

Virginia Bill That Would Ban Franchise Non-Competes Advances in State Senate

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Virginia Senate Bill 798, introduced by former in-home senior care franchisee Sen. Chris Head, was passed unanimously by the Virginia Senate on January 17, 2025. The bill would amend Virginia's Retail Franchising Law to require franchise agreements for a Virginia location to be governed by the laws of Virginia. It would make it illegal to offer or enter into such a franchise agreement "that restricts the right of a franchisee to engage in the business of offering, selling, or distributing goods or services at retail after termination or expiration of the franchise agreement." It will be heard in a Virginia House of Delegates Labor & Commerce Committee, likely sometime during February 2025.

Why it Matters:

Covenants not to compete are hallmarks of franchising. Some argue that they are necessary to protect a franchisor's confidential and proprietary information from misuse by former franchisees to the detriment of both the franchisor and its remaining franchisees. Many franchisees think such provisions restrict their ability to hold a franchisor accountable, since the non-compete traps franchisees in the relationship with little recourse to advocate for their benefit.

Very few states have outlawed post-termination or expiration covenants not to compete in franchise agreements. California is well-known for its law that makes non-competes unlawful in most contracts, including employment and franchise agreements, unless the covenant is given in the context of selling a business as a going concern. Illinois restricts the ability of a franchisor to enforce a non-compete following the expiration of a franchise agreement unless the franchisor has offered the franchisee the right to renew. Indiana restricts the duration and scope of acceptable post-relationship non-competes. But to this author's knowledge, no state's law, even California's, is as far-reaching in restricting post-relationship competitive restrictions in franchise relationships as the Virginia bill.

What to Do if the Bill Passes:

If a franchisee seeks to break away from the franchisor during the term of the franchise agreement, the franchisor did not violate applicable franchise sales law, that the franchisee has the option to rescind the franchise, and the franchisor fulfilled its material obligations under the franchise agreement, then the franchisor should have a claim for lost future profits for the franchisee abandoning the franchise without cause. If Virginia passes this bill into law, it will be important for franchisors selling in Virginia to ensure that their standard franchise agreement clearly states that the franchisor has the right to collect such damages.

As to the expiration of the franchise, traditionally, most franchisees have had the option to continue the franchise relationship at expiration if they sign the franchisor's "then-current form of franchise agreement." The problem has been that franchise agreements have often become more one-sided for the franchisor, particularly as a system matures, and if there is a non-compete applicable upon non-renewal then the franchisee has little ability to negotiate more favorable terms at "renewal." The

bill, if enacted, would dramatically change that dynamic at expiration.

One provision that franchisors might consider adding to their agreements is an option for the franchisor to purchase the business as a going concern at expiration, if the franchisee does not accept the franchisor's offer of a new agreement at least 90 days prior to expiration. The provision would require the franchisor to pay the fair market value of the franchised business, including goodwill attributable to local use of the trademarks, and also require the franchisee to agree to provisions that are customary in a business purchase and sale agreement. Covenants not to compete, after sale of a business for value, are customary and should be enforceable following such an arms-length sale, notwithstanding the language of the Virginia bill.

Another approach that may be helpful to franchisors is to define all customer information collected or obtained by the Franchisee during the franchise relationship as proprietary to the franchise system and forbid the use of that information subsequent to the end of the franchise relationship. Such a provision should state that the Franchisee has a license to use the customer data during the relationship, and that license (and the local goodwill with those customers) is an asset that the Franchised Business that the Franchisee may sell to a new franchisee as part of an approved transfer. Such a provision, particularly with franchisees who are new to the system and the industry, may enable the franchisor to stop a former franchisee from using the customer data under trade secret laws, notwithstanding the bill discussed above. Such a restriction would make it less attractive for the franchisee to leave the system. However, such a provision could also have negative ramifications for the franchisor if it is sued by a franchisee's customer.

The details of each such provision, and others to protect truly proprietary and unique assets of a franchise system, require careful consideration and customized drafting. However, if Virginia enacts this bill into law, then it would join a select group of states that have tilted the playing field in favor of veteran franchisees, and franchisors will need to consult with experienced counsel who understands the ramifications of contract provisions.