

BLOGS

Encroachment

Franchisee's Claim that Franchisor Breached the Implied Covenant Survives Motion to Dismiss

A federal court in Colorado has denied a motion to dismiss a franchisee's claim that the franchisor breached the implied duty of good faith and fair dealing. *Kazi v. KFC US, LLC*, 2020 WL 6680361 (D. Colo. Nov. 12, 2020). The franchise agreement in question stated that KFC would not operate, or permit a third party to operate, another KFC within a one-and-a-half mile radius of Kazi's restaurant. In March 2019, after execution of the franchise agreement, KFC issued a policy allowing franchisees to request an impact study if KFC intended to permit the development of a new location within 10 miles of an existing location. Under these guidelines, KFC would either (i) permit development of the location if the potential impact was less than 10% on the existing location, (ii) conduct further review if the potential impact was between 10% and 15% on the existing location, or (iii) not permit development if the potential impact was more than 15% on the existing location. In April 2019, KFC notified Kazi of a potential new location outside of his protected territory, but within 10 miles of his unit. Kazi requested an impact study. KFC conducted the study, which showed a potential impact of about 13%. Believing the results of the KFC study were wrong, Kazi commissioned his own study, which showed a potential impact of between 33% and 36%. Kazi requested KFC not grant a franchise for the proposed location, but KFC refused. Kazi then filed a lawsuit claiming breach of the express contract terms, breach of the implied covenant, and other claims. KFC sought to dismiss all claims.

Kazi first sought to have the court agree that the guidelines were a part of the franchise agreement, and that a breach of the guidelines was therefore a breach of the contract. Since the franchise agreement could only be amended in writing and signed by both parties, and the parties had not signed guidelines, the court held the guidelines did not amend the franchise agreement and dismissed Kazi's claim for breach of the express terms of the contract. The court then considered Kazi's claim that KFC breached the implied covenant of good faith and fair dealing. KFC argued that the implied covenant cannot prevent a party from exercising its express rights under the franchise agreement. The court pointed out, though, that the franchise agreement simply stated that KFC would not place a location within a one and half mile radius of the restaurant, and did not grant KFC unfettered rights to place locations outside that radius. The implied covenant required KFC to act reasonably and not inconsistently with the parties' expectations, according to the court. By issuing the guidelines, KFC had told its franchisees how it would act when considering another franchise location within

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10 miles of an existing location. KFC argued that it had not breached the implied covenant because it had followed the guidelines by doing the study. However, since the franchisee's own study contradicted KFC's, the court found that the franchisee had alleged sufficient facts that could support a conclusion that KFC's study was deficient and, if true, the guidelines were not followed. As a result, the court denied KFC's motion to dismiss this claim.