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A SUI GENERIS APPROACH TO FRANCHISE TERMINATIONS

I. Introduction

Franchising did not achieve real significance until after World War II. In response to the great upsurge in the automobile and oil industries, businessmen searched for a new method of distribution readily adaptable to such growth.\(^1\) With both its managerial and capital ease, combined with a greater freedom from antitrust restraints, franchising was certainly preferable to “chain” distribution. This unique business arrangement has lived up to its promise. Franchising now accounts for over $90 billion in sales annually or around 15% of the gross national product.\(^2\)

The increasing prominence of franchising in our economy has warranted a corresponding increased scrutiny of the practices used by franchisors. A special concern to the franchisee is the termination of a franchise or a failure to renew an existing franchise agreement. Serious questions have been raised as to whether certain suspect policies of the supplier are being implemented through the dealer’s fear of losing his franchise.\(^3\) Coupled with this coercion element are the equities to be considered in cancellation. The franchisee, while investing sizeable amounts of money and assuming direct responsibility of the local operation, often finds himself in default through a contract provision about which he was in no position to bargain with the more powerful supplier.\(^4\) A resulting termination often means both harsh financial loss and years of work negated for the dealer.

This narrow issue of franchise termination has given rise to the corresponding problem of fashioning legitimate remedies. Major considerations are: (1) whether state or federal legislation should control the area, (2) whether the Federal Trade Commission can adequately handle the problems of franchising, and (3) whether franchising should be treated sui generis or dealt with on general contract principles. Regardless of what form the regulation takes, an analysis of franchising reveals that special steps must be taken to preserve its economic dynamism.

II. State Legislation

A. Need for Regulation

There are three major types of franchises: (1) those mainly concerned with distributing the franchisor’s product, (2) those concerned with distributing a way or method of doing business, and (3) those concerned with establishing a manufacturing or processing plant. Fast food restaurants and gas stations are

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\(^2\) Lightman, Economic Aspects of Trademarks in Franchising, 14 IDEA 481 (1971).
\(^4\) Mobil Oil Corp. v. Rubenfeld, 72 Misc. 2d 623 (Civ. Ct., Queens Co. 1972).
the two most common examples of the first situation. Within this group it is important to distinguish between situations where a franchise represents the dealer's entire business (service station) and where it comprises only part of his larger operation (a hardware dealer with several different franchised products). This difference can be essential in the process of bargaining for the franchise. The gas station dealer has little leverage to mold the franchise agreement terms, whereas the small retailer can always rely on competing products if he finds the terms onerous. It is the dealer who exercises such little power in negotiating the termination clauses of a franchise who needs protection. Accordingly, the majority of applicable state legislation is passed with such a franchisee in mind and for purposes of this discussion will be the one meant by the term franchisee.

To the franchisor, a franchise is a license coupled with certain restrictions designed to enforce either uniformity or minimum standards of service. To the franchisee, however, it is more than merely bargaining for marketing and distribution; it is tying himself to the keystone of the franchising relationship: the franchisor's reputation. The dealer not only invests sizeable income and years of work, but also assumes high risks and direct responsibility, all in exchange for the goodwill associated with a separate business over which he exercises minimal control. This initial inequity can easily give rise to abuses appearing at a later stage. Arbitrary or unjust termination is perhaps the harshest of these since it so often results in severe economic loss despite the goodwill the franchisee may have contributed to the operation. The franchisor with his dominant economic position can stipulate conditions that place the dealer in constant danger of default. For example, some agreements are so severe that they state that whether termination is appropriate should be left to the supplier's discretion. The excesses of such lopsided bargaining are demonstrated by *Loew's Inc. v. Somerville Drive-In Theatre Corp.* where the court would have allowed a termination motivated by "sheer perversity." Generally, then, franchise agreements provide for short notice, include omnibus clauses giving rise to default, and stipulate that any failure by the franchisee to meet the conditions of the contract must be remedied to the franchisors' satisfaction.

There is no question that these practices are being employed by suppliers: the annual turnover of gas station dealers based on insolvency, terminations, and failure to renew varies from 25-40%. This high rate of failure is understandable considering that no common law cause of action exists for unjust termination or failure to renew. This is accentuated by the fact that most courts only require that usual contract procedures be observed and often ignore the inequality of bargaining power. A concern over a lack of remedies available to dealers is largely responsible for the current state regulations of terminations and failures

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8 *Id.* at 234, 148 A.2d at 605.
to renew. Indeed, one court at least felt compelled to call on the New York legislature to enact laws ameliorating the franchisees’ position.18

B. Inadequacy of Uniform Commercial Code

Many writers have advocated that the unconscionability provision in UCC § 2-302 be adopted to prevent unjust terminations.14 Since courts, however, are reluctant to find per se unconscionable conditions in a franchise agreement there has been little success using UCC § 2-302.15 Division of Triple T Service Inc. v. Mobil Oil Corp.16 exemplifies this recalcitrance by the courts. The court not only rejected a finding of per se unconscionability but also adhered to a strict contract analysis of the franchise relationship.17

This application of contract analysis to franchising reflects the most pervasive problem in the area. The UCC employs contract principles based on the assumption that the parties are in an equal position to bargain for the “thing” to be exchanged. Its tests of good faith and unconscionability are not designed to take into account situations where there is an already existing imbalance in bargaining power.18 As long as the courts lack an appreciation of this, the effect of the UCC on terminations will probably be negligible.19

C. Responsive State Statutes

Amelioration of this lack of remedies can be found in several new state statutes enacted to protect franchisees. Significantly, these statutes do incorporate an awareness of the special nature of a franchise and provide safeguards for the franchisee that go beyond mere contract principles.

There are two major types of state legislation dealing with franchising: (1) those requiring full disclosure to the franchisee20 and (2) those regulating termination.21 This discussion will concern the latter.

Presently, twenty-two states have limited the franchisor’s power to terminate by demanding that “good cause” or some equivalent be demonstrated by the supplier to justify termination.22 Generally, these statutes also include provisions that prohibit threats of termination, allow franchisees to seek a temporary in-
junction restraining termination, require sufficient notice be given before termination, allow a reasonable amount of time for the dealer to cure a default, and entitle the franchisee to receive fair market value for any supplies on hand at the time of cancellation. One important point, which will be developed later, is that these statutes significantly vary from the Automobile Dealer’s Day in Court Act. That federal act was initially considered to be a magna carta for automobile dealers since it purported to ban arbitrary terminations by car manufacturers. The courts, though, have strictly construed the “bad faith” requirement.

Automobile dealers, facing this high burden, have had little success in making out “unjust cancellation.” In contrast, the state laws offer more comprehensive protection since the franchisor must demonstrate his reasons for terminating a franchise. This difference is vital since the dealer is usually reluctant to pursue a lengthy, expensive suit against the supplier when the burden of proof is on him. This change marks an important step towards realizing the special problems of franchising that cannot be dealt with in a traditional manner.

D. Constitutional Validity of State Statutes

1. The Contract Clause

While this new legislative remedy may appear to be a panacea to franchisees, some recent court decisions have questioned its constitutionality. The problem of retroactivity as proscribed by the contract clause of the Constitution is presented in Globe Liquor Co. v. Four Roses Distillers Company. A recent Delaware law provided that franchisors could not “unjustly terminate a franchise” or “unjustly fail or refuse to renew a franchise.” In Globe Liquor, Four Roses had issued a franchise to Globe Liquor to distribute Four Roses’ products in Delaware. The contract called for expiration one year after inception. With a month to go in the agreement, the supplier notified the dealer that it did not intend to renew the franchise; Globe Liquor sued for damages and an injunction under the state Franchise Security Law. The Delaware Supreme Court held that the subsequently enacted statute created a “substantive change in the rights and obligations under this contract” and was therefore invalid under the contract clause of the Constitution. The First Circuit dealt with this same issue in Fornaris v. Ridge Tool Co. and held that Puerto Rico’s new Dealer’s

23 Id.
25 Id. preambe.
29 DELAWARE CODE ANN. tit. 6, § 2552(g) (Supp. 1970).
30 DELAWARE CODE ANN. tit. 6, § 2552(h) (Supp. 1970).
31 DELAWARE CODE ANN. tit. 6, § 2553(a) (Supp. 1970).
32 281 A.2d at 21.
Contract Law, prohibiting unjust terminations, gave rise to a constitutionally impermissible retroactive change of contractual obligations.

These cases suggest that state legislation may not bring immediate relief to existing franchises. It is encouraging, though, that both the Delaware Supreme Court in Globe Liquor and the First Circuit Court of Appeals in Fornaris held that the statute was not unconstitutionally vague or arbitrary.

2. The Preemption Doctrine

Preemption has also appeared as a possible constitutional limitation on state protective policies. Shell Oil Company v. Marinello decided by the New Jersey Supreme Court and Mariniello v. Shell Oil Company decided by the District Court of New Jersey illustrate this present dilemma. A comparison of the reasoning applied to each of these two cases reviews the alternative judicial responses to New Jersey's recent franchise termination statute.

The case involving Frank Marinello, decided by the New Jersey courts, concerned the interpretation of a lease of premises and a dealer agreement entered into between Shell Oil Company and a dealer. Since 1959 these two parties had consistently done business, but in 1972 Shell notified Marinello that it intended to terminate the franchise. Marinello filed for an injunction to stop the termination, while Shell countered by filing a summary dispossess complaint to have the dealer removed from the premises. The trial court made three important determinations: First, the Franchise Practices Act did not apply to previously executed agreements and thus avoided any contract clause questions; second, there was an implied covenant in the agreement on Shell's part not to terminate without good cause; third, Marinello had substantially performed his obligations under the agreement. Of equal importance, though, was the trial court's realization that the parties did not bargain as equals and that such an imbalance should be taken into account when determining whether a termination is made without good cause.

The state Supreme Court reiterated this imbalance between the dealer and supplier in its affirmance: "where there is grossly disproportionate bargaining power, the principle of freedom to contract is nonexistent and unilateral terms result. In such a situation courts will not hesitate to declare void as against public policy grossly unfair contractual provisions which clearly tend to the injury of the public in some way."

This reliance on a state's public policy was not without precedent. In

35 423 F.2d at 567.
36 281 A.2d at 22, 423 F.2d at 568.
39 120 N.J. Super. at 369-370, 294 A.2d at 260.
40 Id. at 375-376, 294 A.2d at 263.
41 Id. at 379, 294 A.2d at 265.
42 Id. at 375-376, 294 A.2d at 263.
43 63 N.J. at 408, 307 A.2d at 601.
deTreville v. Outboard Marine Corp., the Fourth Circuit held that the common law of South Carolina anticipated the safeguards contained in UCC §§ 1-203 and 2-309. Here the termination of a dealer who for nine years had been a franchisee with Evinrude was void as against the "good conscience" of the state even though the agreement had given broad unilateral termination powers to the franchisor. Thus, even though the new statutes may be delayed due to retroactivity considerations, the courts may utilize the argument that such statutes are a codification of existing public policy in the state.

However, in a case with similar facts, involving Frank Marinello's brother, William, the New Jersey District Court made it clear that this same New Jersey Franchise Practices Act was void under the Supremacy Clause of the Constitution because Congress had already expressed its intent to fully regulate the area of trademark infringement and unfair competition.

The Lanham Act controls trademark practices. One provision states that the holder of a federally registered mark has exclusive rights to its use. A franchise which involves a trademark generally consists of a licensing arrangement whereby the holder of the mark permits another to employ his mark but does not give up the exclusive right to its use. When the specific period of the license expires or when the agreement is terminated, the trademark reverts back to the holder.

While trademarks are concededly regulated by Congress, the intent of the Act is to deal with "deceptive and misleading use of marks." This is an entirely different concept than either the bargaining status of the parties or any resulting coercion that might result from such an imbalance in bargaining which is the concern of the New Jersey Franchise Practices Act. Since preemption of state legislation by federal law is essentially a question of Congressional intent, this difference of subject matters between the two statutes is vital. "Clearly the aligned state and federal enactments must deal with the same subject for Congress to be able to manifest an intent to supersede the state's exercise of its power in that area."

Yet, even if the statutes should be considered as dealing with an area regulated by Congress, it is still doubtful that they should be preempted. Out of the many preemption cases resulting from labor law and civil rights enactments, the Supreme Court has stated that the test for state law preclusion is not so much primary purpose but whether "any state regulation . . . frustrates the full effec-

44 439 F.2d 1099 (4th Cir. 1971).
45 Id. at 1100.
46 368 F. Supp. 1401.
48 368 F. Supp. at 1405.
49 Id.
52 15 Glickman, supra note 4, § 4.03[3], at 4-33.
tiveness of federal law... This is qualified by _Schwartz v. Texas_ in which the court held that it "will not be presumed that a federal statute was intended to supersede the exercise of the power of the state unless there is a clear manifestation of intention to do so." Thus, even applying the test of whether the state legislation interferes or impairs federal superintendence of the area, preemption is inappropriate since Congress never intended to deal with franchise terminations. Moreover, state laws dealing with franchise terminations do not in any way hinder the rights given to a trademark holder by the Lanham Act. The Franchise Practices Act is designed not to qualify a franchisor's rights to his trademark upon termination but rather regulate the process or relationship that may give rise to an unbridled power to terminate. The trademark with all its rights granted by the Lanham Act is different from the "process" used in licensing and terminating the use of the mark.

Similar economic legislation by states in areas that are in fact predominantly regulated by Congress has been upheld. This only adds credence to the theory that state franchising laws should not be preempted since they deal with an area left open by Congress. The recent case of _R.E. Spriggs Co. v. Adolph Coors Company_ holds that "[i]n the absence of a clear showing of a conflict with federal policy." The California Court of Appeals reasoned that the history of the Sherman Antitrust Act clearly showed that Congress did not intend to preclude any parallel state efforts to control unfair competitive practices.

Comity between state and federal laws received support from the Supreme Court in _Merrill Lynch, Pierce, Fenner and Smith, Inc. v. Ware_. The Court held that where a state has developed a strong policy of protection from economic pressures on wage earners that such a policy should prevail if it does not conflict with federal regulation. This spirit of cooperation is in keeping with the concept of federalism previously enunciated by the Supreme Court.

Indeed, two recent decisions of the Supreme Court, _Goldstein v. California_

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57 344 U.S. 199 (1952).
58 _Id_. at 202-03.
60 _Id_. at 653, 112 Cal. Rptr. 585 (Ct. App. 1974).
61 _Id_. at 664, 112 Cal. Rptr. 592.
62 _Id_. at 660, 112 Cal. Rptr. 589.
64 _Id_. at 139-40.
65 In _Oregon—Washington R.R. Co. v. State of Washington_, 270 U.S. 87, 101 (1926), the Supreme Court stated that an area where the police power of the states is generally attributable should not be preempted unless Congress has affirmatively filled the area. Reiterated in 315 U.S. 146, 169, "[o]ur duty to deal with contradictory functions of state and nation, on any occasion, and particularly when one or the other is challenged by private interests, calls for the utmost effort to avoid conclusions which interfere with the governmental operations of either."
66 412 U.S. 546, 559 (1973), "Similarly, it is difficult to see how the concurrent exercise of the power to grant copyrights by Congress and the states will necessarily and inevitably lead to difficulty."
and Kewanee Oil Co. v. Bicron Co.,67 have been extremely conciliatory towards states participating under their police powers in the control of areas traditionally considered left to Congress. Since Congress has not been directly involved with franchise legislation these principles of comity militate all the stronger for a tolerance of state franchise regulation.

Indeed, Judge Coolahan in his first Mariniello opinion68 did not mention preemption. He decided that it was not the common law of New Jersey to require a franchisor to show just cause in terminating or failing to renew a franchise agreement. This decision that the state law did not mandate just cause in termination is defensible since it did precede the New Jersey Supreme Court's affirmation in the companion Mariniello69 case. Yet after the state Supreme Court decision, the second Mariniello opinion70 completely ignored a discussion of the Erie doctrine. With there then being no question as to the common law policy of New Jersey, the district court decided instead that the New Jersey Franchise Practices Act was in fact being applied to this franchise and therefore void to the extent that it interfered with the Lanham Act.71 Thus, not only does the preemption argument in its substance appear inappropriate, but the manner in which it was utilized may be seriously questioned as to its compliance with notions of comity and federalism. Instead, the U.S. Supreme Court's denial of certiorari to Shell's direct appeal from the New Jersey Supreme Court's decision defining the state's public policy appears more consistent with such notions.72 It is suggested then, that before state remedies are effective, the courts need to expand their notions of franchising from those of mere contract to a realization of the special substantive principles created by the franchise relationship itself.

III. Federal Activity Towards Protection of Franchisees

A. Proposed Federal Legislation

While it does not appear that state franchise legislation regulating termination procedures of suppliers is preempted by any existing federal law, it cannot be seriously argued that Congress, given the expansive construction of the Commerce Clause, would lack the power to legislate in the area. Though nothing yet has been enacted in this area, several franchise practices bills have been proposed.73 It is important to realize that these proposals are not considered as amendments to the Lanham Act, but instead as approaches to another substantive area of the law. Again there are two major types: those dealing with full disclosure and those concerned with fair termination provisions. While it is beyond

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67 94 S. Ct. 1879, 1891 (1974), held: "However, since there is no real possibility that trade secret law will conflict with the federal policy favoring disclosure of clearly patentable inventions partial preemption is inappropriate."
68 1973-1 Trade Cas. ¶74,547 at 94,405.
71 Id. at 1406.
72 42 U.S.L.W. 3460.
the scope of this discussion to thoroughly analyze these bills, an examination of some provisions shows a strong similarity to the state statutes. A bill proposed by Senator Hart would require good cause to terminate a franchise agreement and also would provide that the franchisee receive fair compensation for any equipment and inventory on hand at the time of termination.\footnote{Senator Hart's bill was rejected by Sen. Jud. Com. S. 1967, 91st Cong., 1st Sess. (1969).} Both of these concepts are incorporated in state statutes dealing with termination.\footnote{See note 21 supra.}

The most recent proposals in the area, S. 1694 and H.R. 16510,\footnote{BNA ANTI-TRUST & TRADE REG. REP. (No. 681), A-25 (Sept. 24, 1974).} have met with stiff criticism from both the Federal Energy Administration and the oil companies.\footnote{Id. at A-25.} Both bills provide a federal cause of action for certain cancellations or failures to renew by oil suppliers. Even when based on justifiable reasons, the oil company must give ninety days' written notice. For impermissible terminations, the dealer may sue for actual and punitive damages as well as an injunction.\footnote{Id. at A-25.} Oil dealers feel federal legislation is necessary to counter many of the pressures exerted on them by the oil companies. While the burden of making out just cause lies with the supplier, there is little chance that the law will serve as a shield for incompetent dealers since the dealer must still initiate the proceedings. Regardless of their relative merits, the bills do at least indicate a Congressional awareness that abuses exist and that current safeguards as found in the antitrust laws are not adequate.

### B. Automobile Dealer's Day in Court Act

A forerunner of these proposed bills and the strongest federal analogy to parallel state franchise regulation is found in the Automobile Dealer’s Day in Court Act,\footnote{Id. at A-26.} hereinafter referred to as ADDCA. Passed in 1956, this statute was designed to remedy unfair termination practices resulting from the imbalance of bargaining power between car manufacturers and their dealers.\footnote{70 Stat. 1125 (1956); 15 U.S.C. 1221-25 (1970).} The Act requires good faith on the franchisor’s part both in termination and failure to renew situations.\footnote{15 U.S.C. 1222 (1970).} While the manufacturer may still indulge in tactics of encouragement, persuasion, or urging, the bill specifically prohibits the use of any coercion or intimidation.\footnote{15 U.S.C. 1221(e) (1970); U.S. CODE CONG. & AD. NEWS 4596 (1956).}

Most of the litigation concerning this use of coercion by manufacturers has been disappointing to the dealers. Courts have been very strict in deciding what constitutes illegal coercion.\footnote{Freed, A Study of Dealers' Suits Under the Automobile Dealers' Franchise Act, 41 U. DET. L. J. 245 (1964); 15A Glickman, supra note 4, § 13.03[4], at 13-24.} Complicating the dealer’s remedy is the fact that the burden to make out the violation is on the franchisee. The impracticability of a dealer maintaining a long, expensive suit against a major car manufacturer coupled with such a high quantum of proof required to show lack of good faith frequently results only in frustration. State franchise regulations, however, address
themselves to this problem by allocating the burden of showing good cause for termination to the franchisor, a notion based on the fact that the supplier is in a better situation to demonstrate motives in cancelling a dealer. Yet, the actual effect of ADDCA can be measured accurately only by the more subtle influence it has had on automobile industry practices. Since the Act allows federal courts to determine the propriety of certain terminations, an impetus developed on the part of manufacturers to devise internal grievance procedures. This way the franchisor builds his argument that he has acted in good faith by attempting to work out any problems within his own structure. Fortunately, such a change is not purely superficial. It does in fact provide an appeal mechanism for the dealer without engaging the costs and time involved with court action.

ADDCA also contradicts the notion that the Lanham Act preempts state franchise laws. The auto industry is based entirely on the concept of trade-name distribution. Yet, Congress has seen fit to impose sanctions on a manufacturer who does not bargain in good faith with his dealer. Such legislation is not aimed at regulating trademark infringement but rather at policing the nexus between supplier and dealer. If preemption is really pertinent to this new legislation by states, then its proper role would only be in regard to possible conflicts with the Automobile Dealer's Day in Court Act.

C. Federal Trade Commission Activity

The FTC has also exhibited significant concern over franchising practices. In *F.T.C. v. Texaco, Inc.*, the Supreme Court held that the purpose of § 5 of the Federal Trade Commission Act was to “combat in their incipiency trade practices that exhibit a strong potential for stifling competition.” The Court found that while ultimate decisions concerning what is unlawful competition rests with the courts, FTC determinations are entitled to great weight. In *Texaco*, the FTC had found that Texaco had used its “dominant economic power” to coerce dealers into purchasing tires, batteries, and accessories (TBA) from a tire company with whom Texaco had a compact. This finding reflects the FTC's appreciation of how a supplier's power is often employed to achieve illegal ends. There is support, then, for the notion that franchising misconduct is of such import that it falls within the jurisdiction of the FTC to police unfair competitive practices.

Many of the policy considerations involved in the state legislation concerning terminations are in fact shared by the FTC as indicated by the current case

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84 See note 21 supra.
85 15 GLICKMAN, supra note 4, § 9.01[9], at 9-11.
86 Id.
87 Id.
88 15 U.S.C. § 1225 (1970), “This chapter shall not invalidate any provision of the laws of any state except insofar as there is a direct conflict between an express provision of this chapter and an express provision of state law which cannot be reconciled.”
89 393 U.S. 223 (1968).
90 Id. at 225.
91 Id. at 226.
92 Id. at 228.
of *Adolph Coors Company v. F.T.C.* The FTC had ruled that Coors had illegally restrained competition by, among other things, using unfair, short-term termination provisions in its distributors' contracts. The Commission ordered Coors to cease and desist from making threats of termination without providing sixty days' notice when cause could be shown and one hundred eighty days' notice when there was no cause, and to provide an opportunity for prompt arbitration of issues pertinent to the termination.

It could be argued that the state legislation passed to control the termination powers of franchisors is also designed to prohibit the antitrust practices of tie-ins and resale price maintenance. A look at recent cases shows that the tool most often used to implement these practices is the dealer's fear of termination.

Ten years ago the court in *Susser v. Carvel Corp.* held that some tying arrangements were justified to maintain the quality of a franchisor's product. This is in accord with the Lanham Act requirement that the quality of a trademarked product be continued. Otherwise the holder of the trademark runs the risk of being considered to have abandoned his rights to the mark.

Nevertheless, the courts have shown that this duty of quality control cannot be used as a shield to avoid scrutiny for restraint of trade violations. In *Siegel v. Chicken Delight, Inc.*, the district court held that when there is a *per se* violation of the Sherman Act, justification for it is to be construed narrowly, especially when arising out of the supplier's dominant economic leverage. Thus state legislation such as New Jersey's Franchise Practices Act does not constitute the first time that the exclusive rights of a holder of a federally registered trademark have been qualified.

The Supreme Court has decided a series of cases that increasingly show the extent to which a dominant party can pressure a weaker bargaining counterparty to carry out the supplier's policies. In *United States v. Parke, Davis & Co.*, the Court noted that pressure is endemic to many antitrust practices between supplier and dealer. Even the time-honored principle of refusal to deal, as enunciated in *United States v. Colgate*, was declared void when used to effectuate a restraint of trade. By cutting off retailers who would not abide by Parke, Davis & Co.'s price schedule, the supplier was only further intimidating other retailers to comply.

The step from questioning a refusal to deal to prohibiting threats of termination was made by the Supreme Court in *Simpson v. Union Oil Co.* There the Court, consistent with its previous distinctions between normal busi-
ness decisions to terminate based on profit considerations and those based on
effectuating practices violative of the antitrust laws, stated: "[w]e made clear in
United States v. Parke, Davis & Co., . . . that a supplier may not use coercion
on its retail outlets to achieve resale price maintenance. We reiterate that view,
adding that it matters not what the coercive device is."10

This progressive checking of dominant economic power finally came to
franchising with the case of F.T.C. v. Texaco.107 There these principles of
balance were applied to evaluating the relationship between an oil supplier and a
dealer. The Supreme Court stated that "[t]he sales commission system for market-
ing TBA is inherently coercive."108 This is bolstered by the Court’s description
of factors, found in Atlantic Rfg. Co. v. F.T.C.,109 that make such pressure pos-
sible: "Among the sources of leverage in Atlantic’s hands are its lease and equip-
ment loan contracts with their cancellation and short-term provisions."110

It would seem reasonable to suggest, then, that there is ample Supreme
Court precedent holding that coercion resulting from dominant economic power
is at times definitely illegal. Moreover, there has been considerable discussion by
the courts and commentators that terminations are also improper when they
occur after a supplier has been determined to have violated antitrust provisions.111
Thus, the fear of cancellation, often used to both the dealer’s and the consumer’s
detriment, can only be rectified if the franchisee is secure in knowing that the
franchisor must have good cause to terminate. By putting this qualification on
the supplier’s power, the merits of his justification will be examined by the courts,
thereby making it less likely that inherent antitrust violations will comprise the
basis of his excuse.112

IV. Need for a Sui Generis Approach to Franchising

A. A Fiduciary Relationship

The cases discussed above expressed judicial concern over the ability of the
franchisor to compel the dealer to follow the supplier’s dictates, regardless of their
legality. State legislatures share this concern but also deal with the issue of the
goodwill and money a dealer may contribute to a franchisee. Many times the
franchisee is left with nothing even though his operation of the franchise may
have been very successful. In order to properly allocate risks and benefits in
franchising, it is necessary to consider the unique relationship of a franchisee to
a franchisor.

It has been suggested that franchising is an appropriate area of the law in

106 Id. at 17.
108 Id. at 229.
110 Id. at 368.
111 Industrial Bldg. Materials, Inc. v. Interchemical Corp., 437 F.2d 1336 (9th Cir. 1970); Milson Co. v. Southland, 454 F.2d 363, 366 (7th Cir. 1971); Wade, Some Antitrust Problems in Terminating Franchises, 44 St. John’s L. Rev. 23 (1969); Selected Antitrust Problems of the Franchisor: Exclusive Arrangements, Territorial Restrictions, and Franchise Ter-
112 454 F.2d at 366.
which to find a fiduciary relationship. Since the parties “simply do not bargain as equals,” the needed protection for franchisees would come as a result of the franchisor’s added duty to the dealer. Indeed, the criteria established to determine a fiduciary relationship would readily qualify franchising. The elements necessary are: control or power of one party over another, unequal bargaining power in establishing the relationship, an imbalance of high risks to low benefits, and the opportunity for abuse. If a franchise relationship is to be considered fiduciary in nature, then the usual mandate prohibiting any acts made in self-preference would govern. This would eliminate many of the pressures placed on dealers to subscribe to supplier policies even if detrimental to the dealer and the public. The general counsel of the FTC has endorsed this notion by stating that “franchisors frequently speak of their relationship with their franchisees as being one of trust and confidence. It is truly a fiduciary relationship.”

*Mobil Oil Corp. v. Rubenfeld* provides an excellent appraisal of the franchise business arrangement. Judge Kassoff discussed the need to accept the franchising arrangement as fiduciary. The court immediately noted Mobil’s dominance and decided that the oil company had used its leverage in a manner that breached a supplier’s duty of good faith. Again, this case dealt with a relationship between an oil supplier and dealer that had lasted for several years. However, when Rubenfeld, the dealer, refused to go along with Mobil’s insistence that he purchase more TBA, he was terminated. The court stressed the fact that such a dealer was not to be disposed of through normal contract exercises. The dealer stood in a special status to the more powerful oil company and therefore was entitled to a showing of good faith on the part of the supplier.

Both *Shell Oil Company v. Marinello* (decided by the state courts) and *Division of Triple T Service, Inc. v. Mobil Oil Corp.* consistently referred to the arrangement between supplier and dealer as a franchise and rejected the view that it should be considered as an ordinary lease or contract. It was in light of this essential difference that the New Jersey Supreme Court specifically announced that the freedom to contract was void as against the public policy of the state. This is hardly a new concept in the law. Other areas dealing with business relationships such as partnership, corporations, and joint ventures have not been limited to contract law. Rather, in each of these cases the courts have developed special substantive principles to adequately meet the needs and pur-

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113 381 U.S. 357; 393 U.S. at 227, “[t]he average dealer is a man of limited means who has what is for him a sizable investment in his station. He stands to lose much if he incurs the ill will of Texaco.” See also Brown, *Franchising—A Fiduciary Relationship, 49 Tex. L. Rev. 650 (1971).*

114 381 U.S. at 368.


116 *Hearings on the “Impact of the FTC on Small Business” before the Subcom. on Urban & Rural Economic Development of the Senate Select Comm. on Small Business, 91st Cong., 2d Sess. 143 (1970), statement by John V. Buffington, General Counsel, FTC.*


118 Id. at 406, 339 N.Y.S.2d at 638.

119 Id. at 408, 339 N.Y.S.2d at 635.


122 63 N.J. at 408, 307 A.2d at 601.
poses of the relationship. In some areas these common law developments are now codified into statutory form as in the Uniform Partnership Act, and the Model Business Corporation Act.

B. Consistency of a Sui Generis Approach with Existing Law

The fact that franchising cannot be sufficiently regulated by traditional legal reasoning is evinced by the New Jersey Supreme Court’s statement that the freedom to contract pales when in violation of the state’s public policy. This corresponds with the Supreme Court’s holding that the right of refusal to deal is void when coercion is the real motive for that refusal. What is pertinent, though, is that the state’s public policy be reasonable in finding and regulating such coercive ability. Notwithstanding this, it would appear that current state legislation is comparable in its analysis of franchising to the federal concept as established by the Supreme Court and the FTC.

Indeed, there is precedent for special qualifications being put on the rights of a supplier from antitrust considerations: ADDCA and Supreme Court rulings like Parke, Davis and Texaco. Other areas of the law provide analogies where public policy has curtailed contract freedom, such as UCC § 2-302 and the banning of “yellow dog contracts” in labor law. Accordingly, current state legislation tries only to provide similar protection to a specific group of people. This protection allows dealers to be free from arbitrary or unlawfully motivated terminations. Such a concern is constitutionally substantiated by the grant of police power to the states to provide for the general welfare of its populace as held in both Globe Liquor and Fornaris.

Moreover, a sui generis approach to franchising would not interfere with legitimate termination, whether derived from state statutes or courts. Both state legislatures and courts recognize that cancellation or failure to renew not connected with tie-ins, resale price maintenance, or bad faith are within the proper exercise of the franchisor. In fact, the courts have shown considerable tolerance in allowing terminations based on profit motives, protection of the supplier’s image or that of his product, failure to increase sales, and a desire to consolidate franchises.

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123 362 U.S. at 45.
125 393 U.S. 223 (1968).
127 423 F.2d at 566.
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