

CHAPTER FIVE — FRANCHISING

Fairness in Franchising: The Need for a Good Cause Termination Requirement in California

Current California law fails to protect franchisees from the abuses connected with unfair termination. This Comment discusses specific shortcomings of the various legal theories that apply to franchise termination cases. The author then proposes that California adopt a requirement that good cause exist before any franchise is terminated.

Arlene Rossman owned a successful McDonald's franchise in Northern California.¹ In 1972 Mrs. Rossman married Don Anthony, an employee of the McDonald's corporation. McDonald's notified the newlyweds that McDonald's employees were not permitted to marry franchisees and requested Mr. Anthony's resignation from McDonald's. In return, the corporation offered the Anthonys additional McDonald's franchise opportunities.

As of 1976, McDonald's had failed to honor its offer to grant the Anthonys additional franchises. Consequently, Mr. Anthony notified McDonald's of his intent to pursue other business opportunities. McDonald's did not object. Mr. Anthony thereafter invested his separate funds in a company franchising the Maid-Rite Hamburger chain. The Anthonys assured McDonald's that the Maid-Rite operation did not use any part of the McDonald's

¹ All of the facts concerning the Anthony case were extracted from the statement of Mrs. Anthony reprinted in *Hearings Before the Subcommittee on Consumer Protection and Finance, 95th Cong., 1st Sess. 475-83 (1977)*, [hereinafter cited as *Subcommittee Hearings*].

system. The Anthonys invited McDonald's to inspect the Maid-Rite operations, but McDonald's declined.

Instead, McDonald's initiated a campaign of harassment against Mrs. Anthony. McDonald's refused to notify Mrs. Anthony of upcoming promotions or provide her with current supplier price lists. McDonald's also denied her the opportunity to participate in cooperative advertising schemes or attend regional meetings. McDonald's pursued its campaign against Mrs. Anthony even though company officials admitted that her franchise was one of the best run in Northern California. Finally, McDonald's terminated Mrs. Anthony's franchise without good cause, thirteen years before the scheduled date of termination.² Attorneys for McDonald's informed Mrs. Anthony that the company would not pay her for the terminated franchise.

Franchisor abuses, such as the Anthony case,³ are common.⁴ It is far more common, however, for the franchisor to coerce franchisees into operating their franchise as the franchisor directs using the threat of termination or nonrenewal.⁵ Because of this

² The McDonald's franchise agreement is one of the most favorable towards franchisees in existence. This agreement, however, provided McDonald's with grounds to terminate Mrs. Anthony for her husband's acts although his acts did not hurt the franchise operation. For representative McDonald's contract clauses, see *Subcommittee Hearings, supra* note 1, at 199.

³ See note 1 *supra*.

⁴ This coercive power is well-documented. Committees of both the United States Senate and the House of Representatives have held hearings over the past fourteen years on the abuses in the franchise relationship and their effect on small businesses. These hearings reveal a consistent pattern of franchisor abuse. See *Distribution Problems Affecting Small Business: Hearings Before Sub-comm. No. 4, House Select Comm. on Small Business, 88th Cong., 1st Sess. (1963)* (nine volumes); *Distribution Problems Affecting Small Business: Hearings Before the Sub-comm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 89th Cong., 2d Sess. (1966)* (three volumes); *Franchise Legislation: Hearings Before the Sub-comm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 90th Cong., 1st Sess. (1967)* (one volume); *Impact of Franchising on Small Business: Hearings Before and Report of the Senate Select Comm. on Small Business, 91st Cong., 2d Sess., (1970)* (one volume); *The Economic Effects of Franchising: Hearings Before the Senate Select Comm. on Small Business, 92nd Cong., 1st Sess. (1971)* (one volume); *Hearings on H.R. 5016 and H.R. 9144 Before the Sub-comm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 95th Cong., 1st Sess. (1977)* (one volume).

⁵ The ability of the franchisor to terminate or refuse to renew the franchise creates the great imbalance of power that exists between franchisors and franchisees. H. BROWN, *FRANCHISING: REALITIES AND REMEDIES* 4-5 (2d ed. 1978).

coercive power,⁶ the concept of the franchisee as an independent business-person is a myth.⁷ Moreover, franchisors often use this power for their own economic gain to the corresponding detriment of the franchisee. Legislation requiring good cause to terminate any franchise is necessary to prevent these abuses⁸ and to insure the efficient and continued operation of franchising in the California economy.⁹

The first section of this comment examines the source of the franchisor's coercive power as well as its consequences. Section Two illustrates how existing disclosure requirements¹⁰ and other

See notes 13-32 and accompanying text *infra*.

This comment uses the terms franchisees, dealerships, and distributorships interchangeably. Each of these terms is appropriate because, in economic terms, franchising is merely a form of "marketing or distribution in which a parent company, the franchisor, grants an individual or firm, the franchisee, the right, or franchise, to do business in a prescribed manner over a certain period of time in a specified place." C. VAUGHN, *FRANCHISING: ITS NATURE, SCOPE, ADVANTAGES AND DEVELOPMENTS* 24 (1974). According to this definition, dealerships and distributorships *are* franchises. The Appendix herein defines franchising in substantially the same manner as above. Appendix Ch. 1, § 2 *infra*. The definition in the appendix also includes distributorships, dealerships or any other form of marketing falling within the alternative definition as a franchise.

⁶ See notes 13-32 and accompanying text *infra*.

⁷ The power to inspect, coupled with the threat of termination for failure to meet franchisor directives, standards or methods, deprives franchisees of the advantages of ownership and control that historically were key factors in the success of franchising. See H. BROWN, *FRANCHISING: TRAP FOR THE TRUSTING* 23 (1969).

⁸ In the Appendix the author proposes a draft of legislation which would meet the need for franchisee protection and still protect the legitimate interests of the franchisor. This proposed legislation is fashioned after other recently introduced legislation. See *H.R. 5016* 95th Cong., 1st Sess. (1977); *H.R. 2305* 96th Cong., 1st Sess. (1979); *A.B. 295* Reg. Sess. (1979), introduced by California Assemblyman Bruce Young. In addition, to these sources, the author reviewed Assemblyman Young's working files on *A.B. 295*, to ascertain the major concerns of both franchisor and franchisee groups regarding the proposed legislation. The legislation in the appendix differs from the Young bill in at least one major aspect. See note 111 *infra*.

⁹ In 1977, California led the nation in the franchising of goods and services and accounted for much of the nation's \$238 billion in franchise related sales. U.S. DEPARTMENT OF COMMERCE, *INDUSTRY AND TRADE ADMINISTRATION, FRANCHISING AND THE ECONOMY, 1975-1977*, 52-54.

¹⁰ To date, California regulates the sale of franchises in a manner analogous to securities regulation. See *CAL. CORP. CODE* §§ 31000-31516 (West 1977 and Cum. Supp. 1980). For example, franchisors must disclose to prospective fran-

substantive remedies¹¹ fail to protect the franchisee. Section Three discusses the necessary elements of any meaningful good cause legislation. The comment concludes that franchising abuses can only be curbed by remedial legislation circumscribing the franchisor's terminative powers.¹² The appendix offers a draft of such legislation.

chisees all "material" facts and information concerning the franchise offered for sale. The purpose of this disclosure approach is to insure that franchisees have available the information necessary to make an intelligent and informed investment decision. CAL. CORP. CODE § 31001 (West 1977).

¹¹ Franchisees bring actions under antitrust laws, securities laws, common law fraud principles, "bad faith" and fiduciary theories to secure protection from abusive termination practices. See text accompanying notes 33-96 *infra*.

¹² Good cause termination legislation has been attacked on Federal pre-emption and Constitutional grounds. The Federal pre-emption claims, however, are generally unsuccessful. See Brown & Cohen, *Franchising, Constitutional Considerations For Good Cause State Legislation*, 16 HOUS. L. REV. 21, 44-51 (1978). Arguments that good cause legislation violates the "contracts" clause, U.S. CONST., art. I, § 10, have sometimes succeeded when the legislation is retroactively applied to existing franchise agreements and is inconsistent with the previously negotiated terms of those agreements. See *Consumers Oil Corp. v. Phillips Petroleum Co.*, 488 F.2d 816, 819-20 (3d Cir. 1973); *Mobil Oil Corp. v. Handley*, 76 Cal. App. 3d 956, 143 Cal. Rptr. 321 (2d Dist. 1978); *Globe Liquor Co. v. Four Roses Distillers Co.*, 281 A.2d 19 (1971), *cert. denied*, 404 U.S. 873 (1971). *But see*: *C.A. May Marine Sup. Co. v. Brunswick Corp.*, 557 F.2d 1163 (5th Cir. 1977); *American Motor Sales v. Div. Of Motor Vehicles*, 445 F. Supp. 902, 910 (E.D. Va. 1978). Retroactive application alone should not be sufficient to invalidate the legislation. Retroactivity is only one factor the court considers in determining whether the state has unconstitutionally impaired an existing contract. *Veix v. Sixth Ward Bldg. & Loan Ass'n*, 310 U.S. 32 (1940); see also Huchman, *The Supreme Court And The Constitutionality Of Retroactive Legislation*, 73 HARV. L. REV. 692 (1960). One could argue that when a good cause requirement is applied to existing contracts it is not a retroactive impairment of contracts but merely the reasonable regulation of an ongoing business relationship. *Cf. New Motor Vehicle Bd. v. Orrin W. Fox Co.*, 439 U.S. 96, 106 (1978) (California's regulation of the number of automobile franchises in an area upheld as a reasonable state regulation of a business relationship).

Prospective application of good cause legislation, of course, would not present a "contracts" clause problem. Good cause legislation would unquestionably apply to those franchise contracts entered into or renewed after the effective date of such legislation. Thus, even if such legislation could not be retroactively applied, it would still have great prospective impact. *Union Oil Company v. Moesch*, 88 Cal. App. 3d 72, 151 Cal. Rptr. 517 (2d Dist. 1979).

I. THE INHERENT COERCIVENESS OF THE FRANCHISING RELATIONSHIP

The franchising relationship can be inherently coercive to franchisees.¹³ This section illustrates how the power of termination threatens the franchisees' business investment and therefore causes them to submit to the dictates of franchisors in their daily operations.¹⁴ An analysis of typical franchise terms will further illustrate how franchisees are controlled by franchisors.

Franchisees fear the power of termination because its exercise generally means the loss of their capital investment¹⁵ and the good will they have created.¹⁶ Actual termination by the franchisor is rarely required as the mere threat is usually enough to compel franchisee compliance. Franchisees must submit to franchisors or inevitably risk the loss of their franchise investment.¹⁷

¹³ See, e.g., H. BROWN, *supra* note 7.

¹⁴ See note 4 *supra*.

¹⁵ Franchisees usually must invest capital to purchase the franchise's equipment, land, buildings, signs, fees, and operating inventory. Brown & Cohen, *Franchise Equities*, 63 MASS. L. REV. 109 (1978). Upon termination or nonrenewal of the franchise, franchisees usually lose this capital investment. See, e.g., notes 31 & 111 *infra*.

¹⁶ Franchisees develop good will for the franchise through extensive personal efforts in operating the franchise. See *Milsen & Co. v. Southland Corp.*, 454 F.2d 363 (7th Cir. 1971); H. Brown, *supra* note 7, at 25. Upon termination of the franchise, franchisees usually lose this good will value along with their capital investment. See, e.g., notes 31 & 111 *infra*. For this reason, it is important that the good will of the franchise be considered a property interest of the franchisee, acquired through extensive personal efforts and capital expenditure. This assumption is one of the underlying rationales of good cause legislation. Such legislation seeks to compensate the franchisee for the loss of this good will upon the termination or nonrenewal of the franchise. See Appendix Ch. 6, § 1, *infra*. It should be noted, however, that if the franchisee operates one of many trademarked franchises with uniform products, services and advertising, then the franchisee's contribution to the creation of good will is probably less significant. *Kugler v. Aamco Automatic Transmissions, Inc.* 337 F. Supp. 872, *aff'd*, 460 F.2d 1214 (8th Cir. 1972). The facts of each case will determine the amount the franchisee should receive for developing good will for the franchise.

¹⁷ The contractual right of franchisors to terminate without cause and without payment to franchisees for the good will value of the franchised business is the single most serious problem in the franchising relationship. *Subcommittee Hearings*, *supra* note 1, at 449 (statement of Timothy H. Fine, General Counsel for the National Franchise Association Coalition). The franchisors' power to terminate or not renew franchises without adequate payment magnifies expo-

The franchisor's right or power to terminate originates in the typically one-sided franchise agreement which acts as an adhesion contract.¹⁸ This agreement sets forth the rights and obligation of both the franchisor and the franchisee, including the franchisee's right to operate the franchise. These franchise agreements grant franchisors the power to terminate or refuse to renew franchises for almost any reason.¹⁹ Franchisors insist that

nentially the inherent dominant economic power of franchisors. The United States Supreme Court recognized this point in *Federal Trade Commission v. Texaco, Inc.*, 393 U.S. 223, 226 (1968) (holding Texaco's requirement that dealers buy supplies from it an unfair method of competition in violation of section five of the Federal Trade Commission Act.)

¹⁸ Adhesion or standardized contracts have one distinguishing feature. There is generally an absence of any negotiation over the contract terms. These contracts are simply form contracts. There is no negotiating over the terms of the agreement because the parties to an adhesion contract are usually in unequal bargaining positions. The stronger party dictates the contract terms and will not change them upon the weaker party's objection. Wilson, *Freedom Of Contract And Adhesion Contracts*, 14 INT'L. & COMP. L. Q. 172, 181-82 (1965). See also Kessler, *Contracts of Adhesion—Some Thoughts About Freedom Of Contract*, 43 COLUM. L. REV. 629, 631 (1943). This distinguishing feature is present in most franchise contracts. The franchisor exploits his or her superior bargaining strength and offers a standard contract to prospective franchisees on a take-it-or-leave-it basis. See *Ungar v. Dunkin Donuts of America, Inc.*, 531 F.2d 1211 (3d Cir. 1976), cert. denied, 429 U.S. 823 (1976); *Semmes Motors, Inc. v. Ford Motor Co.*, 429 F.2d 1197 (2d Cir. 1970); *Subcommittee Hearings, supra* note 1, at 125 (statement of Cathleen Douglas, Legal Counsel to the National Beer Wholesaler's Association of America). In addition, a gross disparity generally exists between franchisors and franchisees in bargaining skills, financial strength, and in access to professional advisors and business experts. See generally *Federal Trade Commission v. Texaco, Inc.*, 393 U.S. 223, 227 (1968); *Ford Motor Co. v. United States*, 335 U.S. 303, 323 (1948); *Photovest Corp. v. Fotomat Corp.*, [1977-1] Trade Cas. (CCH) ¶ 61,529 (S.D. Ind. 1977); *Henningson v. Bloomfield Motors, Inc.*, 32 N.J. 358, 391, 161 A.2d 69, 87 (1968); 6 CORBIN, CONTRACTS § 1266, at 57 (1960); Note, *Automobile Franchises*, 70 HARV. L. REV. 1239, 1240 (1957).

¹⁹ Because franchise agreements are adhesion contracts, they contain provisions which are extremely difficult for franchisees to comply with. The result is that franchisees are constantly in peril of non-compliance with the franchise agreement. See *Federal Trade Commission v. Texaco, Inc.* 393 U.S. 223 (1968); see also note 48 *infra*. Courts, citing the right of freedom of contract, uphold these contracts absent fraud or unconscionability. See *Campbell Soup Co. v. Wentz*, 172 F.2d 80 (3d Cir. 1948); see generally J. MURRAY, JR., MURRAY ON CONTRACTS § 350 (2d rev. ed. 1974). Thus courts have approved the franchisor's nearly absolute right to terminate according to any term in the franchise agreement. See *Division of Triple T Service, Inc. v. Mobil Oil Corp.*, 304 N.Y.S.2d 191, 60 Misc. 2d. 312 (1969); Annot., 64 A.L.R. 3d 6, § 21(b)

they need termination powers to maintain the quality, uniformity and reputation of their business systems.²⁰ The terms of most franchise agreements, however, reach far beyond basic franchisor protection.

For example, franchise agreements typically require that the franchisee purchase supplies exclusively from the franchisor.²¹ If the franchisee fails to do so, the franchisor may terminate the franchise agreement. Thus, even if comparable goods are available elsewhere at a lower cost, the franchisee must purchase from the franchisor. Moreover, because the franchisor has a captive market, the purchase price for franchisor-supplied goods is generally more costly and is likely to be exorbitant.²²

If franchisees are permitted to purchase from third-party sources at all,²³ the franchise agreement usually requires that the franchisor approve those sources.²⁴ The purpose of this is to

(1975), and cases cited therein; see generally Gellhorn, *Limitations On Contract Termination Rights — Franchise Cancellations*, 1967 DUKE L. J. 465, 476, n. 43; Rubin, *The Theory Of The Firm And The Structure Of The Franchise Contract*, 21 J. LAW & ECON. 223, 224-25 (1978).

²⁰ See note 23 *infra*.

²¹ H. BROWN, *supra* note 7, at 4.

²² While it is recognized that part of the cost of the franchise may include purchasing supplies at premium prices, the price for such supplies have too often been unreasonable. Currently, franchisees may pay up to seven times the market price for ingredients and constituent parts of the franchised product. See H. BROWN, *supra* note 5, at 23, 27, 140. See also *Klinzing, v. Shakey's, Inc.* 49 F.R.D. 32 (E.D. Wis. 1970) (the franchisor charged \$21.50 for a package of spices costing \$3.00 on the open market.)

²³ Franchisors can require that franchisees purchase necessary supplies from them. There is some justification for requiring franchisees to purchase directly from the franchisor because, under the Lanham Trademark Act, a franchisor must exercise quality control over the licensee or risk loss of the trademark. 15 U.S.C. § 1064(e) (1963). This argument, however, ignores the fact that the overwhelming majority of franchise agreements are adhesion contracts designed to give franchisors control, not protection. See notes 18 & 19 *supra*. Franchisors can enforce the quality and uniformity of the franchised products by simply setting standards. If the franchisor provides these standards to the franchisee at the outset of the franchise relationship, and the franchisee violates them, good cause for termination would exist.

²⁴ See *KFC Corp. v. Diversified Packaging Corp.*, 549 F.2d 368, 552 F.2d 601 (5th Cir. 1977). Courts have recognized the franchisor's right to protect his or her trademark and have generally allowed franchisors wide latitude to impose the controls necessary to assure uniform quality of product and service. See *Dawn Donut Co. v. Hart's Food Stores, Inc.*, 267 F.2d 358 (2d Cir. 1959); *Susser v. Carvel*, 206 F. Supp. 636 (S.D.N.Y. 1962), *cert. dismissed*, 381 U.S.

allow the franchisor to retain some control in order to maintain the quality and reputation of the franchise. Unfortunately, however, this situation lends itself to illegal kickbacks and, once more, to higher costs for franchisees.²⁵ Even when the franchise agreement permits the purchase of supplies from any source, so long as quality control standards are met, franchisors often refuse to furnish the franchisee with the necessary standards.²⁶

Another example of a typical franchise agreement provision that can be coercive is the franchisor's right of inspection. Standard boilerplate clauses authorize franchisors to inspect business premises and records. Ostensibly, this power protects the franchisor's trade-mark.²⁷ However, it also permits the franchisor to oversee the daily operation of the franchise and search for technical violations of the franchise agreement.²⁸ These intrusions erode the franchisee's position as entrepreneur

125 (1965).

²⁵ The use of approved sources clauses invites exploitation of franchisees. It is likely that the "approved" sources have been approved only because they have made payments to the franchisor. The suppliers recover these payments by charging higher prices to franchisees. H. BROWN, *supra* note 5, at 26. See generally *Ungar v. Dunkin' Donuts Of America, Inc.*, 531 F.2d 1211 (3d Cir. 1976), *cert. denied*, 429 U.S. 823 (1976) (in dicta, the court noted the franchisee's allegations that the suppliers secretly paid the franchisor.)

²⁶ In one case, the franchising agreement provided that the franchisee purchase all supplies from the franchisor or approved sources during the initial year of the franchise operation. Thereafter, the franchisee could purchase supplies from any source so long as the franchisee met the franchisor's standards. For four years, however, the franchisor refused to give the franchisee the requisite specifications for the supplies. See H. BROWN, *supra* note 7, at 15.

²⁷ See note 23 *supra*.

²⁸ The power of inspection gives franchisors a practical means of enforcing the provisions of the adhesion franchise agreement. Franchisors, through inspection, can readily detect noncompliance with the franchise agreement terms. Franchisees, therefore, in order to avoid termination, must constantly strive for full compliance with every contract term no matter how technical the term or how expensive the compliance. See note 19 and accompanying text *supra*.

The franchisor's power of inspection has other uses as well. One franchisee testified that his franchisor used this power to determine the franchisee's selling prices. Once the franchisor has this information, he could increase the cost of the franchisee's supplies in accordance with each increase in the franchisee's selling prices. The franchisor thus maximized profits while the franchisee was effectively prevented from ever earning a higher profit on his investment. *Subcommittee Hearings*, *supra* note 1, at 471 (statement Of Clifton Rosett, Basikin-Robbins Ice Cream Franchisee).

and small business owner.²⁹

Franchisors may also threaten to exercise termination powers to prevent franchisees from giving testimony to government officials investigating franchise abuses or illegal practices.³⁰ Used in this manner, termination clauses tend to prevent detection of the very franchise abuses they help create.

The inherent coerciveness of the franchising relationship leads to greater expense and loss of autonomy for the franchisee. As long as franchisors have unrestricted termination powers, abuses will persist.³¹ The dream of owning an independent franchise can become a nightmare.³² The following section considers the remedies available to an unfairly terminated franchisee and examines their effectiveness in controlling the abuses which occur in the franchising relationship.

II. INADEQUACY OF EXISTING LEGAL REMEDIES IN PREVENTING FRANCHISOR ABUSES

Critics of good cause termination legislation³³ insist that cur-

²⁹ See note 7 and accompanying text *supra*.

³⁰ See *Subcommittee Hearings, supra* note 1, at 118 (statement of Russell G. Hopkins, Chief Executive Officer of the National Beer Wholesalers Association).

³¹ The abusive use of termination clauses persists because franchisors find many uses for them aside from controlling the day-to-day operations of their franchisees. For example, termination clauses especially benefit franchisors when the operation or expectations of the franchise change. If the franchise performs better than initially anticipated, a franchisor might terminate its franchisees and establish company-owned franchises. See note 36 *infra*. Franchisors might also use a termination clause to continue practices which otherwise violate the antitrust laws. In 1975, for example, the Times Mirror Company notified its 314 independently franchised distributors in Southern California of their termination and replacement by the company's own employees. This changeover enabled the Times Mirror Company to fix the retail prices of the newspapers sold by its distributors as the distributors became company employees rather than independent contractors. Earlier, the federal government had denied Times Mirror's application for an exemption from the antitrust laws prohibiting such vertical price-fixing. However, such an exemption was unnecessary once the distributors became Times Mirror employees. The initial franchisees lost the good will and the capital investment in their distributorships. *Subcommittee Hearings, supra* note 1, at 454-55. For numerous other examples of franchising abuses, see *Subcommittee Hearings, supra* note 1, at 468-547.

³² See note 1 and accompanying text *supra*.

³³ As used in this comment, the term "good cause termination legislation"

rent disclosure laws and various substantive legal remedies provide franchisees with adequate protection from coercive and abusive practices by franchisors.³⁴ This section examines these various legal remedies and concludes that the protection they offer is inadequate. The protection is inadequate because most courts have found the underlying legal theories inapplicable in the majority of cases of franchisee abuse or wrongful termination.³⁵ Courts which have applied these remedies in termination cases have found it necessary to resort to creating legal fictions and implied covenants to make the theories applicable.³⁶ Until good cause legislation is enacted, the only hope of those few abused franchisees who can afford to litigate is that a court will create a legal fiction based on one of the following legal remedies.³⁷

A. Disclosure Theory

California currently protects franchisees with the Franchise Investment Law.³⁸ This law requires franchisors to disclose information regarding the franchise sufficient to permit prospective franchisees to make an intelligent investment decision.³⁹

means any legislation that prohibits franchisors from terminating a franchise relationship without good cause.

³⁴ Critics of good cause termination legislation are usually the representatives of franchisor associations. See note 55 and accompanying text *infra*.

³⁵ See notes 38-96 and accompanying text *infra*.

³⁶ In one such case, *Shell Oil Co. v. Marinello*, 63 N.J. 402, 307 A.2d 598 (1973), *cert. denied*, 415 U.S. 920, the New Jersey Supreme Court found the Shell Oil Company termination provision unconscionable and unenforceable against a dealership. The court stated that the gasoline dealership involved could not be terminated without good cause. The Court protected the dealer from an unfair termination in this case by construing a simple leasing agreement for the physical premises as a franchise and, then, implying a covenant in that lease that termination could be for good cause only. Shell Oil undoubtedly did not intend either of these results to be part of its initial leasing bargain. The force of this common law development is limited, however, by the fact that the New Jersey legislature had enacted a good cause statute the previous term. The effective date of the legislation was too late to apply it to the case at bar. Therefore, the court rested its decision on New Jersey public policy as illuminated by the good cause statute just passed.

³⁷ See notes 57-64 and accompanying text *infra*.

³⁸ CAL. CORP. CODE §§ 31000-31516 (West 1977 & Cum. Supp. 1980).

³⁹ One of the stated purposes of the California disclosure approach is to give the franchisee a better understanding of the relationship between the franchisor and the franchisee. *Cal. Corp. Code* § 31001 (West 1977).

This means the franchisor must disclose all relevant financial information concerning the franchise, the franchisor and the franchise contract prior to entering into a franchise agreement with the prospective franchisee.⁴⁰ The Franchise Investment Law also requires franchisors to register franchise offerings with the California Commissioner of Corporations.⁴¹

The Franchise Investment Law and a similar Federal rule,⁴² help franchisees combat the abusive and overreaching practices of franchisors by dissuading prospective franchisees from entering into any franchise relationship.⁴³ Mandatory disclosures

⁴⁰ The franchisor must disclose information concerning: the name, nature and requirements of the offered franchise; the criminal history of the franchisor relating to fraud; the number and exclusive areas of franchises currently operating; and the conditions under which the franchisor may terminate or refuse to renew the franchise agreement. See CAL. CORP. CODE § 31111 (West 1977).

⁴¹ CAL. CORP. CODE § 31111 (West 1977). The California law exempts established franchisors from the general disclosure requirements. Established franchisors are those with a net worth of at least five million dollars and at least 25 operating franchises for the five-year period prior to the proposed sale. With respect to termination, these "established" franchisors must disclose only the conditions under which they may terminate or refuse to renew a franchise.

This established franchisor exemption is perhaps unwise. Some of the largest and most established franchisors are responsible for the most egregious abuses. For example, one company that franchises Jack-In-The-Box restaurants, decided that it no longer desired to operate independently owned franchises so it refused to renew the thirty day lease for all 640 of its franchisees. *Battle v. Ralston Purina Co.*, No. 70-1878-F (C.D. Cal., filed Aug. 21, 1970).

⁴² A recently promulgated Federal Trade Commission (F.T.C.) rule also requires franchisors to give prospective franchisees a disclosure statement concerning the franchise. Disclosure Requirements and Prohibitions Concerning Franchising And Business Opportunity Ventures, 16 C.F.R. § 436 (1979). Patterned after the California approach, this new F.T.C. rule creates a minimum Federal standard of disclosure applicable to all franchise offerings. Because of its similarity to earlier disclosure approaches, the new F.T.C. rule is subject to the same criticisms concerning its effectiveness in combatting termination abuses.

For an interpretation of the rule and its disclosure standards, see Federal Trade Commission, *Franchising and Business Opportunities, Rules and Guides* (1979), reprinted in *TRADE REG. REP. (CCH)* (Aug. 1, 1979).

⁴³ Although one rationale of required disclosure statements is that they dissuade prospective franchisees from entering franchise relationships that might be oppressive, this result is not usually achieved. Franchisees continue to enter these relationships because they do not consult legal counsel before investing in the franchise and do not understand the full legal import of most clauses in the franchise agreement. See H. BROWN, *supra* note 7, at 5. If after the

which suggest overreaching or excessive control by the franchisor may discourage the prospective franchisee from investing and thereby avert a future termination. The parties never commence a relationship which would be destined to deteriorate because of excessive franchisor controls.⁴⁴

Disclosure rules, however, do not equalize the parties' bargaining power⁴⁵ or provide substantive relief for franchisees upon wrongful terminations.⁴⁶ Their usefulness is limited to protecting the investing public from uninformed decisions. The disclosure requirements do not punish franchisors who unfairly terminate franchisees or provide compensatory damages to

franchise relationship commences, the franchisee receives legal advice as to the invalidity of the franchisor's requirements under the antitrust laws, the franchisee may still not have the resources to fight any such antitrust abuses. The franchisee must either accept the abusive clauses or risk termination. See notes 51-66 and accompanying text *infra*.

⁴⁴ U.S. DEPARTMENT OF COMMERCE, INDUSTRY AND TRADE ADMINISTRATION, FRANCHISING IN THE ECONOMY 1976-1978, 24.

⁴⁵ *Id.*

⁴⁶ Disclosure rules fail to provide substantive relief in most cases as the money involved in many unjust termination cases is not enough to warrant F.T.C. involvement. *Subcommittee Hearings, supra* note 1, at 125 (statement of Cathleen Douglas, Legal Counsel to the National Beer Wholesaler's Association of America). See note 47 *infra*. Further, the new F.T.C. disclosure approach is patterned after California's Franchise Investment Law which has not been very successful in protecting franchisees from unfair terminations. See note 41 *supra*. For example, these disclosure rules do not reach some of the most abused contract terms of all. CAL. CORP. CODE § 31011 (West 1977) exempts from disclosure the franchisor requirement that the franchisee purchase goods "at a bona fide wholesale price." However, franchisees cannot determine if a franchisor's failure to disclose purchase requirements violates the California Act unless the franchisors disclose the constituent parts so that franchisees can price them on the market. Franchisors, however, are unwilling to disclose ingredients or parts of trademarked products. See note 26 *supra*.

The Federal disclosure approach also exempts from disclosure certain information necessary in order to determine the cost of supplies. The only purchase requirements that must be disclosed under the Federal rule are those from either the franchisor or its affiliates. The F.T.C. defines affiliate as a person, association, or business entity that *controls* the franchisor or owns ten per cent or more of the franchisor's outstanding stock. 16 C.F.R. § 436.2 (i). This definition of control ignores the most common required purchase arrangement. This is where the franchisor contracts with non-affiliated third-party sources for supplies for their franchisees. The new F.T.C. rule does not require disclosure of these required sources of supply. This gap in the disclosure requirements makes them practically worthless in informing prospective franchisees of the exact nature of the relationship that they are about to enter.

franchisees upon such terminations.⁴⁷ Moreover, disclosure of grounds for termination does not even warn the franchisee that technical compliance with every franchise agreement provision can be oppressive.⁴⁸

Indeed, disclosure requirements generally have little effect upon industry termination practices. First, because of the unequal bargaining positions of the parties, most franchise agreements are adhesion contracts whether there is full disclosure or not.⁴⁹ Second, even if franchisors make their contract terms less oppressive, they retain the same degree of control over the franchising relationship through the threat or power of termination.⁵⁰ Thus, disclosure approaches are inadequate to protect

⁴⁷ F.T.C. authority to promulgate the new disclosure rule is derived from the Federal Trade Commission Act, 15 U.S.C. §§ 41-46, 47-58 (1976). This Act's purpose is to protect the public but not to punish wrongdoers. *See, e.g.*, *Doyle v. F.T.C.*, 356 F.2d 381 (5th Cir. 1966); *Regina Corp. v. F.T.C.*, 322 F.2d 765 (3d Cir. 1963). The purpose of California's disclosure rule is merely to inform franchisees of the exact nature of the franchise they are entering. *See CAL. CORP. CODE* § 31001 (West 1977).

⁴⁸ Technical compliance with every term, or full compliance with some terms currently permitted in franchise agreements is likely to be impossible. *See note 19 supra*. *Cf. Federal Trade Commission v. Texaco*, 393 U.S. 223, 227 (1968) (the Court noted that full compliance with the "housekeeping" provisions of the Texaco lease agreement might be onerous). In addition, many franchise agreements grant the franchisor unilateral power to make critical decisions. These include the setting of wholesale prices of the goods and services furnished to the franchisee, the standards prescribed in the operations manual, and product specifications. *See Brown & Cohen, Franchising: Constitutional Considerations For Good Cause State Legislation*, 16 HOUS. L. REV. 21, 33-35 (1978). Because the franchisor also has the power to change the requirements unilaterally, compliance can be extremely difficult.

The good cause legislation proposed in the Appendix, *infra*, would alleviate many of the problems of "technical" compliance. The legislation requires that franchisees comply only with those terms that are lawful, reasonable, material, and non-discriminatory. Appendix Ch. 1, § 10 *infra*. This approach is similar to that taken in Washington. That state's good cause legislation defines good cause as the failure of the franchisee "to comply with any lawful, material provision of the franchise agreement." WASH. REV. CODE ANN. § 19.100, 180. Franchisors cannot claim good cause for termination under these standards when attempting to enforce vague or unreasonable contract provisions.

⁴⁹ *See notes 18-19 and accompanying text supra*.

⁵⁰ The power of termination gives the franchisor as much dominion over the franchisee as any well-drafted contract of adhesion. Therefore, if disclosure rules allow the franchisor to use persuasion, the franchisor is free to coerce the franchisee in daily operations. The threat of termination is so effective in controlling franchisees, that one author states: ". . . [t]he slightest whisper is

franchisees from franchise termination abuses. Similarly, other legal theories which franchisees have used also fail to prevent the numerous unfair terminations that annually occur. Most noteworthy are actions brought under the antitrust laws.

B. Antitrust Theory

The primary statutory basis for federal antitrust actions is the Sherman Act,⁵¹ under which franchisees can sue for the loss of profits,⁵² loss of good will,⁵³ and loss of business.⁵⁴ Opponents of federal good cause legislation view the antitrust laws as a virtual panacea for all franchisee ills.⁵⁵ They argue that franchisees have successfully used these laws to protect against unwarranted terminations.⁵⁶

quite effective. For that reason, legislative approval of 'recommendation, endorsement, exposition, persuasion, urgency, or argument,' fails to answer the problem." BROWN, *supra* note 5, at 50-51. See also note 84 *infra*.

⁵¹ 15 U.S.C. §§ 1-7 (1973).

⁵² See *Clapper v. Original Tractor Cab. Co.*, 270 F. 2d 616 (7th Cir. 1959), *cert. denied*, 361 U.S. 967 (1960).

⁵³ See *Standard Oil Co. v. Moore*, 251 F. 2d 188 (9th Cir. 1957).

⁵⁴ See *Osborn v. Sinclair Refining Co.*, 324 F. 2d 566 (4th Cir. 1963).

⁵⁵ In a prepared statement for the Subcommittee on Consumer Protection and Finance, Phillip Zeidman, Washington Counsel for the International Franchise Association (representing franchisors), argued that the federal antitrust laws effectively protect franchisees from the following abuses: *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977) (unreasonable territorial or customer restrictions); *Simpson v. Union Oil Co.*, 396 U.S. 13 (1969) (price fixing); *American Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230 (3d Cir. 1975), *aff'g. in part, rev'g. in part and remanding*, 365 F. Supp. 1073 (D.N.J. 1973) (unreasonable restrictive covenants); *Coleman Motor Co. v. Chrysler Corp.*, 525 F.2d 1338 (3d Cir. 1975) (monopolization and monopolization attempts). *Subcommittee Hearings, supra* note 1, at 296-97. These cases are the exceptions, however. The practices condemned in each of these cases were antitrust violations in and of themselves. The franchisor's actions would have been actionable even without the unfair termination. See notes 57-59 and accompanying text *infra*.

⁵⁶ For example, in *George W. Warner & Co. v. Black & Decker Mfg. Co.*, 277 F.2d 787 (2d Cir. 1960), a franchisee was terminated after bidding against his supplier for a government contract and winning it. The court held that "when the manufacturer's actions go 'beyond mere announcement of his policy and the simple refusal to deal, and he employs other means which effect adherence to his resale prices' then he has put together a combination in violation of the Sherman Act." 277 F.2d at 790 (quoting *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960)). The key item to note here, however, is the supplier's vertical fixing of prices. This act alone is a *per se* violation of the antitrust laws.

Successful litigants, however, are rare.⁵⁷ The antitrust laws apply only to limited aspects of the franchising phenomena.⁵⁸ Antitrust remedies do not protect franchisees from unwarranted terminations unless the terminations further a specific antitrust violation or are in retribution for the instigation of antitrust litigation by a franchisee.⁵⁹

Even if a franchisor's activity is prohibited by the antitrust laws, success is still unlikely.⁶⁰ The franchisee must satisfy heavy

Albrecht v. Herald Co., 390 U.S. 145 (1968); Kiefer-Stewart v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951); Dr. Miles Medical Co. v. John D. Parke & Sons, Inc., 220 U.S. 373 (1911).

⁵⁷ Courts usually reject franchisee's antitrust claims for treble damages. See P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 316(d), at 70-71 (1978); note 60 and accompanying text *infra*. Similarly, franchisees are usually denied a remedy under contract and tort law. See Horton, *Legal Remedies of a Distributor Terminated Pursuant To A Contractual Provision For Termination Upon Notice*, 3 CREIGHTON L. REV. 88 (1970); Bohling, *Franchise Terminations Under the Sherman Act: Populism and Relational Power*, 53 TEX. L. REV. 1180, 1181-82 (1975); notes 33-96 and accompanying text.

⁵⁸ U.S. GOVERNMENT PRINTING OFFICE, ANTITRUST LAW AND ADMINISTRATION: A SURVEY OF CURRENT ISSUES, reprinted in U.S. GOVERNMENTAL PRINTING OFFICE, ACHIEVING THE GOALS OF THE EMPLOYMENT ACT OF 1946—THIRTIETH ANNIVERSARY REVIEW 20 (1976).

⁵⁹ The F.T.C., for example, receives approximately 50 letters a week on franchise problems. Of these, one-half normally concern franchise terminations. The F.T.C. does not act on these complaints unless there is a direct relationship to some other anticompetitive practice. *Subcommittee Hearings, supra* note 1, at 245 (statement of Daniel Schwartz, Deputy Director, Bureau of Competition, Federal Trade Commission).

See generally *Universal Brands, Inc. v. Phillip Morris, Inc.*, 546 F.2d 30 (5th Cir. 1977); *Adolph Coors Co. v. F.T.C.*, 497 F.2d 1178 (10th Cir. 1974); *Joseph E. Seagrams & Sons, Inc. v. Hawaiian Ohe & Liquors, Ltd.*, 416 F.2d 71 (9th Cir. 1969); *Ace Beer Distributors, Inc. v. Kohn, Inc.*, 318 F.2d 283 (6th Cir. 1963).

⁶⁰ Franchisees often lose their antitrust actions. See, e.g., *Anaya v. Las Cruces Sun News*, 455 F.2d 670 (10th Cir. 1972) (holding that termination and refusal to deal with a franchisee was not an antitrust violation even where it affected 25 per cent of the newspaper deliveries within the city); *Ricchetti v. Meister Brau, Inc.*, 431 F.2d 121 (9th Cir. 1970), *cert. denied*, 401 U.S. 939 (1971) (the franchisee's antitrust action was dismissed because the franchise termination did not substantially lessen competition or tend to create a monopoly); *Ace Beer Distributors, Inc. v. Kohn, Inc.*, 318 F.2d 283 (6th Cir. 1963) (holding that a conspiracy between the brewer and others to destroy a distributor's business and to eliminate him from interstate commerce by termination of his franchise was not an antitrust violation absent results proscribed by the Sherman Antitrust Act); *Packard Motor Car Co. v. Webster Motor Car Co.*, 243 F.2d 418 (D.C. Cir. 1957), *cert. denied*, 355 U.S. 822 (1957) (holding that

burdens of proof before a cause of action will lie for an illegal tying arrangement.⁶¹ In cases involving price fixing, franchisees rarely can prove the franchisor's illegal intent.⁶²

The time⁶³ and expense⁶⁴ of antitrust litigation also preclude

the Sherman Antitrust Act was not violated by a manufacturer entering an agreement to cancel one franchisee and grant another an exclusive area franchise).

⁶¹ To bring a successful antitrust action the franchisee must prove the existence of a contract, combination or conspiracy, resulting in restraint of interstate trade. 15 U.S.C. § 1 (1973). The most common action under the antitrust laws is for franchisee coercion in illegal tying arrangements. A tying arrangement exists where a supplier sells something which the franchisee needs and cannot obtain from another source on condition that the buyer also purchase other undesired products. *See Annot.*, 14 A.L.R. Fed. 473 (1973).

To prove the existence of an illegally tied product, the franchisee must show that the arrangement involves two distinct products, one which can only be obtained by buying the other; that the seller has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product; and that the arrangement affects a "not insubstantial" amount of commerce. *Northern Pacific Ry Co. v. United States*, 356 U.S. 1 (1958). The franchisor also has three available defenses: first, the protection of the tradename through a quality control program, *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43 (9th Cir. 1971); second, trade secret; and, finally the single product defense. For a discussion of these latter two defenses, *see Kugler v. Aamco Automatic Transmissions, Inc.*, 460 F.2d 1214 (8th Cir. 1972).

⁶² *Subcommittee Hearings, supra* note 1, at 138.

⁶³ For example, in one case a franchisee knew of a price-fixing scheme. He complained to the F.T.C. in 1964 but the agency refused to take action. In 1971 when the franchisee became chairman of a rival brewery, he instituted an antitrust action. It took six years to resolve this case. *Subcommittee Hearings, supra* note 1, at 155-56 (statement of James Valenti, owner, beer distributing company). It is not uncommon for antitrust litigation to extend for years. *See NATIONAL COMMISSION FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES, REPORT TO THE PRESIDENT AND ATTORNEY GENERAL* (1979). For a general discussion of the time and expense involved in antitrust litigation, *see Comment, Parens Patraie Suits By State Attorney Generals: An Effective Antitrust Remedy For Small Business*, this issue at 648.

⁶⁴ In 1969, one author noted that the minimum retainer for the average antitrust case was probably in the vicinity of \$25,000. This amount must be significantly increased to reflect current costs. H. BROWN, *supra* note 7, at 97. One recent case illustrates how expensive antitrust litigation can become. In *SCM Corp. v. Xerox Corp.*, 463 F. Supp. 983 (D. Conn. 1978), *remanded*, 549 F.2d 32 (2d Cir. 1979), estimates of the combined legal costs to both parties exceeded \$50,000 per day of trial. The trial lasted approximately seven months. 463 F. Supp. at 986. For a general discussion of the costs associated with such litigation, *see Green, Marks & Olson, Settling Large Case Litigation: An Alternative Approach*, 11 *LOY. L.A.L. REV.* 493, 499 (1978); *Comment, Parens Patraie*

most franchisees from bringing such actions.⁶⁵ Assuming the franchisee can surmount these burdens, the courts cannot require cause for termination under the antitrust laws. This is true even if the franchisor uses the threat of termination to coerce franchisees into anti-competitive practices.⁶⁶ Thus, the antitrust laws offer inadequate protection to the abused franchisee.

C. Securities Theory

Federal securities laws⁶⁷ as well as the California Blue Sky laws⁶⁸ do not effectively protect franchisees. Often franchisors are not even subject to these laws. The sale of a franchise is not the sale of a security unless the franchise is an "investment contract."⁶⁹ This requires that the alleged investor, the franchisee, retain no meaningful control over the funds transferred to the franchisor,⁷⁰ and that the profits from the franchise come substantially from the franchisor's efforts.⁷¹ Because franchisees usually contribute long hours and substantial amounts of capital to the enterprise courts rarely characterize the typical franchise as an investment contract.⁷²

Suits By State Attorney Generals: An Effective Antitrust Remedy For Small Business, this issue at 648.

⁶⁵ *Subcommittee Hearings*, *supra* note 1, at 151-55 (statement of Frank Harlock).

⁶⁶ In *Adolph Coors Co. v. F.T.C.*, 497 F.2d 1178 (10th cir. 1974) *cert. denied*, 419 U.S. 1105 (1975), the company threatened to terminate those distributors who would not engage in anticompetitive behavior. However, the Tenth Circuit held that the F.T.C. could not require cause for termination as a remedy for antitrust violations as the termination provisions were a matter of private contract. As long as the contract provisions were reasonable, the F.T.C. could not interfere. *See also* 497 F.2d 1189 (dissent).

⁶⁷ *See* note 69 *infra*.

⁶⁸ *See* CAL. CORP. CODE §§ 25000-25804 (West 1977).

⁶⁹ *See* Securities Exchange Act of 1934, 15 U.S.C. § 78(c)(a)(10) (1977); Securities Act of 1933, 15 U.S.C. 77(b)(1) (1977). California law is substantially the same. *See* CAL. CORP. CODE § 25019 (West 1977). *See* note 71 *infra*.

⁷⁰ *See* *S.E.C. v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943) (holding that a campaign to sell assignments of oil leases was the sale of a security within the securities laws.)

⁷¹ *See* *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946) (holding that an investment contract contemplates and requires: a) an investment of money, b) in a common enterprise, c) with the expectation of profits solely from others' efforts). California law defines investment contract in substantially the same manner. *See* 49 Op. Cal. Att'y Gen. 124 (1967).

⁷² Courts have held franchises were securities where the franchisee was in

When the securities laws do apply, they are still inadequate to protect franchisees. Because these laws merely require the disclosure of material facts concerning the franchise to prospective franchisees,⁷³ they are no more effective than the existing disclosure laws in protecting franchisees.⁷⁴ Only when the franchisor materially misrepresents or omits to disclose a material fact, such as the grounds upon which the franchise may be terminated, could a franchisee successfully challenge his subsequent termination under the securities laws. This limited use of the disclosure theory under the securities laws offers no meaningful protection to franchisees.

D. Common Law Fraud Theory

Some franchisees seek protection from termination abuses under common law fraud principles.⁷⁵ Generally, these complaints are contract actions which allege fraud in the inducement⁷⁶ of the franchise investment. However, to recover under a fraud theory,⁷⁷ a franchise must prove that the franchisor's

fact a "passive" distributor and the real selling of the product was by the franchisor's agents. *United States v. Herr*, 338 F.2d 607 (7th Cir. 1964). One court held that steak-house franchise sales were not the sale of securities even though the franchisor had absolute authority to hire, train and place managers in the franchised outlets. The court reasoned that the local investors still had the ability to exercise some control. *See Mr. Steak, Inc. v. River City Steak, Inc.*, 324 F. Supp. 640 (D. Colo. 1970).

⁷³ See S.E.C. Rule 10(b)(5), 17 C.F.R. § 240.10(b)(5).

⁷⁴ See notes 38-50 and accompanying text *supra*.

⁷⁵ Harold Brown, who writes extensively on franchising, concludes that the fraud and misrepresentation theories do not provide a remedy for many dealings that are unfair, overbearing, in bad faith or unconscionable. H. BROWN, *supra* note 5, at 157. Franchisors usually win these fraud cases if the franchise agreement states termination may be at will—even in those cases where the franchisor has a secret policy of terminating distributorships when they become more profitable. *See Annot.*, 64 A.L.R. 3d § 21, at 6 (1975), and the cases cited therein.

⁷⁶ Fraud in the inducement is fraud that either induces the franchisee to invest in the franchise which he or she would not otherwise have done, or it induces the franchisee to believe that the franchise relationship entered into is something other than it actually is. *See C.I.T. Corp. v. Panac*, 25 Cal. 2d 547, 549, 154 P.2d 710, 712 (1944).

⁷⁷ To recover under a fraud theory, franchisees must prove that there was a "false representation of a material fact, made with knowledge of its falsity and with the intent to induce reliance thereon upon which plaintiff justifiably relies to his injury." *Watt v. Patterson*, 125 Cal. App. 2d 788, 792, 271 P.2d 200,202

statements were misrepresentations of material facts and not merely the opinions of the franchisor.⁷⁸

Further, even in those situations where a contract action based on common law fraud principles is appropriate, relief is limited to either rescission or actual damages.⁷⁹ Such damages include only "out-of-pocket" expenses⁸⁰ and do not compensate franchisees for one of the most valuable parts of their investment: the good will of the operating franchise.⁸¹ Thus, the common-law fraud remedy does not adequately protect franchisees from termination abuses.

(1st Dist. 1954).

⁷⁸ A franchisor's misrepresentations in the form of opinion, possibility or promise do not constitute fraud. *Wilke v. Coinway, Inc.*, 257 Cal. App. 2d 126, 64 Cal. Rptr. 845 (1st Dist. 1967) (holding a franchisee cannot justifiably rely upon mere statements of opinion by the franchisor.)

Opinion includes such things as sales "puffery," *Harting v. Cebrian*, 10 Cal. App. 2d 10, 51 P. 2d 195 (1st Dist. 1935) statement of value, *Craig v. Wade*, 159 Cal. 172, 112 P. 891 (1911); and profitability of the business, *Eck v. McMichael*, 176 Cal. App. 2d 368, 1 Cal. Rptr. 369 (4th Dist. 1959). Further, the misrepresentations must be of "material" facts. A fact is material if it induces the franchisee to enter the franchise relationship. See *Miller v Brode*, 186 Cal. 409, 199 P. 531 (1929). This aspect of the law ignores the reality that promises, assurances and projections by the franchisor influence a franchisee's decision to invest.

⁷⁹ The available relief for breach of contract is compensatory damages. CAL. CIV. CODE § 3300 (West 1970). This remedy is exclusive of exemplary or tort damages unless otherwise expressly allowed by statute.

⁸⁰ CAL. CIV. CODE § 3300 (West 1970). See *Holder v. Home Sav. & Loan Ass'n of Los Angeles*, 267 Cal. App. 2d 91, 72 Cal. Rptr. 704 (4th Dist. 1968) (holding that recoverable damages for a vendee because of fraud in the inducement of the contract is the actual out-of-pocket loss.)

⁸¹ In a limited number of cases, franchisees could bring actions in tort for a franchisor's fraudulent conduct. Under a tort theory, the franchisee might collect exemplary damages in addition to compensatory damages. CAL. CIV. CODE § 3294 (West 1970). Only through recovery of exemplary damages in a successful tort action could the franchisee receive compensation for the good will value associated with his franchise. See *Ward v. Taggert*, 51 Cal. 2d 736, 336 P. 2d 534 (1959) (holding exemplary damages available where the gravamen of the franchisee's action is not breach of contract, but rather the fraud inherent in the breach). However, the franchisee has no absolute right to exemplary damages and must still prove oppression, malice or the intent to defraud. *Farmy v. College Housing, Inc.*, 48 Cal. App. 3d 166, 121 Cal. Rptr. 658 (2d Dist. 1975). The franchisee must also prove the existence of misrepresentations of material facts. See note 78 *supra*.

E. Good Faith Theory

Another avenue which the wrongfully terminated franchisee might take is an action based on the franchisor's bad faith. In California, every contract has an implied covenant of good faith and fair dealing that neither party will act to injure the right of the other to receive the benefits of their agreement.⁸² The theory is that a termination without cause is not in good faith and deprives the franchisee of the benefits of the franchise agreement.⁸³ However, while this theory has enjoyed limited success in California with contracts covered by the Uniform Commercial Code⁸⁴ and in the area of insurance claims,⁸⁵ it has not been successfully employed in the franchising context.⁸⁶

⁸² California common law implies a covenant of good faith in every contract. See *Brown v. Superior Court*, 34 Cal.2d 559, 212 P.2d 878 (1949). But see notes 83-86 and accompanying text *infra*.

⁸³ For examples of how the good faith requirement has been used in automobile franchise cases, see notes 87-90 *infra*.

⁸⁴ The UNIFORM COMMERCIAL CODE (U.C.C.), provides that "every contract of duty within this Act imposes an obligation of good faith in its performance or enforcement." U.C.C. § 1-203. The U.C.C.'s provisions apply only to the sale of goods, however, and are thus only persuasive in the franchising context. U.C.C. § 2-105(1).

Under U.C.C. § 2-309 a contract may be terminated at any time by either party after giving reasonable notice. Thus, even if the U.C.C. provisions apply, franchisees receive no real protection against bad faith terminations.

For a discussion on the applicability of the U.C.C. to the franchising relationship, see Hewitt, *Termination of Dealer Franchises and the Code—Mixing Classified and Coordinated Uncertainty With Conflict*, 22 Bus. Law. 1075, 1082-86 (1967).

⁸⁵ The implied covenant of good faith and fair dealing is used most often in an area of insurance claims. Courts have held that an insurance company is liable for excess losses incurred by the insured when the company in bad faith refuses to settle a claim within the policy limits. See *Delos v. Farmers Ins. Group*, 93 Cal. App. 3d 642, 651, — Cal. Rptr. —, —, (4th Dist. 1979).

⁸⁶ The California courts have consistently implied a covenant of good faith in insurance contracts and in contracts to purchase or sell where performance is limited to a single purpose. See *Universal Sales Corp. v. California Press Mfg. Co.*, 20 Cal. 2d 751, 771, 128 P.2d 665 (1942) (holding an implied covenant of fair dealing and good faith existed in a contract for the purchase of a machine); *Steinmeyer v. Warner Cons. Corp.*, 42 Cal. App. 3d 515, 116 Cal. Rptr. 57 (1st Dist. 1974) (holding that an injunction properly issued to prevent the defendants from interfering in bad faith with the completion of an agreement with the plaintiff to purchase all of the capital stock of a corporation). The courts, however, have not implied covenants of good faith in continuing relationships such as franchises. See generally *Tameny v. Atlantic Richfield*

Good faith requirements, whether implied or express,⁸⁷ do not protect franchisees from termination abuses. Courts will not imply a covenant of good faith if the parties include an inconsistent provision in their agreement.⁸⁸ The courts reason that an

Co., 88 Cal. App. 3d 646, (2d Dist. 1979) (holding that an employee under a contract at will does not have an action in tort for the bad faith breach of his employment contract. The California Supreme Court has granted a petition for hearing in this case, however); *Division of Triple T Service, Inc. v. Mobil Oil Corp.*, 304 N.Y.S.2d 191, 60 Misc. 2d 812 (1969) (holding that the good faith principles of the U.C.C. do not apply to a franchisor who terminates without cause and in bad faith).

Generally, the courts have held that the harsh result of termination or the wrongful motivation behind a termination are irrelevant if the franchisor had the right to terminate under the franchise agreement. See Gellhorn, *Limitations On Contract Termination Rights—Franchise Cancellations*, 1967 DUKE L.J. 465, 468.

⁸⁷ For example, an express good faith requirement exists in automobile dealership franchises from termination abuses. 15 U.S.C. §§ 1221-25 (1974). This Act, the "Automobile Dealers' Day In Court" Act, gives franchisees a cause of action if the manufacturer fails to act in good faith. In its twenty year existence, the Act has proven to be a virtual farce. Brown, *A Bill Of Rights for Auto Dealers*, 12 B.C. IND. & COM. L. REV. 758, 791-92 (1971). The Act requires the franchisee to prove actual coercion, intimidation or threats. 15 U.S.C. § 1221 (e) (1974). Franchisors are specifically allowed to use recommendation, endorsement, persuasion, urging, or argument to seek franchisee compliance with their wishes. Yet, permission to persuade, when coupled with the threat of termination, is permission to coerce and that leads to abuses in franchising. For example, in *Overseas Motors, Inc. v. Import Motors Ltd.*, 375 F. Supp. 499 (E.D. Mich. 1974), *aff'd*, 519 F.2d 119 (6th Cir. 1975), the court held that the franchisee failed to show the requisite coercion even though he proved that the manufacturer had "pinched off" his flow of cars and then terminated his franchise in accordance with the terms of their franchise agreement. See also *Leach v. Ford Motor Co.*, 189 F. Supp. 349 (S.D. Cal. 1960) (holding that the termination of a franchisee for failure to meet the franchisor's estimated market potential for the franchise was not actionable because it was motivated by business judgment and not bad faith). For further examples, see 15A G. Glickman, *Business Organizations, Franchising*, 13-56.8-10 (1979).

In the final analysis, franchisees win very few cases under the good faith standard of the Act. So few in fact, that the courts have had little opportunity to delineate the elements that constitute recoverable damages. 15A G. Glickman, at 13-56.10.

⁸⁸ The California courts have not expanded their use of the implied covenant of good faith beyond insurance and single purchase contracts. See note 86 *supra*. Further, the courts refuse to imply a covenant of good faith against express terms or supply a term in regard to which the contract is intentionally silent. See *Taylor v. Nat. Supply Co.*, 12 Cal. App. 2d 557, 56 P.2d 263 (2d

implied covenant of good faith, with respect to termination, would be contrary to the parties' intentions if the franchise agreement provides for termination at will.⁸⁹ Franchisees need more protection from unfair termination practices than that provided by the good faith requirement.⁹⁰

F. Fiduciary Theory

Finally, franchisees might combat termination abuses by applying fiduciary trust principles to the franchise relationship. The theory is that the franchisor's control of the franchising relationship⁹¹ is so complete that it creates a fiduciary relationship.⁹² Thus, franchisors owe certain fiduciary obligations to their franchisees which are breached if the franchises are terminated without good cause.⁹³

Dist. 1936); *Foley v. Eules*, 214 Cal. 506, 6 P.2d 956 (1931); *Tanner v. Title Ins. & Trust Co.*, 20 Cal.2d 814, 129 P.2d 383 (1942).

⁸⁹ See, e.g., *Bushwick-Decatur Motors, Inc. v. Ford Motor Co.*, 116 F.2d 675 (2d Cir. 1940) (holding that a provision in an automobile dealership contract that allowed the agreement to be terminated at will gave the manufacturer an unqualified power to terminate the contract, regardless of good faith); *Tameny v. Atlantic Richfield Co.*, 88 Cal. App. 646 3d, (2d Dist. 1979) (1979) (a California Court of Appeal refused to extend the concept of bad faith breach of contract beyond the insurance setting. The Court held that the company could terminate the employee at will as that was an express term in their employment contract).

⁹⁰ The good faith approach to protecting franchisees has been used for the past twenty years in the automobile industry. During this period it has not adequately protected franchisees from unfair terminations. Accordingly, there is no reason to expect that a good faith requirement would provide adequate protection for other types of franchisees because they would still be required to prove the franchisor's wrongful intent in terminating the franchise. Further, as long as adhesion contracts are standard in the franchising industry, franchisees will always be in or near breach of the franchise agreement. See note 19 *supra*. As such, the franchisor could claim a valid business reason for terminating the franchise and escape any liability. See note 87 *supra*. For an analysis of the good faith standard and how it was used in the automobile industry, see generally S. McCauley, *LAW AND THE BALANCE OF POWER*, (1966).

⁹¹ See notes 13-32 and accompanying text *supra*.

⁹² The General Counsel for the F.T.C. states: "Franchisors frequently speak of their relationship as being one of trust and confidence. It is truly a fiduciary relationship." *Impact of Franchising on Small Business: Hearings Before the Sub-comm. on Urban and Rural Economic Development of the Senate Select Committee on Small Business*, 91st Cong., 2d Sess. 143 (1970) (statement of John Buffington, General Counsel, F.T.C.).

⁹³ See H. BROWN, *supra* note 5, at 262.

The viability of this theory is unclear because there have been so few cases discussing it.⁹⁴ One of the few cases to discuss the fiduciary theory held that the Mobil Oil Corporation, under fiduciary principles, needed good cause to terminate a seventeen-year-old gasoline selling franchise.⁹⁵ Courts, however, may be reticent to import these essentially fiduciary trust principles into the contractual commercial setting of a franchise relationship.⁹⁶

Like the antitrust, securities, good faith and disclosure approaches, the fiduciary theory is inadequate to protect California franchisees from termination abuses. Most wrongful terminations are simply outside the ambit of these legal theories. While the fiduciary theory may protect franchisees in situations where

⁹⁴ This avenue of recovery might work where the franchisor's control of the franchise relationship is pervasive. Pervasive control exists whenever the franchisee transmits gross receipts to a franchisor for disbursement, is required to disclose all operations or records to the franchisor or where the franchisor has an absolute power of inspection, supervision and discipline. See H. BROWN, *supra* note 5, at 263. The fiduciary theory might also be used in those cases involving long-term relationships. See note 95 and accompanying text *infra*.

⁹⁵ Mobil Oil Corp. v. Rubinfeld, [1973] Trade Cas. ¶74,306 (Civ. Ct. N.Y. Dec. 27, 1972), *aff'd* [1974] Trade Cas. (CCH) ¶75,066 (N.Y. Sup. Ct. Jan. 8, 1974). The court held that a fiduciary relationship existed because of the long-term lease arrangement and the confidence reposed in Mobil Oil, Inc., by the dealer. Specifically, the Court held that good cause was required to terminate the dealership and that it did not exist where the conduct complained of was the franchisee's refusal to sell Mobil tires, batteries, and accessories and the refusal to sell gas at Mobil's prices. *Contra*, A.B.C. Packard Inc. v. General Motors Corp., 275 F.2d 63 (9th Cir. 1960) (holding that no fiduciary relationship existed between the car manufacturer and the dealer although the relationship spanned eighteen years; a gross imbalance in relative economic bargaining strength existed and the dealer proved that the manufacturer had a secret policy of terminating distributorships when it became more profitable to distribute the automobiles itself).

It should be noted that petroleum dealerships are currently protected from termination abuses under the Petroleum Marketing Act, 15 U.S.C. §§ 2801-2841 (1979). This act prohibits the bad faith termination of any petroleum franchise. Although this standard does not give the same level of protection as a good cause standard, the federal act specifically pre-empts any inconsistent state legislation regulating petroleum franchise terminations. 15 U.S.C. § 2806 (1979).

⁹⁶ See, e.g., Broomfield v. Kosow, 349 Mass. 749, 212 N.E.2d 556 (1965) (holding that fiduciary obligations should apply to a business relationship only if the plaintiff proves the defendant's superior bargaining position, knowledge of the plaintiff's complete reliance and unjust enrichment. 349 Mass. at 753, 212 N.E.2d at 560-61).

franchisors exercise complete control, it is inadequate to prevent most inequitable terminations. A legislatively prescribed good cause termination requirement is necessary to *augment* existing remedies and guarantee franchisees complete protection. Such legislation would insure the beneficial and just operation of franchises in the future.

III. GOOD CAUSE TERMINATION LEGISLATION

Good cause termination legislation is necessary to control the abusive practices common to the franchising relationship.⁹⁷ Existing legal remedies are inadequate.⁹⁸ Good cause legislation would provide franchisees with the comprehensive protection necessary to protect their total investment, including good will.⁹⁹ Many states currently recognize the need for good cause termination legislation.¹⁰⁰ California does so with respect to automo-

⁹⁷ For a discussion of the coercive nature of the franchising relationship and the types of abusive practices that exist, see notes 13-32 and accompanying text *supra*.

⁹⁸ See notes 33-96 and accompanying text *supra*.

⁹⁹ A good cause termination requirement, for example, would limit franchisors' ability to force franchisees to engage in illegal or anticompetitive practices. Franchisees would no longer feel obliged to engage in such practices because franchisors would no longer wield the threat of termination. Failure to submit to a franchisor's request for illegal activity would not constitute good cause. Thus, franchisees who refused to participate in such activity could not be terminated and thereby lose the value of their investment and good will.

¹⁰⁰ The following states have good cause legislation of general application: Arkansas, ARK. PUBLIC LAW 355 of 1977; Connecticut, CONN. GEN. STAT. ANN., tit. 42, § 133(f) (West Cum Supp. 1980); Delaware, DEL. CODE ANN., tit. 6, § 2551 (1975); Hawaii, HAW. REV. STAT., tit. 26, § 482(E) (1976); Indiana, IND. CODE, § 23-2-2.7 (1978); Michigan, MICH. COMP. LAWS ANN. § 445.1527 (West Cum. Supp. 1979); Minnesota, MINN. STAT. ANN. ch. 80C.15 (West Cum. Supp. 1980); Missouri, MO. ANN. STAT. § 407.400 (Vernon 1978); Nebraska, 1978 NEB. LAWS, Legis. Bill No. 202, § 4; New Jersey, N.J. STAT. ANN., tit. 56, § 10 (West Cum. Supp. 1979); Virginia, VA. CODE, tit. 13.1, ch. 8, § 557 (1978); Washington, WASH. REV. CODE ANN., tit. 19, § 100 (1978); Wisconsin, WIS. STAT. ANN., ch. 135 (West Cum. Supp. 1979); Puerto Rico, P.R. LAWS ANN., tit. 10, ch. 14, § 278 (1975). In addition, thirty-two states have enacted similar legislation covering automobile dealerships, 19 states protect gasoline dealerships, and 17 states specifically protect dealerships in breweries, farm implements or liquor. The pattern of these enactments is summarized in chart form in [1978] STATE BUSINESS FRANCHISE DISCLOSURE LAWS (CCH) ¶ 99. For a discussion of the specific requirements of each of these laws, see 15 G. GLICKMAN, BUSINESS ORGANIZATIONS FRANCHISING, § 3.03, 3-17 (1979).

bile dealership¹⁰¹ and petroleum distribution¹⁰² franchises.

The principal benefit of good cause termination legislation is that it would insure fairness in the franchisor-franchisee relationship.¹⁰³ Fairness is achieved by protecting the legitimate interests of both the franchisee and the franchisor. First, it is reasonable to require that franchises be terminated only for good cause.¹⁰⁴ Such a requirement offers franchisees the fullest protection possible for their investments. Second, good cause termination requirements also protect the franchisor's business interests by allowing legitimate terminations. If, for example, the franchisee repeatedly¹⁰⁵ violates a commercially reasonable, lawful and non-discriminatory provision,¹⁰⁶ the franchisee, after receiving notice and an opportunity to cure once, could be freely terminated.¹⁰⁷

Good cause termination legislation would also clarify and add certainty to the law controlling franchise relationships and termination. With such legislation in effect, courts would no longer need to fashion novel legal theories¹⁰⁸ or resort to legal fictions to resolve franchise termination disputes fairly. The vagueness

¹⁰¹ CAL. VEH. CODE § 3060 (West Cum Supp. 1980).

¹⁰² CAL. BUS. & PROF. CODE § 20999.1 (West Cum. Supp. 1980).

¹⁰³ See note 18 *supra*.

¹⁰⁴ See generally *Seegmiller v. Western Men, Inc.* 20 Utah 2d 352, 353, 437 P. 2d 893, 894 (1968). The counter-argument most often given by franchisor is that the courts substitute their view of what is fair "for a bargain which is arrived at by two consenting adults negotiating with one another to enter what remains, despite the efforts of courts, legislatures and social critics, still an essentially private transaction." INT'L FRANCHISE ASSN., FRANCHISING AND ANTI-TRUST: EIGHTH ANNUAL LEGAL AND GOV'T. AFFAIRS SYMPOSIUM 12 (1975). The franchisors' argument, however, ignores congressionally documented abuses in franchising and the adhesive character of franchise agreements. See note 4 *supra*.

¹⁰⁵ See Appendix, Ch. 3, §§ 2, 4 *infra*.

¹⁰⁶ Such provisions, for example, would include: failure by the franchisee to pay franchise fees; failure of the franchisee to follow contract terms regarding quality control of the product or other requirements necessary to maintain the reputation or standards of the franchisor's trademarked product for purposes of the Lanham Act.

¹⁰⁷ Since franchises are usually long-term commercial relationships, franchisees should be given a reasonable opportunity to cure their defect. The approach of the U.C.C. which governs commercial relationships involving the sale of goods, should be adopted. U.C.C. § 2-508, permits a seller of goods to cure a defective tender of goods. See also Appendix Ch. 3, § 1 *infra*.

¹⁰⁸ See note 36 and accompanying text *supra*.

of the term "good cause" would not be problematic because courts and counsel could look to decisions interpreting other statutes using the same language for guidance.¹⁰⁹

Good cause termination legislation, to be fair and effective, should contain certain basic provisions. First, such legislation should require that franchisors give notice of their intent to terminate franchisees for a breach of the franchise agreement.¹¹⁰ Second, mandatory buy-out procedures for terminated franchisees must be included and should provide just compensation for the franchisee's investment, inventory and good will.¹¹¹ Third, mandatory arbitration clauses should be included to settle those cases where the parties cannot agree upon a buy-out sum.¹¹² Finally, franchisors should bear the risk of non-persuasion, and thus the burden of proving the existence of good cause in any

¹⁰⁹ For a complete listing of those states that currently have good cause statutes similar to that proposed here, see note 100 *supra*.

¹¹⁰ Traditional notions of fairness demand that notice be given. *Fiorntino v. Mason*, 233 Mass. 451, 124 N.E. 283 (1919) (holding a landlord not liable for breach of a covenant to repair where the tenant did not give notice of the need to repair); U.C.C. § 2-607 (3)(a) (notice by the buyer of the seller's breach is a constructive condition precedent to any statutory remedy); 3A CORBIN, CONTRACTS §§ 724-727 (1960). See also Appendix Ch. 3, § 1, *infra*.

¹¹¹ Congressional records illuminate the losses suffered by franchisees upon their termination. For example, one newspaper distributor had his franchise cancelled because the publisher was "displeased" with the distributors pricing policy. The distributor lost his initial \$12,500 investment as a non-refundable franchise "fee" along with the good will that he had developed over ten years of operating the distributorship. *Subcommittee Hearings, supra* note 1, at 132.

Not all good cause legislation provides a buyout procedure for terminated franchisees. The proposed legislation in the Appendix Ch. 6, § 1 *infra*, provides franchisees with a mandatory buyout provision which compensates them for the reasonable value of the good will of the business. This should act to deter arbitrary terminations as it will require franchisors to fully compensate franchisees for the going concern value of the franchise. A proposed California law, A.B. 295 REG. SESS. (1979), introduced by Assemblyman Bruce Young, fails to provide such a buyout procedure upon non-renewal of the franchise without cause. Non-renewal, however, has many of the same abuses that are connected with termination without cause. Although the franchisee receives all that is required by the contract if the franchisor refuses to renew, such traditional contract reasoning is not applicable to the franchise situation. Franchises are generally long-term relationships that the parties intended to continue unless breaches of their agreement occur. The same amount of good will is developed by the franchisee and should be paid for upon a discontinuance of the franchise relationship. *But see* note 16 and accompanying text *supra*.

¹¹² See Appendix Ch. 6, § 2 *infra*.

franchise termination dispute.¹¹³

In addition to these four provisions,¹¹⁴ good cause termination legislation should give non-renewed franchisees the right to sell their franchise.¹¹⁵ The franchisee should receive sufficient notice of the non-renewal to allow for the solicitation of buyers and to insure the sale of the franchise at a fair price. Buyers, however, should be required to meet the franchisor's then current standards for new franchisees.¹¹⁶ The right to sell should exist in all non-renewal cases except those where the franchisor is ceasing all similar franchise activity in that area.¹¹⁷ These four provisions,¹¹⁸ in conjunction with the right to sell, would destroy any franchisor incentive to fail to renew franchise agreements in the hopes of reselling them at a premium. Upon the sale of a franchise, the profit representing the good will of the franchise would go to the party who created it, rather than the franchisor.

The California Legislature should now recognize that the same evils which prompted earlier good cause termination legislation exist in all franchise relationships. Piecemeal and stop-gap legislating will not protect California franchisees. Good cause as a prerequisite for any franchise termination is necessary for franchisee protection. The enactment of a comprehensive franchise reform bill will provide this much needed protection.

CONCLUSION

Franchising as a form of market distribution is important to California. The potential for abuse is inherent in the franchise relationship. Such abuse must be effectively controlled to insure the continued growth and benefits of franchising. The power of franchisors to terminate or fail to renew franchise agreements

¹¹³ Such a requirement exists, for example, in California law protecting petroleum distribution franchisees. See *Mobil Oil Corp. v. Handley*, 76 Cal. App. 3d 956, 143 Cal. Rptr. 321 (2d Dist. 1978).

¹¹⁴ See notes 110-113 and accompanying text *supra*.

¹¹⁵ See Appendix Ch. 5, § 1, *infra*.

¹¹⁶ *Id.*

¹¹⁷ *Id.* See *Consumers Oil Corp. v. Phillips Petroleum Company*, 488 F.2d 816 (3d Cir. 1973) (holding that an area withdrawal by the franchisor is good cause for termination of franchisees in that area); however, sham withdrawals whose only purpose is to terminate franchisees prematurely should be prohibited, CAL. BUS. & PROF. CODE § 20999.1(c) (West Cum. Supp. 1980); Appendix Ch. 1, § 11 *infra*.

¹¹⁸ See notes 110-113 and accompanying text *supra*.

should be circumscribed as it is the source of most of the abuses in franchising. Franchisors should not be allowed to terminate at will for any breach of the franchise agreement because technical compliance with every contract term is often difficult, financially devastating or impossible for franchisees.

Good cause termination legislation will not equalize the parties' bargaining position nor place the franchisee in a superior bargaining position. Such legislation will, however, provide effective protection from prevalent termination abuses that cannot be obtained under the disclosure, antitrust, securities, fraud, good faith or fiduciary theories. Such legislation will also give official endorsement to legitimate business and termination practices of franchisors, thereby clarifying the law. Since the Federal government has not taken the initiative in this important area, the states must.¹¹⁹ California should expand its present laws and pass good cause termination legislation for all franchisees.

Raymond King

¹¹⁹ Despite the national character of franchising and the benefits inherent in a uniform national approach, federal good cause legislation is unlikely. Congress has overwhelmingly defeated such legislation in the past: *H.R. 8349*, 94th Cong., 1st Sess. (1976); *H.R. 5016*, 95th Cong., 1st Sess. (1977). Currently, Congress has before it a bill substantially the same as the ones it has rejected in the past. *H.R. 2305*, 96th Cong., 1st Sess. (1979). The federal approach favors disclosure, as opposed to franchise regulation. The new F.T.C. rule took nine years to become effective. Congress probably will not retreat from this approach to pass a good cause termination statute.

APPENDIX

CHAPTER 1 DEFINITIONS

Section 1 For purposes of this Act:

1. the term "antitrust laws" includes—

- (a) the Sherman Act, 15 U.S.C. §§ 1-7 (1977);
- (b) the Clayton Act, 15 U.S.C. §§ 12, 13, 14-21, 22-27 (1977);
- (c) the Federal Trade Commission Act, 15 U.S.C. § 41-46, 47-48 (1977);
- (d) sections 73 and 74 of the Wilson Tariff Act, 15 U.S.C. §§ 13, 13a, 13b and 21a (1977).

Section 2 As used in this Act, "franchise" means any commercial relationship created by agreement, contract, lease, or other understanding, whether written or oral, between two or more persons by which:

1. (a) the franchisee is granted the right to engage in the business of offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by the franchisor; and

(b) the operation of the franchisee's business is substantially associated with the franchisor's trademark, service mark, trade name, or other identifying symbol or name owned or controlled by the franchisor; or

2. (a) the franchisor represents that it will lend more than nominal assistance to the franchisee in the franchisee's organization, promotional activities, management, marketing plan, method of operation, or other business affairs; and

(b) the franchisee is required to pay, directly or indirectly, a franchise fee.

Section 3 A "franchisee" is a person to whom a franchise is granted.

Section 4 A "franchisor" is a person who grants or has granted a franchise.

Section 5 "Area franchise" means any contract or agreement between a franchisor and a subfranchisor whereby the subfranchisor is granted the right, for consideration given in whole or in part for such right, to sell or negotiate the sale of franchises in the name or on behalf of the franchisor.

Section 6 A "subfranchisor" is a person to whom an area franchise is granted.

Section 7 "Franchise" includes "area franchise."

Section 8 “Franchise fee” means any fee or charge that a franchisee of subfranchisor is required to pay or agrees to pay for the right to enter into a business under a franchise agreement, including, but not limited to, any such payment for such goods and services.

However, an agreement to purchase goods at a bonafide wholesale price shall not be considered a franchise fee if no obligation is imposed upon the purchaser to pay for a quantity of goods in excess of that which a reasonable businessperson normally would purchase by way of a starting inventory. However, in all cases upon demand of the purchaser, the franchisor must provide the purchaser with the specifications necessary to determine what the bonafide wholesale price is.

Section 9 “Person” means an individual, corporation, partnership, joint venture, association, joint stock company, trust or an unincorporated organization.

Section 10 “Good cause” shall include, but not be limited to, the failure of the franchisee to comply with any lawful, reasonable, material and non-discriminatory requirements contained in the franchise agreement.

Section 11 “Marketing area withdrawal” means the cancellation of, termination of, or failure to renew a franchise by a franchisor for the purpose of enabling such franchisor to withdraw from the business of granting, organizing, supplying, or directing franchises within a particular marketing area of the state—

1. which is not a violation of the antitrust laws;
2. where such franchisor does not sell or provide, directly or indirectly, in such marketing area the same goods and services covered by such franchise during the 5-year period beginning on the date of the cancellation, termination, or failure to renew; and
3. where such franchisor pays the franchisees involved reasonable compensation for the value of their business pursuant to Chapter 6 of this Act.

CHAPTER 2. JURISDICTION

Section 1 This Act shall apply to any franchise where either the franchisee is domiciled in this state or the franchise is or has been operated in this state.

CHAPTER 3. NOTICE OF TERMINATION REQUIREMENT

Section 1 No franchise may be terminated by a franchisor unless the franchisor notifies the franchisee of the intention to terminate in writing and by certified mail. Such notice must describe the failure of the franchisee to meet a contract term which failure permits the franchisor to terminate pursuant to Chapters 4 and 5. In any event, the franchisee shall have 30 days after receiving such notice to cure the failure.

Section 2 The notice required in Chapter 3, Section 1, is not required if:

1. the franchisee is determined bankrupt, or
2. the franchisee fails to operate the franchise for five consecutive days during a period when the franchisee is required to operate by the franchise agreement unless the failure is due to fire, flood, earthquake or other cause beyond the franchisee's control; or
3. the franchisor and the franchisee agree in writing to terminate the franchise; or
4. the franchisee, after curing a failure constituting good cause for termination under Chapter 4, engages in the same noncompliance whether or not notice of such noncompliance is given; or
5. the franchisee fails to pay any franchise fees owing to the franchisor within five days after receiving notice that such fees are overdue.

CHAPTER 4 GROUNDS FOR TERMINATION AND NONRENEWAL OF FRANCHISES

Section 1 No franchisor may cancel, fail to renew, or otherwise terminate a franchise unless—

1. the franchisor is effecting a marketing area withdrawal; or
2. the franchisor has good cause to terminate or fail to renew and the franchisee has failed to cure the defect within 30 days of the notification as required by Chapter 3.

CHAPTER 5 ADDITIONAL REQUIREMENTS UPON NONRENEWAL OF FRANCHISES

Section 1 Unless a franchise has been terminated pursuant to this Act, no franchisor may refuse to renew a franchise unless:

1. the franchisor provides written notice of such intent 180 days prior to the expiration of the franchise term and permits the franchisee during this 180 day period to sell the franchise to

a purchaser meeting the franchisor's then current requirements for granting new franchises; or

2. if the franchisor is effecting a market withdrawal and:

(a) agrees not to enforce any covenant of the nonrenewed franchisee not to compete with the franchisor or franchisees of the franchisor; and

(b) the failure to renew is not for the purpose of converting the franchise to operation by employees or agents of the franchisor's own account; or

3. the franchisor and the franchisee agree not to renew the franchise in writing.

CHAPTER 6 COMPENSATION FOR FRANCHISEES UPON A GOOD CAUSE TERMINATION OR NONRENEWAL

Section 1 In addition to meeting the requirements of this Act, the franchisor terminating or not renewing a franchise shall:

1. pay the franchisee reasonable compensation for the loss of the value, including good will of the franchise attributable to the franchisor's termination or failure to renew; and

2. repurchase the resalable current inventory meeting the franchisor's current standards. This inventory must be repurchased, however, only if it was required by the franchise agreement and for use or sale in the franchise. The franchisor shall pay the lower of the fair market value or the price paid by the franchisee.

Section 2 If the parties cannot agree on the reasonable compensation as described in Section 1, they shall submit the determination of such amount to binding arbitration. Any arbitrator employed shall be selected by the parties from a list supplied by the American Arbitration Association or any other third party agreed to by both the parties.

CHAPTER 7 EFFECT ON OTHER LAWS

Section 1 Nothing in this Act shall invalidate or restrict any other right or remedy of any franchisee under any existing law.

CHAPTER 8 BURDEN OF PROOF

Section 1 In any suit brought under this Act, a franchisor shall have the burden of establishing and proving the existence of good cause for terminating their franchisee(s) and any other justification specified herein.

CHAPTER 9 PROHIBITION ON WAIVER OF RIGHTS

Section 1 Any condition, stipulation, provision, or term of any franchise agreement waiving any right granted under this Act, or relieving any person from liability imposed by this Act, shall be void and unenforceable.