Franchisees as Third-Party Beneficiaries to Franchisor's Agreements with Other Franchisees or Vendors

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I. Introduction

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Third-party beneficiary rights can significantly impact the outcome of a franchise law case. In many circumstances, whether a party is a third-party beneficiary can determine whether a dispute has any remedy at all. In franchise law in particular, third-party beneficiary rights are critical because franchisors enter into contracts with a variety of parties—including franchisees, vendors, or suppliers—that will impact the franchise system generally. Thus, the franchisors contracts will, in many instances, impact current and potential franchisees even though they had no direct involvement in the contract. When relationships go awry, because each franchise is individually owned and operated, the only remedy available to franchisees may stem from them asserting third-party beneficiary rights in the contracts signed by their franchisor.

This article examines the conditions under which franchisees enjoy third-party beneficiary rights to agreements that have been entered into between their franchisors and other franchisees or vendors. As expected, many cases hold that an unequivocal statement in the contract that a party clearly is an *intended third-party beneficiary* is required for a party to enjoy such rights. These rights are useful in a range of situations, including to establish standing to bring suit by or against a party as well as to determine liability for activities ranging from the purchase of goods to recruiting and hiring activities. While a simple clear clause in the contract stating party "X" is an intended third-party beneficiary is simple enough, in practice courts' interpretations of those clauses can vary, particularly state to state. Moreover, sometimes those interpretations present more of an evidentiary issue, where

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it must be determined whether the facts at hand fall within a third-party beneficiary clause of a contract even if one clearly exists.

This article begins by giving a general overview of third-party beneficiary rights and obligations. It then examines the distinction between finding these rights via evidentiary findings versus direct findings. Finally, the article considers scenarios where franchisors have attempted to use third-party beneficiary rights to control competitive behaviors that can damage the brand, like employee poaching, when a franchisee may or may not be a third-party beneficiary to a vendor agreement made by the franchisor, and the rare occasions when a vendor successfully enjoys third-party beneficiary rights in the franchise agreement between franchisor and franchisee.

II. Overview of Third-Party Beneficiary Law

A. *General Overview of Third-Party Beneficiaries*

Typically, an individual must be a party to a contract to enforce its terms,[1] but that rule is subject to exceptions. Nearly all jurisdictions in the United States allow a third party to enforce a contract or promise made for their benefit, as a third-party beneficiary.[2] This rule is true even though the third party is not a party to the contract and did not offer any consideration for the contract.[3]

Most jurisdictions have well-developed common law establishing the third-party beneficiary exception. Some, like California, Georgia, and South Dakota, have gone further and codified the rule.[4] Typically, a third-party beneficiary to a contract must prove that he or she was an intended beneficiary of the contract.[5] Often, someone is an intended beneficiary of the contract

1. *See* Culhane v. Aurora Loan Servs. of Neb., 708 F.3d 282, 290 (1st Cir. 2013) ("[A] non-party who does not benefit from a contract generally lacks standing to assert rights under that contract."); *see also* Fla. Chem. Co., LLC v. Flotek Indus., Inc., No. CV 2021-0288-JTL, 2021 WL 3630298, at *11 (Del. Ch. Aug. 17, 2021) ("As a general matter, only a party to a contract has standing to enforce it.").

2. 16 Am. Jur. 2d *Proof of Facts* § 1 (2024) ("The prevailing rule in nearly all American jurisdictions is that a third person may, in his own right and name, enforce a contractual promise made for his benefit even though he is a stranger both to the contract and to the consideration for the contract.").

3. *See* Siopes v. Kaiser Found. Health Plan, Inc., 312 P.3d 869, 888 (Haw. 2013) ("A third party beneficiary is one for whose benefit a promise is made in a contract *but who is not a party to the contract*.") (emphasis in original) (citation omitted); CounselNow, LLC v. Deluxe Small Bus. Sales Inc., 430 F. Supp. 3d 1247, 1256 (D. Utah 2019) ("[T]hird-party beneficiaries to a contract . . . hav[e] enforceable rights created in them by a contract to which they are not parties and for which they give no consideration.").

4. Cal. Civ. Code § 1559; Ga. Code Ann. § 9-2-20(b); S.D. Codified Laws § 53-2-6.

5. *See* Robins Dry Dock & Repair Co. v. Flint, 275 U.S. 303, 307 (1927) ("Before a stranger can avail himself of the exceptional privilege of suing for a breach of an agreement, to which he is not a party, he must, at least, show that it was intended for his direct benefit." (citation omitted)); McKinney v. United States, 75 F. Supp. 3d 266, 274 (D.D.C. 2014) ("An intended third party beneficiary has the right to enforce a contract against a breaching promisor."); Singh v. Royal Caribbean Cruises Ltd., 576 F. Supp. 3d 1166, 1190 (S.D. Fla. 2021) ("[F]or a third party to qualify as intended beneficiaries, the contract must refer to a well-defined class of readily identifiable persons that it intends to benefit." (internal quotation marks and citation omitted)).

because "performance of the promise will satisfy an obligation of the promise to pay money" to the beneficiary (a creditor beneficiary) or because "the promisee intends to give the beneficiary the benefit of the promised performance" (a donee beneficiary).[6]

This standard results in a highly fact-intensive inquiry.[7] It is also a high burden. Many jurisdictions have a presumption against finding someone is a third-party beneficiary to a contract.[8] That presumption can be overcome if it is clear that the parties intended the contract to benefit the third-party beneficiary. The critical question is what *the parties* intended. It is not enough that a party merely *expects* that it is a third-party beneficiary.[9] Instead, a party seeking third-party beneficiary status must prove that the parties to the contract themselves contemplated that the contract would be for the third-party beneficiary's benefit.[10] Courts look, for example, at the breadth of the terms of the contract, whether the terms of the contract reveal any intent, and whether the parties to the contract had an articulable interest in the third-party beneficiary.[11] They also consider whether it would have been reasonable for a third-party beneficiary to rely on the fact that the contract was intended to benefit him or her.[12] That primary benefit must be more than a mere incidental or consequential benefit to the contract.[13] Incidental and consequential benefits include benefits that flow to subcontractors,[14] and

6. Restatement (Second) of Contracts § 302(1) (Am. Law Inst. 1981); *see* ThorWorks Indus. v. E.I. DuPont De Nemours & Co., 606 F. Supp. 2d 691, 695 (N.D. Ohio 2008) (distinguishing between creditor and donee beneficiaries).

7. Catskill Litig. Tr. v. Park Place Ent. Corp., 169 F. App'x 658, 660 (2d Cir. 2006) ("[W]hether [a party] is actually a third-party beneficiary of the contract signed . . . is a fact-intensive inquiry."); Harrison v. Gen. Motors, LLC, No. 21-12927, 2024 WL 187702, at *2 (E.D. Mich. Jan. 17, 2024) (applicability of third-party beneficiary exception is a "fact-intensive exercise").

8. *See* MCI Telecomms. Corp. v. Texas Utils. Elec. Co., 995 S.W.2d 647, 651 (Tex. 1999) ("[A] presumption exists that parties contracted for themselves unless it 'clearly appears' that they intended a third party to benefit from the contract."); *see also* GECCMC 2005-C1 Plummer St. Off. Ltd. P'ship v. JPMorgan Chase Bank, Nat'l Ass'n, 671 F.3d 1027, 1034 (9th Cir. 2012) (noting "presumption against third-party beneficiaries").

9. *See* Deschamps v. Farwest Rock, Ltd., 474 P.3d 1282, 1286 (Mont. 2020); Irani Eng'g, Inc. v. Arcadia Gas Storage, LLC, No. 01-21-00113-CV, 2022 WL 3588746, at *8 (Tex. App. Aug. 23, 2022) ("It is not enough for a third party to benefit to conclude that they are a third-party beneficiary."); Fortitude Energy, LLC v. Sooner Pipe LLC, 564 S.W.3d 167, 181 (Tex. Ct. App. 2018).

10. *See* Marcuzzo v. Bank of the West, 862 N.W.2d 281, 290 (Neb. 2015).

11. Miss. High Sch. Activities Ass'n, Inc. v. R.T., 163 So. 3d 274, 277 (Miss. 2015) (addressing factors).

12. *See* Chevron U.S.A., Inc. v. United States, 110 Fed. Cl. 747, 782 (Fed. Cl. 2013); Dewakuku v. Martinez, 271 F.3d 1031, 1041 (Fed. Cir. 2001) ("In analyzing the language itself to ascertain intent, we look to whether the beneficiary would be reasonable in relying on the promise as manifesting an intention to confer a right on him.").

13. *See* Restatement (Second) of Contracts § 302 (Am. Law Inst. 1981) (distinguishing between "'intended' beneficiary, who acquires a right by virtue of a promise, from an 'incidental' beneficiary, who does not"); Smith v. Rainey, 747 F. Supp. 2d 1327, 1341 (M.D. Fla. 2010) (same); Hacker v. Shelter Ins. Co., 902 N.E.2d 188, 194 (Ill. App. Ct. 2009) (same).

14. *See, e.g.*, *In re* Wave Energy, Inc., 467 F. App'x 248, 251 (5th Cir. 2012).

the benefits that homeowners receive from agreements between their loan servicers and the Federal National Mortgage Association.[15]

However, a third-party beneficiary need not be named in the contract.[16] It is enough that the terms of a contract reveal the parties intended the contract to benefit the third-part beneficiary. So, for example, when the plaintiff is a member of the class of individuals for whom the contract is created, they may assert third-party beneficiary rights even though they are not specifically named.[17]

While the contract must have been intended to directly benefit the third-party beneficiary, that need not be the *only* benefit. The contract may be created for the benefit of multiple parties, so long as it was also for the "direct or substantial benefit" of the third-party beneficiary.[18] Further, there can be more than one third-party beneficiary to a contract. A third-party beneficiary may be one individual, or it may be a "class of individuals."[19]

What evidence may be used in such an inquiry is a case-specific question. Sometimes parties may use extrinsic evidence to prove that they were the intended beneficiary of a contract.[20] But courts typically do not allow extrinsic evidence when the terms of the contract are explicit and unambiguous.[21] Either way, clauses in contracts negating or disclaiming the existence of third-party beneficiaries are strong evidence that the contracting parties did not intend for the contract to benefit a certain individual.[22] Any third-

15. *See, e.g.*, Edwards v. Aurora Loan Servs., LLC, 791 F. Supp. 2d 144, 151 (D.D.C. 2011).

16. *See* Outdoor Servs., Inc. v. Pabagold, Inc., 230 Cal. Rptr. 73, 76 (Cal. Ct. App. 1986) ("It is not necessary that an express beneficiary be specifically identified in the contract; he or she may enforce it if he or she is a member of a class for whose benefit the contract was created."); Sullivan v. United States, 625 F.3d 1378, 1380 (Fed. Cir. 2010) ("[T]he third party does not need to be specifically identified in the contract.").

17. Wilson v. Bank of Am. Pension Plan for Legacy Cos., No. 18-CV-07755-TSH, 2019 WL 2552192, at *4 (N.D. Cal. June 20, 2019), *on reconsideration*, No. 18-CV-07755-TSH, 2019 WL 4479677 (N.D. Cal. Sept. 18, 2019); Montgomery Bank, N.A. v. Alico Rd. Bus. Park, LP, No. 2:13-CV-802-FTM-29CM, 2014 WL 6305396, at *3 (M.D. Fla. Nov. 13, 2014) ("A third party is an intended beneficiary of a contract between two other parties only if a direct and primary object of the contracting parties was to confer a benefit on the third party.").

18. *See, e.g.*, Adv. Concepts Chicago, Inc. v. CDW Corp., 938 N.E.2d 577, 581 (Ill. App. Ct. 2010).

19. Guy v. Liederbach, 459 A.2d 744, 747 (Pa. 1983) ("[T]he grant of standing to a narrow class of third party beneficiaries seems 'appropriate' under Restatement (Second) of Contracts . . . .").

20. *See* Dona Ana Mut. Domestic Water Consumers Ass'n v. City of Las Cruces, 516 F.3d 900, 907 (10th Cir. 2008) ("[T]he burden is on the person claiming to be a third-party beneficiary to show that the parties to the contract intended to benefit him. He may do so using extrinsic evidence if the contract does not unambiguously indicate an intent to benefit him.") (internal quotation marks and citation omitted); Charter Bank v. Francoeur, 287 P.3d 333, 338 (N.M. Ct. App. 2012) (same).

21. *See* CDP Event Servs., Inc. v. Atcheson, 656 S.E.2d 537, 540 (Ga. Ct. App. 2008) ("Parol evidence cannot confer third-party beneficiary status where the contract itself fails to do so."); Bariteau v. PNC Fin. Servs. Grp., Inc., 285 F. App'x 218, 222 (6th Cir. 2008) ("[W]hen an agreement itself establishes that an individual is not a third-party beneficiary of it, extrinsic evidence generally has little role to play.").

22. *See In re* Lehman Bros. Holdings Inc., 479 B.R. 268, 275–76 (S.D.N.Y. 2012), *aff'd*, 513 F. App'x 75 (2d Cir. 2013) ("[E]ven where a contract expressly sets forth obligations to specific

party beneficiary seeking to enforce the terms of a contract bears the burden of showing that the contract is valid in the first place.[23]

Third-party beneficiaries have the same rights as true parties to a contract.[24] That means they can sue for injunctive relief and specific performance to enforce terms of a contract.[25] They can also recover typical contract damages.[26] Some courts have made clear that third-party beneficiaries may only enforce and recover damages on terms that were made to their benefit.[27] So, for example, if the contract is subject to arbitration, the third-party beneficiary's claims are also subject to arbitration.[28]They have no power to enforce other unrelated terms in the contract.[29]

Third-party beneficiaries do not take on any contractual obligations when enforcing the terms of the contract.[30] They also cannot be held liable by parties to the contract.[31]

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individuals or categories of individuals, those individuals do not have standing to enforce those obligations by suing as third-party beneficiaries when the contract contains a negating clause.").

23. *See* Town of Oyster Bay v. Doremus, 942 N.Y.S.2d 546, 548 (App. Div. 2012) ("[T]o state a cause of action to enforce a promise to another, as a purported third-party beneficiary, the [plaintiff] must allege: (1) the existence of a valid and binding contract between other parties, (2) that the contract was intended for its benefit, and (3) that the benefit to it is sufficiently immediate to indicate the assumption by the contracting parties of a duty to compensate it if the benefit is lost.").

24. *See* Czajkowski v. Haskell & White, LLP, 144 Ca. Rptr. 3d. 522, 528–29 (Ct. App. 2012) ("Third party beneficiaries may under appropriate circumstances possess the rights of parties to the contract."); Wenneker Distilleries v. Olifant USA, Inc., No. 1:11-CV-01010, 2012 WL 2319136, at *2 (M.D. Pa. June 19, 2012) ("Regarding the third party beneficiary claim, third party beneficiaries, along with the parties to a contract, can enforce the terms of that contract.").

25. *See* Pepsi-Cola Bottling Co. of Pittsburg, Inc. v. Pepsico, Inc., 175 F. Supp. 2d 1288, 1293 (D. Kan. 2001) ("Plaintiff might be entitled to a permanent injunction on its claim that Bottling Group breached its rights as a third-party beneficiary."); Lebensfeld v. Bashkin, 534 N.Y.S.2d 221, 222 (App. Div. 1988) (determining plaintiff could "seek specific performance of the agreement as a third-party beneficiary").

26. *See* Harman v. MIA Serv. Contracts, 858 P.2d 19, 23 (Mont. 1993) (stating that a third-party beneficiary has a "right to seek contract damages"); Crabtree v. Aetna Cas. & Sur. Co., 438 So. 2d 102, 106 (Fla. Dist. Ct. App. 1983) (same).

27. *See* Archer W. Contractors, Ltd. v. Estate of Pitts, 735 S.E.2d 772, 778 (Ga. 2012) ("[A] third party beneficiary . . . can only enforce those promises made directly for his benefit.") (internal quotation marks and citation omitted); Wilson v. Hatch Bank, No. 23CV813-JES (MPP), 2024 WL 1355492, at *6 (S.D. Cal. Mar. 29, 2024) (same)

28. *See*, *e.g.* Republic of Iraq v. ABB AG, 769 F. Supp. 2d 605, 609 (S.D.N.Y. 2011), *aff'd sub nom.* Republic of Iraq v. BNP Paribas USA, 472 F. App'x 11 (2d Cir. 2012) ("A non-party may compel arbitration where traditional principles of state law such as assumption, piercing the corporate veil, alter ego, incorporation by reference, third-party beneficiary theories, waiver and estoppel render an arbitration agreement enforceable at the non-party's behest." (internal quotation marks and citation omitted)).

29. *Id.*

30. Dynamic Worldwide Logistics, Inc. v. Exclusive Expressions, LLC, 77 F. Supp. 3d 364, 374 (S.D.N.Y. 2015) ("Although intended third-party beneficiaries may enforce contract terms in their favor, the mere fact that a party is a beneficiary does not create contractual obligations for that beneficiary."); Milos Prod. Tanker Corp. v. Alero Mktg. & Supply Co., No. 222CV01545CASEX, 2023 WL 4296055, at *5 (C.D. Cal. June 28, 2023) (collecting cases).

31. *See* Motorsport Eng'g, Inc. v. Maserati SPA, 316 F.3d 26, 29 (1st Cir. 2002) (third party beneficiary was not liable for breach of contract).

B. *Evidentiary Use versus Direct Findings of Third-Party Beneficiary Rights and Obligations*

In some instances, a court will make a direct finding (i.e., a finding based on the face of the contract) that one is—or is not—a third-party beneficiary to a contract, while in others a court will determine if a party has rights—or does not—as a third-party beneficiary by examining evidence to make the ruling. A direct finding is based on the law.[32] A finding using evidence, like the interpretation of an ambiguous contract, is based upon the facts entered at the trial court level.[33] While it would seem intuitive to assume that when courts use a particular approach it is predictable, in practice it is not.

Procedurally, evidence of a contract is entered at the trial court level, and the court applies the evidence to the law to determine the outcome of the case. At the trial court level, courts use an evidentiary method more often than a direct finding to determine whether a party is a third-party beneficiary, but courts may take either approach. The use of evidence in a decision lowers the likelihood of being overturned on appeal.[34] However, when a decision is being reviewed by an appellate court, on average more outcomes are determined by a direct finding than by drawing on the evidence and factual findings of the trial court below.[35]

This likelihood may be due to the differing standards of review on appeal—de novo for questions of law and clearly erroneous for questions of fact.[36] In other words, at the appellate level, questions of fact are given more deference to the findings below and questions of law are given no deference.[37] Strategically, if there is an evidentiary basis for the finding at the lower court level, it is less vulnerable to being overturned on appeal.

Nevertheless, direct findings are used frequently when determining whether a party is a third party-beneficiary. The old tenet that "what is in the contract governs" rings true here. As mentioned above, the words written in the contract are critical to the determination, because they are the best evidence of the parties' intent with regard to third-party beneficiary rights.[38]

These direct findings have been used to determine whether a party is a third-party beneficiary that (1) can compel or avoid arbitration; (2) is able to enforce a contract made between franchisees, including a settlement agreement;[39] or (3) is entitled to a judgment requiring a party to pay or perform

32. Laurie Ratliff, How to Draft Good Findings of Fact and Conclusions of Law 1–3 (2014).
33. *Id.*
34. Julia Rugg, Daniel Solomon, Mary Calkins & Matt Hicks, The Writing Center at Georgetown University Law Center, Identifying and Understanding Standards of Review (2019).
35. Ratliff, *supra* note 32, at 1.
36. Rugg, *supra* note 34, at 2.
37. *Id.*
38. *See* Robins Dry Dock & Repair Co. v. Flint, 275 U.S. 303, 307 (1927).
39. *See* Chu v. Dunkin' Donuts Inc., 27 F. Supp. 2d 171, 174 (E.D.N.Y. 1998).

for the benefit of that third party—for example, where a franchisor does not approve a potential new franchisee for the purchase of an existing franchise operation.

In *Tillery v. Raffone*[40] for example, three of the four defendants did not sign the franchise agreements in question, so the franchisee plaintiff sought to prevent invocation of the arbitration clause. The court made a direct finding that the non-signatory defendants were third-party beneficiaries, citing cases involving entities who were alter egos of each other. As a result, they were entitled to invoke the arbitration clause.[41]

While most cases seem to determine third-party beneficiary rights through direct findings, the issue of standing seems to be determined through the evidentiary method.[42] Despite the multitude of direct findings that one is or is not a third-party beneficiary, the courts use evidence to determine standing in third-party suits. For example, in *Devore v. H&R Block Tax Services*,[43] the U.S. District Court for the Central District of California stated that "whether a particular person is an intended beneficiary is a question of fact."[44] In *Crawford v. SAP America, Inc.*,[45] the court noted a lack of evidence showing that the parties intended to give legally enforceable rights to the plaintiffs when it ruled that plaintiffs lacked standing as third-party beneficiaries because "there [was] no compelling evidence that, by entering into those contracts, the parties intended to give legally enforceable rights to the Plaintiffs."[46] Unsurprisingly, this finding based on a lack of evidence in the record was made *after* the court stated there was no explicit third-party obligation stated in the contracts themselves.[47] That is because courts must first determine if a contract is unambiguous before turning to extrinsic evidence.[48] While the determination of third-party beneficiary rights may be an issue of fact, the courts have routinely made direct findings based primarily on the language in the contracts themselves to determine whether the parties to the contract intended the contract to bestow rights and/or obligations on a third party.

Furthermore, there have been cases where the individual signed the franchise agreement, and then assigned the agreement to an entity. Later, a dispute arises, and a settlement agreement results. Eventually, the dispute goes

40. Tillery v. Raffone, Civ. No. 3-90-0871, 1991 WL 185158 (E.D. Tenn. June 28, 1991).

41. *Id.* at *4–5.

42. *See* Devore v. H&R Block Tax Servs., No. CV 16-946 DSF, 2016 WL 11520668, at *6 (C.D. Cal. May 11, 2016); Crawford v. SAP Am., Inc., 147 F. App'x 234, 238 (3d Cir. 2005); *see also* Rajaraman v. GEICO Indem. Co., Case No. 23-CV-425-JPS, 2023 WL 8367752, at *26–27 (E.D. Wis. Oct. 31, 2023) (*citing* Transameria Premier Life Ins. Co. v. Selman & Co., LLC, 401 F. Supp. 3d 576, 595 (D. Md. 2019)).

43. Devore v. H&R Block Tax Servs., No. CV 16-946 DSF, 2016 WL 11520668 (C.D. Cal. May 11, 2016).

44. *Id.* at *6 (*citing* Souza v. Wetlands Water Dist., 38 Cal. Rptr. 3d 78, 88 (Ct. App. 2006)).

45. Crawford v. SAP Am., Inc., 147 F. App'x 234 (3d Cir. 2005).

46. *Id.* at 238.

47. *Id.*

48. Dona Ana Mut. Domestic Water Consumers Ass'n v. City of Las Cruces, 516 F.3d 900, 907 (10th Cir. 2008).

before the court, and the individual wants to assert third-party beneficiary rights. In a case involving 7-Eleven, this was the scenario but with several layers, which added to the complexity of the matter. A settlement agreement resulted from the dispute. The individual plaintiff asserted breach of the settlement agreement. The court relied on the complaint to find that no allegations or facts could support a finding of third-party beneficiary rights under the settlement agreement because, on the face of that document, it did not reserve third-party beneficiary status to the individual. The court stated that "the obligations that are alleged to be in dispute are duties owed to the corporation, not to [the individual plaintiff] as its principal."[49] Hence, the individual plaintiff was not a third-party beneficiary of the duties owed by 7-Eleven because it was clear on the face of the documents that, while the individual had assigned his rights to the entity, he failed to reserve any ability to claim third-party beneficiary status under the settlement agreement.[50]

In sum, while the use of evidence for determining third-party beneficiary status is dominant at the trial court level, the higher courts tend to look to the language in the contracts to determine whether one is a third-party beneficiary. As with all contractual related issues in the law, the threshold question is whether the contract is ambiguous, and trial courts appear more willing than appellate courts to find ambiguity as it relates to third-party beneficiary status.

III. The Franchisee as a Third-Party Mechanism for Franchisors to Help Prevent Franchisees from Poaching Each Other's Employees

Third-party rights in the franchise context can be used in a variety of scenarios. One trend has been to include a "no-poach" clause in the franchise agreement. Other franchisees then become third-party beneficiaries to the franchise agreement. In this scenario, franchisees enjoy third-party rights restricting another franchisee's ability to hire and recruit employees from each other or the franchisor within the same brand. In *Washington v. Covelli*,[51] the State of Ohio Court of Appeals recognized the third-party right of a franchisee in the franchise agreement, paving the way for the franchisee to recover for "poaching" practices under a tortious interference with business relationships claim.[52] Here, the third-party rights allowed the franchisee to recover damages for "poaching" activities.

As another example, in *Gator Apple, LLC v. Apple Texas Restaurants, Inc.*,[53] the franchise agreement contained a provision stating that it intended to

49. Guvenal v. 7-Eleven, Inc., 2019 U.S. Dist. LEXIS 207699, at *15 (W.D. Pa. Dec. 3, 2019).

50. *Id.* at 15–16.

51. Washington v. Covelli, 35 N.E.3d 578 (Ohio Ct. App. 2015).

52. *Id.* at 585; *see also* Butler v. Jimmy John's Franchise, LLC, 331 F. Supp. 3d 786 (S.D. Ill. 2018).

53. *See* Gator Apple, LLC v. Apple Tex. Rests., Inc., 442 S.W.3d 521, 528 (Tex Ct. App. 2014).

protect franchisees from the "poaching" of employees by other franchisees. As such, the Court of Appeals of Texas found as a matter of law that a franchisee was a third-party beneficiary of the franchise agreement between franchisor and another franchisee.[54]

However, this approach has come under significant fire in the last six years and is the subject of considerable antitrust litigation and attack from the Washington Attorney General.[55] As such, it has fallen out of favor. Three cases in the last two years produced opinions on the issue, which remains unsettled. The only clarity in the law at this time is that using "no poach" clauses in franchise agreements may result in extensive and complex litigation.

The most recent opinion, *In re Papa John's Employee and Franchisee Employee Antitrust Litigation*, involved one of several class actions filed against fast food chains following an investigation by the Washington State Attorney General into "no-poach" provisions in franchise agreements.[56] The settlements that resulted from the investigation required franchisors to remove "no-poach" provisions from their franchise agreements.[57] The *In re Papa John's* court declined to reach a finding, stating that the evidence to do so was not yet in the record and remanded the case for further proceedings.[58] However, from the court's analysis the question seems to be whether a franchise system is one economic enterprise. The court in that case seemed to take the view that *one* franchise system might be *one* economic enterprise.[59] For now, though, we wait for the courts to have another opportunity to clarify this issue.

Around the same time, the Seventh Circuit reviewed an "anti-poach" or no-poach clause in the McDonald's franchise agreements.[60] In *Deslandes v. McDonald's United States, LLC*, the plaintiffs argued the restriction was an ancillary agreement in the sense that antitrust law uses the term.[61] This court rejected that argument, stating that the restriction itself does not promote output of the product being produced, such as Big Macs, french fries, and McFlurries.[62] As in *In re Papa John's*, the court made note of whether the

54. *Id.* at 529.

55. Office of the Attorney General, Washington State, Bob Ferguson, https://www.atg.wa.gov/labor-and-antitrust (last visited June 29, 2024).

56. *In re* Papa John's Emple. & Franchisee Employee Antitrust Litig., 2023 WL 5997294 (W.D. Ky. Sept. 15, 2023) (The Washington Attorney General's investigation focused on whether these provisions amounted to per se anticompetitive restrains on purchasing power for the purchase of labor. If so, the "no-poach" provisions would be deemed a monopsony which would constitute anti-competitive behavior under The Sherman Act); *see also* Deslandes v. McDonald's United States, LLC, 81 F. 4th 699, 703–04 (7th Cir. 2023).

57. *In re Papa Johns*, 2023 WL 5997294, at *4.

58. *Id.* at *14.

59. *Id.* at *12 (Papa John's is one economic enterprise, and as they were not entering into "no-poach" arrangements with other brands, it would seem to reason that the "no-poach" provisions in one franchise system would not be anti-competitive behavior under the Sherman Act. However, we will have to wait and see if and when a court actually rules on this issue.).

60. *Deslandes*, 81 F.4th at 702.

61. *Id.*

62. *Id.* at 704.

franchise system was to be treated as a single enterprise. This court seemed to take the view that a franchise system was a single enterprise. And, as such, it cannot be treated as a labor market all its own.[63] To illustrate, a no-poach clause in a McDonald's franchise agreement does not restrict an employee of McDonald's from going to work at Wendy's.[64] Nonetheless, the court left the issue of using third-party rights as a no-poach mechanism undecided and remanded this case for further proceedings.

In *Arrington v. Burger King Worldwide, Inc.*, a court considered the no-hire (or no-poach) clause, which in this case was limited to six months after the employee left employment.[65] The court focused on whether the franchisee undertook "concerted action" for purposes of the Sherman Act.[66] Ultimately, the appellate court remanded the matter to the district court to develop the record and determine which level of scrutiny to apply—*per se*, quick-look, or rule of reason.[67] Interestingly, the analysis also did lean toward that determination of whether a franchise system was to be considered one enterprise.[68]

In sum, while the use of third-party rights to reduce employee "poaching" activity from within a brand might seem like a useful method for providing some stability within a franchise system and reducing "infighting," it is not currently recommended due to the risks of antitrust litigation and action by state regulators.

IV. Franchisees as Third-Party Beneficiaries to Franchisor Agreements with Vendors or Suppliers

Franchisees sometimes argue they are third-party beneficiaries to agreements between their franchisor and vendors. These cases are rare, and it is even rarer for franchisees to prevail on these arguments, but it is a potential avenue for recovery. No hard and fast rules exist about when franchisees may be considered third-party beneficiaries of vendor contracts. Instead, these cases are highly fact-specific and turn on the unique terms of the vendor contract and the products and services being provided.

63. *Id.* at 703 (*citing* Elliott v. United Ctr., 126 F.3d 1003 (7th Cir. 1997)).
64. *Id.* at 702–03.
65. Arrington v. Burger King Worldwide, 47 F. 4th 1247, 1250 (11th Cir. 2022).
66. *Id.* (*citing* the Sherman Act, 15 U.S.C. § 1).
67. *Arrington*, 47 F.4th at 1257 (*citing* Procaps S.A. v. Patheon, Inc., 845 F.3d 1072, 1084 n. 3 (11th Cir. 2016)).
68. *Id.* at 1252–53.This case seems to imply that the law is going to come down on one side or the other. The now quiet and still yet to be determined joint-employer doctrine would have franchisors saying that they are not one economic enterprise. Here, franchisors would benefit from arguing that they are one economic enterprise. It seems that franchisors are not going to be allowed to have it both ways. However, the fact that the courts are using licensing arrangements as an analogy in its opinion reveals that there may be an argument for an exception to this analysis under franchise law specifically. Afterall, how will the courts reconcile treating a license the same as a franchise if franchisors are to comply with FTC and state opportunity statutes? This is beyond the scope of this article, but nevertheless an important area to watch for developments.

A. *When A Franchisee May Be a Third-Party Beneficiary to a Vendor Agreement*

Like all third-party beneficiary cases, the focus is on the intended beneficiary of the agreement at issue. When agreements are explicit that the franchisee is an intended beneficiary of an agreement between a vendor and the franchisor, courts will allow franchisees to step in and assert their rights as a third-party beneficiary. For example, in *Oil Express National, Inc. v. Burgstone*,[69] the U.S. District Court for the Northern District of Illinois allowed a franchisee to assert a claim as a third-party beneficiary to a supply agreement between oil supplier Citgo and the franchisor.[70] The franchisee operated a quick oil-change business as part of a franchise system.[71] The franchisor entered into an agreement with Citgo whereby Citgo would sell the franchisor and participating franchisees petroleum products for pre-determined prices.[72] Citgo was required to collect certain funds on each bulk gallon of oil products that it sold to locations within the franchise system.[73] Citgo was then required to distribute the amounts collected to the franchisor, who was required to hold them in specific accounts for advertising services performed on behalf of the franchisor or its franchisees.[74] The franchisees argued that that the franchisor breached the agreement with Citgo by failing to deposit all the monies that it received from Citgo into a separate account for advertising.[75]

The court held that the "face of the supply agreement between Citgo and [the franchisor] clearly makes franchisees beneficiaries of the contract."[76] The agreement explicitly stated that the funds would be used for advertising for the franchisees' benefit.[77] There was little question, according to the court, that the agreement between the franchisor and Citgo was ultimately meant to benefit franchisees.[78] Because of this reading, the franchisees could sue to enforce the contract and collect damages for any breach by the franchisor.[79]

Thus, any franchisee looking to assert rights as a third-party beneficiary to an agreement between the franchisor and a vendor should study the terms of the relevant agreement closely. Franchisees will have better luck asserting third-party beneficiary claims if there is an explicit reference to their benefit in the terms of the contract.

69. Oil Express Nat'l, Inc. v. Burgstone, 958 F. Supp. 366, 372 (N.D. Ill. 1997).
70. *Id.* at 368.
71. *Id.*
72. *Id.* at 372.
73. *Id.*
74. *Id.*
75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.*

B. *When a Franchisee May Not Be a Third-Party Beneficiary to a Vendor Agreement*

Alternatively, when the agreement between the franchisor and the vendor is truly just for the benefit of the franchisor and the vendor, and any benefit to the franchisee is incidental, courts will not allow a franchisee to step in as a third-party beneficiary. *Danjor, Inc. v. Corporate Construction, Inc.*[80] is an illustrative example. There, a purchaser of a daycare franchisee tried to assert a claim as a third-party beneficiary of the agreement between its franchisor and the company that constructed its daycare center.[81] The franchisor had hired a construction company to construct the daycare center for the franchisee, and, after the fact, the franchisee complained of numerous construction defects at the center.[82] The Georgia Court of Appeals held that the franchisee could not assert claims as a third-party beneficiary because there were no explicit references in the contract between the franchisor and the construction company to the franchisee.[83] The contract "contained no generic references to the franchisee of the daycare center or any specific reference to the [specific franchisee plaintiff]."[84] The construction company understood that it was working directly with the franchisor and did not know of the franchisee's identity until after construction began.[85] The franchisee was therefore barred from asserting any claims as a third-party beneficiary to the contract between the franchisor and the construction company.[86]

Danjor shows just how explicit the benefit to the franchisee must be on the face of agreement between a franchisor and a vendor for a franchisee to assert rights as a third-party beneficiary. Even though the daycare was constructed for the use by a franchisee, and the franchisee would necessarily benefit from the construction, the court did not consider the franchisee an intended beneficiary absent specific references to their benefit in the agreement.

As another example, in *2470 Cadillac Resources, Inc. v. DHL Exp. (USA), Inc.*,[87] a New York court held that a franchisee of a domestic shipping services company did not have standing to bring a third-party beneficiary claim on a reseller agreement between its franchisor and DHL, the operator of global delivery and shipping networks.[88] The court held that the franchisee could not establish that the agreement at issue was created for its benefit.[89] While the agreement did authorize third-party resellers like the franchisee

80. Danjor, Inc. v. Corp. Constr., Inc., 613 S.E.2d 218 (Ga. Ct. App. 2005).
81. *Id.* at 219.
82. *Id.*
83. *Id.* at 221.
84. *Id.*
85. *Id.*
86. *Id.*
87. 2470 Cadillac Resources, Inc. v. DHL Exp. (USA), Inc., 923 N.Y.S.2d 530 (App. Div. 2011).
88. *Id.* at 531.
89. *Id.*

at issue, the court held that the purpose of the agreement was to "generate revenues for both [the franchisor] and [DHL]." Any benefit to franchisees as third-party resellers was "an incidental by-product of the agreement."[90]

These cases make clear that whether a franchisee may assert a claim as a third-party beneficiary to a contract between the franchisor and a vendor turns on how explicit the reference to the franchisee's benefit appears in the contract at issue. When the contract clearly references the franchisee on its face, franchisees are more likely able to assert a claim as a third-party beneficiary. When the contract is silent as to the franchisee, even if the franchisee would benefit greatly from the terms of the contract, the franchisee is likely not considered a third-party beneficiary. Franchisors entering into vendor agreements will want to be intentional about when and how they reference the franchisee to make clear whether or not they intend the franchisee to be a beneficiary of that agreement.

V. Third Party Vendors as Third-Party Beneficiaries to Franchise Agreements

In addition to franchisees asserting their rights as third-party beneficiaries to agreements between vendors and franchisors, third parties to franchise relationships will sometimes argue they are third-party beneficiaries to agreements between the franchisee and the franchisor. Again, these cases are rare, and it is even rarer for vendors to prevail as third-party beneficiaries.[91] But on occasion third parties have successfully asserted claims as third-party beneficiaries to franchise agreements. These cases are also highly fact dependent and turn on the specific language in the franchise agreement.

Because franchise agreements rarely include specific clauses indicating that a third party is an intended beneficiary, courts are reluctant to award third-party beneficiary status in this context. For example, in *Capital National Bank of New York v. McDonald's Corp.*,[92] the U.S. District Court for the Southern District of New York found that a franchisee's bank was not a third-party beneficiary to the franchise agreement.[93] The case arose after a McDonald's terminated a franchisee and the franchisee subsequently filed for bankruptcy.[94] The bank sued McDonald's for wrongful termination of the franchise on behalf of the franchisee as a third-party beneficiary.[95] The court held that nothing in the franchise agreement indicated that it was

90. *Id.*
91. The spouses of franchisees and undisclosed investors in franchises sometime attempt to assert third-party rights in a franchise agreement. A discussion of those claims is beyond the scope of this article.
92. Cap. Nat'l Bank of New York v. McDonald's Corp., 625 F. Supp. 874 (S.D.N.Y. 1986).
93. *Id.* at 883.
94. *Id.* at 877.
95. *Id.* at 882.

created to benefit the bank.[96] The bank therefore lacked standing to assert any claims as a third-party beneficiary.[97]

Courts seem more willing to find third parties to be third-party beneficiaries of franchise agreements when the relationship between the third party and the franchisor is particularly close. For example, in *Hossain v. JMU Properties, LLC*,[98] the D.C. Court of Appeals held that a landlord was an intended third-party beneficiary of a franchise agreement.[99] In that case, the same individual owned both the landlord entity and the franchisor entity.[100] The franchisee sued the landlord entity for wrongful eviction, and the landlord entity counterclaimed against the franchisee for breach of the franchise agreement as a third-party beneficiary.[101] The court held that the landlord entity was a third-party beneficiary of the franchise agreement because the same individual owned both entities and signed both the lease and the franchise agreement and the franchise agreement referred to the terms of the lease.[102] The court held that as an ascertainable third-party beneficiary, the counterclaim for breach of the franchise agreement was proper.[103]

Courts are also willing to treat associations of franchisees as third-party beneficiaries of a franchise agreement. In *International Pizza Hut Franchise Holders Ass'n, Inc. v. Supreme Pizza, Inc.*,[104] an association of franchisees sought to bring an action to enforce the terms of a franchisee's agreement with franchisor Pizza Hut.[105] The franchise agreement required the franchisee to comply with the association's bylaws.[106] A federal court in Kansas held that the contractual terms were clearly created for the benefit of the association and that the association could therefore enforce the terms of the contract.[107]

Sometimes, customers of a franchisee try to argue that they are third-party beneficiaries of a franchise agreement. These claims normally fail because there are very limited situations where a customer could prove they are the intended beneficiary of an agreement between a franchisor and a franchisee. For example, in *Bright v. Sandstone Hospitality LLC*,[108] a hotel guest argued he was a third-party beneficiary of the franchise agreement between a franchisee and the hotel franchisor.[109] The customer was injured at a hotel and attempted to enforce the terms of the franchise agreement requiring

96. *Id.* at 883.
97. *Id.*
98. Hossain v. JMU Props., LLC, 147 A.3d 816, 823 (D.C. 2016).
99. *Id.* at 823.
100. *Id.* at 818.
101. *Id.*
102. *Id.*
103. *Id.*
104. Int'l Pizza Hut Franchise Holders Ass'n, Inc. v. Supreme Pizza, 464 F. Supp. 65 (D. Kan. 1978).
105. *Id.* at 66.
106. *Id.*
107. *Id.* at 67.
108. Bright v. Sandstone Hosp. LLC, 755 S.E.2d 899 (Ga. Ct. App. 2014).
109. *Id.* at 903.

quality-assurance inspections.[110] The Georgia Court of Appeals held that "[a]n examination of the franchise contract between the [franchisor] and the [franchisee] shows no intent to benefit third persons such as hotel guests."[111] It helped that the franchise agreement included a specific disclaimer that the agreement was "exclusively for the benefit of the parties" and that there were "no third-party beneficiaries."[112] Those drafting franchise agreements may consider whether to adopt a similar disclaimer to make clear the parties do not intend customers to be considered intended beneficiaries of the agreement.

VI. Conclusion

Franchising involves an elaborate web of contracts. There are contracts between the franchisor and the franchisee, contracts between the franchisor and vendors, and contracts that the individual franchisee uses to operate its business. That web is made only more complicated by state law on third-party beneficiaries.

Intended beneficiaries to a contract can assert rights under the contract as if they were a signing party. This can be a powerful tool for parties that may otherwise have no recourse, such as franchisees that seek to enforce the terms of a franchisor's vendor contract on which they rely. But the tool is fraught with uncertainty. Individual states and even individual courts have different perspectives on what facts entitle someone to become a third-party beneficiary. The inquiry is highly fact-intensive and can result in significant litigation without a satisfying outcome. Parties looking to assert rights as a third-party beneficiary should look closely at the relevant contract to determine their chances of success. The more explicitly a contract indicates that a party is intended to be a third-party beneficiary, the more likely a court will find that a party is in fact a third-party beneficiary.

There are steps contracting parties can take to make it more or less likely that a court will deem a third party to be a third-party beneficiary. Parties can add language to their contracts making it abundantly clear that the agreement is for the benefit of a third party. They can also add language making it abundantly clear that they do not intend a party to benefit from the contract. This addition can create more certainty in a legal landscape that is otherwise highly fact-dependent and uncertain.

110. *Id.*
111. *Id.*
112. *Id.*