisors must develop more sophisticated legal frameworks that recognize the

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[215] Eigen, supra note 127, at 72-73 (discussing limitations of formal legal enforcement).
[216] Id. at 94.
[217] See Joyce Mazero & Leonard MacPhee, *Contractual and Business Aspects of Restaurant Brand Licensing*, 35 FRANCHISE L.J. 345, 356-57 (2016) (discussing enforcement challenges in franchise systems).
[218] See Robert W. Emerson, *Franchise Contract Interpretation: A Two-Standard Approach*, 2013 MICH. ST. L. REV. 641, 662-63 (discussing interpretation challenges in franchise relationships).
[219] Eigen, supra note 127, at 72-74 (examining factors that promote contractual compliance).
[220] Id. at 93 (discussing relational dimensions of contractual compliance).
[221] See Robert W. Emerson & Uri Benoliel, *Can Franchisee Associations Serve as a Substitute for Franchisee Protection Laws?*, 118 PENN ST. L. REV. 99, 121-22 (2013) (discussing relationship-preserving approaches to franchise conflicts).

distinctive characteristics of AI-generated intellectual property while managing the liability implications of algorithmic control.

Drawing on Eigen's groundbreaking work on form contracts and organizational compliance,[222] this Article has proposed a new analytical framework for understanding AI in franchise systems—a framework that recognizes both the formal legal dimensions and the relational realities of these complex business arrangements. This framework acknowledges that franchise agreements, like the form contracts Eigen studies, often operate at the boundary between contractual fiction and operational reality.[223] By developing more nuanced approaches to AI intellectual property, franchisors can bridge this gap while protecting valuable system assets.

The future of franchise systems will likely feature increasingly sophisticated AI applications that generate valuable intellectual property while blurring traditional boundaries of control and ownership. Courts and regulators have only begun to address the complex legal questions these systems raise. By adopting the forward-looking approaches outlined in this Article, franchisors can position themselves advantageously within this evolving legal landscape while avoiding the pitfalls that have ensnared early AI adopters.

As Eigen persuasively argues, "meaningful consent requires both transparency and choice."[224] In the context of AI-enhanced franchise systems, this principle suggests that franchisors should pursue not only legal protection of intellectual property rights but also meaningful engagement with franchisees regarding the development, deployment, and benefits of AI systems. The most important thing to do is to test AI under attorney-client privilege on a regular cadence. By balancing proprietary interests with collaborative approaches, franchisors can maximize the value of AI-generated intellectual property while minimizing associated legal risks.

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[222] Eigen, supra note 79; Eigen, supra note 127.
[223] See Eigen, supra note 79, at 382 (discussing the "legal fiction" in modern contractual relationships).
[224] Eigen, supra note 79, at 428.