Washington Law Review

Volume 48 | Number 2

2-1-1973

State Regulation of Franchising: The Washington Experience

Donald S. Chisum
University of Washington School of Law

Follow this and additional works at: https://digitalcommons.law.uw.edu/wlr

Part of the Business Organizations Law Commons, and the Commercial Law Commons

Recommended Citation
Donald S. Chisum, *State Regulation of Franchising: The Washington Experience*, 48 Wash. L. Rev. 291 (1973).
Available at: https://digitalcommons.law.uw.edu/wlr/vol48/iss2/2

This Article is brought to you for free and open access by the Law Reviews and Journals at UW Law Digital Commons. It has been accepted for inclusion in Washington Law Review by an authorized editor of UW Law Digital Commons. For more information, please contact cnyberg@uw.edu.

WASHINGTON LAW REVIEW
Volume 48, Number 2, 1973

STATE REGULATION OF FRANCHISING: THE WASHINGTON EXPERIENCE

Donald S. Chisum*

* Associate Professor of Law, University of Washington. A.B., Stanford University, 1966, LL.B., 1968. I wish to thank the following members of the Corporate Planning Seminar, 1971-72, at the University of Washington School of Law who studied franchising with me and supplied invaluable research assistance and comments: Jerry Bassett, John Denman, Roger Fisher, Jerry Johnson, Milan Gail Ryder, Randall Stewart, Gary A. Swenson, and Beatrice Thorslund.

CONTENTS

I. General Remedies—Franchisor Sales Practices 299
A. Common Law Remedies for Misrepresentation 300
B. State and Federal Securities Acts 303
1. Franchises as Securities under Federal Law 304
2. Franchises as Securities under State Laws 307
C. Federal Trade Commission Act 309

II. General Remedies—Unfair Practices by Franchisors . . . 313
A. Common Law and Uniform Commercial Code Protection Against "Unfair Practices" 315
1. Termination 315
2. Control of Sources of Supply 320
B. The Automobile Dealers Day-in-Court Act 321
C. The Federal Antitrust Laws 325
1. Tying Agreements and the *Chicken Delight* Case . 326
2. Injunctions Against Franchise Terminations 331
3. Unfair Franchise Practices and Section 5 of the Federal Trade Commission Act 332

III. The Washington Act 334
A. Coverage 336
1. Interstate Transactions—Choice of Law 336
(a) Sales and Solicitation 338
(b) Advertising 339
(c) Fair Practices Provision 341
2. Definition of a "Franchise" 342
3. Exemptions 345
(a) Exempt Relationships 345
(b) Unconditionally Exempt Transactions 347
(c) Conditional Exemptions 348
(d) The "Hertz-Avis" Exemption 351
B. Administrative Regulations and Procedures 352
1. Registration of Franchise Offerings 352
2. Stop Order Proceedings 353
3. Registration of Brokers and Selling Agents 354
4. Impounding of Franchise Fees 355
5. Control of Advertising 358

C. Disclosure Requirements and Standards 358
1. Delivery of Offering Circular to Prospective Franchisee 358
2. Contents of the Offering Circular 360
3. Required Items of Disclosure—Projected Franchisee Earnings 361
4. Section Seventeen—The Antifraud Provisions . . . 368
D. The Fair Practices or "Franchisee Bill of Rights" Section 369
1. Right of Association 371
2. Control of Sources of Supply—Unreasonable Prices—"Kick Backs" 371
3. Discrimination Between Franchisees 373
4. Exclusive Territories 375
5. Releases and Waivers of Liability 375
6. Standards of Franchisee Conduct 376
7. Refusals to Renew 377
8. Terminations 379
9. Chain Distributorships 380
10. Constitutional Problems in Applying the Franchise Act to Existing Franchises 381
E. Remedies 383
1. Public Remedies 383
2. Private Civil Remedies 384
(a) Violations in Connection with Sales of Franchises 384
(b) Violations of the Fair Practices Section 387
3. Arbitration Agreements 387

Conclusion 389

INTRODUCTION

Franchising as a system of marketing goods and services has grown tremendously in recent years. Franchising now accounts for approximately 90 billion dollars in annual sales or about ten percent of our country's gross national product.[1] Ninety percent of the franchise businesses operating today were established after 1954.[2]

A threshold problem in any discussion of franchising is one of definition: what is a franchise and how is it unique as a marketing system? One author, Professor Thompson, identifies four elements that set "franchises" apart from other marketing systems and relationships:[3]

1. Although the franchisee may be economically dependent on the franchisor, he is a legally independent member of the franchising system;
2. The franchisee's business is operated with the advantages of name and standardization of the franchisor accruing to the franchisee;
3. The franchisee's business came into being in its present form (although not necessarily physically), with the expressed purpose of marketing the franchisor's products or service;
4. A formal agreement, most commonly called a "franchise agreement" or "franchise contract," is in existence. The agreement calls for a continuing, although not necessarily indeterminate, relationship.

Thompson further identifies two major classes of franchises: product and service franchise systems,[4] and trademark licensing franchise systems.[5] In the former, the franchisor contributes by license the right to *distribute* the franchisor's products under the franchisor's trade name and trademark.[6] Examples include automobile dealerships (a manufacturer/retailer system) and beverage syrup licenses (a

1. *Report of the Senate Select Comm. on Small Business on the Impact of Franchising on Small Business, Based on Hearing Before the Subcomm. on Urban and Rural Economic Development,* 91st Cong., 2d Sess., at 1 (1970).
2. Burck, *Franchising's Troubled Dream World,* FORTUNE, March, 1970, at 117-18.
3. D. THOMPSON, FRANCHISE OPERATIONS AND ANTITRUST 7-8 (1971).
4. *Id.* at 10-11.
5. *Id.* at 12-17.
6. A retailer does not become a "franchisee" merely because he advertises and sells a product by use of the manufacturer's trademark. An appliance dealer who advertises "Acme" washing machines would not pro tanto be an Acme franchisee. The dealer operates under his own name, his business was not created to sell Acme alone, and there is no agreement calling for a continuing relationship. A franchisee, on the other hand, would operate a business in which all four elements set forth by Thompson are present. *See* note 3 and accompanying text *supra*.

manufacturer/wholesaler system). In the latter, the franchisor contributes by license to the franchisee the right to *produce and sell* goods or services under the franchisor's trademark or trade name. In turn, the trademark franchisor retains the right to control the manner in which the franchisee conducts his business. Indeed, such control is essential to the validity of the franchisor's trademark since trademarks function in part to guarantee the consistent quality of the product identified by the mark.[7] Examples of trademark licensing are motels, day care centers and fast food establishments.

Trademark licensing franchise systems account for most of the recent growth in franchising and for most of the public attention now directed toward franchising.[8] A recent United States Senate committee report identifies the following industries as leaders in franchising growth: "fast food; automobile parts, stores and services; convenience grocery stores; coin-operated laundry and dry cleaning establishments; motels, and a heterogeneous group of service-type franchises."[9]

Franchise systems expand in areas where it is advantageous to combine local operation, financing, and management with national reputation and national advertising.[10] Franchising offers substantial

7. An owner of a trademark may license others to use it only if he retains the right to exercise control "in respect to the nature and quality of the goods or services in connection with which the mark is used." 15 U.S.C. §§ 1055, 1127 (1970). In times past, trademarks functioned solely to identify the origin of goods. Hence, the law did not permit licensing and use of a trademark on goods made by more than one person. Gradually, trademarks acquired a second function—that of warranting the consistent quality of the goods sold under the mark. Trademarks could be licensed so long as the licensor continued to control the quality of the goods sold under his mark. D. THOMPSON, *supra* note 3, at 13. The Lanham Act of 1946 recognizes trademark licensing and establishes quality control as its sine qua non. Section 5 provides that "where a . . . mark . . . is . . . used legitimately by related companies, such use shall . . . not affect the validity of such mark . . . provided such mark is not used in such manner as to deceive the public." 15 U.S.C. § 1055 (1970). In turn, section 45 defines a "related company" as any person who is controlled in respect to the quality of the goods sold under the mark. 15 U.S.C. § 1127 (1970). *See* Turner v. HMH Publishing Co., 380 F.2d 224 (5th Cir. 1967); E. I. duPont de Nemours & Co. v. Celanese Corp., 167 F.2d 484 (C.C. Pa. 1948). *See generally* Developments in the Law—Trademarks and Unfair Competition, 68 HARV. L. REV. 814, 871-73 (1955).

8. The relative growth patterns of the two types of franchises are illustrated by statistics supplied by the Small Business Administration on the number of outlets. "Older franchise groups," mostly product and service systems such as auto dealers and gasoline stations, accounted for 375,880 outlets in 1969 with a projected increase to 402,100 by 1976, an increase of approximately 7%. "New industry groups," mostly trademark systems such as fast food and coin-op dry cleaning, accounted for 164,120 outlets in 1969 with a projected increase to 252,900 by 1976, an increase of approximately 54%. *Report on the Impact of Franchising, supra* note 1, at 29.

9. *Id.* at 5.

10. D. THOMPSON, *supra* note 3, at 12.

advantages to both franchisors and franchisees over the most probable alternative marketing system: vertical integration.[11] The franchisor obtains a distribution system for his goods, supplies or business plan and an opportunity to expand his operation with relatively modest capital investment, since the franchisee generally supplies some portion of the investment capital required for the local operation. The franchisor can earn substantial income through franchise fees and/or royalty income.

The franchisee, on the other hand, gains access to an established brand name, tested marketing techniques, advertising and training aids. More importantly, the franchisee remains, at least in theory, an independent businessman. As one judge remarked:[12]

> The franchise method of operation has the advantage from the standpoint of our American system of competitive economy, of enabling numerous groups of individuals with small capital to become entrepreneurs . . . . If our economy had not developed that system of operation these individuals would have turned out to have been merely employees. The franchise system creates a class of independent businessmen; it provides the public with an opportunity to get a uniform product at numerous points of sale from small independent contractors, rather than from employees of a vast chain.

Empirical data indicating a lower failure rate for franchised small businesses than for nonfranchised small businesses substantiates to some extent these advantages to franchisees.[13]

Franchising may or may not fulfill its promise to be "the salvation of the 'small independent businessman' "[14] and "the last stand against the creeping octopus of nationwide *Mergeritis*."[15] What is clear, however, is that franchising suffers from growing pains—pains attributable in part to the tardiness of the legal system in its adjustment to the peculiar problems presented by franchising.

---

11. Vertical integration is the technique whereby the producer acquires distribution outlets as an addition to the production entity.

12. Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962) (Dawson, J.), *aff'd,* 332 F.2d 505 (2d Cir. 1964), *cert. dismissed as improvidently granted,* 381 U.S. 125 (1965). *Cf.* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 386 (1967).

13. D. THOMPSON, *supra* note 3, at 33-34 (overall failure rate of 60%, compared to only 10% for franchisees).

14. *Hearings on Franchise Legislation before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary,* 90th Cong., 1st Sess., at 513 (1967).

15. Slater, *Some Socio-Economic Footnotes on Franchising,* 11 BOSTON U. BUS. REV. 19, 20 (1964).

Many of the problems center around two aspects of franchising.[16] The first is the process of selling franchises. Instances of outright fraud in the sale of franchises continue to plague the industry.[17] But fraud aside, the evidence indicates that persons with little or no business experience and no access to expert advice make substantial investments in franchises without the benefit of full and accurate disclosure of the material facts concerning the transaction.[18] The second aspect is the continuing relationship between the franchisor and the franchisee. The franchisor normally occupies an overwhelmingly stronger bargaining position and drafts the franchise agreement so as to maximize his power to control the franchisee.[19] Franchisors have used this power to terminate franchises arbitrarily, to coerce franchisees under threat of termination, and to force franchisees to purchase supplies from the franchisor or approved suppliers at unreasonable

16. Selling abuses and franchisor coercion do not exhaust the problems with franchising. Other problems not covered by this article include (1) the liability of franchisors for the obligations of franchisees [*see* Porter v. Arthur Murray, Inc., 249 Cal. App. 2d 410, 57 Cal. Rptr. 554 (4th Dist. 1967)]; (2) the tax aspects of franchise transactions [*see* INT. REV. CODE of 1954, § 1253; Note, *The "Dairy Queen" Cases: A Suggested Approach to the Taxation of Franchise Sales,* 34 U. CHI. L. REV. 884 (1967); Comment, *Federal Taxation of Franchise Sales,* 44 WASH. L. REV. 617 (1969)]; and (3) the accounting practices of franchisor companies [Goodwin, *The Name of the Franchising Game Is: The Franchise Fee, The Celebrity or Basic Operations?,* 25 BUS. LAWYER 1403, 1409-12 (1970); MacKay, *Accounting for Initial Franchise Fee Revenue,* 129 J. ACCOUNTANCY 66 (1970)].

17. *See* Brown, *Franchising—A Fiduciary Relationship,* 49 TEXAS L. REV. 650, 652-53 (1971). The Chief Postal Inspector of the U.S. Post Office Department informed the Senate Select Committee on Small Business that "During the past 5 years, we have investigated 612 cases of this general type (franchise frauds) *which in total have occasioned the loss of over $27 million to investors.* A total of 219 convictions [for mail fraud] have thus far resulted." *Report on the Impact of Franchising, supra* note 1, at 12 (emphasis added). *See, e.g.,* United States v. Bessesen, 433 F.2d 861 (8th Cir. 1970).

18. The Attorney General of New York concluded after an investigation of franchise sales practices in his state: "In almost every instance, the franchise-offering literature was either inaccurate, misleading, wholly lacking, or blatantly false as to material facts necessary to making an intelligent investment decision." *Report on the Impact of Franchising, supra* note 1, at 13.

19. One study lists 12 areas of franchising managerial activities over which the franchisor normally exercises control: source of products; source of equipment; product assortment; resale pricing; quality of product or service; facilitating services such as business hours, credit and delivery; franchisee advertising; sales quotas; training programs; recordkeeping systems; use of registered trademark; and architectural design of franchisee's place of business. S. Gillespie, An Analysis of Control in Franchise Distribution Systems, 1966 (unpublished thesis in University of Illinois, Urbana library), *quoted in* D. THOMPSON, *supra* note 3, at 45-47. Franchisors may reserve control over the activity in the franchise contract itself or exercise it more informally through distribution of a detailed policy and operating manual to which all franchisees are asked to conform. Fear of termination or failure to renew by the franchisor causes franchisees to conform in general to the franchisor's policies and requirements.

prices, to carry excessive inventories, to operate long, unprofitable hours, and to employ other unprofitable practices.[20]

The persistence of these kinds of abuses and grievances creates pressure for special legislation at both the state[21] and federal[22] level to protect the interests of franchisees. In Washington state, this pressure led to the enactment of a lengthy and detailed statute entitled the "Franchise Investment Protection Act."[23] The Act responds to selling practices problems with registration,[24] disclosure,[25] escrow,[26] and anti-fraud provisions.[27] It responds to the problems of the franchisor-franchisee relationship with a "fair practices" or "Franchisee Bill of Rights" section.[28]

This article assesses the role of the Washington Franchise Investment Protection Act in remedying problems in franchising. First, consideration is given to the adequacy of general remedies presently available to franchisees for sales practice abuses and franchisor coercion, apart from Washington's special statute, to determine whether such a statute is needed. The provisions of the statute are then examined in detail.

20. *See generally* H. BROWN, THE REALITIES OF FRANCHISING (1970); H. BROWN, FRANCHISING: TRAP FOR THE TRUSTING (1969); Lefkowitz, *Franchising Abuses—One State's Approach,* 75 CASE & COM. 13, 15 (1970).

21. Legislation has been proposed in numerous states. *See* Wall Street Journal, Oct. 11, 1971, at 22, col. 1. California enacted a franchise investment law in 1970 dealing solely with disclosures and sales practices. CAL. CORP. CODE §§ 31000-31516 (West Supp. 1972). *See generally* Augustine & Hrusoff, *Franchise Regulation,* 21 HASTINGS L. J. 1347 (1970); Pennebaker, *Franchisors Beware: A New Franchise Investment Law,* 45 L.A.B. BULL. 463 (1970); Comment, *A Tempest in a Chicken Basket: Some Reflections on Franchise Regulation in California,* 17 U.C.L.A.L. REV. 1101 (1970). Delaware enacted a statute dealing with the termination of franchises. DEL. CODE ANN. tit. 6, §§ 2551-55 (Supp. 1970). New Jersey enacted a statute dealing with termination, transfers, and unreasonable restrictions on franchisees. N.J. STAT. ANN. § 56:10-1 to -12 (Supp. 1971). Arkansas enacted a statute dealing with royalties and advertising fees charged by franchisors. ARK. STAT. ANN. §§ 70-801 to -806 (1971).

22. Senator Williams introduced bills in 1970 and 1971 providing for full disclosure in franchise sales. Franchise Full Disclosure Act of 1970, S. 3844, 91st Cong., 2d Sess. (1970); Franchise Fair Practices Act of 1971, S. 2399, 92nd Cong.. 1st Sess. (1971). Senator Hart advocates enactment of a "Fairness in Franchising Act" regulating termination and other franchisor practices. S. 2472, 92nd Cong., 1st Sess. (1971).

23. Ch. 252 [1971] Wash. Laws, 1st Ex. Sess., *as amended,* ch. 116 [1972] Wash. Laws, 2d Ex. Sess.

24. WASH. REV. CODE §§19.100.020, .040 (Supp. 1972).

25. *Id.* § 19.100.080.

26. *Id.* § 19.100.050.

27. *Id.* § 19.100.170.

28. *Id.* § 19.100.180.

I. GENERAL REMEDIES—FRANCHISOR SALES PRACTICES

The practical economics of franchising aggravates the danger of sales practice abuses. On the one hand, the incentives for a high level of sales are strong. Sales bring in substantial initial franchise fees that enrich the sales personnel and inflate the earnings of the franchisor company. On the other hand, franchises are sold to relatively inexperienced persons who are investing a high portion of their savings to obtain a business of their own.[29] Buyer caution and resistance to sales talk are weakened by a general public belief that franchising is the wave of the future.[30]

It should surprise no one, therefore, that exaggerated, misleading, or false representations and nondisclosure have often accompanied the sale of franchises. One commentator lists the specific areas of information most often misrepresented to franchisees: prospective earnings claims; statements that the franchise system is a tested, proven "going concern" and profit producer; statements that no experience is necessary; the amount of initial working capital needed; the aids available from the franchisor to the prospective franchisee; and the expertise used in compiling and the value of the franchisor's business manuals.[31]

In cases of outright fraud in connection with the sale of franchises, existing criminal and civil remedies are adequate in theory.[32] The problem is one of enforcement. For transactions involving misrepresentation and nondisclosure, existing legal remedies are not adequate. Three existing sources of possible relief must be considered: (1) common law remedies for misrepresentation; (2) the application of

29. The Senate Select Committee on Small Business cites a survey by the Attorney General of New York of more than 10,000 persons who recently purchased franchises. The survey reveals that 65% previously earned less than $15,000 per year in their prior occupations. The Committee also notes that minority groups and retired military personnel are frequent victims of franchise frauds. *Report on the Impact of Franchising, supra* note 1, at 13.

30. "In the late 1960's over-optimistic and clearly distorted appraisals of franchising were spread by a business and consumer press enthusiastically extolling its limitless growth prospects and glowing, get-rich stories." Axelrad, *Franchising—Changing Legal Skirmish Lines or Armageddon? Some Observations from the Foxhole,* 26 Bus. Lawyer 695, 704 (1971).

31. *Id.*

32. The federal mail fraud statute, 18 U.S.C. § 1343 (1970), has been applied to franchise schemes: *See* note 17 *supra.*

state and federal securities laws; and (3) the application of the Federal Trade Commission Act.

A. *Common Law Remedies for Misrepresentation*

Common law remedies for misrepresentation hold only limited promise as a cure for franchise sales abuses. They are inadequate for many of the same reasons that long ago led state legislatures and Congress to conclude that common law remedies are inadequate to cure analogous abuses in the sale of securities.[33] The common law remedies tend to be redressive rather than preventive, and they require only truth in statements volunteered, not affirmative disclosure of all material information.[34]

The three basic common law remedies are damages for breach of warranty, damages for deceit, and rescission. Warranty probably plays as small a role in the sale of franchises as it does in the sale of securities.[35] In a typical trademark license franchise, the franchisor warrants by implication only his title to the trademark; there is no implied warranty of quality or value. Because the typical franchise agreement contains an integration clause to the effect that "no representations, inducements, promises or agreements (except duly executed written agreements) between the parties hereto which are not embodied herein . . . shall be of any force or effect,"[36] the parole evidence rule would seem to be a major obstacle to warranty recovery for exaggerated promises and representations made during the sales negotiations. Since warranty is a contractual action, the plaintiff-franchisee is bound by the integration clause,[37] and franchisors are undoubtedly careful to keep inflated claims and predictions out of the written agreement. Should a franchisee prove a breach of warranty, however, the measure of his damage recovery would be governed by the "loss-of-bargain" rule.[38]

33. *See generally* L. LOSS, SECURITIES REGULATION 1430-44, 1624-31 (2d ed. 1961); Shulman, *Civil Liability and the Securities Act,* 43 YALE L.J. 227 (1933).

34. W. PROSSER, LAW OF TORTS § 106, at 695-96 (4th ed. 1971) [hereinafter cited as PROSSER]. *But cf.* Boonstra v. Stevens-Norton, Inc., 64 Wn. 2d 621, 393 P.2d 287 (1964); Oates v. Taylor, 31 Wn. 2d 898, 199 P.2d 924 (1948) (dicta); PROSSER § 106, at 698.

35. *See* Shulman, *supra* note 33, at 230.

36. H. BROWN, FRANCHISING: TRAP FOR THE TRUSTING 127 (1969) (from a sample dealer's franchise agreement currently in use).

37. L. LOSS, *supra* note 33, at 1626.

38. *Id.* at 1628-29. *See* text accompanying note 46 *infra.*

The parole evidence rule is no obstacle to recovery for deceit since an award of damages for deceit is a remedy sounding in tort.[39] But the required "elements" of a cause of action for deceit present difficult problems of proof. These elements are:[40]

> (1) representation of an existing fact; (2) its materiality; (3) its falsity; (4) the speaker's knowledge of its falsity; (5) his intent that it shall be acted upon by the person to whom it is made; (6) ignorance of its falsity on the part of the person to whom the representation is addressed; (7) the latter's reliance on the truth of the representation; (8) his right to rely upon it; and (9) his consequent damage.

The requirement that there be a misrepresentation of a *material fact* will often be an obstacle to the franchisee. Statements of opinion are not considered "facts" but mere puffing and salemanship. Hence, for example, a franchisee will have difficulty recovering for inflated predictions about future earnings from the franchise. On the other hand, statements of intention are considered facts.[41] Hence recovery is possible for failure to deliver the franchise on time or failure to provide special training and services if the franchisor did not in fact intend to fulfill his promises. Justifiable reliance on an opinion is a well established exception to the "puffing rule,"[42] but such reliance has traditionally been difficult to prove. However, the general trend of the law is away from "caveat emptor" and toward allowing buyers to rely without extensive investigation on statements by the seller.[43] The element of *scienter* or knowledge of the falsity by the franchisor may again be difficult to prove although a number of jurisdictions have eliminated the strict *scienter* element and others view it as satisfied if the seller made the statement without any belief as to its truth or with reckless disregard as to its truth or falsity.[44]

---

39. *Id.* at 1626.
40. Gray v. Wikstrom Motors, 14 Wn. 2d 448, 455-56, 128 P.2d 490, 492-93 (1942).
41. PROSSER § 109, at 720-31; Shattuck, *Contracts in Washington, 1937-1957; Part III*, 34 WASH. L. REV. 467, 520-22 (1959); *see, e.g.*, Neff v. Western Cooperative Hatcheries, 241 F.2d 357 (10th Cir. 1957).
42. PROSSER § 109, at 726.
43. *Id.* § 108, at 714-20. The reliance element has been most relaxed in cases where the defendant was far more experienced in the area than the plaintiff. Boonstra v. Stevens-Norton, Inc., 64 Wn. 2d 621, 393 P.2d 287 (1964). This is inevitably the case with a franchisor and prospective franchisee.
44. PROSSER § 107, at 701. Prosser notes a trend in decisions to eliminate the scienter requirement in damage actions for misrepresentation. *Id.* at 710-14, *citing inter alia*, Jacquot v. Farmer's Straw Gas Producer Co., 140 Wash. 482, 249 P. 984 (1926); Pratt v. Thompson, 133 Wash. 218, 233 P. 637 (1925).

Proof of damage may be a formidable task for the franchisee who has been induced by false representations. The American decisions are split between two measures of damages in a tort action for deceit.[45] The "out-of-pocket" rule measures the plaintiff's recovery by the difference between the value of what he has parted with and the value of what he has received. If the franchisor can successfully argue that despite the misrepresentations the franchise is worth what the franchisee paid for it, he escapes liability under the "out-of-pocket" rule. The "loss-of-bargain" rule measures the plaintiff's recovery by the difference between the actual value of what he has received and the value of the franchise if it had been as represented. This rule normally is more favorable to the plaintiff and has been adopted by a majority of American jurisdictions, including Washington.[46] However, since all franchises are unique, and their value is set by innumerable and variable market factors, the franchisee-plaintiff may still be unable to show damage even under the "loss-of-bargain" rule. For example, the impact of failure to provide sufficient training as represented upon the franchisee's earnings would be difficult to show.[47]

Of the three common law remedies, rescission can most easily be established. Misrepresentation of a material fact upon which the buyer relied is sufficient;[48] the franchisee need not show *scienter* on the part of the franchisor[49] nor a causal connection between the misrepresentation and any damage suffered. The parole evidence rule does not preclude proof of the misrepresentation, and recovery is measured by a restitution standard. Two obstacles to restitution, however, are the twin doctrines of laches and ratification. If an unsophisticated and uncounseled franchisee continues to operate the franchise and pay royalties to the franchisor after discovering the misrepresentation, rescission may be denied.[50]

In general, the common law remedies fail to meet adequately the

45. PROSSER § 110, at 733-36.

46. Salter v. Heiser, 39 Wn. 2d 826, 239 P.2d 327 (1951).

47. However, if the fact of damage is clear, the courts do not let uncertainty as to the amount stand in the way of recovery. Sigman v. Stevens-Norton, Inc., 70 Wn. 2d 915, 425 P.2d 891 (1967).

48. L. Loss, *supra* note 33, at 1627. Washington takes the position that innocent misrepresentation is sufficient for rescission, although some cases continue to use "fraud" language. Shattuck, *supra* note 41, at 523.

49. In a number of jurisdictions, including Washington, innocent misrepresentation may also give rise to a cause of action for damages. *See* note 44 *supra*.

50. *Cf.* Graff v. Geisel, 39 Wn. 2d 131, 143, 234 P.2d 884, 891 (1951).

problem of franchise sales abuses. The prospect of liability undoubtedly restrains some franchisors, but the remedies can be pursued only through litigation, the expense of which may be too great for many franchisees. Further, none of the three remedies is available for simple nondisclosure by franchisors of material information.

The general rule is that a party dealing at arm's length with another need not disclose material information.[51] An exception to this rule is expressed in section 551 of the Restatement of Torts:[52] "One party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated . . . such matters as the other is entitled to know because of a fiduciary or other similar relation of trust and confidence between them." It can be argued that such a relation of confidence does exist between franchisor and prospective franchisee; prospective franchisees are typically inexperienced in business matters and rely on the superior knowledge and experience of the franchisor. Whether in fact the common law does impose such a fiduciary duty of affirmative disclosure on franchisors is unclear.[53]

B. *State and Federal Securities Acts*

The state and federal securities laws are specifically designed to curb sale practice abuses in the securities industry that are in many respects comparable to those that exist in franchising. Securities laws contain mandatory registration provisions[54] which require sellers of securities, unless expressly exempted, to file a registration statement with an administrative agency that makes a preliminary assessment of the adequacy of disclosure by the seller.[55] The laws then require that prescribed information be provided to prospective purchasers of the securities in the form of a prospectus or offering circular.[56] The pur-

51. PROSSER § 106, at 695-96; *cf.* RESTATEMENT OF TORTS § 551 (1938).
52. RESTATEMENT OF TORTS § 551(2)(a) (1938).
53. *Compare* Sigman v. Stevens-Norton, Inc., 70 Wn. 2d 915, 425 P.2d 891 (1967), *with* Asheim v. Pigeon Hole Parking, Inc., 175 F. Supp. 320, 328-29 (E. D. Wash. 1959).
54. Securities Act of 1933 § 5(a), (c), 15 U.S.C. § 77*l* (1970). WASH REV. CODE § 21.20.140 (1959).
55. Securities Act of 1933 §§ 6-8, 15 U.S.C. §§ 77f-77h (1970); WASH. REV. CODE §§ 21.20.210, 230, 280 (1959). Persons participating in the distribution of securities are also subject to registration requirements as broker-dealers. Securities Exchange Act of 1934 § 15, 15 U.S.C. § 78o (1970); WASH. REV. CODE §§ 21.20.040-.135 (1959).
56. Securities Act of 1933 §§ 2(10), 5(b), 10(a), 15 U.S.C. §§ 77b(10), 77e(b), 77j(a), (1970); WASH. REV. CODE § 21.20.230 (1959).

chaser has an express civil remedy for any false or misleading information in the prospectus or circular.[57] Finally, the laws prohibit generally any false or misleading statement or omission in connection with the sale of the securities.[58]

Whether the securities laws can be applied directly to the sale of franchises depends on a very fundamental question: *is a franchise a "security"?*[59] A security is statutorily defined in both state and federal securities laws to include a long list of things such as any "note," "stock," "evidence of indebtedness" or "investment contract."[60] The term "investment contract," which is not defined, is perhaps the broadest category and the only one that might subsume the typical franchise. Despite the similarity in statutory definitions, state law has in some instances taken a more expansive view of "investment contract" than federal law in the area of franchises.

1. Franchises as Securities under Federal Law

In *SEC v. W. J. Howey Co.*,[61] the United States Supreme Court definitively construed the term "investment contract" in the federal securities laws. The Court announced:[62]

> [A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . .

In *Howey*, land sales contracts involving small tracts of orange groves

57. Securities Act of 1933 § 11, 15 U.S.C. § 77*l* (1970); Wash. Rev. Code § 21.20.430 (1959).

58. Securities Act of 1933 §§ 12(2), 17(a), 15 U.S.C. §§ 77*l*(2), 77q(a) (1970); Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1970); SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1972); Wash. Rev. Code § 21.20.010 (1959). Both state and federal decisions have implied private civil remedies for violations of the antifraud prohibitions. Supt. of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971); Shermer v. Baker, 2 Wn. App. 845, 472 P.2d 589 (1970).

59. *See generally* Goodwin, *Franchising in the Economy: The Franchise Agreement as a Security Under Securities Acts, Including 10b-5 Considerations*, 24 Bus. Lawyer 1311 (1969); Note, *Franchises and Founders' Contracts: Securities or Not?* 8 Idaho L. Rev. 146 (1971); Comment, *The Franchise Agreement: A Security for Purposes of Regulation*, 1970 U. Ill. L. F. 130; Note, *Franchise Regulation Under the California Corporate Securities Law*, 5 San Diego L. Rev. 140 (1968).

60. Securities Act of 1933 § 2(1), 15 U.S.C. § 77b(1) (1970); Wash. Rev. Code § 21.20.005(11) (1959).

61. 328 U.S. 293 (1946).

62. *Id.* at 298-99.

were held to be investment contracts and hence securities. The tracts were offered along with a service contract, and the purchasers, who were nonresidents, obviously had no intention of cultivating the groves themselves.[63] The common enterprise and reliance-solely-on-the-efforts-of-others tests were thus met.

With franchises, the *Howey* requirement that the anticipated profits come *solely* from the efforts of others has been hard to satisfy since the typical franchise contemplates the active participation of the franchisee-investor. Accordingly, a number of lower courts have held that franchises are not investment contracts or securities.[64] The agency charged with administration and enforcement of the federal securities laws, the Securities and Exchange Commission (SEC), has also indicated that it does not consider most franchises to be securities, preferring to leave federal regulation of franchising to the Federal Trade Commission.[65]

Some commentators argue that the "solely" part of the *Howey* test should not be applied so literally.[66] The requirement should exclude from coverage of the securities acts only those investors who have practical and actual control over the business and an opportunity to protect their investment. Such active entrepreneurs are not as apt as passive investors to fall prey to misrepresentation, nondisclosure, and fraud, the prevention of which is the purpose of securities laws. With many franchises, however, the participation of the franchisee is only ministerial. In franchises of the "mom and pop" variety, the franchisee-investor is inexperienced in business and relies upon the fran-

---

63. Although prospective purchasers were technically free to make arrangements with other service companies, the sales literature stressed the superiority of the company connected with the offeror of the tracts. *Id.* at 295. Hence, the tracts and the service contract were functionally parts of a single investment package.

64. Chapman v. Rudd Paint & Varnish Co., 409 F.2d 635 (9th Cir. 1969) (discussion of federal and Washington State securities acts); Beefy Trail, Inc. v. Beefy King Int'l, CCH FED. SEC. L. REP. ¶ 93,603 (M.D. Fla. 1972); McCoy v. Convenient Food Mart, Inc., TRADE REG. REP. ¶ 73,873 (D. Neb. 1972); Mr. Steak, Inc. v. River City Steak, Inc., CCH FED. SEC. L. REP. ¶ 92,838 (D. Colo. 1970), *aff'd*, 460 F.2d 666 (10th Cir. 1972); Drug Management, Inc. v. Dart Drug Corp., CCH. FED. SEC. L. REP. ¶ 91,293 (D.D.C. 1968).

65. *Hearings on the Impact of Franchising on Small Business Before the Subcomm. on Urban and Rural Economic Development of the Senate Select Comm. on Small Business*, 91st Cong., 2d Sess., at 706-11 (1970) (testimony of Mr. Loomis, General Counsel of the SEC).

66. Goodwin, *supra* note 59, at 1318-21. *See also* Long, *An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulations,* 24 OKLA. L. REV. 135 (1971).

chisor to take charge of the business affairs of the franchise venture. Thus, the franchisor may choose the site or design of the building, arrange the purchase of equipment and supplies, hire the manager or assistant manager, set the hours of operation, set prices, and make other management decisions. The franchisee may be prohibited from advertising independently or selling additional products or services. Such nondiscretionary participation should not exclude the franchise from being a security since the degree of control dictates that the success of the franchise outlet is dependent to an overwhelming degree upon the good will toward the franchise generated by the franchisor.

To date, neither the SEC nor the federal courts have been disposed to distinguish managerial from ministerial participation in determining whether a franchise is an investment contract.[67] However, a recent SEC release dealing with multi-level distributorships may indicate a more flexible approach to the non-participation requirement of *Howey*. The SEC states:[68]

> The existence of a security must depend in significant measure upon the degree of *managerial authority* over the investor's funds retained or given; and performance by an investor of duties related to the enterprise, even if financially significant and plainly contributing to the success of the venture, may be irrelevant to the existence of a security if the investor does not control the use of his funds to a significant degree. The "efforts of others" referred to in *Howey* are limited, therefore, to those types of *managerial efforts* but for which the anticipated return could not be produced.

Whether this approach will be applied to franchises generally remains to be seen.

---

67. *E.g.*, Mr. Steak, Inc. v. River City Steak, Inc., *supra* note 64.

68. SEC Securities Act Release No. 5211 (Nov. 30, 1971) (emphasis added). The SEC's campaign against multi-level distributorships and pyramiding schemes recently bore fruit in a decision of a district court in Oregon which held that the "adventures" offered by Glen Turner's Dare To Be Great, Inc. were securities. SEC v. Glenn W. Turner Enterprises, Inc., CCH Fed. Sec. L. Rep. ¶ 93,606 (D. Ore. 1972). The adventures offered buyers the opportunity to make money by recruiting additional participants. While the buyers were asked to find prospects, the court held that these efforts were qualitatively insignificant to the success or failure of the enterprise which turned primarily on the defendant's efforts and the extent to which the market had been saturated. For a discussion of the Franchise Act's ban on chain distributorship schemes, see notes 458-61 and accompanying text *infra*.

2. *Franchises as Securities under State Laws*

Most state courts follow the *Howey* definition of an investment contract.[69] Hence the active participation by the franchisee in many states bars the arrangement from being a "security" for purposes of state securities laws. For example, in *Koscot Interplanetary, Inc. v. King*,[70] the Texas Court of Civil Appeals held that investments in a multi-level marketing program did not constitute a security since the investors realized profits from their own efforts in recruiting people into the program as well as from the efforts of third parties.[71]

In order to avoid the nonparticipation barrier and include at least some franchises within the ambit of the securities laws, some states have adopted the so-called "risk capital" or "separate business risk" theory. The theory originated in an opinion by the Attorney General of California in 1967.[72] The opinion concludes that where a franchisee is to participate in the franchised business only nominally in exchange for a share of the profits, a security is involved, and where the franchisee participates actively and the franchisor provides goods and services, no security is involved *unless* "the franchisor intends to secure a *substantial* portion of the initial capital that is needed to provide such goods and services from the fees paid by the franchisee or franchisees."[73] If the franchisee is supplying risk capital to the franchisor,[74] he is in effect making an investment in the franchisor's business of supplying goods and services, a business venture separate from the franchised business in which he participates.[75]

69. *E.g.*, Chapman v. Rudd Paint & Varnish Co., 409 F.2d 635, 641 (9th Cir. 1969) (interpreting the Securities Act of Washington).

70. 452 S.W.2d 531 (1970).

71. *Accord*, Gallion v. Alabama Market Centers, Inc., 282 Ala. 679, 213 So. 2d 841 (1968).

72. 49 OP. CAL. ATT'Y GEN. 124 (1967).

73. *Id.* at 125 (emphasis added).

74. A difficult problem with the risk capital test is to determine when in fact franchisees are providing risk capital. Following the Attorney General's opinion, the California Corporations Commissioner issued guidelines that provided that an implication will arise that a franchise is a security unless the franchisor can show: (1) adequate capital to operate the franchising program for an indefinite length of time, without the necessity of resorting to the funds to be contributed by the franchisee; (2) successful business operation in the past; and (3) adequate facilities to administer the franchising program successfully. An exemption was provided for franchisors having a "net worth of not less than $500,000 immediately prior to the sale of a franchise." Cal. Div. of Corps. Bull. No. 67-8 (July 14, 1967).

75. An Oregon court recently adopted the risk capital test as a supplement to the *Howey* test for construing "investment contract." Oregon *ex rel.* Healy v. Consumer

In 1969, the Attorney General of the State of Georgia adopted the California risk capital theory and embellished it with his own "integrated risk" concept.[76] Under the integrated risk concept, security status is not avoided by mere adequacy of the franchisor's initial capital: "All franchise systems, however capitalized, are susceptible to securities regulation until such time as the franchise is so well established as a system that success or failure of an individual franchise is not disproportionately keyed to the success or failure of the other franchisees."[77] The Georgia Attorney General concludes that the franchisor will have to "provide a sufficient number of franchisor-owned and operated outlets to establish the system as a going enterprise without dependence upon the individual activities of the franchisee's co-franchisors [sic], or the franchisor will have to comply with the registration requirements" for the sale of securities.[78]

Both the risk capital and integrated risk tests are ingenious methods of eluding the *Howey* nonparticipation requirement. They are, however, at best truncated approaches to the problem of franchise sales practice abuses. Such abuses are not confined to the new or thinly-capitalized franchising operations that are subject to regulation as sales of securities under those tests.[79] Full, fair, and accurate disclosure should be enforced in connection with the sale of *all* franchises.

Two approaches to an integrated regulatory treatment of franchise sales are available. The first is to treat all franchises as securities by softening or rejecting the *Howey* nonparticipation requirement and broadening the concept of "investment contract." The Supreme Court of Hawaii took a significant step in this direction in *State v. Hawaii Market Center, Inc.*[80] While the case involved so-called "founders'

Business System, Inc., 482 P.2d 549, 554 (Ore. App. 1971). The Attorney General of Utah also adopted the risk capital test. 3 CCH BLUE SKY L. REP. ¶ 70,893 (January 7, 1971).

76. 1969 OP. GA. ATT'Y GEN. 661; 3 CCH. BLUE SKY L. REP. ¶ 70,850 (Nov. 14, 1969).

77. *Id.* at 665.

78. *Id.* The Attorney General's opinion may not be supported by Georgia case law. *See, e.g.,* Georgia Market Center, Inc. v. Fortson, 225 Ga. 854, 171 S.E.2d 620 (1969) (applying the *Howey* formula, but noting that it should not be adhered to with such strictness that a mere token participation in an enterprise would prevent the contract from being classified as a security); *accord,* Goldsmith v. American Food Serv., Inc., 123 Ga. App. 353, 181 S.E.2d 95 (1971).

79. Note, *Regulation of the Franchise as a Security,* 19 J. PUB. L. 105, 126 (1970).

80. 485 P.2d 105 (Hawaii 1971). *See also* D.M.C. of Colorado, Inc. v. Hays, 3 CCH BLUE SKY L. REP. ¶ 70,897 (Dist. Ct. Denver 1971); Florida Discount Centers, Inc. v. Antinori, 226 So. 2d 693 (Fla. App. 1969), *aff'd,* 232 So. 2d 17 (Fla. 1970).

contracts,"[81] the court chose to define a "security" for the purposes of the state's securities act broadly, possibly broadly enough to include virtually all franchises. Following the analysis of Professor Coffey,[82] the court held that an investment contract is created whenever:[83]

(1) An offeree furnishes initial value to an offeror, and
(2) a portion of this initial value is subjected to the risks of the enterprise, and
(3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and
(4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.

The second approach is to exclude all franchises from being defined as securities but to enact a disclosure statute or administrative regulation that is especially tailored to meet the problems of franchising. California, which attempted to regulate the sales of some franchises as securities, subsequently abandoned the effort when it enacted a "Franchise Investment Law."[84] With the enactment of the Franchise Investment Protection Act, the State of Washington has now adopted this approach.

C. Federal Trade Commission Act

Section 5 of the Federal Trade Commission Act prohibits "unfair or deceptive acts or practices in commerce."[85] As it has been developed by the Federal Trade Commission (FTC), the substance of this prohibition is potentially a strong weapon against franchise sales practice abuses. While the FTC has shown considerable interest recently in the problems

---

81. *See generally* Note, *Franchises and Founder's Contracts: Securities or Not?*, 8 IDAHO L. REV. 146, 152-56 (1971). A founder's contract has been described as a contract whereby a person can become a founder-member by purchasing certain merchandise at inflated prices and by additionally executing an agreement stating that the purchaser may by several methods earn income.
82. Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 W. RES. L. REV. 367 (1967).
83. 485 P.2d at 109.
84. Stats. 1970, ch. 1400, CAL. CORP. CODE §§ 31000 *et seq.* (West 1971).
85. 15 U.S.C. § 45(a)(1), (6) (1970).

of franchising, questions remain as to the efficacy of its procedures and enforcement tools.

The substantive standards of misrepresentation developed under section 5 are broader than common law concepts of fraud and deceit.[86] It is sufficient that the representation, considered in context, has the capacity or tendency to deceive an ordinary purchaser or even an ignorant, unthinking and credulous purchaser.[87] Nondisclosures as well as affirmative misstatements can constitute a deceptive practice if an overall misleading impression is created.[88]

The FTC has proceeded against a number of franchisors for violations of section 5 in connection with sales practices. For example, in *International Sales Co.*,[89] the FTC provisionally accepted a consent order prohibiting two firms from overstating franchisees' potential earnings, misrepresenting that the necessary experience and training would be provided, misrepresenting that top sales-producing locations would be found for franchisees, and misrepresenting that the firms would repurchase or help resell the business if the purchaser wished to leave it. And in *Century Brick Corp. of America*,[90] a consent order prohibited five affiliated firms from falsely claiming that (1) they had many successful dealers earning from $20,000 to over $50,000 per year; (2) the dealer would get an exclusive sales territory and would be paid if other dealers were permitted to do business in it; (3) they would pay all expenses for the dealer or his employee to visit and receive training at their home offices; and (4) they would provide dealers with free installation of machines, sales leads, and advice and assistance whenever needed.

The amount of protection against franchise sales practice abuses that the FTC can offer is dependent upon the resolution of two ques-

86. *See generally* Comment, *Deceptive Advertising*, 80 HARV. L. REV. 1005, 1038-63 (1967).

87. *Id.* at 1040-43 (and cases cited therein).

88. *Id.* at 1047-51.

89. 3 TRADE REG. REP. ¶ 19,663 (FTC June 22, 1971). The consent order also required that the firms:

> (1) write into all contracts that they may be cancelled by written notification within three days and that they are not final and binding until respondents have placed merchandise in locations satisfactory to the customer; (2) submit a report to the Commission each year for three years after the initial compliance report, describing all customer complaints received during the previous year that involve the prohibited practices and explaining the disposition of each complaint.

Id.

90. 3 TRADE REG. REP. ¶ 19,391 (FTC Oct. 27, 1970).

tions concerning the scope of its enforcement authority. The first question relates to the FTC's authority under section 5 to promulgate detailed rules and regulations that can have the force of law. The case-by-case approach to franchise abuses suffers from some of the same defects of the common law remedies: it tends to be remedial rather than preventive and does not supply comprehensive disclosure standards. The FTC has recognized the need for such standards by giving notice of a "Proposed Trade Regulation Rule Involving Disclosure Requirements and Prohibitions Concerning Franchising."[91] The Rule lists 27 items of specific information that franchisors must present to prospective franchisees in a statement.[92] It prohibits certain kinds of earnings predictions and any claim made without sufficient substantiation, and it requires a three-day "cooling-off" period following execution of the franchise agreement during which the franchisee is free to cancel without penalty.

The proposed rule is excellent in conception, but whether it can have the force of law and be binding in adjudication is not clear. The FTC explains the force of its Trade Regulation Rules as follows: "Where a trade regulation rule is relevant to any issue involved in an adjudicative proceeding thereafter instituted, the Commission may rely upon the rule to resolve such issue, provided that the respondent shall have been given a fair hearing on the applicability of the rule to the particular case."[93] Although the FTC has not been given specific "legislative" rule making authority by the Federal Trade Commission Act, section 6(g) of the Federal Trade Commission Act does empower the FTC "from time to time to classify corporations and to make rules and regulations for the purpose of carrying out the provisions" of the Act.[94] But arguably this section confers authority only to issue procedural and interpretative regulations.[95]

One commentator suggests that the best approach to this problem

91. 4 TRADE REG. REP. ¶ 38,029 (Nov. 10, 1971).

92. The substance of the items is discussed in connection with the disclosure provisions of the Washington Franchise Investment Protection Act. *See* notes 370-96 and accompanying text *infra*.

93. FTC General Procedures, 16 C.F.R. § 1.12(c) (1972).

94. 15 U.S.C. § 46g (1970).

95. *See* National Petroleum Refiners Ass'n v. FTC, 340 F. Supp. 1343 (D.D.C. 1972) *(appeal pending)*, holding that the Federal Trade Commission Act does not confer upon the FTC the authority to promulgate Trade Regulations that have the effect of substantive law. The court held that section 6(g) of the Federal Trade Commission Act "conveys only the authority to make such rules and regulations in connection with its houskeeping chores and investigative responsibilities." *Id.* at 1348.

of implied legislative rule-making authority is to determine in each statute whether "it is rational and fair to permit the determination to be made in a binding general regulation or to require that the issue remain open in each case."[96] Applying this test to the FTC's authority in the area of misrepresentation, the commentator concludes that since fraud is "traditionally outlawed by statutes or general regulations, and the likelihood of variation from case to case of the merits of defined types of advertising . . . is not great," the FTC should have implied authority to issue binding regulations protecting against misrepresentation.[97]

The second question concerning the scope of the FTC's enforcement authority relates to the remedies it can invoke.[98] The FTC only has power to enter a "cease and desist" order prohibiting prescribed future conduct.[99] Since no actual penalties are imposed until the respondent is found in a subsequent judicial proceeding initiated by the Department of Justice to have violated the order,[100] violators are allowed at least one "free bite." Since the FTC lacks authority to seek a preliminary injunction, the respondent may continue the alleged unfair practices during the long investigatory and adjudicatory period.[101] Finally, it is unclear whether the FTC has authority to require that restitution be paid to victims of deceptive practices.[102]

---

96. Fuchs, *Agency Development of Policy Through Rule-Making*, 59 NW. U.L. REV. 781, 801 (1965).

97. *Id.* at 803-04.

98. *See generally* Comment, *supra* note 86, at 1063-1101.

99. 15 U.S.C. § 45(b)-(*l*) (1970).

100. Violation of a cease and desist order carries a penalty of not more than $5000 for each violation. 15 U.S.C. § 45(*l*) (1970).

101. It may be noted that the FTC's jurisdiction is limited by the requirement that only those deceptive practices that are "in [interstate] commerce" are unlawful. 15 U.S.C. §§ 44, 45(a)(1) (1970). However, the interstate commerce requirement is rarely an obstacle in the case of franchising since most franchisors sell franchises in more than one state with similar sales tactics and literature. Such activity is sufficient to fulfill the "in commerce" requirement. Guziak v. FTC, 361 F.2d 700 (8th Cir. 1966).

102. It has long been assumed that the FTC lacks authority to order restitution or other relief to a private party. The FTC was created to remedy public, not private, wrongs. FTC v. Klesner, 280 U.S. 19 (1929). In a recent proceeding, however, the FTC claimed authority to order restitution in dicta. Curtis Publishing Co., 3 TRADE REG. REP. ¶ 19,719 (FTC June 30, 1971). It indicated that such relief would be appropriate where "the retention of the money or property of consumers may be deemed to be a continuing violation of Section 5, separate and apart from any misrepresentation or deceptive sales scheme which may be utilized by the seller." This may be the case where a consumer has been deceived into paying value for something "either worthless or of only token value." Subsequent to the *Curtis* dicta, a FTC hearing examiner ordered restitution in a franchise fraud case though personally doubting the FTC's authority. Seattle Times, March 14, 1972, at D8, col 3.

A bill introduced to the Ninety-Second Congress entitled the "Consumer Product Warranties and Federal Trade Commission Improvement Act" would significantly expand the express powers of the FTC in the area of deceptive practices.[103] First, it would expand the FTC's jurisdiction to all activities "affecting commerce."[104] Second, it would grant the FTC power to seek preliminary injunctions.[105] Third, it would grant the FTC power to initiate court actions for civil penalties against those engaged in any act with actual knowledge or knowledge fairly implied on the basis of objective circumstances that such act is unfair and deceptive and is prohibited by section 5.[106] Fourth, it would grant the FTC power to seek through court action specific redress for consumers injured by unfair or deceptive acts or practices.[107] Finally, the Act would grant the FTC power to "issue procedural and interpretive rules defining with specificity acts or practices which are unfair or deceptive to consumers." [108]

The FTC can play an important role in the prevention of franchise sales practice abuses. Stringent federal standards for disclosure in franchise sales will overcome the reluctance of states to adopt tough regulations for fear of deterring the entry of new franchise businesses. However, even if the FTC's powers are enlarged by the proposed Improvement Act, and it adopts the proposed Trade Regulation Rule, a role remains for state legislation in the area of franchise sales practice abuses. The Federal Trade Commission Act still would not provide a private civil remedy enforceable in court upon the initiative of the franchisee alone.[109]

II. GENERAL REMEDIES— UNFAIR PRACTICES BY FRANCHISORS

A fair consensus can be gathered for the proposition that the law ought to deter and remedy misrepresentations and nondisclosures in connection with the sale of franchises. No such consensus is possible

103. Title II, S. 986, 92d Cong., 1st Sess. (1971) *(as amended).*
104. *Id.* §§ 201, 205, 209.
105. *Id.* § 210.
106. *Id.* § 202.
107. *Id.*
108. *Id.* § 206.
109. Another recent bill in Congress would allow private class actions by consumers based on violations of section 5 of the Federal Trade Commission Act. S. 984, 92d Cong., 1st Sess. (1971).

for the idea that the law should go further and intervene to alter the balance of bargaining power between franchisee and franchisor. Franchisors cling to the principle of "freedom of contract": the law places the responsibility for making a definite agreement upon the parties, and courts enforce contracts with little power to alter their terms. Franchisees, on the other hand, claim that unquestioning adherence to freedom of contract allows franchisors to abuse their power to control the franchisees' businesses. Thus, franchisees urge that courts be authorized to review the fairness of the substance and use of powers reserved by franchisors regardless of the terms in the franchise agreement.

Criticism of franchisor practices stresses two areas of alleged abuse of the franchisor-franchisee relationship: (1) arbitrary exercise of powers of termination, and (2) unjustified control over franchisees' sources of supply.[110]

Termination provisions in franchise agreements are of two types. An agreement for a product and service franchise may specify no duration at all, or may be terminable at will or on short notice by the franchisor.[111] Trademark licensing franchises, on the other hand, normally are granted for a set number of years since they initially involve payment of a substantial franchise fee. However, the franchise agreement usually expressly grants the franchisor the right to terminate in the event of *any* breach by the franchisee of any of the provisions of the franchise agreement.[112] Since the typical franchise agreement imposes a myriad of detailed requirements, a franchisee is likely to be continually in breach and hence subject to termination by the franchisor. In either instance, critics argue that the franchisee, being in constant fear of termination, is subject to coercion and unfair treatment by the franchisor.[113]

110. These two complaints do not exhaust the list of unfair practices. A Senate report cites "failure by the franchisor to live up to his promises" and "unprofitable mandatory working hours imposed upon the franchisee" as other frequent abuses. *Report on the Impact of Franchising, supra* note 1, at 13-14. *See* text accompanying notes 404-56 *infra*.

111. *See, e.g.*, Division of Triple T Serv., Inc. v. Mobil Oil Corp., 60 Misc. 2d 720, 304 N.Y.S.2d 191 (1969) (service station dealership terminable on 30 days' notice during first year, on 90 days' notice thereafter).

112. *See, e.g.*, H. Brown, Franchising: Trap for the Trusting 114, 124-25 (1969) (fast food franchise for 20 years terminable if dealer fails to observe any term of the agreement).

113. Comment, *A Tempest in a Chicken Bucket: Some Reflections on Franchise Regulation in California*, 17 U.C.L.A.L. Rev. 1101, 1111-12 (1970).

The consequences of termination to the franchisee are harsh. The franchisee loses the value of the goodwill toward the franchisor's product or service, even though the goodwill may be partly attributable to the franchisee's own efforts. Also, the franchisee may be left with inventory and supplies that are of no value except in connection with the terminated franchise. Finally, the franchisee may be bound by a covenant not to compete with the franchisor in the area.[114]

Trademark licensing franchisors typically control their franchisees' sources of supply;[115] the franchisee must either buy supplies from the franchisor or from approved sources of supply. The stated reason is to maintain quality control, but critics claim that such rigid controls in fact serve merely to enrich the franchisor in the form of unreasonably high prices for supplies and "kick-backs" from suppliers.[116]

A number of possible sources of relief from alleged termination and control of supply abuses will be examined in order to assess the impact of remedies available to franchisees under the new Washington Franchise Investment Protection Act.[117] The examination includes an analysis of common law and Uniform Commercial Code contract principles, state and federal automobile dealer "day-in-court" acts, and the federal antitrust laws.

A. Common Law and Uniform Commercial Code Protection Against "Unfair Practices"

1. Termination

The common law offers franchisees little solace from arbitrary or unfair terminations by franchisors.[118] A franchise of unspecified dura-

114. Such a clause will generally be included if the franchisor provides the physical plant for the business. The clause will provide that for a specified period of time after termination and within a certain distance from the franchise location, the franchisee will not engage in the same or similar activities. The clause is often applicable regardless of the cause for termination. A franchisee has a strong case against the enforceability of such a clause if the franchisee is terminated without good cause and if the franchisee does not receive full compensation for the value of the business as a going concern. H. BROWN, *supra* note 112, at 40.

115. *See* note 7 and accompanying text *supra*.

116. *See* text accompanying notes 416-25 *infra*.

117. *See* text accompanying notes 404-57 *infra*.

118. *See generally*, Horton, *Legal Remedies of a Distributor Terminated Pursuant to a Contractual Provision of Termination upon Notice*, 3 CREIGHTON L. REV. 88 (1969); Hewitt, *Termination of Dealer Franchises and the Code—Mixing Classified and Coordinated Uncertainty with Conflict*, 22 BUS. LAWYER 1075 (1967).

tion is construed to be terminable at will.[119] If the franchise specifies the conditions under which the franchisor may terminate, he may exercise that right without any showing of good faith or fairness to the franchisee:[120]

> Dealers doubtless accept these one sided contracts because they think that the right to deal in the product of the manufacturer, even on his terms, is valuable to them; but, after they have made such contracts, relying upon the good faith of the manufacturer for the protection which the contracts do not give, they cannot, when they get into trouble, expect the courts to place in the contracts the protection which they themselves have failed to insert.

The courts refuse to intervene to correct any imbalance in power between the parties to a franchise agreement:[121]

> To attempt to redress this balance by judicial action without legislative authority appears to us a doubtful policy. We have not proper facilities to weigh economic factors, nor have we before us a showing of the supposed needs which may lead the manufacturers to require these seemingly harsh bargains.

Apparently only one state, South Carolina, has adopted a contrary position and imposed limitations on the exercise of express powers of termination. In *Philadelphia Storage Battery Co. v. Mutual Tires Store*,[122] the court concluded that a franchise or dealership "may not

119. *E.g.*, Mayflower Air-Conditioners, Inc. v. West Coast Heating Supply, Inc., 54 Wn. 2d 211, 339 P.2d 89 (1959) (terminable at will subject to giving reasonable notice); National Grocery Co. v. Santaella & Co., 160 Wash. 262, 295 P. 128 (1931); *see generally* 9 S. WILLISTON, CONTRACTS § 1017A (3rd ed. 1967); Annot., 19 A.L.R.3d 196 (1968). The Uniform Commercial Code provides that a contract of indefinite duration is valid "for a reasonable time" and termination must be with "reasonable notification." UNIFORM COMMERCIAL CODE § 2-309.

Under the "Missouri Doctrine" followed by some courts, "franchise agreements involving . . . a substantial investment by the dealer and existing for an indefinite duration cannot be terminated until after a reasonable period of time has elapsed." Gellhorn, *Limitations on Contract Termination Rights—Franchise Cancellations*, 1967 DUKE L.J. 465, 479-81 (and cases cited); *see also* Seegmiller v. Western Men, Inc., 20 Utah 2d 352, 437 P.2d 892, 894 (1968) (dicta that franchise of indefinite duration terminable only for unsatisfactory performance). The idea is to give the dealer an opportunity to recoup his investment. The Missouri Doctrine offers only limited protection to franchisees, however. It does not apply if a reasonable period has elapsed already or if termination conditions are expressly stated in the agreement.

120. Ford Motor Co. v. Kirkmajer Motor Co., 65 F.2d 1001, 1006 (4th Cir. 1932).

121. Buskwick-Decatur Motors, Inc. v. Ford Motor Co., 116 F.2d 675, 677 (2d Cir. 1940); *accord*, Rubinger v. International Tel. & Tel. Corp., 193 F. Supp. 711, 718 (1961).

122. 161 S.C. 487, 159 S.E. 825, 826 (1931). *Philadelphia Storage Battery* was fol-

be terminated, if the manner of termination be against equity and good conscience." In a recent federal decision applying the law of South Carolina, the court noted that the *Philadelphia Storage Battery* standard of conduct is "far more stringent than one forbidding only actual fraud, and it may apply to an unconscionable reason for termination as well as to the causing of needless injury in the course of termination."[123] The federal court also observed that South Carolina "may have anticipated a national trend," citing sections 2-309 and 1-203 of the Uniform Commercial Code.[124]

A number of common law contract doctrines ameliorate possible harsh effects of unlimited powers of termination. If the agreement is silent as to notice, the courts may require notice within a reasonable period prior to termination in order to give the dealer or franchisee time to make other arrangements.[125] Also the franchisee may be able to rely upon waiver or estoppel to preclude a franchisor from alleging a default by the franchisee of the type which the franchisor has ignored in the past.[126] Finally, the franchisor's attempt to retain the entire franchise fee as liquidated damages upon termination of the franchise for cause may be held void as a penalty.[127] However, these doctrines do not alter the basic common law right to terminate in accordance with the provisions of the agreement.

---

lowed in Gaines W. Harrison & Sons, Inc. v. J.I. Case Co., 180 F. Supp. 243 (E.D.S.C. 1960). In *J.I. Case Co.* the court concluded:

> With the background of Harrison's long and faithful representation of Case, the refusal to renew the dealership unless Harrison would invest a large amount of money in tractors which he did not want and would agree not to deal in any competitive line of tractors could, and evidently was, found by the jury to be so arbitrary as to lack "equity and good conscience" within the principle of the Philadelphia Storage Battery Case.

Id. at 253.

123. deTreville v. Outboard Marine Corp., 439 F.2d 1099, 1100 (4th Cir. 1971).

124. *Id.* UNIFORM COMMERCIAL CODE § 2-309(3) invalidates certain unconscionable terminations, and section 1-203 imposes an obligation of "good faith" in the performance or enforcement of every contract or duty governed by the Code.

125. Mayflower Air-Conditioners, Inc. v. West Coast Heating Supply, Inc., 54 Wn. 2d 211, 339 P.2d 89 (1959). The Uniform Commercial Code provides that in a contract of indefinite duration "an agreement dispensing with notification is invalid if its operation would be unconscionable." UNIFORM COMMERCIAL CODE § 2-309. *Compare* Mastran v. William Freihager Baking Co, 5 UCC REP. SERV. 988 (E.D. Pa. 1968), *with* Sinkoff Beverage Co. v. Joseph Schlitz Brewing Co., 51 Misc. 2d 446, 273 N.Y.S.2d 364 (1966).

126. Gellhorn, *supra* note 119, at 486-89.

127. *Cf.* Lee v. Bergesen, 58 Wn. 2d 462, 364 P.2d 18 (1961). In Educational Beneficial, Inc. v. Reynolds, 67 Misc. 2d 739, 324 N.Y.S.2d 813 (1971), the court held invalid as a penalty a "non-refundable enrollment fee" which a computer school was to retain regardless of when a student dropped. The fee bore no rational relationship to any damage the school might sustain. *See also* UNIFORM COMMERCIAL CODE § 2-718(1).

Franchisees subjected to termination might seek to rely upon the doctrines of good faith and unconscionability found in article 2 of the Uniform Commercial Code. By its terms article 2 applies only to "transactions in goods,"[128] which would not seem to cover many franchise arrangements.[129] However, courts have applied Uniform Commercial Code provisions outside its domain by analogy, reasoning that the provisions should be given the same consideration as case authority.[130]

The Uniform Commercial Code imposes a general obligation of good faith in the performance of contracts.[131] This requirement is of little assistance to the franchisee who has been terminated according to the express terms of the franchise agreement. In *Division of Triple T Service, Inc. v. Mobil Oil Corp.*, the court held that the UCC's good faith requirement "merely relates to the honesty imposed upon the parties during the *term* of the contract . . . . Consequently, unless the termination clause be deemed unconscionable there is no implicit requirement that it be exercised other than as provided for in the contract."[132]

The Code also provides that a court may either refuse to enforce a contract or clause of a contract which it finds to have been unconscionable at the time it was made or it may limit the application of an unconscionable clause to avoid any unconscionable effect.[133] There is little indication, however, that the principle of unconscionability will be used extensively to remedy unfair terminations of franchises. The comment to the Code stresses that "[t]he principle is one of the prevention of oppression and unfair surprise . . . and not of disturbance of allocation of risks because of superior bargaining power."[134] In view of this purpose, the court in *Triple T Service* held that a provision allowing an oil company to terminate an automobile service sta-

128. UNIFORM COMMERCIAL CODE § 2-102.

129. UNIFORM COMMERCIAL CODE § 2-105(1) defines "goods" as "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities . . . and things in action."

130. *E.g.*, Division of Triple T Serv., Inc. v. Mobil Oil Corp., 60 Misc. 2d 720, 304 N.Y.S.2d 191 (1969).

131. UNIFORM COMMERCIAL CODE § 1-203. The Code states: "'Good faith' means honesty in fact in the conduct or transaction concerned." *Id.* § 1-201(19).

132. 60 Misc. 2d 720, 304 N.Y.S.2d 191, 201 (1969).

133. UNIFORM COMMERCIAL CODE § 2-302(1).

134. UNIFORM COMMERCIAL CODE § 2-302, Comment 1.

tion dealership upon 30 days' notice was not unconscionable.[135] Further, the code requires the court to consider the conscionability of the contract in the light of its "commercial setting, purpose and effect."[136] Termination clauses in the franchise industry are relatively uniform and overwhelmingly favorable to the franchisor.

Commentators have urged that the doctrine of unconscionability be applied expansively in order to develop minimum standards of fairness for termination of dealerships and franchises. For example, Professor Gellhorn argues that the courts should scrutinize the reasonableness of a contract term the breach of which is the basis for an attempted termination,[137] weigh the effect of termination upon the franchisee with the effect of continuation upon the franchisor,[138] and take a flexible approach to remedies.[139] Gellhorn urges that his suggestions do not really involve any radical departure from traditional contract law principles, but rather are a mere extension of the kinds of inquiries courts have long made in judging whether liquidated damages provisions are in fact invalid as penalties.[140] Gellhorn also feels that case-by-case adjudication based on minimum standards of fairness is preferable to any elaborate and inflexible legislative rules on franchise termination such as have now in fact been adopted in Washington.[141] No court decision to date has used either the common law or the Uniform Commercial Code doctrine of unconscionability to create a stan-

135. 60 Misc. 2d 720, 304 N.Y.S.2d 191 (1969).

136. UNIFORM COMMERCIAL CODE § 2-302(2).

137. Gellhorn, *Limitations on Contract Termination Rights—Franchise Cancellations*, 1967 DUKE L.J. 465. According to Gellhorn, the courts, in testing the reasonableness of terms, should require that "the condition which 'creates' the right to terminate the agreement in one party must bear a reasonable relationship to the risks sought to be allocated and the benefits granted by the agreement." *Id.* at 512. For example, a franchisor who charges a high initial franchise fee and receives a small royalty should not be able to terminate a franchise for low sales volume since the franchisee bears most of the risk of substandard sales. *Id.* at 514.

138. In testing the effects of a particular termination, the courts should inquire "whether the harm which will or is likely to result to the terminated party from enforcing the termination provision is proportional to the harm which will or is likely to result to the terminating party if the provision is not enforced." *Id.* at 517-18. Thus, the court might weigh the expected loss to the franchisee of being ousted from business and the expected loss to the franchisor as a result of continuing the allegedly substandard franchisee.

139. For example, the courts may be reticent about forcing upon a franchisor an unwanted relationship but could condition the franchisor's right to terminate upon his offer to repurchase the franchisee's specialized equipment and inventory. *Id.* at 519-20; *cf.* WASH. REV. CODE § 19.100.180(2)(j) (Supp. 1972), discussed at notes 452-57 and accompanying text *infra*.

140. Gellhorn, *supra* note 137, at 511-21; *see* note 127 *supra*.

141. Gellhorn, *supra* note 137, at 506-07; *see* notes 452-57 and accompanying text *infra*.

dard of fairness in franchise termination such as Professor Gellhorn suggests.

2. *Control of Sources of Supply*

A franchisee required by the franchise agreement to purchase supplies from the franchisor or approved sources at unreasonably high prices can look to two possible common law remedies. The first is the doctrine of unconscionability discussed in connection with termination. More promising, however, is the law of fiduciary duties and its prohibition of realizing secret profits from a relationship of trust.

The leading case applying the law of fiduciary duties to franchising is the decision of the High Court of Justice of Ontario in *Jirna, Ltd. v. Mister Donut of Canada, Ltd.*[142] Under the agreement, the plaintiff franchisee was required to purchase "all ingredients and commodities" from the dealer or dealer-approved sources. During the negotiations for the franchise, the franchisee was assured that it would benefit from the mass purchasing power of the franchising organization. It was not disclosed to the franchisee that the franchisor would profit in any fashion from the franchisee's purchases of supplies. In fact, the franchisor negotiated secret agreements with approved suppliers to receive rebates from 5 percent to 20 percent.

The franchisee sued for an accounting of all rebates received by the franchisor. The court granted the relief. Despite the clause in the agreement that the "relationship between the parties is only that of independent contractors," the court found that a relationship of trust and confidence in fact existed. The franchisor retained almost total control over the franchisee and invited the franchisee to trust its greater experience. From this relationship of confidence flowed a fiduciary duty of loyalty on the part of the franchisor—including a duty to account for any secret profits derived from the relationship.

The Canadian court did not purport to establish any new legal principles: "[T]here is nothing new in the principles sought to be imposed. Surely all that is being done is simply to make a new application of a well-recognized principle."[143] It relied on familiar decisions, including that of Justice Cardozo in *Meinhard v. Salmon.*[144]

142. 13 D.L.R. (3d) 645 (1970).
143. *Id.* at 655.
144. 249 N.Y. 458, 164 N.E. 545 (1928) (holding that "[j]oint adventurers, like

One commentator asserts that the courts have relied upon three factors in classifying relationships as fiducial: (1) "pervasive powers held by one party"; (2) "gross disparity of the parties in a complex transaction usually of long duration"; and (3) "rampant opportunities for abuse, particularly through clandestine self-preference."[145] All three factors are present in many franchise arrangements. If a franchise is deemed to involve a fiduciary relationship, the franchisor would be restrained not only from retaining secret rebates but also from employing a wide variety of other unfair practices.[146]

While no reported American decision has yet accepted fully the notion that a franchise imposes fiduciary duties on the franchisor, no decision has squarely rejected the notion either. Common law fiduciary duties of loyalty thus remain a potential source of relief from unfair practices by franchisors.[147]

B. *The Automobile Dealers Day-in-Court Act*

Since the common law offers franchisees minimal aid in altering the balance of bargaining power with franchisors, it is no surprise that franchisees have sought refuge in legislation. Automobile dealers were the first to do so successfully. Although the Automobile Dealers Day-In-Court Act of 1956[148] applies to only a small segment of fran-

copartners, owe to one another, while the enterprise continues, the duty of finest loyalty"). *Id.* at 546.

145. Brown, *Franchising—A Fiduciary Relationship,* 49 TEXAS L. REV. 650, 655 (1971).

146. *Id.* at 670-72. Another commentator is skeptical: "[T]his theory of trust law seems even more unwieldy, limited and difficult for a plaintiff than common law fraud." Goodwin, *The Name of the Franchising Game Is: The Franchise Fee, The Celebrity or Basic Operations?* 25 BUS. LAWYER 1403, 1405 (1970). No reasons for this conclusion are given.

147. In addition to common law fiduciary duties, Washington's statutes prohibiting "corrupt influencing of agents" and "grafting by employees" may provide a source for attacking rebates and kick-backs to franchisors. The statutes make it a misdemeanor for any person to "offer . . . any compensation . . . to any agent . . . with intent to influence his action in relation to his principal's . . . business" and for any agent to "ask or receive . . . any compensation . . . upon any agreement . . . that he shall act in any particular manner in connection with his principal's business; or, being authorized to purchase . . . supplies . . . for his principal, . . . ask or receive . . . a commission . . . from any person with whom he may deal in relation to such matters." WASH. REV. CODE §§ 49.44.060-.070 (1959). It is possible to argue that a franchisor who arranges for and designates a source of supply for a franchisee is in effect acting as agent for the franchisee and hence prohibited from receiving a kick-back. *See generally,* Comment, *Control of Nongovernmental Corruption by Criminal Legislation,* 108 U. PA. L. REV. 848, 852-56 (1960).

148. 15 U.S.C. § 1222 (1970).

chisees, the accumulated experience of 16 years under the Act offers insights into the likely impact of a more general franchisor good faith statute such as section 18 of the Washington Franchise Investment Protection Act.

The Automobile Dealers Act was enacted because of persistent complaints by dealers that they were subject to unfair practices such as unreasonable sales quotas, forced purchases of unwanted cars and accessories, and restrictions on transfers of franchises.[149] Employees of the manufacturers enforced these practices under express or implied threats to exercise the manufacturer's contract right to terminate the dealership upon short notice or for unsatisfactory performance.

The Act authorizes a dealer to bring suit in federal court to recover damages resulting from the manufacturer's failure to act "in good faith in performing . . . terminating . . . or not renewing the franchise."[150] The manufacturer can defend by showing "the failure of the dealer to act in good faith,"[151] which is defined as the duty to act "in a fair and equitable manner . . . so as to guarantee the one party freedom from coercion or intimidation [or threats thereof] . . . from the other party."[152] "Recommendation" or "argument" does not constitute a lack of good faith.[153]

As to the initial construction question of whether the statutory standard of "good faith" is to be limited to lack of "coercion" or whether the statute imposes a duty of general fairness on the manufacturer, the courts adopted the former interpretation confining the statutory remedy to acts of "coercion."[154]

149. *See generally*, BROWN, *supra* note 112, at 77-86; Kessler & Stern, *Competition, Contract, and Vertical Integration*, 69 YALE L.J. 1 (1959); Kessler, *Automobile Dealer Franchises: Vertical Integration by Contract*, 66 YALE L.J. 1135 (1957); Note, *Statutory Regulation of Manufacturer-Dealer Relationships in the Automobile Industry*, 70 HARV. L. REV. 1239 (1957).

150. 15 U.S.C. § 1222 (1970).

151. *Id.*

152. 15 U.S.C. § 1221e (1970).

153. *Id.* The line between a mere "recommendation" of a course of action and a "threat" to terminate for failure to follow the recommendation is, of course, a fine one. Autowest, Inc. v. Peugeot, Inc., 434 F.2d 556, 562 (2d Cir. 1970); Note, *supra* note 149, at 1250.

154. *E.g.*, Kotula v. Ford Motor Co., 338 F.2d 732 (8th Cir. 1964); Globe Motors, Inc. v. Studebaker-Packard Corp., 328 F.2d 645 (3rd Cir. 1964); Milos v. Ford Motor Co., 317 F.2d 712 (3rd Cir. 1963).

The record of cases filed under the Dealers Act reflects this restrictive definition of "good faith." A 1965 study of 90 cases filed indicates that 24 were settled, 21 did not reach the trier of fact, 7 resulted in verdicts for the manufacturer, and 6 resulted in verdicts for the dealer (5 of which were set aside by judicial action). *See* Macaulay,

In applying the statutory remedy, the courts recognize two principles: (1) the Act was not intended to create another remedy for mere breach of contract;[155] and (2) merely showing valid reasons for terminating the franchise will not insulate the manufacturer from liability if those reasons are pretexts for coercion.[156]

The approach to the "coercion" issue has been first to examine the provisions of the franchise agreement that have been enforced against the dealer. If the provision imposed by the manufacturer is "reasonable, objective and nondiscriminatory," then its enforcement does not constitute coercion.[157] Several decisions have distinguished two types of conditions:[158] (1) those that "benefit only, or primarily, the manufacturer";[159] and (2) those that "work to the mutual advantage of both parties." The former are "particularly suspect."[160]

A wide variety of conditions have survived challenge, including requirements that the dealer (1) submit monthly financial statements, (2) maintain satisfactory and competitive business facilities, (3) meet reasonable minimum sales responsibilities, (4) provide reasonable working capital, (5) advertise in a certain way and hire more salesmen, (6) devote full time to the business, (7) relocate his facilities, and (8) obtain approval of any transfer of the dealership.[161] On the other hand, a recent decision held that "termination for failure to adhere to a manufacturer's suggested resale price to dealers" states a good cause of action under the Dealers Act.[162] Another decision found "coercion"

Changing a Continuing Relationship Between a Large Corporation and Those Who Deal With It: Automobile Manufacturers, Their Dealers, and the Legal System—Part II, 1965 WISC. L. REV. 740, 742-49 (1965). Dealers have fared somewhat better since 1965, recovering substantial monetary judgments in a number of cases. *E.g.*, York Chrysler-Plymouth, Inc. v. Chrysler Credit Corp., 447 F.2d 786 (5th Cir. 1971); Autowest, Inc. v. Peugeot, Inc. 434 F.2d 556 (2d Cir. 1970); Mt. Lebanon Motors, Inc. v. Chrysler Corp., 283 F. Supp. 453 (W.D. Pa. 1968), *aff'd*, 417 F.2d 622 (3rd Cir. 1969).

155. Globe Motors, Inc. v. Studebaker-Packard Corp., 328 F.2d 645 (3rd Cir. 1964). *Cf.* Autowest, Inc. v. Peugeot, Inc., 434 F.2d 556 (2d Cir. 1970) (a dealer must prove something more than threat to terminate lawfully).

156. York Chrysler-Plymouth, Inc. v. Chrysler Credit Corp., 447 F.2d 786, 791 (5th Cir. 1971): "The Dealers Day in Court Act contemplates a cause of action even upon the assertion of legal rights if there is failure of good faith in the exercise thereof."

157. Macaulay, *supra* note 154, at 762-73.

158. Autowest, Inc. v. Peugeot, Inc., 434 F.2d 556, 561 (2d Cir. 1970); Volkswagen Interamericana v. Rohlsen, 360 F.2d 437, 442 (1st Cir. 1966).

159. *See Autowest, supra* note 158, at 561. Examples are requirements that a dealer purchase large stocks of vehicles and parts or maintain a low gross profit margin.

160. *Id.* at 561. Examples of the latter are requirements that a dealer improve its service or managerial efficiency.

161. *See* cases cited in York Chrysler-Plymouth, Inc. v. Chrysler Credit Corp., 447 F.2d 786, 793 n.8 (5th Cir. 1971).

162. *Autowest, supra* note 158, at 561.

established by both the manufacturer's refusal to supply automobiles unless the dealer ordered unwanted models and by his refusal to credit the dealer for services performed under warranty arrangements.[163]

After examining the fairness of the franchise terms, the courts examine whether the franchise was administered fairly.[164] As Professor Macaulay observes, "manufacturers' personnel who see dealers and make decisions about the quality of their performance have some discretion, and discretion can be abused."[165] Dealers have had little success in establishing that they have been victims of a personal vendetta unrelated to legitimate business considerations because of the difficulty of presenting adequate evidence of the alleged "plot."[166] Further, it is not enough to show merely that manufacturers' personnel took personal pleasure in terminating a dealership for otherwise good cause.[167]

Where a manufacturer's lack of good faith has been shown, the courts have taken a flexible approach to remedies. In awarding damages based on loss of future profits, the decisions apply the principle that "the wrongdoer should bear the risk of uncertainty that his own conduct has created."[168] Though the Dealers Act authorizes suits to "recover the damages . . . sustained" and does not mention equitable relief,[169] the courts have implied the power to issue injunctions against wrongful termination. In affirming a temporary injunction, a recent opinion noted that the hardship to the manufacturer of continued operation of the franchise during litigation is rarely proportionate to the hardship suffered by a terminated dealer.[170] Damages are often an inadequate remedy; dealers want "to sell automobiles, not to live on the income from a damages award."[171] If the balance of hardships tips strongly toward the dealer, he need only show on the merits that seri-

163. American Motors Sales Corp. v. Semke, 384 F.2d 192 (10th Cir. 1967).
164. *See* Macaulay, *supra* note 154, at 773-79.
165. *Id.* at 774.
166. *See, e.g.*, Kotula v. Ford Motor Co., 338 F.2d 732 (8th Cir. 1964).
167. *See* Macaulay, *supra* note 154, at 775.
168. *See, e.g.*, Autowest, Inc. v. Peugeot, Inc., 434 F.2d 556, 565 (2d Cir. 1970); American Motors Sales Corp. v. Semke, 384 F.2d 192 (10th Cir. 1967); *cf.* Bigelow v. RKO Radio Pictures, Inc. 327 U.S. 251, 264-65, *rehearing denied*, 327 U.S. 817 (1946).
169. 15 U.S.C. § 1222 (1970).
170. Semmes Motors, Inc. v. Ford Motor Co., 429 F.2d 1197, 1204-07 (2d Cir. 1970) (dealer granted temporary injunction despite evidence that dealer had defrauded manufacturer).
171. *Id.* at 1205.

ous, substantial, difficult, and doubtful questions as to the termination exist in order to obtain a temporary injunction.[172]

The experience under the Automobile Dealers Act teaches that the courts are apt to be cautious in the application of any franchisor good faith legislation. They fear the adverse economic consequences to the consuming public of any guarantee of tenure to an inefficient franchisee.[173] Yet that experience also teaches that the courts can under legislative mandate develop minimum standards of fair treatment of franchisees whose independent livelihoods depend on the continuation of their franchised businesses.

C. *The Federal Antitrust Laws*

Franchisees frequently have resorted to litigation based on the federal antitrust laws in their quest for remedies for alleged unfair practices by franchisors. The purpose of the antitrust laws is the preservation of competition, not individual competitors.[174] Hence a franchisee has no antitrust remedy for an allegedly arbitrary termination or a threat of termination by a franchisor pursuing its own self-interest.[175] The franchisee may have such a remedy, however, if the franchisor's actions are taken in order to enforce agreements or practices that are themselves contrary to the antitrust laws.[176]

Since the statutory prescriptions of the federal antitrust laws are very general and stated in terms of the effect of a practice on competition, the antitrust restraints on franchising have been evolving slowly through case-by-case litigation. The litigation centers on the right of franchisors to control such matters as the franchisee's prices and sources of supply,[177] the products and services the franchisee may or

172. *Id.* at 1205-06.

173. *See* Kessler & Stern, *supra* note 149, at 107-10.

174. *See* Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962).

175. *E.g.*, Bushie v. Stenocord Corp., 460 F.2d 116 (9th Cir. 1972); Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418 (D.C. Cir. 1957); Schwing Motor Co. v. Hudson Sales Corp., 138 F. Supp. 899 (D. Md. 1956), *aff'd*, 239 F.2d 176 (4th Cir. 1956).

176. *E.g.*, Milsen Co. v. Southland Corp., 454 F.2d 363 (7th Cir. 1971) (allegations that franchisors of convenience grocery stores combined to restrain trade through tie-ins and price-fixing, that franchisors required franchisees not to buy goods from competitors, and that franchisors attempted to monopolize the wholesale and retail grocery business were sufficient to establish a prima facie case of antitrust violations).

177. *E.g.*, Wurzberg Brothers, Inc. v. Head Ski Co., 276 F. Supp. 142 (D.N.J. 1967); Susser v. Carvel Corp., 206 F. Supp. 636 (S.D.N.Y. 1962), *aff'd*, 332 F.2d 505

must offer,[178] and the territories and customers with whom the franchisee may deal.[179] Competing public interests must be balanced.[180] On the one hand, there is a public interest in free intrabrand competition in franchised goods or services and in unhampered competition for input supplies. On the other hand, there is a public interest in vigorous interbrand competition. Stressing the latter, franchisors argue that if they are unable to exercise extensive control over franchisees, the only alternative will be more costly vertical integration. This will create barriers to entry into the industry and hence lessen the competition in that industry. Recently, however, the interest in intrabrand competition seems to have attained the upper hand.[181]

1. Tying Agreements and the Chicken Delight Case

With trademark licensing franchise systems,[182] the major antitrust problem is the legality of franchisor control over the franchisee's sources of supply. The antitrust approach is now literally incorporated by reference into Washington law since the new Franchise Investment Protection Act allows only "reasonably necessary" controls over a franchisee's sources of supply and directs the courts to be "guided by" decisions under the antitrust laws in determining whether such controls are legal.[183]

Franchisor control over the franchisee's sources of supply runs into the antitrust doctrine prohibiting "tying arrangements." A tying arrangement is defined as "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product

(2d Cir. 1964); *see generally* Garlick, *Pure Franchising, Control and the Antitrust Laws: Friends or Foes?*, 48 J. URBAN L. 835 (1971).

178. FTC v. Texaco, Inc., 393 U.S. 223 (1968); *cf.* Atlantic Refining Co. v. FTC, 381 U.S. 357 (1965).

179. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967); United States v. Sealy, Inc., 388 U.S. 350 (1967).

180. *See generally* D. THOMPSON, FRANCHISE OPERATIONS AND ANTITRUST 143-47 (1971).

181. *E.g.*, United States v. Topco Associates, Inc., 405 U.S. 596 (1972) (territorial restraints incident to private brand system illegal per se under section 1 of the Sherman Act despite evidence that system enhances competitive position of independent grocers against chains).

182. *See* text accompanying note 7 *supra*.

183. WASH. REV. CODE § 19.100.180(2)(b) (Supp. 1972). *See* text accompanying notes 416-25 *infra*.

from any other supplier."[184] A tying arrangement may run afoul of either section 3 of the Clayton Act or section 1 of the Sherman Act.[185] In assessing the competitive impact of tying arrangements, the Supreme Court has relied upon the "leverage theory": "They [tying arrangements] deny competitors free access to the market for the tied product, not because the party imposing the tying requirements has a better product or a lower price but because of his power or leverage in another market."[186] Thus the theory is that tying may enable the seller to extend his power or monopolistic position in the market for the tying product over into the market for the tied product. At least one commentator has argued forcefully and at length that the Court's leverage theory does not make sense in economic terms and that tying arrangements should be declared legal except under unusual circumstances.[187] Nevertheless, the Court has not abandoned the leverage theory.[188]

In a recent decision, *Siegel v. Chicken Delight, Inc.*,[189] the United States Court of Appeals for the Ninth Circuit applied the prohibition of tying arrangements to a trademark licensing franchisor's control over his franchisee's sources of supply. *Siegel* was a treble damage antitrust class action brought by franchisees of Chicken Delight, a fast-food franchisor. The action challenged the legality of requirements in the standard franchise agreement that franchisees purchase from Chicken Delight (1) cooking equipment, (2) dip and spice mixes, and (3) trade-mark bearing paper packaging. In the trial court, the judge directed a verdict for the plaintiffs as to the packaging tying

184. Northern Pac. Ry. v. United States, 356 U.S. 1, 5-6 (1958).

185. Section 3 of the Clayton Act specifically prohibits "sale of goods . . . on the condition . . . that the . . . purchaser thereof shall not use or deal in the goods . . . of a competitor . . . of the . . . seller, where the effect of such . . . sale . . . may be to substantially lessen competition. . . ." 15 U.S.C. § 14 (1970). Section 1 of the Sherman Act prohibits generally "every contract . . . in restraint of trade. . . ." 15 U.S.C. § 1 (1970). Section 3 of the Clayton Act is limited to sales of goods. Hence tying arrangements involving services and intangibles must be judged under section 1 of the Sherman Act. Although the Supreme Court at one time indicated that a higher standard of proof was required to invalidate a tying arrangement under section 1 than under Clayton Act section 3, Times-Picayune Pub. Co. v. United States, 345 U.S. 594 (1953), the distinction has not been emphasized in later cases. Northern Pac. Ry. v. United States, 356 U.S. 1 (1958).

186. Northern Pac. Ry. v. United States, 356 U.S. 1, 6 (1958).

187. Markovits, *Tie-ins, Reciprocity, and the Leverage Theory, Part II: Tie-ins, Leverage, and the American Antitrust Laws*, 80 YALE L.J. 195 (1970).

188. *See* Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495 (1969).

189. 448 F.2d 43 (9th Cir. 1971).

arrangement, and the jury found for the plaintiff as to the cooking equipment and dips and spice mixes.[190] The judgment was affirmed on appeal although a limited new trial on the issue of damages was ordered.

In affirming the judgment, the court rejected several objections raised by Chicken Delight to the application of the tying prohibition. First, Chicken Delight claimed that its trademark franchise is not an item separate from the packaging, mixes and equipment. Rather, it offers a single package, the Chicken Delight franchise system. The court of appeals held otherwise, relying upon the change in the conception of a trademark from a "strict emblem of source" to a "representation of product quality." The "goodwill of the Chicken Delight trademark does not attach to the multitude of separate articles used in the operation of the licensed system."[191] Therefore, the franchise was held to be a distinct tying product. Second, Chicken Delight claimed that it did not have the necessary economic power in the market for the tying product to appreciably restrain free competition in the markets for the tied products, stressing the large number of fast-food franchises, including chicken franchises, in business. The court of appeals rejected this claim, reasoning that Chicken Delight's unique trademark together with its demonstrated power to impose tying arrangements justified a directed verdict on the issue.

Chicken Delight claimed that its requirements, even if they constituted tying arrangements, could be justified as reasonable restraints on three different grounds. Chicken Delight first contended that the "arrangement was a reasonable device for measuring and collecting revenue"—presumably meaning that any excess over the fair market value for the supplies was royalty to Chicken Delight for license of the franchise. The court rejected this contention because there is "no authority" for it and because other means of collecting revenue exist—such as royalties based on sales volume or fees computed per unit of time. Chicken Delight next contended that when it first entered franchising it was a new business entitled to impose tying arrangements under the "critical new business period" doctrine of *United States v. Jerrold Electronics Corp.*[192] and that transition to dif-

190. Siegel v. Chicken Delight, Inc., 311 F. Supp. 847 (N.D. Cal. 1970), *aff'd*, 448 F.2d 43 (9th Cir. 1971).

191. 448 F.2d at 49.

192. 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961). In

ferent arrangements would not be feasible. The court held that the *Jerrold* defense expired after Chicken Delight became an established franchise.

Finally, Chicken Delight contended that the tying arrangements were necessary for purposes of quality control and marketing identity. The court of appeals held that a requirement imposed in the interest of quality control and uniformity must be the "less restrictive alternative" available. Such an alternative would be written specifications of the type and quality of the supplies to be used.[193] Hence the trial court correctly directed a verdict for the plaintiffs on the question of justification as to paper packaging since the printing and color were "easily specifiable." Chicken Delight asserted that its dip and spice mixes yielded a distinct flavor and were trade secrets and that its cookers prepared food in a special manner. Hence the justification for these tying arrangements turned on disputed fact questions which were submitted to the jury. The court of appeals affirmed without extended discussion the jury's verdict that specification was practicable.

Chicken Delight is probably a correct decision, given the Supreme Court's clear indication of hostility toward tying arrangements and its acceptance of the leverage theory. Hence, the *Chicken Delight* court cannot be faulted for failing to require inquiry into the actual economic impact of Chicken Delight's arrangements such as whether a surcharge on certain supplies is more or less restrictive on competition at the retail level than a royalty on gross sales. If *Chicken Delight* is followed in other circuits, it bodes ill for direct franchisor control over sources of supply. A prior decision by the Second Circuit, *Susser v.*

Jerrold the defendant sold highly complex community antenna television systems. It sold the systems only as a whole and on condition that Jerrold install and service the system. The court held that both practices, though tying arrangements, were nevertheless legal during the initial period when Jerrold was launching a "new business with a highly uncertain future." Quality control and customer satisfaction were critical during this period. After the Jerrold system became established, however, the justification for the tying arrangements ceased.

193. The rule that quality control cannot justify a tying arrangement unless specifications are not feasible originates with language in Standard Oil Co. v. United States, 337 U.S. 293, 306 (1949): "The only situation, indeed, in which the protection of good will may necessitate the use of tying clauses is where specifications for a substitute would be so detailed that they could not practicably be supplied." The dictum was applied in Dehydrating Process Co. v. A.O. Smith Corp., 292 F.2d 653 (1st Cir. 1961), where the court held that the defendant's requirement that purchasers of an unloading device also purchase the defendant's glass-lined silo was justified by seven years of unsatisfactory experience with selling unloaders alone with specifications.

Carvel Corp.,[194] indicated that quality control might be a broad defense available to franchisors, especially in the area of food franchises where taste is "so insusceptible of precise verbalization" and specifications may be impossible to administer for hundreds of franchisees. *Chicken Delight* indicates that quality control is not so talismanic and is a question for factual inquiry in each case in which it is alleged as a justification for tying arrangements.

The extent of the recoverable damages inflicted upon franchisees by the illegal tying arrangement was a difficult question in *Chicken Delight*. The franchise agreements specified no franchise fee or royalty payments. Chicken Delight argued in the trial court that any damages represented by overcharges for the tied supplies should be reduced by the reasonable value of the Chicken Delight trademark license. The trial court rejected this argument but was reversed by the court of appeals which reasoned that the parties could not have intended that the license be granted literally free of charge. The court remanded for a new trial on damages, which were to be measured by the difference between the amount of the overcharge for the tied products and the value of the tying product (the franchise). The court rejected Chicken Delight's argument that the fair value of the franchise must necessarily be equal to the amount of the overcharges since the franchisees were willing to pay the latter to obtain the former:[195]

> The franchisees' apparent willingness to pay the ultimate cost of the arrangement is clouded by the fact that they may well have been unaware of what that cost would come to in practice. Had the full amount of the over-charge on the tied items been openly specified as the cost of the tying items, agreement might not have been forthcoming.

The court of appeals' approach to the damage issue in *Chicken Delight* casts light on the real purpose that is served by applying the antitrust prohibition of tying arrangements to franchisor control over franchisee sources of supply. Though the courts speak of preserving competition in the market for the tied product, it is beyond belief that Chicken Delight's control over its franchisees' source of paper packaging, for example, would have any significant effect on competition in the vast paper and printing industry. In fact, the prohibition of tying

---

194. 332 F.2d 505, 520 (2d Cir. 1964).
195. 448 F.2d at 52-53.

serves to protect the franchisee by forcing the franchisor to specify his compensation in a clear and open manner.

2. *Injunctions Against Franchise Terminations*

A treble-damage recovery for an antitrust violation[196] by the franchisor is an enticing prospect for franchisees. Often, however, franchisees are equally interested in preventing the termination of their businesses by the franchisor. Two recent decisions illuminate the prospects of a franchisee pressing antitrust claims against his franchisor and obtaining injunctive relief against termination. In *Helfenbein v. International Industries, Inc.*,[197] franchisees sought an injunction against their eviction from leased franchise premises on the ground that the leases required illegal tie-in agreements. They also sought to stay a pending arbitration that was to determine the amount owed by the franchisees to the franchisor for franchise fees, rent, equipment use, and goods and services furnished. The court denied a temporary injunction and stay of the arbitration even though the plaintiffs offered to pay the amounts due for rent, franchise fees, and services (the items other than the goods which were allegedly tied illegally) should they be granted an injunction against arbitration and eviction. The court felt that the plaintiffs were attempting to use their refusal to pay past due accounts coercively to impose their position on the legality of the tie-in requirements and to involve the court in the coercion.

To be contrasted with *Helfenbein* is *Milsen Co. v. Southland Corp.*[198] The franchisees brought suit against the franchisor seeking relief from illegal price fixing and tying requirements. Noting that the plaintiffs had established a prima facie case that the franchisor was engaged in illegal practices, the court granted a temporary injunction conditioned only on the franchisees keeping current the rent due for use of the franchise premises. During the litigation the plaintiff-franchisees did not have to continue paying the prescribed franchise fees for various services by the franchisor. The court found that the franchisor was using a fee-rebate system to enforce its tying arrangement for dairy products and also was not attempting to collect

196. 15 U.S.C. § 15 (1970).
197. 438 F.2d 1068 (8th Cir. 1971).
198. 454 F.2d 363 (7th Cir. 1971).

the full franchise fee unless the franchisee failed to purchase dairy supplies from the franchisor's designated source. Hence the franchise fees and the antitrust violations were connected. Following *Chicken Delight,* the court held that the franchisor could offset against any damages a reasonable value of the franchise.

Neither *Helfenbein* nor *Milsen* takes what normally would seem to be the appropriate approach to interim relief in antitrust suits by franchisees. If the plaintiff-franchisee makes a prima facie case of antitrust violations by the franchisor, the court should temporarily enjoin the franchisor from continuing the practices or terminating the franchise for the franchisee's failure to abide by illegal terms. Equitable relief is usually justified since the balance of hardship weighs heavily in the franchisee's favor and the damages caused by improper termination would be impossible to determine with precision. However, the franchisee should be required to fulfill current obligations under the franchise, including the payment of royalties and the maintenance of quality standards.[199]

3. *Unfair Franchise Practices and Section 5 of the Federal Trade Commission Act*

The impact of section 5 of the Federal Trade Commission Act on franchise sales practice abuses has already been discussed.[200] Section 5's prohibition of "unfair or deceptive acts or practices in commerce"[201] could also provide the foundation for movement by the FTC into other areas of unfair practices by franchisors, such as arbitrary terminations and reacquisitions of franchises without adequate compensation.[202]

The Supreme Court has emphasized that section 5 goes "beyond antitrust" and can cover acts and practices not in violation of the Sherman and Clayton Acts. In *Atlantic Refining Co. v. FTC*[203] for

199. *Cf.* Costandi v. AAMCO Automatic Transmissions, Inc., 456 F.2d 941 (9th Cir. 1972) (franchisees suing for damages and restitution enjoined pendente lite on franchisor's counterclaim for breach of contract from using franchisor's trademark since franchisees refused to pay fees or respect quality control procedures).

200. *See* notes 85-109 and accompanying text *supra*.

201. 15 U.S.C. § 45(a)(1) (1970).

202. *See generally* Kamenshine, *Competition Versus Fairness in Franchising,* 40 GEO. WASH. L. REV. 197, 204-13 (1971).

203. 381 U.S. 357 (1965).

example, the Court upheld the application by the FTC of section 5 to an arrangement between Atlantic Refining and Goodyear Tire under which Atlantic Refining induced its dealers to purchase Goodyear tires, batteries, and accessories from Goodyear, and Goodyear paid a ten percent commission on such sales to Atlantic Refining. The Court noted that the commission plan was not a tying arrangement in the antitrust sense since Atlantic Refining dealers were not expressly required to purchase tires, batteries and accessories. Nevertheless, it had a similar effect since Atlantic exerted not only its natural economic power over dealers but also used direct and overt threats of reprisal against dealers not purchasing Goodyear products. The Court also held that the FTC could prohibit the commission plan itself, if inherently coercive, and not just the acts of coercion on dealers. In *FTC v. Texaco, Inc.*,[204] the Court upheld FTC action against a similar commission plan between Texaco and B. F. Goodrich even though there was no evidence of acts of direct coercion or threats of reprisal. The court stressed the subtle power that Texaco had over its dealers whose franchises were subject to termination on short notice. Lower court decisions since *Atlantic Refining* and *Texaco* have held that the commission plan, though a violation of section 5, is not a violation of the Sherman Act and hence cannot support a private action for treble damages.[205]

More recently, the Supreme Court has upheld the FTC's authority to prohibit under section 5 as "unfair," acts and practices that do not even resemble antitrust violations.[206] In a case involving FTC action against a trading stamp company's efforts to stop "trafficking" in its stamps, the Court remanded to the FTC for additional findings, describing the "reach" of section 5 in expansive terms by stating that the FTC may consider "public values beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws."[207] The Court cited with apparent approval a FTC statement that in assessing the fairness of a practice it considers such factors as whether the practice is within the "penumbra of some common-law, statutory or other established concept of unfairness," whether it is "immoral, unethical,

204. 393 U.S. 223 (1968).
205. Belliston v. Texaco, Inc., 455 F.2d 175 (10th Cir. 1972); Lee Nat'l Corp. v. Atlantic Richfield Co., 308 F. Supp. 1041 (E.D. Pa. 1970).
206. FTC v. Sperry & Hutchinson Co., 405 U.S. 233 (1972).
207. 405 U.S. at 244.

oppressive or unscrupulous," and whether it "causes substantial injury to consumers . . . ."[208]

Thus, section 5 seems to provide ample authority for the FTC to define and prohibit certain franchisor practices as "unfair" to franchisees. There is evidence that the FTC has in fact informally acted to protect franchisees from unfair practices.[209] However, FTC enforcement through section 5 of standards of fairness in franchising is subject to the same remedial problems—the apparent absence of rule-making authority and private remedies—that are discussed above in connection with sales practice abuses.[210]

III. THE WASHINGTON ACT

The impetus for enactment of franchise legislation in Washington began in the Consumer Protection Division of the Washington State Attorney General's Office.[211] The Division had accumulated a number of complaints about franchisor sales and competitive practices. After investigating these complaints and reviewing the conclusions reached

---

208. *Id.* at 244 n.5.

209. FTC protection of dealers has been criticized on the ground that it may preserve inefficient dealers and franchisees and thus harm competition:

> The efforts of the Commission to protect small dealers from allegedly unfair and coercive business practices constitutes a dark chapter in the Commission's history. Much of this enforcement activity does not eventuate in formal proceedings. What happens is that a dealer who is terminated, for whatever reason, is likely to complain to the Commission, knowing that the relevant Commission staff is well disposed toward "small business." The staff uses the threat of an FTC proceeding to get the supplier to reinstate the dealer, and if threats fail—usually they succeed—the FTC may file a complaint charging the supplier with having cut off the dealer, because he was a price cutter, or for some other nefarious reason. Our impression, in sum, is that the Commission, especially at the informal level, has evolved an effective law of dealer protection that is unrelated and often contrary to the objectives of the antitrust laws. The Commission is supported in this endeavor by the Supreme Court's rulings that Section 5 of the FTC Act empowers the Commission to suppress practices that *resemble* antitrust violations.

REPORT OF PRESIDENT NIXON'S TASK FORCE ON PRODUCTIVITY AND COMPETITION (1969), *reprinted in* BNA ANTITRUST & TRADE REG. REP. No. 413, at X-3 (June 10, 1969).

In a recent proposed complaint, the FTC announced that it was considering requiring gasoline companies to alter their dealer station leases so that (1) they would be subject to cancellation only for good cause, and (2) the question of good cause would have to be submitted to arbitration. Wall Street Journal, Nov. 7, 1972, at 2, col. 3.

210. *See* notes 85-109 and accompanying text *supra*.

211. For a detailed description of the legislative history of the Act, *see* J. Fletcher, Franchise Investment Protection Act, June 1971 (unpublished thesis in University of Washington Law School Library) [hereinafter cited as Fletcher]. Mr. Fletcher was a draftsman of the Act while working as a legal intern for the Washington Attorney General's Office. His thesis contains the successive drafts of the various bills proposed with comments thereon.

by the Federal Trade Commission, the New York State Attorney General's Office, and agencies of other states which had investigated franchising, the Division concluded that protective legislation was needed.[212] A franchise bill was drafted, combining the registration and disclosure provisions of the California Franchise Investment Law[213] and the "fair practice" provisions of a bill introduced in the Massachusetts legislature.[214]

The final draft of the bill was introduced into both houses of the Washington legislature on February 19, 1971, as House Bill 938 and Senate Bill 755.[215] The House Bill died in the Business and Professional Committee.[216] The Senate Bill was reported out of the Senate Judiciary Committee, however, and passed the Senate with a few amendments to the definition of "franchise" and the "fair practices" section.[217]

Subsequently, Senate Bill 755 was reported out of the House Rules Committee.[218] On the floor of the House, franchisor interests expressed stiff opposition to the bill.[219] The result was more amendments, including the "Hertz-Avis" exemption[220] and a provision delaying the effective date of the Act from January 1, 1972 to May 1, 1972 in order to give the franchise interests another opportunity to amend the Act during the 1972 Session of the legislature.[221] As amended, the bill passed both the House and the Senate and was signed by Governor Evans.

A vigorous legislative battle over the Act was anticipated in the 1972 Session of the legislature with franchisor interest groups, including the International Franchise Association, expected to press for diluting amendments. William Clarke, Chief of the Consumer Protec-

---

212. *Id.* at 11.
213. CAL. CORP. CODE §§ 31000-31516 (West Supp. 1972).
214. Commonwealth of Massachusetts Fair Dealing In Franchising Act, H. 2279 (1970), reproduced in *Report on the Impact of Franchising, supra* note 1, Appendix M at 131.
215. Fletcher, at 44.
216. *Id.*
217. *Id.* at 46-52.
218. *Id.* at 52.
219. *Id.*
220. WASH. REV. CODE § 19.100.030(5) (Supp. 1972). This provision exempts those "engaged in the business of renting or leasing motor vehicles through an interdependent system of direct and franchised operations in interstate commerce in twenty or more states." *See* text accompanying note 307 *infra.*
221. Fletcher, at 52-57.

tion Division, vowed to defend staunchly the Act and the public interest it sought to protect.[222] In fact, the conflict was settled behind closed doors. Mr. Clarke and Attorney General Slade Gorton met with representatives of the franchise industry and reached agreement on a set of amendments which in several respects diluted the protection offered to franchisees by the Act.[223] The amendments were hastily attached to a "title-only" bill[224] and approved[225] without significant public participation.

The remainder of this Article will discuss the provisions of the Washington Franchise Investment Protection Act relating to coverage, administrative procedures, disclosure requirements, fair practice standards, and remedies for violations.

A. Coverage

1. Interstate Transactions—Choice of Law

Franchises are generally sold on a regional or national basis. Consequently, questions inevitably will arise as to the territorial coverage of the Act.[226] Since franchisors generally advertise the availability of franchises in nationally circulated media, a franchisor may sell a franchise located in Washington to a resident of another state who may or may not change his residence to Washington. Conversely, a franchisor may sell a franchise located in another state to a Washington resident. Finally, franchisors may seek to have franchise agreements with

222. Wong, *In Absence of Federal Rules, More States Begin Regulating the Franchise Industry,* Wall Street Journal, Oct. 11, 1971, at 22, col. 1-3.

223. Weakening amendments added in 1972 include several exemptions from registration, *see* text accompanying notes 302-05 *infra;* a provision apparently restricting the contents of the franchise offering circular, *see* text accompanying note 361 *infra;* a provision restricting disclosures on prior franchise failures, *see* text accompanying note 379 *infra;* a provision allowing earnings projections in franchise sales, *see* text accompanying note 385 *infra;* a provision diluting the prior prohibition of "kick-backs," *see* text accompanying note 423 *infra;* and a provision authorizing awards of attorneys' fees against suing franchisees, *see* text accompanying note 482 *infra.* On the other hand, some amendments were constructive, such as the provision on termination, *see* text accompanying note 451 *infra;* and the ban on chain distributorships, *see* text accompanying note 458 *infra.*

224. E.S.H.B. No. 417, 42d Wash. Legis., 2d Ex. Sess. (1972). A "title-only" bill is one introduced without text to meet time limits on the filing of bills. Such bills also have the effect of preventing public discussion of proposed legislation.

225. Ch. 116 [1972] Wash. Laws, 2d Ex. Sess.

226. For a general discussion of the similar problem of the territorial coverage of state securities laws, see Loss, *The Conflict of Laws and the Blue Sky Laws,* 71 HARV. L. REV. 209 (1957).

Washington residents actually executed in a different state in order to avoid the provisions of the Act.

To determine the territorial coverage of the Act, the pertinent language of its provisions must be examined. Section 2 makes it unlawful "to sell or offer to sell any franchise *in this state*" unless the offer has been registered.[227] "Offer to sell" is defined broadly to include "every attempt or offer to dispose of or solicitation of an offer to buy a franchise or an interest in a franchise."[228] Section 8 directs that "[a]ny person offering for sale or selling *within this state, whether or not one or more franchises will be located within this state* must present [certain information] to prospective franchisees forty-eight hours prior to the sale."[229] Section 10 provides that "[n]o person shall publish *in this state* any advertisements offering a franchise subject to the registration requirements of this law unless a true copy of the advertisement, has been filed . . . " seven days in advance with the administrator of the Act.[230] Section 11 provides that "[n]o person shall publish *in this state* any advertisements concerning a franchise subject to the registration requirements . . . " if the administrator has found the advertisement to be false or misleading.[231] The terms "advertisement"[232] and "publish"[233] are defined broadly in the Act.

The California Franchise Investment Law contains an adequate definition of the key phrase "in this state" which carefully spells out the territorial coverage of the law as to advertising, soliciting and selling franchises in California.[234] Unfortunately, a comparable defi-

227. WASH. REV. CODE § 19.100.020 (Supp. 1972) (emphasis added).
228. *Id.* § 19.100.010(15).
229. *Id.* § 19.100.080 (emphasis added).
230. *Id.* § 19.100.100 (emphasis added).
231. *Id.* § 19.100.110 (emphasis added).
232. " 'Advertisement' means any written or printed communication or any communication by means of recorded telephone messages or spoken on radio, television, or similar communication media published in connection with an offer or sale of a franchise." *Id.* § 19.100.010(1).
233. " 'Publish' means publicly to issue or circulate by newspaper, mail, radio, or television or otherwise to disseminate to the public." *Id.* § 19.100.010(13).
234. CAL. CORP. CODE § 31013 (West Supp. 1972):

(a) An offer or sale of a franchise is made in this state when an offer to sell is made in this state, or an offer to buy is accepted in this state, or, if the franchisee is domiciled in this state, the franchised business is or will be operated in this state.

(b) An offer to sell is made in this state when the offer either originates from this state or is directed by the offeror to this state and received at the place to which it is directed. An offer to sell is accepted in this state when acceptance is communicated to the offeror in this state; and acceptance is communicated to the offeror in this state when the offeree directs it to the offeror in this state reasonably believing the offeror to be in this state and it is received at the place to which it is directed.

nition was omitted from the Washington Act in favor of the more ambiguous provision in section 16:[235]

> Any person who is engaged or hereafter engages directly or indirectly in the sale or offer to sell a franchise or in business dealings concerning a franchise, either in person or in any other form of communication, shall be subject to the provisions of this chapter, shall be amenable to the jurisdiction of the courts of this state and shall be amenable to the service of process under RCW 4.28.180, 4.28.185 and 19.86.160.

R.C.W. §§ 4.28.180 and 4.28.185 are the Washington "long-arm" statutes which establish Washington jurisdiction over persons in other states for causes of action arising out of business or tortious conduct done within the state. R.C.W. § 19.86.160[236] is the long-arm statute of the Consumer Protection Act which allows out-of-state service of process on persons who have "engaged in conduct in violation of [the Consumer Protection Act] which has had the impact in this state which this [Act] reprehends." However inartful the draftsmanship, in most situations the legislative intent of section 16 is reasonably clear. The impact of the long-arm statutes incorporated by the Act upon sales and solicitation, advertising, and fair practices will be considered separately.

(a) Sales and Solicitation. Section 16, the "impact" language of the Consumer Protection Act and the broad definition of "offer to sell"[237] indicate that a "minimum contacts" approach should be taken in regard to the registration and disclosure provisions (sections 2 and 8) of the Act. Thus, if a Washington resident is solicited in person, by telephone, or through the mail to invest in a franchise, the offer must have been previously registered in Washington (unless exempted by the Act) regardless of the location of the franchise, the sub-

(c) An offer to sell is not made in this state merely because (1) the publisher circulates or there is circulated on his behalf in this state any bona fide newspaper or other publication of general, regular, and paid circulation which has had more than two-thirds of its circulation outside this state during the past 12 months, or (2) a radio or television program originating outside this state is received in this state.

235. WASH. REV. CODE § 19.100.160 (Supp. 1972).

236. "Personal service of any process in an action under this chapter may be made upon any person outside the state if such person has engaged in conduct in violation of this chapter which has had the impact in this state which this chapter reprehends." WASH. REV. CODE § 19.86.160 (Supp. 1972).

237. *See* note 228 and accompanying text *supra*.

sequent negotiations or the actual signing of a franchise agreement.[238]

A closer question is whether the registration and disclosure provisions of the Act should apply whenever the franchise is to be located in Washington. The California law would apply to franchises located in the state only if the franchisee is domiciled in the state or the offer to sell or buy is made in the state.[239] It can be argued that the Washington Act did not intend to offer protection to residents of other states who make franchise investments in Washington. On the other hand, such a construction might encourage franchisors to sell all their Washington franchises to residents of other states, thereby depriving Washington residents of advantageous business opportunities.[240] On balance, however, the approach of the California law should be followed.

(b) Advertising. The Act requires franchise advertisements to be filed with the administrator of the Act seven days prior to publication (section 10)[241] and prohibits the publication of advertisements which the administrator has found to be misleading (section 11).[242] In the original draft of the bill, section 10 (prefiling) was applicable only to persons who "publish in this state any advertisement concerning a franchise subject to the registration requirements" of the Franchise Act while section 11 (administrative control) was applicable to all persons who "publish in this state any advertisement concerning a franchise."[243] The purpose of these sections apparently was to give the administrator control over all misleading franchise advertising dissem-

238. The constitutionality, under the commerce clause and due process clause of the United States Constitution, of applying the Washington Act broadly to all solicitations of Washington residents wherever their origin seems assured. *See* Travelers Health Ass'n v. Commonwealth *ex rel.* State Corp. Comm'n, 339 U.S. 643 (1950); Merrick v. N.W. Halsey and Co., 242 U.S. 568 (1917); *see also* Loss, *supra* note 226, at 226-27.

239. "An offer or sale of a franchise is made in this state when . . . if the franchisee is domiciled in this state, the franchised business is or will be operated in this state." CAL. CORP. CODE § 31013(a) (West Supp. 1972).

240. It should be noted that Washington has expressed an interest in avoiding the adverse "impact" on Washington residents which results from the unscrupulous business dealings of any nonresidents. WASH. REV. CODE § 19.86.160 (Supp. 1972). The resulting "impact" arguably could come indirectly from the injury to the nonresident franchisee operating in Washington.

241. WASH. REV. CODE § 19.100.100 (Supp. 1972), discussed at notes 346-52 and accompanying text *infra.*

242. WASH. REV. CODE § 19.100.110 (Supp. 1972), discussed at notes 346-52 and accompanying text *infra.*

243. *See* Fletcher, *supra* note 211, at Appendix H. The provisions were copied from the California Franchise Investment Law. CAL. CORP. CODE §§ 31156-57 (West Supp. 1972).

inated in the state—even if the franchisor was exempt or otherwise not subject to the registration requirement. When the original bill reached the floor of the Senate, concern was expressed that section 11 might impose an "unconstitutional burden on interstate commerce with respect to those advertisements published in national magazines and merely distributed in Washington."[244] Consequently, section 11 was amended so as to apply only to advertisements "subject to the registration requirement."

The constitutional problem alluded to is probably not substantial.[245] In any event, the amendment is inept considering its purpose. First, it goes beyond its purpose by freeing from any administrative control advertising of franchises offered in Washington but exempt from registration. Second, it did not really accomplish its purpose. The issue is complex due to the draftsmen's failure to recognize that virtually any "advertisement" also constitutes an "offer to sell" a franchise within the meaning of the Act.[246] An advertisement is an "offer to sell" a franchise which can be made in the state only if it is registered or exempt from registration.[247] Hence an advertisement in a nationally circulated newspaper or magazine often would be subject to the registration requirement of the Act as an "offer to sell" and a fortiori not removed from sections 10 and 11.

The proper path around this labyrinth would have been to leave sections 10 and 11 as they were in the original draft but to limit carefully the scope of "offer to sell" so as to exclude advertisements in na-

244. Fletcher, *supra* note 211, at 49.

245. *Cf.* note 238 *supra*.

246. Franchise advertisements are "offers" under the Act. *Compare* WASH. REV. CODE § 19.100.010(1) (Supp. 1972) *with* § 19.100.010(15). This seems clear from the comparable treatment of advertisements under the state and federal securities acts. "Offer" is defined in the securities statutes in a fashion virtually identical to the Washington Franchise Investment Protection Act. *See* 15 U.S.C. § 77b(3) (1970); WASH. REV. CODE § 21.20.005(10) (Supp. 1972). An advertisement indicating availability of a security has long been considered an "offer." *See, e.g.*, Securities Act Release No. 3844 (Oct. 8, 1957). All advertising of securities is severely confined under federal law by the requirement that written offers be made only in a complete statutory prospectus. It is generally not feasible to place all the information required to be in a prospectus in an advertisement. The only advertising allowed under federal law is the so-called "tombstone ad" which merely identifies the security and where to obtain a prospectus. SEC Rule 134, 17 C.F.R. § 230.134 (1972). Washington law is more liberal than federal law in that written offers of securities can be made after registration by means of public advertisements so long as a buyer receives a prospectus before the sale is consummated. WASH. REV. CODE § 21.20.230 (Supp. 1972). This same liberality toward advertisements is followed in the Washington Franchise Investment Protection Act.

247. *See* note 246 *supra*.

tionally circulated newspapers and magazines. This was done in the California Franchise Investment Law.[248] The failure of the draftsmen of the Washington Act to follow suit is inexcusable. A similar result perhaps can be achieved through a salvaging construction of "offer to sell."[249] As a precaution, franchisors not registered in Washington should include in their advertisements disclaimers voiding the offer to Washington residents as is the common practice with securities advertisements.[250]

Only advertisements in a national publication should be exempt from the Act's registration provisions. If a Washington resident responds to such an advertisement, no reply by the franchisor should be permitted unless the franchisor has complied with the Act.[251]

(c) Fair Practices Provisions. Section 18 of the Act attempts to regulate the continuing relationship between the franchisor and franchisee, imposing both specific and general requirements that the parties deal with each other in good faith.[252] The Act does not indicate the territorial coverage of section 18. It would seem, however, that the state where the franchise is actually located usually has the greatest interest in a transaction which creates a continuing relationship between a franchisor and a franchisee.[253] This would be especially true if the state where the franchise is located is also the franchisee's current domicile. Since the law of the situs state generally applies to questions of performance of the franchise agreement,[254] section 18 should be construed as applying to all franchises located in Washington, re-

---

248. CAL. CORP. CODE § 31013(c) (West Supp. 1972):

> An offer to sell is not made in this state merely because (1) the publisher circulates or there is circulated on his behalf in this state any bona fide newspaper or other publication of general, regular, and paid circulation which has had more than two-thirds of its circulation outside this state during the past 12 months, or (2) a radio or television program originating outside this state is received in this state.

249. "Offer to sell" should not, however, be narrowed so as to exclude all advertisements. Franchisors should be prohibited from publishing advertisements in local media or utilizing direct mail advertising unless they have complied with the Act's registration requirement.

250. It is not clear whether such a self-serving legend is in fact effective to prevent an advertisement from being an "offer." *See* 1 L. LOSS, SECURITIES REGULATION 242-43 (2d ed. 1961).

251. Such a reply would be an "attempt to dispose of a franchise" and thus an "offer to sell." WASH. REV. CODE § 19.100.010(15) (Supp. 1972).

252. *Id.* § 19.100.180(1).

253. The Washington courts follow the "center of gravity" or "most significant relationship "approach to the contract choice of law problem. Baffin Land Corp. v. Monticello Motor Inn, Inc., 70 Wn. 2d 893, 425 P.2d 623 (1967).

254. RESTATEMENT (SECOND) OF CONFLICTS OF LAW § 196 (1971).

gardless of where the franchise agreement was negotiated and executed.

If a clause in a franchise agreement attempts to apply the law of another jurisdiction in a situation in which the Washington Act would otherwise apply, the clause should be invalid under section 22 of the Act which voids any "provision purporting to bind any person acquiring a franchise at the time of entering into a franchise . . . agreement to waive compliance with any provision" of the Act.[255]

2. *Definition of a "Franchise"*

Adequately defining the term "franchise" is one of the most difficult tasks in drafting franchise legislation.[256] Attempted definitions tend to be both over- and under-inclusive in terms of solving the problems and abuses which have been the impetus for franchise legislation. The primary legislative concern has been with "franchises" sold on a broad scale as prepackaged businesses with goodwill already generated by the franchisor to persons of relatively modest means and limited sophistication. The typical promotion of these franchises offers employment and entrepreneurial opportunities to persons without general or specific business experience.

The Washington Act defines a franchise as an "agreement . . . in which a person grants to another person, a license to use a trade name, service mark, trade mark, logotype or related characteristic in which there is a community interest in the business of offering . . . goods or services . . . and in which the franchisee is required to pay . . . a franchise fee . . . ."[257] "Franchise fee" is then defined in an elaborate fashion to include generally any capital investment fee, royalty-type payment, payment for the mandatory purchase of goods or services, training or training school fee or other payment. Excluded from the definition of "franchise fees" are amounts realized from purchases or leases of property at a fair market or rental value and from bona fide wholesale transactions.[258] The Washington defini-

255. WASH. REV. CODE § 19.100.220 (Supp. 1972).

256. *See* H. BROWN, FRANCHISING: TRAP FOR THE TRUSTING 3-4 (1969); D. THOMPSON, *supra* note 3, at 7-17.

257. WASH. REV. CODE § 19.100.010(4) (Supp. 1972).

258. *Id.* § 19.100.010(11). It is important to note that a required payment for *services*, even at reasonable value, is not excluded. Thus the typical charge to franchisees for advertising of the franchise system would constitute a "franchise fee."

tion is similar but not identical to the definitions in the California Franchise Investment Law[259] and the proposed Federal Trade Commission Rule.[260]

Given the concern of the legislature with franchise sales practice abuses and other unfair practices by franchisors, the definition of "franchise" in the Washington Act is under-inclusive in two respects. First, there is no justification for requiring that the agreement include a license to use a *trademark* or "related characteristic." It is true that *most* franchises sold involve such a license. But a person might be induced to make a substantial investment in a prepackaged business to be conducted in his own name as an outlet for the franchisor's goods or services. Simply selling goods which bear the franchisor's trademark does not constitute a licensed "use" of the trademark.[261] In this respect, the FTC's definition seems preferable as it requires only that there be a "continuing commercial relationship . . . under circumstances where the franchisor continues to exert any control over the method of operation of the franchisee," with control through a trademark license being just one example of such control.[262]

Second, there does not seem to be adequate justification for requiring that there be a "franchise fee" as defined in the Act. It is true that "franchise fee" is defined broadly to include franchisors who might attempt to extract a hidden fee in the form of overcharges for property sold to the franchisee. But the risk that a relatively unsophisticated person will make a substantial investment in a prepackaged

259. CAL. CORP. CODE § 31005 (West Supp. 1972):

"Franchise" means a contract . . . between two or more persons by which: (a) a franchisee is granted the right to engage in the business of offering . . . goods or services under a marketing plan or system prescribed in substantial part by a franchisor; and (b) the operation of the franchisee's business is substantially associated with the franchisor's trademark . . . or other commercial symbol designating the franchisor . . . ; and (c) the franchisee is required to pay . . . a franchise fee.

260. Federal Trade Commission, *Proposed Trade Regulation Rule Involving Disclosure Requirements and Prohibitions Concerning Franchising, Definitions,* 5 TRADE REG. REP. ¶ 50,310 (Nov. 10, 1971) [hereinafter cited as Proposed FTC Rule]:

"Franchise" means every aspect of the relationship between a franchisor and a franchisee by an . . . agreement . . . which involve [s] . . . a continuing commercial relationship by which a franchisee is . . . permitted to offer . . . the goods . . . manufactured, processed, or distributed by the franchisor, or the right to offer . . . services established, organized, directed, or approved by the franchisor, under circumstances where the franchisor continues to exert any control over the method of operation of the franchisee, particularly, but not exclusively, through trademark, trade name, or service mark licensing, or structural or physical layout of the franchisee's business.

261. *See* note 6 *supra.*

262. *See* note 260 *supra.*

franchise business (including real property, fixtures and inventory) without adequate information exists whether or not a franchise fee as defined in the Act is charged. The original draft of the Washington Act did not include any requirement that there be a franchise fee. The requirement was added on the floor of the Senate in response to lobbying pressure by business groups such as the Washington Business Association.[263] Apparently, the reason for the pressure was the concern of firms such as Sears, Penney's and Montgomery Ward that some of their branch stores would be covered under the original definition of a franchise.[264] Again, the FTC's definition seems preferable, as it does not require payment of a franchise fee.[265]

On the other hand, the definition of a "franchise" in the Washington Act seems over-inclusive in at least one respect: it is not confined to prepackaged and standardized businesses.[266] Consider, for example, an organization that sells cleaning solvent to local dry cleaners and prescribes and enforces quality service standards. In return, a local subscribing dry cleaner is granted the right to display a regionally or nationally advertised symbol of quality.[267] If a fee is charged for the quality control, or the advertising, the arrangement would seem to constitute a "franchise" within the meaning of the Washington Act. Yet such an arrangement is not the sort of standardized, prepackaged franchise sold to persons not previously in the trade that concerned the Washington legislature. In this respect, the California Franchise Investment Law's definition seems preferable. It requires that the agreement grant "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 a franchisor."[268]

263. *See* Fletcher, *supra* note 211, at 45-49.
264. *Id.*
265. *See* note 260 *supra*. The effect of the narrow definition of a franchise in allowing easy evasion of the Franchise Act's protective provisions was publicized in a recent article on a couple who lost over $9000 on "distributorships." They were not protected by the Act since the distributorships involved no "franchise fee"—merely large investments in inventory. Schwartz, *The Sad Story of 'Mr. and Mrs. Gullible,'* Seattle Times, Nov. 19, 1972, at A-16, col. 1-8.
266. The Proposed FTC Rule suffers from the same kind of over-inclusiveness in that it covers continuing commercial relationships where the franchisor "continues to exert *any* control over the method of operation of the franchisee." *See* note 260 *supra* (emphasis added).
267. Such a symbol of quality may be federally registered under the Lanham Act as a "certification mark." 15 U.S.C. § 1054 (1970).
268. *See* note 259 *supra* (emphasis added).

3. *Exemptions*

The Washington Franchise Investment Protection Act contains several exemptions. First, the general definition of "franchise" exempts a number of specific relationships,[269] thereby removing them entirely from the provisions of the Act. Second, various types of franchise transactions are unconditionally exempt from the registration requirements of sections 2 and 4,[270] while other specified transactions are exempt from the registration requirement only if the franchisor discloses information to the franchisee similar to that which would be required in the registration.[271] Finally, the Act exempts one special type of franchise from both the registration and fair practices sections,[272] leaving such franchises subject only to the antifraud section of the Act.

(a) Exempt Relationships. The Act excludes three types of relationships from the definition of a "franchise."[273] The first exclusion is for "the payment of a reasonable service charge to the issuer of a credit card by an establishment accepting or honoring such credit card or any transaction relating to a bank credit card plan."[274] This exclusion is seemingly necessitated by the over-inclusiveness of the definition of a "franchise."[275] Credit card agreements between issuing companies and merchants do involve a continuing commercial relationship, a license to use a symbol, and a "franchise fee." However, while there are some problems with these agreements, they are not of the same dimension as those connected with the typical prepackaged franchise business that concerned the Washington legislature.[276] The

269. WASH. REV. CODE § 19.100.010(4)(c) (Supp. 1972).
270. *Id.* § 19.100.030(1)-(3).
271. *Id.* § 19.100.030(4).
272. *Id.* § 19.100.030(5).
273. *See* note 269 *supra*. These exclusions appear to be the obvious result of the powerful lobbying efforts of banks, insurance companies, and automobile manufacturers.
274. WASH. REV. CODE § 19.100.010(4)(a) (Supp. 1972); *cf.* CAL. CORP. CODE § 31103 (West Supp. 1972). "Bank credit card plan" is defined in WASH. REV. CODE § 19.100.010(5) (Supp. 1972). This exclusion was added as part of the 1972 amendment package.
275. *See* note 266 and accompanying text *supra*.
276. Agreements between merchants and credit card issuers usually include restrictive clauses which preclude retailers from offering merchandise at reduced prices to persons willing to pay cash rather than use a credit card. There is also evidence of pressure by banks on retailers to maintain an account with the bank issuing the card. *See* Comment, *Price Fixing and Tying Arrangements Between Credit Card Issuers and Retailers,*

first half of the exclusion is really an exception to the definition of a "franchise fee," but questions may arise as to what is a "reasonable service charge." Presumably, the typical "discount" which credit card companies such as Carte Blanche, American Express, and Diner's Club deduct from the sales volume charged on their cards will be viewed as a reasonable service charge. The second half of the exclusion is broader in scope. The intent is to exclude not only agreements between local banks and merchants but also agreements between local banks and the national interchange system for cards such as Bank-Americard and Master Charge.[277]

The second exclusion from the definition of a "franchise" covers "actions or transactions otherwise permitted, prohibited or regulated under laws administered by the insurance commissioner of this state."[278] The apparent intent is to exempt from regulation under the Act relationships between insurance companies and their agents and brokers. The exemption cannot be justified by asserting that regulation equivalent to that provided by the Franchise Act is imposed by the insurance commissioner. Although the state insurance laws regulate the business of insurance generally and provide for the licensing of insurance agents and brokers,[279] the purpose of such regulation is to protect the public and not to control either the procurement of agents and brokers by insurance companies or the continuing relationship between the parties.[280] The exemption may be justified, however, on the ground that these types of relationships have not been shown to involve the kinds of problems that led to the enactment of the Franchise Act. Further, the public interest in insurance practices may dictate that no additional protection against termination be afforded to brokers and agents beyond that afforded by the common law.[281]

---

28 WASH. & LEE L. REV. 371 (1971). Such agreements do not, however, involve the kind of pervasive control over the merchant's business as is involved with the typical franchise.

277. For general discussions of bank charge cards, *see* Brandel & Leonard, *Bank Charge Cards: New Cash or New Credit?*, 69 MICH. L. REV. 1033 (1971); Webster, *Bank Charge Cards—Recent Developments in Regulation and Operation,* 26 BUS. LAW. 43 (1970).

278. WASH. REV. CODE § 19.100.010(4)(b) (Supp. 1972). This exclusion was added as part of the 1972 amendment package.

279. WASH. REV. CODE §§ 48.17.010-.580 (1959).

280. *See* 16A J. APPLEMAN, INSURANCE LAW AND PRACTICE § 8951 (rev. ed. 1968).

281. The danger to the consuming public of granting any kind of tenure to an insurance agent who may be incompetent or unscrupulous may outweigh any legitimate interests of the agent in fair treatment to an extent not present in other industries.

The final exclusion from the definition of a "franchise" covers "any motor vehicle dealer franchise subject to the provisions of chapter 46.70 RCW."[282] This exclusion was apparently predicated on the assumption that adequate regulation of motor vehicle franchising already exists under Washington's "baby" Automobile Dealers Act.[283] However, the Motor Vehicle Dealers Act, unlike the Franchise Act, does not address itself to problems with the *sale* of franchises to local dealers. Nevertheless, while sales practice abuses in this area are not unknown,[284] they do not appear to have been a persistent problem. Therefore, exclusion of motor vehicle dealerships from the Franchise Act is probably justifiable.

(b) Unconditionally Exempt Transactions. The Washington Franchise Investment Protection Act exempts three types of transactions from its registration requirement: (1) isolated franchise sales by a franchisee;[285] (2) transactions by executors, sheriffs, receivers, and the like;[286] and (3) sales to financial institutions or to broker dealers where the purchaser is acting for itself or in some fiduciary capacity.[287] These exemptions are substantially identical to the exemptions con-

---

Furthermore, an insurance agent is a catalyst for direct dealing between his clients and insurance companies. This is not the case with franchises in other industries.

282. WASH. REV. CODE § 19.100.010(4)(c) (Supp. 1972). In the 1971 Act the exemption for motor vehicle dealers was contained in section 3 of the Act and was an exemption from the registration provisions of the Act only. The 1972 amendment package made it an excluded relationship, thereby lifting it out of the Franchise Act entirely. *Compare* ch. 116. § 1(4)(c) [1972] Wash. Laws, 2d Ex. Sess. *with* ch. 252, § 3(5) [1971] Wash. Laws, 1st Ex. Sess.

283. WASH. REV. CODE §§ 46.70.180(7), (8), .190-.210 (1969). For a discussion of the Federal Automobile Dealers Act, *see* text accompanying note 148 *supra*. Although Washington's Act is basically similar to the Federal Automobile Dealers Act, it does differ in several specific respects. First, it applies to all "motor vehicle" dealers (defining "motor vehicle" as every device which is self-propelled and capable of being moved upon a public highway (WASH. REV. CODE §§ 46.04.320, .670 (1959)) and not solely to automobile dealers. Second, it is more specific in defining impermissible practices, listing for example, coercion against dealers to order vehicles or parts that they do not desire. WASH. REV. CODE § 46.70.180(7)(a) (1969). Third, it provides almost automatic *ad litem* relief to the dealer from cancellation by the manufacturer. WASH. REV. CODE § 46.70.210 (1969). Finally, it seems to allow free cancellation by the manufacturer not in good faith so long as the dealer is compensated "at a fair going business value for his capital investment." WASH. REV. CODE § 46.70.180(7)(b) (1969). There are no reported appellate opinions interpreting the Washington Motor Vehicle Dealers Act of 1967.

284. One of the most famous episodes was the Tucker car promotion in 1946-47. Tucker raised over $4,000,000 by selling franchises to prospective distributors and dealers. *See In re* Tucker Corporation, 26 S.E.C. 249, 252-53 (1947). The streets of America, of course, were never blessed with the Tucker car.

285. WASH. REV. CODE § 19.100.030(1) (Supp. 1972).

286. *Id.* § 19.100.030(2).

287. *Id.* § 19.100.030(3).

tained in the Washington Securities Act.[288] The first is justified by the franchisee's interest in being able to liquidate his franchise investment without incurring the burden of registration.[289] The exemption is overbroad, however. If the franchisor is already registered to sell franchises in the state, the franchisor should be required to supply information to the franchisee's transferee and should be subject to the remedial provisions of the Act just as if the franchisor sold directly to the transferee. In addition, the exemption should be limited to transactions "wholly free of any involvement by the franchisor."[290] If the franchisor participates in the transfer, it is appropriate to require the franchisor to register and supply the required disclosures to the franchisee's transferee.

The second exemption for transactions by executors, sheriffs, receivers and the like is of questionable wisdom insofar as it may allow sales of franchises beyond those exempted under the "isolated sale" exemption. The third exemption for sales to financial institutions and broker dealers is justified by the high level of buyer sophistication and the correspondingly low need for the protection which registration provides.

(c) Conditional Exemptions. The Act provides three conditional registration exemptions for franchisors whose offerings meet prescribed requirements.[291] All three exemptions are conditioned upon (1) the franchisor's providing timely information to the prospective franchisee similar to that required in a registration statement filed with

288. *Id.* § 21.20.320(1), (6), (8).

289. The "isolated sale" exemption in state securities acts has been narrowly construed. *See* 1 L. Loss, SECURITIES REGULATION 61 (2d ed. 1961). A franchisee holding more than one franchise probably is not freed by the exemption to dispose of them without registration. There is some question whether this Securities Act exemption is superfluous when incorporated into the Franchise Act. The registration requirement of the Franchise Act only applies to "any *franchisor or subfranchisor*" who offers or sells franchises in the state. *Id.* § 19.100.020 (emphasis added); *cf.* CAL. CORP. CODE § 31110 (West Supp. 1972) ("unlawful for *any person* to offer or sell any franchise . . . .") (emphasis added). A franchisee in selling his franchise would appear not to be within the definition of either a "franchisor" (one "who grants a franchise," WASH. REV. CODE § 19.100.010(7) (Supp. 1972)) or a "subfranchisor" (one who is granted the right to sell franchises on behalf of the franchisor, *id.* § 19.100.010(8), (9)). However, the insertion of the exemption would indicate that the legislature must have intended a broader interpretation of the registration requirement than the language of the statute otherwise might indicate. *Cf.* WASH. REV. CODE §§ 19.100.080, .140 (Supp. 1972).

290. Proposed FTC Rule, 5 TRADE REG. REP. ¶ 50,310 (Nov. 10, 1971); *cf.* CAL. CORP. CODE § 31102 (West Supp. 1972) ("sale of a franchise by a franchisee for his own account . . . if the sale is not effected by or through a franchisor").

291. WASH. REV. CODE § 19.100.030(4)(a)-(c) (Supp. 1972).

the director[292] and identical to that which must be provided to prospective franchisees in a registered offering,[293] *and* (2) the franchisor's not having been found by a court to have violated the Franchise Act, the State Consumer Protection Act or "any of the various federal statutes dealing with the same or similar matters" in the last seven years.[294] The effect of the conditional registration exemptions is threefold. First, the franchisor need not pay the registration fee.[295] Second, the franchisor need not provide any additional information required by the statute or the director.[296] Finally, the franchisor is not subject to certain administrative powers of the director, including the power to require an escrow of franchise fees[297] and the power to issue a stop order halting the sale of franchises on various grounds.[298] Since the burdens alleviated by these conditional exemptions do not appear to be excessive for the legitimate franchisor, all the conditional exemptions are of questionable wisdom.

The first conditional exemption is for franchise offerings which meet three additional tests: (1) the franchisor or its parent corporation has a net worth of more than $5 million; (2) the franchisor or its parent corporation has operated the business for at least five years either directly or through 25 or more franchises; and (3) the franchisor requires an initial investment in excess of $100,000.[299] A franchisor

292. *Id.* § 19.100.030(4)(a). The registration statement specifically includes three items which are not required to be disclosed by the conditional exemption: (1) information on the identity and business experience of persons affiliated with the franchisor which the director may require by rule, *id.* § 19.100.040(4); (2) a statement whether any person identified in the registration statement has been found guilty of specified kinds of misconduct, *id.* § 19.100.040(5); and (3) financial statements of the franchisor, *id.* § 19.100.040(7). The director also is given discretion to require information in the registration statement in addition to that specified in the statute, *id.* § 19.100.040(20), but no similar power is given the director to expand the disclosure required under the conditional exemption. *See* notes 360-69 and accompanying text *infra.*

293. The Act expressly requires disclosure to prospective franchisees of the materials specified in WASH. REV. CODE § 19.100.030(4)(a) (Supp. 1972). *Id.* § 19.100.080.

294. *Id.* § 19.100.030(4)(c). The second condition is intended to limit the exemptions to "good guys" with clean records, but it is both ambiguous and incomplete. It omits violations of similar laws in other states and violations found by administrative agencies rather than courts. It is unclear what is included within the "various federal statutes," although the Federal Trade Commission Act is clearly one of them. The exemption obviously was hastily drafted. A better "good guy" test is the more carefully constructed "prior record" statement required in registration statements under the Act. *Id.* § 19.100.040(5).

295. *Id.* § 19.100.240.

296. *See* note 292 *supra.*

297. WASH. REV. CODE § 19.100.050 (Supp. 1972).

298. *Id.* § 19.100.120. *See* notes 320-24 and accompanying text *infra.*

299. WASH. REV. CODE § 19.100.130(4)(b)(i) (Supp. 1972). The Act does not

claiming this particular exemption must file a statement giving notice of such claim with the director.[300] The exemption appears to be a narrow one; in a 1970 publication by the United States Department of Commerce, data on 274 franchise offerings indicated that only six franchisors required $100,000 or more in "equitable capital."[301] The theory of the exemption is that franchisors with a large and established reputation are unlikely to engage in sales practice abuses, and franchisees making such large investments are likely to be able to fend for themselves.

The second conditional exemption is for franchisors who have offered or are offering[302] for sale fewer than ten franchises in the state

directly define "initial investment," and the term does not appear to have any independent legal significance. Its meaning is narrower than the term "estimated total investment" in the two disclosure provisions, *id.* §§ 19.100.030(4)(a)(vi), .040(9). "Estimated total investment" is defined to include the initial franchise fee and other fees (whether payable in one sum or in installments), working capital, deposits, prepaid expenses, fixed assets, (however financed), real property (however financed), leases for real property or fixed assets, and "all other goods and services which the franchisee will be required to purchase or lease." *Id.* "Initial investment" should include the immediate cash outlay required of the franchisee. A key question is whether "initial investment" should also include property purchased by the franchisee and financed through contract, installment purchase or lease. Since the figure of $100,000 is substantial, it seems likely that the legislature did intend to include the cost of property financed and the present value of leases on real and personal property. Items such as fees payable in installments should not be included, however.

The exemption has proven to be somewhat difficult to apply where franchisors do not set a minimum dollar investment. Kentucky Fried Chicken, for example, wrote that it "does not require a franchisee to invest a specific sum of money in his business. However, a favorable location site, a specified type of building, and certain specified equipment are required. We believe that the land, building and equipment would certainly represent an investment in excess of $100,000. However, franchisees are not required to disclose the amount of their investment to the Company." (Letter from Kentucky Fried Chicken to Bernard G. Lonctot, August 21, 1972). The administrator of the Act responded that the tests of the exemption did not appear to have been met. (Letter from Bernard G. Lonctot to Kentucky Fried Chicken, August 23, 1972). This conclusion seems correct in the light of the Act's requirement that "the burden of proving an exception or an exemption from definition is upon the person claiming it." WASH. REV. CODE § 19.100.220 (Supp. 1972).

300. An examination of the claims of exemptions filed with the director reveals that this exemption applies to few franchisors that are not also exempt under the second conditional exemption (10 or fewer franchises). If a franchisor requires a minimum investment of $100,000 or more, it is unlikely to have sold or be offering more than ten franchises in the state of Washington.

301. UNITED STATES DEPARTMENT OF COMMERCE, FRANCHISE COMPANY DATA (1970). The six are: Airway Rent-A-Car System (car rentals), Redi-Spuds of America (food processing), Gamble-Skogmo (general merchandising store), Holiday Inns (motel-hotel), Quality Courts Motels (motel-hotel), and Sheraton Inns (motel-hotel).

302. WASH. REV. CODE § 19.100.030(4)(b)(ii) (Supp. 1972). The statute is grammatically defective, reading "has and is offering for sale fewer than ten franchises." What is intended (apparently) is that a franchisor may offer and sell up to 10 franchises in the state after which he may sell no more—ever—without registering or finding another exemption. The exemption is presumably not available to a franchisor who sold ten franchises prior to enactment of the Act. *Cf.* WASH. REV. CODE § 19.100.900 (Supp. 1972).

of Washington and who do not advertise franchises in any advertising medium located in Washington or Oregon.[303] This exemption allowing up to "ten bites" is unsound on policy grounds. A prospective franchisee's need for the protection offered by registration under the Act does not depend on the number of franchises a franchisor is offering in Washington. The financial burden of registration is not so great as to unduly hamper franchisors who make a small number of offerings in the state. This exemption, added to the Act as part of the 1972 amendment package, seemingly reflects the lobbying clout of the franchise industry and the International Franchise Association.

The third conditional exemption[304] is even less sound than the second. Two statutory prerequisites exist: (1) the franchisor must not charge an annual franchise fee in excess of $1,500[305] and (2) the franchisor must not advertise franchises in any medium located in Washington or Oregon. This exemption allows unlimited offerings of inexpensive franchises to persons in Washington without registration with the director. It is totally incompatible with the general legislative intent to protect persons with limited business sophistication who invest a substantial portion of their savings in a franchise business. The exemption should be repealed.

It should be stressed that the conditional exemptions only apply to the registration provisions of the Act. Franchises sold under the exemptions remain subject to the antifraud and fair practices sections of the Act.[306]

(d) The "Hertz-Avis" Exemption. The final exemption[307] is also conditional, requiring that: (1) the franchisor provide prospective

303. *Id.* § 19.100.030(4)(b)(ii). No reason is apparent why the contiguous state of Oregon is included but that of Idaho is not. "Advertising medium" should be construed broadly to cover all methods of soliciting the public—including general telephone and mail campaigns and booths at fairs. See the broad definition of "advertisement" and "publish" in WASH. REV. CODE § 19.100.010(1), (13) (Supp. 1972), discussed in notes 232, 233 and accompanying text *supra*.

304. *Id.* § 19.100.030(4)(b)(iii).

305. There are problems in applying the $1500 per year franchise fee test. First, many franchisors require a substantial initial payment. Such a lump sum payment is included in the statutory definition of a franchise fee. WASH. REV. CODE § 19.100.010(11) (Supp. 1972). If a franchisor charges an initial fee in excess of $1500 but a continuing annual charge or royalty of less than $1500, is the test met? Second, many franchisors charge a royalty which is stated as a percentage of the franchisee's sales. Hence the size of the annual franchise fee cannot always be determined at the time of the offering.

306. *Id.* §§ 19.100.170, .180(2).

307. *Id.* § 19.100.030(5).

franchisees with certain disclosures,[308] (2) the franchisor have a "clean record,"[309] (3) the franchisor or its parent corporation have a net worth of more than $5 million, (4) the franchisor be "engaged in the business of renting or leasing motor vehicles through an interdependent system of direct and franchised operations in interstate commerce in twenty or more states" and (5) the franchisor be "subject to the jurisdiction of the federal trade commission and the federal antitrust laws."[310] The exemption differs from the other conditional exemptions in that it frees the franchisor not only from the registration requirement but also from the specific provisions of the fair practices section.[311]

A moment's reflection reveals that the exemption can apply to only a few corporations: to wit, Hertz, Avis, National Car Rental. Such private exemptions are unseemly to say the least.[312]

B. *Administrative Regulation and Procedures*

1. *Registration of Franchise Offerings*

To comply with the registration requirement, a franchisor must file a registration statement with the director (the administrator of securities) and pay a $500 filing fee.[313] The registration becomes effective 15 business days after the filing date or the date of the last amendment unless the director either accelerates the effective date or initiates a stop order proceeding.[314] The registration is effective for one year and, absent any contrary determination by the director, can be re-

308. *See* notes 292, 293 and accompanying text *supra*.
309. *See* note 294 and accompanying text *supra*.
310. WASH. REV. CODE § 19.100.030(5) (Supp. 1972).
311. *Id.* § 19.100.180(2). The franchisor remains subject only to the general requirement of the fair practices section that the "parties shall deal with each other in good faith." *Id.* § 19.100.180(1).
312. The exemption actually does not create a closed class, however, and probably is not subject to attack on the basis of the equal protection clause of the United States Constitution or WASH CONST. art. I, § 12. *See* Morey v. Doud, 354 U.S. 457 (1957).
313. WASH. REV. CODE §§ 19.100.040, .240(1) (Supp. 1972). From the effective date of the Franchise Act (May 1, 1972) to September 27, 1972, 20 registration statements for franchise offerings were filed; 13 became effective.

All administrative powers under the Act are given to the Director of the Department of Motor Vehicles. WASH. REV. CODE § 19.100.010(3) (Supp. 1972). In turn, the Director may delegate administration of the Act to the Administrator of Securities. *Id.* § 19.100.270. For a description of the operation of the Washington Securities Division, *see* Rooks, *The Blue Sky of Washington: Registration of Securities of a New Venture*, 6 GONZAGA L. REV. 187, 192-95 (1971).
314. WASH. REV. CODE § 19.100.060 (Supp. 1972).

newed annually by application and payment of a $100 filing fee.[315] The franchisor must file a supplemental report with the director on any "material adverse change in the condition of the franchise" as soon as reasonably possible and before further sale of franchises.[316]

The registration procedure is similar to qualifying for registration under the Washington Securities Act.[317] The one point of substantive difference is the annual renewal requirement imposed by the Franchise Act. Under the Securities Act, registration is effective until revoked or terminated by request,[318] subject to an obligation to keep information in the registration statement reasonably current.[319]

2. *Stop Order Proceedings*

The director is authorized by the Act to issue a stop order denying, suspending, or revoking the effectiveness of a registration statement "if he finds that the order is in the public interest" and that one of the alternative statutory grounds is present.[320] The seven statutory grounds for a stop order, adopted nearly verbatim from the stop order provisions of the Washington Securities Act,[321] are: (1) incomplete, false or misleading information in the registration statement, (2) violation by the franchisor or related persons of the Act or any order issued thereunder, (3) existence of an injunction issued by a competent court against the franchise offering on facts constituting a separate ground for a stop order, (4) illegality of the franchised business, (5) tendency of the franchise offering to "work a fraud upon purchasers," (6) violation of an escrow or impound order, and (7) failure to pay registration fees (grounds only for temporary denial). The scope of the fifth ground—tendency to "work a fraud upon purchasers"—is not clear. It could be limited to deceptive franchise offerings in which the franchisor misrepresents facts, tells "half-truths," or fails to disclose material information. A broader interpretation, more consistent with the remedial purposes of the Act, would extend the concept of fraud and allow the director to assess the

315. *Id.* § 19.100.070(1), (2).
316. *Id.* § 19.100.070(3).
317. WASH. REV. CODE §§ 21.20.210, .220, .240-.260 (1959) and §§ 21.20.230, .270 (Supp. 1972); *see generally* Rooks, *supra* note 313, at 204-06.
318. WASH. REV. CODE § 21.20.260 (1959).
319. WASH. REV. CODE § 21.20.270 (Supp. 1972).
320. WASH. REV. CODE § 19.100.120 (Supp. 1972).
321. WASH. REV. CODE § 21.20.280 (1959).

merits of the franchise being offered and determine whether it involves financial risks which ordinary investors cannot be expected to understand no matter how full the disclosure of information.[322]

The Act requires that notice be given to the applicant and that written findings of fact and conclusions of law be entered by the director in stop order proceedings.[323] The Act further provides that a hearing may be held, either upon order by the director or upon a timely request by the applicant, after notice of the stop order and prior to the entry of findings of fact and conclusions of law.[324]

3. *Registration of Brokers and Selling Agents*

The Act requires persons who offer to sell franchises subject to the registration requirement of the Act to register as franchise brokers or selling agents and prohibits franchisors from employing brokers or agents unless they are registered.[325] Persons register by paying a $50.00 fee and by filing an application containing information required by the director on matters such as the applicant's form and place of organization, method of doing business, qualifications and business history, financial condition and history, and history of any violations of securities laws.[326]

Ordinarily, a requirement in a regulatory statute that brokers, agents and salesmen register with an administrative agency is accompanied by provisions which authorize the agency to deny, suspend or revoke the registration on various grounds such as insolvency, conviction of certain crimes, or commission of "dishonest or unethical prac-

322. Originally, the director was given authority to issue a stop order on the ground that "the applicant has failed to demonstrate that adequate financial arrangements have been made to fulfill obligations to provide real estate improvements, equipment, training, or other items included in the offering." This ground was eliminated by the 1972 amendment package. Ch. 116, § 8 [1972] Wash. Laws, 2d Ex. Sess. Consequently, if the director questions the franchisor's financial ability to perform, the only other avenue which will be open to him to protect prospective franchisees is imposition of an escrow or impound of franchise fees. *See* notes 332-45 and accompanying text *infra*.

323. WASH. REV. CODE § 19.100.130 (Supp. 1972). The stop order procedure is identical to that under the Washington Securities Act. WASH. REV. CODE § 21.20.300 (1959). Stop orders are most commonly entered by the administrator to prevent an incomplete or otherwise inadequate registration statement from becoming effective automatically 15 days after filing.

324. WASH. REV. CODE § 19.100.130 (Supp. 1972).

325. WASH. REV. CODE § 19.100.140 (Supp. 1972).

326. *Id.* § 19.100.140(3). As of September 27, 1972, 15 persons had registered as brokers or selling agents under the Act with the normal pattern being one registered agent for each registered franchise offering.

tices."[327] No such provisions are included in the Franchise Act. The reason for the omission is not evident; most likely, it was merely an oversight of the draftsmen. As a result, however, there is serious doubt whether the administrator of the Franchise Act has the power to revoke the registration of brokers and selling agents. Of course, if the misconduct by the broker or selling agent actually constitutes a violation of the Act and is committed in connection with a registered franchise offering, the administrator can issue a stop order revoking the effectiveness of the *franchisor's* registration statement.[328] But that power still falls far short of the authority granted to administrators of other similar regulatory statutes.[329] The omission should be cured promptly by amendment of the Franchise Act.

The Act requires persons offering franchises for sale to keep and maintain a complete set of records of sales and the disposition of proceeds.[330] It also requires such persons to file reports on franchises sold and the disposition of the proceeds derived therefrom "at such times as are required by the director" in the office of the director.[331]

4. *Impounding of Franchise Fees*

The Act authorizes the director to require as a prerequisite of effective registration that franchise fees be impounded or placed in escrow

327. *See, e.g.*, WASH. REV. CODE § 21.20.110 (1959) (securities broker-dealers, salesmen, and investment advisers); WASH. REV. CODE § 48.17.530 (1959) (insurance agents and brokers).

328. WASH. REV. CODE § 19.100.120(2) (Supp. 1972).

329. *See* note 327 *supra*. To illustrate the potential hiatus which the Act apparently creates, consider a hypothetical franchisor who discloses in its registration application that its president and its chief salesman were both found guilty two years before of criminal fraud involving the sale of securities. That information apparently would not constitute grounds for entrance of a stop order by the administrator. WASH. REV. CODE § 19.100.120 (Supp. 1972); *Cf.* CAL. CORP. CODE § 31115(e) (West Supp. 1972). There are apparently no grounds for denying registration of the two individuals as broker-agents. And the fact of the fraud convictions would not even have to be disclosed to prospective franchisees in the offering circular. *See* text accompanying note 362 *infra*.

330. WASH. REV. CODE § 19.100.150 (Supp. 1972). Read literally, section 15 of the Act applies to any person offering franchises for sale whether or not the franchise offering or the person making it must be registered under the Act. The intent of the legislature, however, probably was to apply section 15 only to franchise brokers and agents who are required to register under the Act.

The administrator of the Act has adopted a rule detailing the records which franchise brokers and selling agents must make and keep. WASH. AD. CODE § 460-82-200 (1972). Such records must be preserved for a period of not less than six years.

331. WASH. REV. CODE § 19.100.150 (Supp. 1972). The administrator of the Act has not as yet adopted a rule requiring regular reports to be filed. He has indicated informally an intent to require quarterly reports.

if he finds "such requirement is necessary and appropriate to protect prospective franchisees."[332] The escrow provision is in response to evidence that in the past persons have paid substantial fees for franchises which were delivered only after inordinate delay or were never delivered due to the franchisor's financial inability to perform.[333] Undercapitalized franchisors often rely upon further franchise sales to sustain their normal operations. The result is a chain: "When the chain is broken by a lag in the sale of franchises, having neither adequate capital nor sufficient income from the percentage of gross sales of franchisees to carry on routine operations, the franchisor closes his doors and moves on, leaving behind a string of unfulfilled obligations to franchisees, suppliers, contractors, employees, and others."[334]

Rules adopted by the administrator of the Franchise Act specify the standards and procedures for impounding franchise fees. Impounding will be ordered "where the applicant has failed to demonstrate that adequate financial arrangements have been made to fulfill obligations to provide real estate, improvements, equipment, inventory, training or other items included in the offering . . . ."[335] Where impounding is imposed, the *entire* franchise fee and all other funds paid by franchisees must be delivered within 48 hours to a depository—a separate trust account with a national bank located in Washington or a Washington bank or trust company.[336] The administrator will authorize a release of some or all of the impounded funds "upon a showing that the franchisor has fulfilled its obligations under the franchise agree-

332. WASH. REV. CODE § 19.100.050 (Supp. 1972).

333. *See, e.g., Interim Hearing on Franchises Before the California Senate Comm. on Insurance and Financial Institutions* 27-28 (Sacramento, Nov. 7, 1969); Augustine & Hrusoff, FRANCHISE REGULATION, 21 HASTINGS L.J. 1347 (1970).

The need for the protection which impounding can provide against grossly undercapitalized franchise schemes is illustrated by testimony of a motel franchisor who sold 70 franchises in a one year period at $12,000 each under a lease-back scheme requiring the franchisor to provide operating capital, furnishings and staff. The franchisor incurred obligations in excess of $14 million. In fact, the franchisor's financial statement showed total assets of $250,000 and liabilities of approximately $2,000,000. *Hearings on the Impact of Franchising on Small Business Before the Subcomm. on Urban and Rural Economic Development of the Senate Select Comm. on Small Business,* 91st Cong., 2d Sess., at 215-17 (1970).

334. Pierno, *Franchise Regulation: The Need for a New Approach,* 44 L.A.B. BULL. 501, 505 (1969).

335. WASH. AD. CODE § 460-80-410 (1972). The impound rules are copied virtually verbatim from rules under the California Franchise Investment Act. CAL. AD. CODE tit. 10, § 310.112-.113.4 (1965). The only difference is that the Washington rules do not allow the franchisor to post a surety bond in lieu of impounding. *Id.* § 310.113.5.

336. WASH. AD. CODE §§ 460-80-420,-430,-440 (1972).

ment, or that for other reasons the impound is no longer required for protection of franchisees."[337]

Granting the administrator authority to require that franchise fees be placed in escrow has been criticized. First, it is argued that "disclosure of what will be done with franchise funds is adequate."[338] This argument is not persuasive; disclosure of mere promises often is not adequate,[339] and the argument assumes that prospective franchisees with limited financial sophistication are capable of carefully assessing the financial risks of the transaction. The evidence suggests that prospective franchisees may not be so capable.[340] Second, it is argued that "it is too easy for the practice to become established as the 'safe' practice that all funds will be escrowed and only released when the franchised business is delivered."[341] The experience to date in Washington does not substantiate this argument. Of the 13 franchise registrations which have become effective in the first five months since the Act went into effect, the administrator has impounded franchise fees in only one instance.[342] Third, it is argued that "the franchisor may need a portion of the proceeds to equip the business for the franchisee."[343] However, the impounding rules do allow release of portions of the franchise fee,[344] while properly discouraging franchises promoted by bootstrap financing with funds of small investors. Finally, it is argued that authority to impound requires the administrator to "make subjective determinations over subjects with which he may be totally unfamiliar."[345] In fact, the state securities administrator is very experienced in assessing investment schemes; if the subject matter cannot be explained to and comprehended by the administrator, the franchisor should not be free to sell franchises to the public without safeguards.

337. *Id.* § 460-80-450.
338. Augustine & Hrusoff, *supra* note 333, at 1380.
339. More helpful than disclosure of promises would be concrete data on the franchisor's prior performance in delivering franchises. The proposed Federal Trade Commission Rule, for example, requires disclosure of "the number of persons who have signed franchise agreements for whom a site has not yet been agreed upon by both franchisor and franchisee" and "the average length of time between the signing of a franchise agreement and the opening of the franchisee's outlet." *See* note 290 *supra*.
340. *See* text accompanying note 29 *supra*.
341. Augustine & Hrusoff, *supra* note 333, at 1380.
342. Abbey Carpet of Nevada, Inc., Washington Securities Administrator File F-5.
343. Augustine & Hrusoff, *supra* note 333, at 1380.
344. WASH. AD. CODE § 460-80-450 (1972).
345. Augustine & Hrusoff, *supra* note 333, at 1380.

5. *Control of Advertising*

The Act provides that no person shall publish in the state an advertisement offering a franchise subject to the registration requirement of the Act unless a copy of the advertisement has been filed with the director seven days in advance.[346] The director is given summary power to prohibit the publication of such an advertisement if he finds that it is false or misleading.[347] A person subject to such an order may obtain a hearing by requesting that the order be rescinded.[348]

The administrator of the Franchise Act has adopted a rule containing a statement of policy governing franchise advertisements.[349] The statement of policy prohibits: (1) any statement implying that the franchise is a "safe investment"; (2) any projection of future franchisee earnings, unless substantiated by data derived from franchises operating under similar conditions;[350] (3) any advertisement made without the name and address of the person making it; (4) endorsements by public figures without full disclosure of the compensation paid or promised to such persons; and (5) any statement referring to exemptions from or reductions in taxation, unless based on the opinion of legal counsel (who must be named).

It should be stressed that the statutory definitions of "advertising" and "publish" are very broad.[351] For example, all printed material prepared for dissemination to the public "in connection with an offer or sale of a franchise" is subject to the filing requirements of the Act.[352]

C. *Disclosure Requirements and Standards*

1. *Delivery of Offering Circular to Prospective Franchisee*

One of the primary purposes of the Franchise Act is to curb franchise sales abuses by requiring full and accurate disclosure of material

346. WASH. REV. CODE § 19.100.100 (Supp. 1972). For a discussion of when an advertisement is published "in the state," *see* text accompanying notes 241-251 *supra*.
347. *Id.* § 19.100.110.
348. *Id.*
349. WASH. AD. CODE § 460-80-500 (1972). The statement of policy is similar to that adopted in California. CAL. AD. CODE tit. 10 § 310.156.1 (1971); *see also* WASH. AD. CODE § 460-28-010 (1972) (rule relating to advertising of securities in Washington).
350. *Cf.* the requirements for disclosure of earnings projections in the offering circular, WASH. REV. CODE §§ 19.100.030(4)(a)(xiv), .040(17), discussed in text accompanying notes 385-96 *infra*.
351. *See* notes 232, 233 *supra*.
352. *Id.*

information to the prospective franchisee.[353] The object of such a disclosure requirement is to get information into the buyer's hands in a timely fashion so that the buyer may use it in arriving at an investment decision. Unfortunately, the disclosure mechanism adopted in the Franchise Act is not adequate to achieve this goal.

The Franchise Act requires that the franchisor present a disclosure document (offering circular) to a prospective franchisee "at least forty-eight hours prior to the sale of the franchise."[354] This procedure is inadequate for at least two reasons. First, 48 hours is simply not enough time for the prospective franchisee to digest the material information. Although a prospective franchisee can ask for more time to study the information before signing a franchise agreement, franchisors can be expected to press for an early closing of the deal in order not to lose a sale. Second, at a point 48 hours before the tentative sale, the prospective franchisee has probably already made an investment decision on the basis of the franchisor's sales talk and sales material which need not contain all the information required to be in the offering circular. The effects of the unrestricted sales material cannot be superseded instantly by the offering circular.[355]

The approach of the proposed Federal Trade Commission Rule is superior to the Franchise Act in this respect. The FTC rule would require that the franchisor furnish the prospective franchisee with the prescribed disclosure document "at the time when contact is first established," which is defined as the earlier of the time when (1) "a direct personal meeting first occurs" or (2) "any document or promotional literature is distributed to a prospective franchisee."[356] The proposed FTC rule couples this early disclosure requirement with a ten day "cooling-off" period during which the franchisee can freely cancel any signed contract.[357]

The 48 hour provision apparently was adopted in Washington because it is included in the California Franchise Investment Act.[358] It is

353. *See* text accompanying notes 211-14 *supra*.
354. WASH. REV. CODE § 19.100.080 (Supp. 1972). The rules of the administrator of the Franchise Act require that a purchaser of a franchise sign a receipt that he or she has received the offering circular 48 hours before signing the receipt and completing the sale. WASH. AD. CODE § 460-80-300 (1972).
355. *Cf.* SEC v. Okin, 132 F.2d 784, 786 (2d Cir. 1943).
356. Proposed FTC Rule, *supra* note 260.
357. *Id.*
358. CAL. CORP. CODE § 31119 (West Supp. 1972).

more lenient than the equivalent provision in the Washington Securities Act,[359] and should be replaced by a provision similar to either that of the Washington Securities Act or that of the proposed FTC rule.

2. *Contents of the Offering Circular*

As originally enacted in 1971, section 8 of the Franchise Act required delivery of an "offering circular" to a prospective franchisee without designating what information needed to be disclosed in the offering circular.[360] A permissible inference would have been that the offering circular should contain all the information in the registration statement filed with the director. The 1972 amendments deleted the reference to "offering circular" and substituted the language "materials specified in section 2(4)(a) [the conditional exemption section] of this 1972 amendatory act."[361] Thus, the Franchise Act seems to require that the offering circular contain only the information which must be disclosed to prospective franchisees by a franchisor wishing to qualify for a conditional registration exemption under the Act.

A comparison of the disclosures required in the conditional exemption section and the disclosures required in the registration statement reveals that three key items of information included in the latter are omitted from the former: (1) the business experience of persons affiliated with the franchisor, (2) any record of specified types of misconduct on the part of persons identified in the registration statement, and (3) the franchisor's financial statements.[362] There does not appear to be any sound reason for keeping these three items of information out of the hands of prospective franchisees. Information regarding the franchisor's personnel and prior misconduct by those identified with the registration is clearly material to a judgment as to the soundness and desirability of a franchise offering. Similarly, the franchisor's financial condition is relevant in assessing the franchisor's ability to perform its obligations under the franchise agreement.

359. Under the Washington Securities Act, a statutory prospectus must precede the first written offer made to a prospective investor by means other than a public advertisement. WASH. REV. CODE § 21.20.230 (Supp. 1972). Since "offer" is broadly construed, *see* note 246, a prospectus must precede or accompany any written or printed sales material. The Washington Securities Act is not as strict as the Proposed FTC Rule, however, since a prospectus need not be given before any direct personal meeting.

360. Ch. 252, § 8 [1971] Wash. Laws, 1st Ex. Sess.

361. Ch. 116, § 6 [1972] Wash. Laws 2d Ex. Sess.; *see* note 293 *supra*.

362. *See* note 292 *supra*.

The administrator of the Franchise Act has adopted rules which in fact require the offering circular to include information other than that specified in section 2(4)(a) of the Act. Included are: (1) the business experience of the franchisor's personnel,[363] (2) financial statements of the franchisor,[364] (3) any arrangement that the franchisor has made with a public figure as to name use or endorsement,[365] (4) the number of franchises sold and proposed to be sold,[366] and (5) the obligations to be performed by the franchisor prior to the opening of the franchised business.[367] Because the Franchise Act unjustifiably fails to grant the administrator express general power to determine what registration information must be included in the offering circular,[368] a substantial question remains as to whether the administrator has exceeded his statutory authority by so expanding the required contents of the offering circular.[369]

3. *Required Items of Disclosure—Projected Franchisee Earnings*

The Act enumerates 20 specific items of information which the franchisor must include in the registration statement.[370] The franchisor also must append a copy of the "typical franchise contract or agreement proposed for use including all amendments thereto."[371] In addition the administrator of the Act is authorized to require additional information in the registration statement,[372] and the franchisor

363. The franchisor is required to list the names and addresses of its officers, directors, trustees, general partners, general manager and principal executive and indicate the principal occupations of each during the past five years. WASH. AD. CODE §§ 460-80-130,-320 (1972).

364. *Id.* §§ 460-80-130(8),-320. The financial statements must be prepared in accordance with generally accepted accounting principles as set forth in the administrator's accounting rules, *id.* § 460-60 *et seq.*, and must be audited by a certified public accountant unless the requirement of audited statements is waived by the director. *Id.* § 460-80-140.

365. *Id.* § 460-80-330(11).

366. *Id.* §§ 460-80-150,-330(12).

367. *Id.* §§ 460-80-130(24),-330(14).

368. WASH. REV. CODE § 21.20.230 (Supp. 1972). *See* notes 360, 361 and accompanying text *supra*.

369. The administrator's authority to require disclosure of additional items of information in the registration statement is clear. WASH. REV. CODE § 19.100.040(20) (Supp. 1972). His authority to require them to be included in the offering circular presented to prospective franchiees, however, is subject to the possible limiting effect of section 8 as discussed in the text. *See also* WASH. REV. CODE § 19.100.250 (Supp. 1972).

370. *Id.* § 19.100.040.

371. *Id.* § 19.100.040(8).

372. *Id.* § 19.100.040(20). In fact the administrator specified three items of informa-

may include comments and additional information relative to the information contained in the statement.[373]

Of the 20 specific items of information, seven provide background information on the franchisor's organization, experience, personnel, and financial status.[374] Five describe terms of the franchise agreement which impose obligations on the franchisee, including conditions of termination or renewal, conditions of transfer or resale, requirements that the franchisee purchase goods or services from certain sources, obligations or restrictions in the goods or services that the franchisee may offer, and covenants not to compete.[375] Four describe the financial terms and conditions affecting the franchisee, including franchisee fees and royalties, other required fees, financing arrangements, and the franchisor's intentions to assign the franchisee's note or contract.[376] Finally, four items provide information relevant to a judgment on the financial prospects of the franchise being offered, including the training program, the supervision and assistance provided by the franchisor, projected sales or earnings, prior franchisee business failures, resales, and transfers in Washington, and the names, addresses and telephone numbers of all operating franchises of the franchisor in Washington.[377]

The disclosure provisions of the Franchise Act, especially those concerned with the financial prospects of the franchise, tend to be incomplete. For example, disclosure of franchise failures, resales, and transfers is limited to such events occurring in Washington state during the previous two years.[378] These temporal and territorial limits obviously dilute the value of this data to the prospective franchisee.[379] Another example is the provision requiring disclosure of the training program, supervision and assistance the franchisor will provide the

tion not included in the statute which must be disclosed in the registration statement. *See* text accompanying notes 365-67 *supra*.

373. WASH. REV. CODE § 19.100.040(23) (Supp. 1972).

374. *Id.* § 19.100.040 (1)-(7).

375. *Id.* § 19.100.040(11), (12), (13), (14), (22).

376. *Id.* § 19.100.040(9), (10), (15), (16). In requiring disclosure as to financing terms and conditions, the Franchise Act fills a loophole in the federal Truth-in-Lending Act which exempts from its disclosure provisions "credit transactions involving extensions of credit for business or commercial purposes . . . ." 15 U.S.C. § 1603(1) (1970); *see generally* Warren & Larmore, *Truth in Lending: Problems of Coverage*, 24 STAN. L. REV. 793, 809-16 (1972).

377. WASH. REV. CODE § 19.100.040(17), (18), (19), (21) (Supp. 1972).

378. *Id.* § 19.100.040(18).

379. The temporal and territorial limits were added in the 1972 amendment package. Ch. 116, §§ 2-3 [1972] Wash. Laws, 2d Ex. Sess.

franchisee.[380] Although such information is of obvious importance to an inexperienced franchisee contemplating investment in a business, the Act seems to require disclosure of little more than promises. Missing is concrete information on the franchisor's past performance and present ability to perform his promises. In contrast with the Franchise Act's weak disclosure requirements, the Federal Trade Commission's Proposed Rule requires disclosure of (1) "the average length of service of personnel who are responsible for assisting the franchisee at his location," (2) "the average number of hours such personnel spent during the past year with each franchisee that was in business for less than one year," (3) "the number of hours of instruction" in a promised training program, and (4) "a brief biography of the instructors who will conduct the training."[381]

The greatest failing of the disclosure provisions is its vague treatment of information regarding prospective franchisee earnings.[382] The central concern of any prospective franchisee is the expected return on the investment of money and effort in the franchise. Since misrepresentation of prospective franchisee earnings has been one of the most persistent abuses in franchisor sales practices,[383] the failure of the Franchise Act to cope adequately with disclosure of prospective earnings has to be viewed as its most serious shortcoming.

As originally enacted, the Franchise Act required "a statement of earnings of past and present franchisees."[384] The provision focused on concrete, historical data. However, it seemed to call for an unwieldy amount of information—at least for large franchise systems. Furthermore, such information could be misleading if comparable data was not supplied to contrast the proposed franchise site to the existing franchises.

The 1972 amendments deleted the requirement that earnings of past and present franchisees be disclosed and substituted the following provision:[385]

380. WASH. REV. CODE § 19.100.040(19) (Supp. 1972).

381. Proposed FTC Rule, *supra* note 260. The director may have the power under his general rule-making authority to require more specific information on training programs and the like. WASH. REV. CODE § 19.100. 250 (Supp. 1972). To date, however, he has not done so. *See* WASH. AD. CODE § 460-80-130 (1972) (repeating the statutory language).

382. WASH. REV. CODE § 19.100.040(17) (Supp. 1972).

383. *See* text accompanying note 31 *supra*.

384. Ch. 252, § 4(18) [1971] Wash. Laws 1st Ex. Sess.

385. WASH. REV. CODE § 19.100.040(17) (Supp. 1972). As amended, the provision is

> A copy of any statement of estimated or projected franchisee sales or earnings prepared for presentation to prospective franchisees or other persons, together with a statement immediately following such statement setting forth the data upon which the estimations or projections are based and explaining clearly the manner and extent to which such data relates to the actual operations of businesses conducted by the franchisor or its franchisees.

The provision actually does not require the franchisor to disclose earnings data. Many franchisors, for example, simply do not prepare any statement of estimated sales or earnings.[386] Since few prospective franchisees would rationally invest in a franchise without having acquired some information about prospective earnings from the franchisor or its sales representative, the lack of any positive requirement that earnings data be disclosed in the registration statement and offering circular suggests that many franchisees will acquire such information only through unregulated sales talk.

Furthermore, on its face the provision does not require that estimates or projections be substantiated in any particular manner. The franchisor only need disclose the data upon which an estimation is based and disclose the extent to which the data relates to actual business operations of the franchisor or its franchisees. In contrast to this lenient statutory disclosure provision is a rule promulgated by the administrator which prohibits projection of future franchisee earnings *in advertising* unless the projection is "(i) based on past earnings records of all franchisees operating under conditions, including location, substantially similar to conditions affecting franchises being offered, (ii) for a reasonable period only, and (iii) substantiated by data which clearly supports such projections."[387] It is not clear whether the administrator's rule is meant to control the disclosures of earnings projections pursuant to the statute.[388] But the administrator's requirement that projections be substantiated by actual performance of franchisees operating under comparable conditions clearly is preferable.

---

similar to the comparable provision of the California Franchise Investment Law, CAL. CORP. CODE § 31111(p) (West Supp. 1972).

386. *See, e.g.*, Success Motivation Institution, Washington Securities Administrator File F-4 ("It is the policy of the Company never to estimate or project distributorship earnings . . . .").

387. WASH. AD. CODE § 460-80-500(b) (1972).

388. Any statement of projected franchisee earnings prepared for general circulation to prospective franchisees would seem to constitute "advertising" and hence to be subject to the administrators' control. *See* text accompanying notes 346-52 *supra*.

Two examples taken from franchise registration statements on file with the administrator of the Act illustrate the weakness of the statute's treatment of earnings disclosures.

Taco Time International.[389] This franchisor of fast food outlets included in its registration statement a chart which estimated the net earnings a franchisee could expect to earn at various levels of gross sales. The chart may be helpful in determining probable expenses, but no data is given in the chart which indicates what level of sales can be expected from a given site or what factors tend to determine the level of sales. Moreover, no data is given indicating the number of franchisees, if any, which have generated such volume of sales and whether in fact the sales/net-earnings relationship was that portrayed by the chart.

Commercial Courier Service.[390] The franchisor is in the business of providing private delivery of promotional sales materials to homes. A franchisee pays a one-time flat fee of $1 per home to obtain an area franchise. The franchisor obtains orders to deliver material at the rate of $40 per thousand and remits 50 percent of the gross proceeds to the franchisee. The franchisee then hires carriers to deliver the material at a rate of $5 per piece per 500 homes. Included in the registration statement is an elaborate chart in grid form indicating potential weekly earnings of a franchisee. The chart indicates for example, that for a $2500 investment (2500 homes) a prospect can make $25 per week if one piece is delivered $[(2.5 \times \frac{40}{2}) - (5 \times \frac{2500}{500}) = \$25 \text{ net}]$ and $250 per week if ten pieces are delivered. Despite the franchisor's cautionary preface that "no predictions have been made about actual prospective earnings, because the company is too young to have reliable data for estimating," the clear implication of the chart is that an investing franchisee can expect to reap healthy profits from 25% per year on up. Yet the chart does not provide any data as to (1) the franchisor's present or future ability to secure any advertising or samples at the $40 rate, (2) the status of competition to the franchisor's services (*e.g.*, inserts in Sunday newspapers or mail delivery), or (3) the availability of carriers at the $5 rate.[391]

389. Taco Time International, Washington Securities Administrator File F-12.
390. Commercial Courier Service, Washington Securities Administrator File F-11.
391. With regard to securities sales, this type of earnings "estimate" based on hypo-

The Franchise Act does give access to hard data on franchise earnings by requiring that the franchisor disclose the names, addresses, and telephone numbers of all operating franchisees located in Washington.[392] The provision enables a prospect to contact franchisees directly and obtain information on expected franchise earnings. The provision is not an adequate substitute for a requirement of full disclosure of earnings data, however. The prospect may be too timid to call other franchisees; franchisees may be hesitant to discuss their financial affairs; there may be few existing franchises in Washington, or the existing ones may not be operating under comparable conditions.

The approach to earnings disclosure in the proposed Federal Trade Commission rule is far better than that in the Washington Franchise Act. The FTC rule requires that upon request a franchisor provide a prospective franchisee with the profit and loss statements of all existing franchises, with names and addresses omitted. In addition, any representation as to potential income has to be based on "actual average figures for all franchises not owned or operated by the franchisor . . . in operation during the entire preceding twelve-month period" and be accompanied by a specific disclaimer.[393] If no independent franchisors operated during the preceding year, any representation of potential income would have to be "based upon sound accounting practices"[394] and be accompanied by a specific disclaimer.[395] The franchisor also must disclose the number of franchises that operated at a loss during the previous year.

The proposed FTC rule, while an improvement over the Wash-

---

thetical sales figures for an untried business has been held to be misleading despite a cautionary preface. "[T]hese statements lend an appearance of predictability of future profits which is improper for a corporation which has yet to start business. Although stated as an estimate of future profits, the use of definite figures is misleading." Thomas Bond, Inc., 5 S.E.C. 60, at 71 (1939).

392. WASH. REV. CODE § 19.100.040(21) (Supp. 1972).

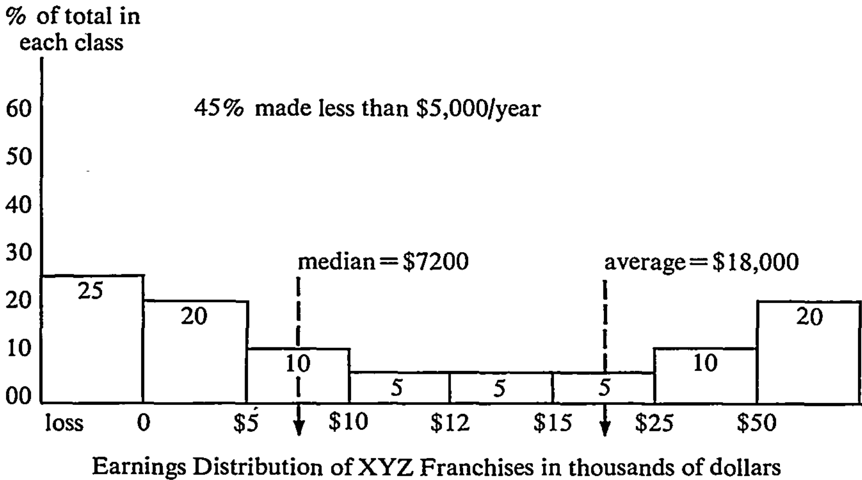
393. Proposed FTC Rule (c)(1), *supra* note 260. The disclaimer would have to be conspicuously displayed and state: "Representations are based on the average earnings or profits of all independent franchisees in operation during the past year. These figures should not be considered as accurate representations of potential earnings or profits of any specific franchisee."

394. Since accountants generally do not make predictions or representations of future earnings, the FTC's use of the qualification "based upon sound accounting practices" may be misleading.

395. Proposed FTC Rule (c)(2), *supra* note 260. The disclaimer must state: "All Representations of Potential Earnings or Profits Are Merely Estimates; No Franchisee Has Been in Operation Long Enough to Indicate What, If Any, Actual Earnings or Profits May Result."

ington Franchise Act, still does not impose a categorical duty to disclose adequate data on franchise earnings. An adequate disclosure of earnings requires a summary of actual earnings data in the form of a distribution table. Chart I illustrates such a distribution table.

CHART I



Earnings Distribution of XYZ Franchises in thousands of dollars

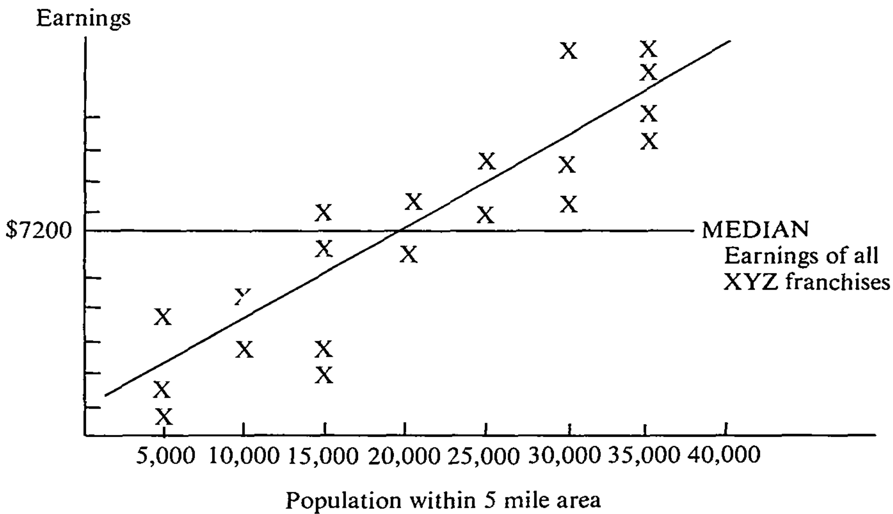
Chart I illustrates the weakness in the proposed FTC rule's reliance on average earnings figures; an average figure often will greatly exceed the median earnings figure due to a few high earning franchises. Franchisors easily could construct distribution tables from the extensive data they normally collect on the sales and earnings of their franchises. Earnings data might be made even more meaningful to prospective franchisees if the franchisor were required to construct and present a table based on simple linear regression analysis whenever the franchisor knows that an identifiable factor has a significant effect on franchisee earnings. Chart II (p. 368) illustrates such a table.

Regression analysis can actually be used with any number of variable factors.[396] Requiring such information, at least from experienced franchisors, would not represent an intolerable burden. Many franchisors undoubtedly have collected and analyzed data in such a fashion.

---

396. W. Wallis & H. Roberts, Statistics: A New Approach 524-58 (1956).

CHART II



4. *Section Seventeen—The Antifraud Provisions*

Perhaps the most important part of the Franchise Act is section 17.[397] Subsection 17(1) makes it unlawful to include an untrue statement of material fact in a document filed with the director or to wilfully omit a material fact required to be stated in such a document. Within the ambit of this subsection are both the registration statement and the offering circular.[398] Three other provisions of section 17 generally deal with problems of fraud and misrepresentation. Subsection 17(2) prohibits the offer or sale of a franchise in the state by means of a written or oral communication which includes an untrue statement of a material fact or omits a material fact necessary to prevent the statements made from being misleading. Subsection 17(3) prohibits employment of any device to defraud, and subsection 17(4) prohibits any act or practice which operates or would operate as a fraud or deceit upon any person.

Subsections 17(2)-(4) are copied verbatim from Rule 10b-5 of the

397. WASH. REV. CODE § 19.100.170 (Supp. 1972). Civil remedies for violation of section 17 are found in section 19. *Id.* § 19.100.190(2), discussed at notes 480-99 and accompanying text *infra*.

398. The administrator of the Act requires that the offering circular be filed along with the registration statement. WASH. AD. CODE § 460-80-130(30) (1972).

Securities and Exchange Commission and from section 20.010 of the Securities Act of Washington.[399] Adoption of the proscriptions used in dealing with security frauds clearly indicates that the same broad standards of fair dealing developed by the courts under the securities laws should apply under the Franchise Act. A key precedent is the recent Washington decision in *Shermer v. Baker*[400] which interpreted "material fact" as meaning "a fact to which a reasonable man would attach importance in determining his choice of action in the transaction in question" and which held that common law fraud and, in particular, an intent to deceive need not be shown under the Securities Act of Washington.

Section 17 clearly prohibits all variety of misrepresentations, misleading statements, and misleading omissions in connection with the sale of franchises. A major question is whether the Washington courts will read into section 17 a fiduciary duty of full and affirmative disclosure upon franchisors in the sales of franchises. The equivalent antifraud rules of the securities laws have been read to impose such a duty upon corporate "insiders" in their dealings with "outsiders."[401] While the analogy is not perfect,[402] the adoption of such a principle seems clearly justified in light of the legislature's manifest concern with franchise sales practice abuses.

It bears stressing that the antifraud rules apply even if the sale of a franchise is exempt from the registration requirement of the Franchise Act.[403]

D. *The Fair Practices or "Franchisee Bill of Rights" Section*

Although the disclosure and registration provisions of the Wash-

399. 17 C.F.R. § 240.10b-5 (1972); WASH. REV. CODE § 21.20.010 (1959).

400. 2 Wn. App. 845, 855-58, 472 P.2d 589, 595-97 (1970).

401. *E.g.*, Shermer v. Baker, 2 Wn. App. 845, 850-55, 472 P.2d 589, 593-95 (1970).

402. In the corporate setting, the buying or selling of securities on the basis of inside information is considered improper partly because of the notion that "a corporate fiduciary, who is entrusted with potentially valuable information, may not appropriate that asset to his own use." Diamond v. Oreamuno, 24 N.Y.2d 494, 248 N.E.2d 910 (1969). In a franchise setting, there is no equivalent divergence of interests since the franchisor would be using its own undisclosed information for its own benefit (*i.e.*, the sale of a franchise on terms it may not be able to obtain with full disclosure of all material facts).

Still many of the same factors that have led to the creation of a fiduciary duty of disclosure in other contexts are present in the franchisor—prospective franchisee relationship. *See* text accompanying notes 52, 53 *supra*.

403. *See* text accompanying notes 269-72 *supra*.

ington Franchise Investment Protection Act follow the basic pattern of the California Franchise Investment Act,[404] the Fair Practices section of the Washington Act (section 18) is unique.[405] Imposing specific restrictions on the terms of franchise agreements and on the behavior of franchisors, section 18 represents an effort by the legislature to alter the balance of bargaining power between franchisor and franchisee. Such direct intervention by the state into the ecomomic relationship between private parties is bound to be controversial.[406] It should be no surprise, therefore, that section 18 of the Washington Franchise Act gained nationwide notoriety[407] and was the object of extensive amendments in the 1972 legislative session.[408]

Subsection 1 of section 18 states generally that "the parties shall deal with each other in good faith,"[409] while the second subsection enumerates 11 specific acts or practices which are prohibited.[410] Apparently, only the "good faith" obligation is imposed on the franchisee as well as the franchisor. It is unclear what impact the general good faith requirement will have beyond the specific provisions of section 18. The 11 specific prohibitions do not exhaust all of the areas in which franchisors allegedly have abused their power to control franchisees. One such area, apparently not dealt with in section 18(2), is the common clause in franchise agreements prohibiting a franchisee from transferring the franchise unless the franchisor approves the transferee.[411] However, the courts may apply the general standard of good faith and require a showing of reasonable grounds as a prerequisite to refusal.[412]

404. CAL. CORP. CODE § 31000 *et seq.* (West Supp. 1972).

405. The Automobile Dealers Acts, while similar in purpose, are much less specific in their terms and much more confined in their coverage than section 18. *See* text accompanying notes 282-84 *supra.* Section 18 is patterned after a proposed franchise fair dealing statute introduced in the Massachusetts legislature. Mass. H. 2279, *reprinted in Hearings Before the Subcomm. on Urban and Rural Business of the Senate Select Comm. on Small Business,* 91st Cong., 2d Sess., pt.1, at 15 (1970).

406. *See* text preceding note 110 *supra.*

407. *See* Wong, *In Absence of Federal Rules, More States Begin Regulating the Franchise Industry,* Wall Street Journal, Oct. 11, 1971, at 22, col. 1-3.

408. Ch. 116, § 10 [1972] Wash. Laws, 2d Ex. Sess.

409. WASH. REV. CODE § 19.100.180(1) (Supp. 1972).

410. *Id.* § 19.100.180(2)(a)-(k).

411. Transfer restrictions might be considered a "standard of conduct" imposed on the franchisee which must be reasonable under section 18(2)(h). But such an interpretation would involve a considerable expansion of the ordinary meaning of the phrase "standard of conduct."

412. *See generally* Comment, *Limiting the Franchisor's Power to Withhold Consent to a Transfer by the Franchisee,* 47 IND. L.J. 559 (1972).

1. *Right of Association*

The Franchise Act prohibits franchisors from restricting or inhibiting "the right of the franchisees to join an association of franchisees."[413] Since the statute merely invalidates "yellowdog" provisions in franchise contracts, it accomplishes very little. The statute does not actually guarantee the right of franchisees to associate for any purpose. If franchisees were organized to bargain collectively with the franchisor or to set retail prices, hours and the like, they could well be in violation of the federal antitrust laws.[414] If, on the other hand, the franchisees are deemed to be "employees" of the franchisor, they have a guaranteed right under the federal labor laws to bargain collectively with their employer.[415] Neither of these questions is affected by the Franchise Act.

2. *Control of Sources of Supply—Unreasonable Prices—"Kick-Backs"*

Three provisions of section 18(2) deal with problems created by franchisor control over franchisee sources of supply.[416] Section 18(2)(b) prohibits a franchisor from requiring "a franchisee to purchase or lease goods or services of the franchisor or approved sources of supply unless . . . the franchisor satisfies the burden of proving that such restrictive purchasing agreements are reasonably necessary for a lawful purpose justified on business grounds, and do not substantially affect competition." The 1972 amendments added two provisions to section 18(2)(b).[417] The first exempts the "initial inventory of the franchise." The purpose of this concession to franchisors is unclear. No equivalent distinction between initial inventory and subsequent purchases has been made under the federal antitrust laws.[418] The second provision directs courts interpreting and applying section 18(2)(b) to be "guided" by the decisions of federal courts under the antitrust laws.

413. WASH. REV. CODE § 19.100.180(2)(a) (Supp. 1972).
414. *See* Columbia River Packers v. Hinton, 315 U.S. 143 (1942); Bambury Fashions, Inc., 179 N.L.R.B. 477 (1969); *see also* McGuire, *The Labor Law Aspects of Franchising*, 13 B.C. IND. & COM. L. REV. 215, 251 n.137 (1971).
415. *See, e.g.*, Mister Softee of Indiana, 162 N.L.R.B. 354 (1966); *see generally*, McGuire, *supra* note 414.
416. *See* text accompanying notes 115, and 142-47 *supra*.
417. Ch. 116, § 10(2)(b) [1972] Wash. Laws, 2d Ex. Sess.
418. *See* text accompanying notes 174-95 *supra*.

Since the legislative intent is to avoid creation of differing state and federal standards on the legality of franchise tying agreements,[419] section 18(2)(b) will have little impact on supply restrictions and will be invoked only when a plaintiff franchisee perceives jurisdictional, procedural, or remedial advantages to a state court action rather than a federal court antitrust action.[420]

Section 18(2)(d) prohibits a franchisor from selling, renting or offering to sell to a franchisee "any product or service for more than a fair and reasonable price."[421] This provision presumably was enacted to protect franchisees who are subject to purchase restrictions which pass muster under section 18(2)(b) and under the federal antitrust laws.

Section 18(2)(e) deals with "kick-backs" to the franchisor from suppliers with whom the franchisee deals. The 1971 provision prohibited kick-backs by requiring that any payment received by a franchisor from a supplier be "promptly accounted for and transmitted to the franchisee."[422] The 1972 amendments eliminated this requirement and substituted a disclosure approach requiring the franchisor to provide a prospective franchisee with "a statement of whether and of the means by which the franchisor derives income from" franchisee purchases of supplies from designated sources.[423] In turn, section 18(2)(e) was amended to require only that the franchisor disclose to the franchisee any benefit received from a supplier with whom a franchisee deals.[424] This presumably means that the franchisor must give to the franchisee a statement of the *exact amounts* received *as they are received* describing from whom they are received.[425]

Sections 18(2)(d) and 18(2)(e) appear to be inconsistent in theory.

419. For a discussion of the federal antitrust law's impact on franchisor control of franchisees' sources of supply, *see* text beginning at note 174 *supra*.

420. One consideration clearly favoring a federal action is the Washington Consumer Protection Act's limitation of treble damages to $1000. WASH. REV. CODE § 19.86.090 (Supp. 1972). *See* text accompanying note 503 *infra*. The federal antitrust laws give an unlimited right to treble damages. 15 U.S.C. § 15 (1970).

421. "Fair and reasonable price" is a vague term but should be interpreted to mean "bona fide wholesale price." *Cf.* WASH. REV. CODE § 19.100.010(11) (Supp. 1972).

422. Ch. 252, § 18(2)(e) [1971] Wash. Laws, 1st Ex. Sess. For a discussion of the legality of controlling sources of supplies, *see* note 142 and accompanying text *supra*.

423. WASH. REV. CODE §§ 19.100.030(4)(a)(x), .040(13) (Supp. 1972).

424. Ch. 116, § 10(2)(e) [1972] Wash. Laws, 2d Ex. Sess.

425. WASH. REV. CODE § 19.100.180(2)(e) speaks of disclosing such benefit, referring back to "money, goods, services, anything of value, or any other benefit, from any other person with whom the franchisee does business"—which implies a particularized disclosure.

If franchisor control over the franchisees' sources of supply is justified by the need for quality control or other reasons, the franchisor can require franchisees to purchase supplies either (1) through the franchisor or (2) from approved sources of supply. If the franchisor sells supplies directly, only a "reasonable price" no higher than market price can be extracted. On the other hand, if the franchisee is forced to deal with approved suppliers, the suppliers can charge a higher than competitive price, relying on the necessity of franchisor approval as insulation from competition. The supplier may split the profits with the franchisor, so long as there is full disclosure of the kick-back. The two sections should consistently follow either the disclosure theory or the prohibitory theory.

3. Discrimination Between Franchisees

Section 18(2)(c) prohibits franchisors from discriminating between franchisees "in the charges offered or made for royalties, goods, services, equipment, rentals, advertising services, or in any other business dealing" unless the franchisor shows that such discrimination is (1) "reasonable," (2) "based on franchises granted at materially different times" and is "reasonably related to such difference in times" or based "on other proper and justifiable distinctions considering the purposes" of the Franchise Act, and (3) "not arbitrary." The section has a dual impact. It forces uniformity in the terms of franchise agreements and requires equality in the enforcement of franchise terms and exercise of franchisors' reserved powers.

The requirement that franchise terms such as the royalty rate be uniform is questionable on policy grounds, and the legislative rationale for such a requirement is unclear. The draftsmen of the Act commented that "the prohibition of price discrimination by a franchisor among its various franchisees is founded on the Robinson-Patman Act."[426] The Robinson-Patman Act, however, only prohibits discrimination in price between different purchasers of the same product where the effect is to lessen competition among the purchasers or among the seller and his competitors.[427] Since section

---

426. Fletcher, *supra* note 211, Appendix I at 7.
427. 15 U.S.C. § 13 (1970). *See generally* P. AREEDA, ANTITRUST ANALYSIS 649-83 (1967).

18(2)(c) applies regardless of the competitive effect on franchisees or franchisors, the section cannot be founded solely on competitive considerations.

An alternative rationale for the section's ban on "discrimination" in franchise terms could be the concept of fairness—the notion that it is unfair for one franchisee to be subject to less favorable terms than those obtained by other franchisees. But it is not at all clear that "most-favored-nation" treatment has become such an accepted part of marketplace morality that it should be enacted into law. Furthermore, any such ban on "discrimination" arguably may have adverse economic consequences. A franchisor, for example, may wish to alter its royalty and other charges according to market conditions at particular sites, charging more at the productive than unproductive sites. Forced to adopt a single royalty structure or at least to bear the burden of justifying any differences, many franchisors simply may not grant franchises at the lean sites.[428] The result may be less than optimal utilization of the franchisor's system.[429]

The lack of a clear legislative purpose will make construction and application of section 18(2)(c) difficult. For example, would the adoption and use of a graduated royalty schedule (*i.e.*, one that varies with the gross revenue) constitute discrimination? Although the same royalty structure is offered to all, in practice it would have a different impact on high and low volume franchisees. If use of such a royalty rate schedule is discriminatory, is it nevertheless reasonable and justifiable?

The requirement of section 18(2)(c) that franchisors treat all franchisees equally in the enforcement of terms and exercise of reserved powers presents fewer problems. It may be used effectively by franchisees as a shield against arbitrary or predatory franchisor decisions regarding, for example, the enforcement of franchise terms, the nonrenewal or termination of franchises, and the withholding of consent to a transfer by the franchisee. One interpretive problem with section

428. For example, section 18(2)(c) may endanger any affirmative program by a franchisor to promote minority-owned franchises by altering royalty and other financial arrangements. *See generally* Harris and Macchiarola, *Increased Franchising Opportunities for Minorities: Some Legal Options*, 16 CATHOLIC LAWYER 326 (1970).

429. For a general discussion of price discrimination in patent licensing, *see* Baxter, *Legal Restrictions on Exploitation of the Patent Monopoly: An Economic Analysis*, 76 YALE L.J. 267 (1966). Much of Baxter's discussion applies equally to discrimination in franchise trademark licensing.

18(2)(c) relates to its interstate application. The section may be construed to require nondiscrimination only among franchisees within Washington, or it may be construed to require nondiscrimination between all franchisees wherever located. The latter construction seems preferable and presumably would have been adopted expressly by the legislature if it had considered the matter.

4. *Exclusive Territories*

Section 18(2)(f) prohibits a franchisor from granting competitive franchises or from directly competing in any exclusive territory specifically granted to a franchisee. As originally enacted, the section required franchisors to grant exclusive territories.[430] The 1972 amendment altered the provision so that an exclusive territory need not be granted, but once granted it must be respected.[431] The amendment also changed the disclosure provisions to require an explicit statement as to whether exclusive territories have been granted.[432] Since the normal expectation is that a franchise is exclusive to some degree, in case of a dispute the burden should be on the franchisor to show that the prospective franchisee understood that the franchise was not exclusive. Thus, section 18(2)(f) merely makes available to a franchisee the remedies of the Franchise Act for franchisor conduct that presumably also constitutes a breach of the franchise contract.

5. *Releases and Waivers of Liability*

Section 18(2)(g) prohibits franchisors from requiring a franchisee to "assent to a release, assignment, novation, or waiver which would relieve any person from liability imposed by this chapter."[433] This section presumably was intended only to invalidate releases which a franchisee was coerced or unfairly pressured into signing and should not

430. Ch. 252, § 18(2)(f) [1971] Wash. Laws, 1st Ex. Sess.
431. Ch. 116, § 10(2)(f) [1972] Wash. Laws, 2d Ex. Sess.
432. WASH. REV. CODE § 19.100.030(4)(a)(xvii) (Supp. 1972); *see* WASH. AD. CODE § 460-80-130(23) (1972).
433. This section invalidating waivers of liability should be compared with section 22 of the Act which voids "any provision purporting to bind any person acquiring a franchise... to waive compliance" with the Franchise Act. WASH. REV. CODE § 19.100.220 (Supp. 1972), discussed at notes 508-12 and accompanying text *infra*.

be read as barring voluntary settlements of claims after negotiations in good faith.

6. *Standards of Franchisee Conduct*

Section 18(2)(h) prohibits franchisors from imposing on franchisees "by contract, rule, or regulation, whether written or oral, any standard of conduct unless the franchisor can sustain the burden of proving such to be reasonable and necessary." This section could prove troublesome in its operation. Franchisors frequently prescribe in minute detail the manner in which their franchisees shall do business.[434] The reason expressed by franchisors for doing so is to ensure "a substantial uniformity in the quality, type, and standards of products, services and manner of operations" in all the franchisor's outlets.[435] This uniformity is considered essential to the goodwill of the entire franchise system and to some extent is required to preserve the validity of the franchisor's trademark.[436]

Sound business practice justifies many requirements imposed by franchisors. Others, however, can be justified solely by the franchisor's interest in uniformity. In light of section 18(2)(h), a standard of conduct justified solely on the ground of uniformity can neither be summarily dismissed nor completely accepted as a justification.

Perhaps the best approach is to weigh the competing interests. Under such an approach, the courts would balance the need for a standard to establish uniformity and to preserve the goodwill of the franchise system with the burden imposed upon the franchisee. Following the lead of decisions under the Automobile Dealers Act, the courts might scrutinize those standards imposed primarily for the benefit of the franchisor more carefully than those imposed for the mutual benefit of the parties.[437] For example, one constant complaint is that franchisors require franchisees to remain open for business during

434. For example, the standard agreement of a well-known ice cream franchisor requires among other things that the franchisee not change the initial store layout without permission, use approved clean uniforms, not permit smoking or gum chewing by employees, display a birthday sign and sign-up cards, not allow coin-operated vending machines on the premises, and paint the interior every two years with colors selected by the franchisor. Baskin-Robbins 31 Ice Cream Store Franchise Agreement §§ 9-11.

435. Baskin-Robbins 31 Ice Cream Store Agreement § 10.

436. *See* text accompanying note 7 *supra*.

437. *See* text accompanying notes 157-60 *supra*.

unreasonable hours. Long hours during unprofitable periods increase to some extent the gross revenue and, hence, the franchisor's royalty, but provide little return to the franchisee for his time. Since such a clause primarily benefits the franchisor and does not seem critical to any interest in uniformity, the courts should subject such provisions to higher standards of reasonableness than clauses relating to the appearance of the premises and the like.

7. *Refusals to Renew*

Section 18(2)(i) provides that a franchisor may refuse to renew a franchise only if it pays the franchisee the fair market value of the inventory, supplies, equipment, and furnishings purchased from the franchisor and the good will of the franchise.[438] However, the franchisor need not pay for the good will if it (1) gives one year's notice of nonrenewal, and (2) agrees in writing not to enforce any covenant which restrains the franchisee from competing with the franchisor.[439]

"Good will" is not defined by the Franchise Act, and its usage in the law is both elusive and variable.[440] In financial and accounting practice, "good will" normally refers to the excess amount paid for a going business over the value of the several assets of the business.[441] Good will exists when the estimated present value of the business' future earnings exceeds the value of its specific assets. Accordingly, the "good will" of a franchise would be derived by determining the fair market value of the franchise business as a whole (or, if no market value can be determined, by capitalizing the earnings of the franchise)[442] and then subtracting the value of the specific assets.[443] The

438. WASH. REV. CODE § 19.100.180(2)(i) (Supp. 1972). The franchisor need not purchase "personalized materials which have no value to the franchisor," nor "inventory, supplies, equipment and furnishings not reasonably required in the conduct of the business." The franchisor also may offset amounts owed to it by the franchisee.

439. The required agreement presumably would relate only to a covenant not to engage in the same line of business in the same area. The franchisor would continue to be able to enforce covenants not to use its trademark, tradename, and distinctive merchandising methods.

440. *See* Note, *An Inquiry into the Nature of Goodwill*, 53 COLUM. L. REV. 660 (1953).

441. *See* de Capriles, *Modern Financial Accounting*, 37 N.Y.U.L. REV. 1001, 1081-83 (1962).

442. If the franchisee normally works full time in the franchise operation, the "earnings" of the franchise should be the net after allowance of a reasonable salary.

443. If a renewal fee is required under the terms of the franchise agreement, the computation of good will would take such a fee into account.

value of "good will" so determined will depend on the duration of the franchise, which presumably would be the normal renewal period.[444] It seems clear from the statute that the threat of having to pay for good will is intended primarily to force the franchisor to give the franchisee substantial advance notice of nonrenewal and to discourage enforcement of covenants not to compete so that the franchisee can continue in business individually or with another franchisor.

There are two significant problems with the requirement that the franchisor purchase the inventory, supplies, equipment and furnishings originally purchased by the franchisee from the franchisor. The obvious purpose of the requirement is to prevent the unnecessary hardship of burdening a franchisee with specialized items which are of little value to him without the franchise but of significant value to the franchisor.[445] There is no good reason for limiting the repurchase requirement to items "purchased from the franchisor."[446] Franchisors will in many instances be able to evade the requirement by having their franchisees purchase equipment and the like from independent suppliers.

The second problem with the repurchase requirement concerns the determination of "fair market value." For inventory and supplies, this normally would be their cost. But there is often very little market for second-hand equipment and furnishings, especially if it is highly specialized.[447] In some cases the franchise agreement may prescribe a basis for determining the value of such equipment.[448] If the value so determined is a reasonable one, it ought to be accepted as setting the fair market value for purposes of section 18(2)(i).

Problems also are raised by the phrase "refuse to renew." With some franchise arrangements, it may not be clear whether a franchisor's action is a refusal to renew governed by section 18(2)(i) or a

---

444. *See* text accompanying note 450 *infra*.

445. Franchisors typically reserve an option to purchase equipment and supplies from terminated franchisees. No similar option to require repurchase typically is given the franchisee, however. H. BROWN, FRANCHISING: TRAP FOR THE TRUSTING 27 (1969).

446. In this respect, section 18(2)(i) appears to be inconsistent with the termination provision, section 18(2)(j), discussed *infra*. The latter requires the franchisor to purchase all the franchisee's inventory and supplies from whomever purchased, except the franchisor need not purchase inventory and supplies not purchased from the franchisor if the franchisee is to retain control of the premises.

447. *See* BROWN, *supra* note 445, at 27.

448. *See, e.g.*, Baskin-Robbins 31 Ice Cream Store Agreement § 23 (setting the repurchase price for equipment at cost less 25% depreciation the first year, 15% a year thereafter, but in no event less than 30% of cost).

termination governed by section 18(2)(j).[449] Consider, for example, a franchise which by its terms can be terminated by either party at will or on specified notice. Although such action ordinarily would be denoted a "termination,"[450] it would seem to be more analogous to a "refusal to renew," considering the purposes of the two sections.[451] With other franchise arrangements, it may not be clear what constitutes a "renewal." Consider a franchise granted for a ten-year period with no reference to any renewal. If after the ten years the franchisor offers to renew for two years, would that offer be a proper renewal or must the franchisor offer to renew for a period equal to the original term? The general expectation of parties entering into franchise transactions is probably that a "renewal" be for a full period.

8. *Terminations*

Section 18(2)(j) provides that a franchisor may not terminate a franchise prior to the expiration of its term except for "good cause."[452] "Good cause" includes "without limitation," noncompliance with "lawful material provisions of the franchise agreement."[453] The franchisor must give written notice of any default and a reasonable opportunity to cure[454] unless the cause of termination is the franchisee's insolvency, voluntary abandonment of the business, or conviction of violating a law relating to the franchise business. Upon termination for good cause, the franchisor must purchase the franchisee's inventory and supplies at fair market value.[455]

449. The difference may be critical since a "termination" must be for good cause while a refusal to renew needs no cause so long as fair compensation and/or proper notice is given by the franchisor.

450. *See, e.g.*, UNIFORM COMMERCIAL CODE § 2-106(3).

451. Section 18(2)(j) refers to terminations of a franchise "prior to the expiration of its term." A franchise of indefinite duration has no real "term" prior to the expiration of which it can be terminated.

452. WASH. REV. CODE § 19.100.180(2)(j) (Supp. 1972). This section, like the refusal to renew section, was rewritten completely in the 1972 amendments. Ch. 116, § 10 [1972] Wash. Laws, 2d Ex. Sess.

453. To be "lawful" a provision must pass muster under the other provisions of section 18(2). It is doubtful whether the requirement that a provision be "material" significantly limits a franchisor's ability to terminate. If a provision meets section 18(2)(h)'s reasonableness test, it would seem a fortiori to be "material."

454. The opportunity to cure "in no event need be more than thirty days" except where the default cannot reasonably be cured in thirty days, in which case the franchisee must initiate "substantial and continuing action to cure" the default within thirty days.

455. Unlike a franchisee refused renewal, a terminated franchisee thus may be left with the specialized equipment and furnishings of the franchise.

This "due process" approach to franchise terminations, coupled with the other provisions of section 18(2), is a constructive solution to the problems created by franchise terminations.[456] It does not interfere with the franchisor's ability to enforce its contract, yet it frees the franchisee from the fear of sudden, arbitrary termination or threat thereof based on a failure to comply with one of the myriad requirements imposed by typical franchise agreements.[457]

9. *Chain Distributorships*

Section 18(2)(k) prohibits anyone from promoting, offering, or granting participation in a "chain distributor scheme."[458] "Chain distributor scheme" is defined as a sales device whereby one person, upon making an investment, is granted the right to recruit other persons who in turn, upon making an investment, are granted a similar right to recruit other persons.[459] This provision was added by the 1972 amendments and logically does not belong either in section 18 or in the Franchise Act. It is clearly not, in the words of the preface to the section, a specific "right" or "prohibition" governing "the relation between the franchisor or subfranchisor and the franchisees." Rather, it is an absolute proscription of a particular kind of sales device which may or may not fit the definition of a franchise. It is a legislative response to the growing number of fraudulent or near-fraudulent sales devices, the most notorious of which is Glenn W. Turner's Dare to Be Great scheme.[460]

Section 18(2)(k) probably does little more than gild the lily. Such multi-level distributorships, unlike the typical franchise, are probably "securities" which can be sold only in compliance with the registration and antifraud rules of existing securities laws.[461]

456. Many franchise agreements contain such notice-cure procedures although usually not as generous to the franchisee. *See, e.g.*, Baskin-Robbins 31 Ice Cream Store Agreement § 16 ("when feasible" notice of termination should allow ten days for the franchisee "to cure the breach or default and to place himself in compliance.")

457. *See* note 438 *supra*.

458. WASH. REV. CODE § 19.100.180(2)(k) (Supp. 1972).

459. WASH. REV. CODE § 19.100.010(16) (Supp. 1972).

460. For a description of the Dare to Be Great scheme with its numerous "adventures," *see* SEC v. Glenn W. Turner, No. 72-390 (D. Ore. 1972), BNA SEC. REG. & L. REP., at H-1 (Sept. 13, 1972).

461. *See, e.g.*, SEC v. Glenn W. Turner, *supra* note 460. The decision in *Turner* is being appealed to the United States Court of Appeals for the Ninth Circuit. *See* BNA SEC. REG. & L. REP. at 5 (Oct. 25, 1972).

10. Constitutional Problems in Applying the Franchise Act to Existing Franchises

The Franchise Act specifies that its provisions "shall be applicable to all franchises and contracts existing between franchisors and franchisees" as well as to all future franchises and contracts.[462] Arguably, application of the Fair Practices section to contract provisions which were enforceable at the time of contract execution may run afoul of the Washington and United States constitutional provisions forbidding laws which impair the obligation of contracts.[463]

The propriety of applying dealer or franchise legislation to existing agreements has been considered in two recent decisions. In *Fornaris v. Ridge Tool Co.,*[464] a federal court of appeals considered a Puerto Rico statute which prohibited terminations or nonrenewal of dealerships except for "just cause" (defined as nonperformance of essential obligations by the dealer) and which provided that damages for violation of the statute should include, without mitigation, the full good will of the business plus an amount equal to five years' profits. The court held that the statute could not be applied constitutionally to a dealership contract signed prior to the enactment of the statute under which the manufacturer reserved the right to cancel without cause. On appeal, the United States Supreme Court reversed the judgment with directions to the lower court to abstain until the Puerto Rican courts had an opportunity to construe the statute in the light of the constitutional problems.[465] The Court stated: "It is conceivable that 'just cause' might be judicially confined to a more narrow ambit which would avoid all constitutional questions."[466] The Supreme Court did not indicate whether it agreed with the First Circuit's analysis of the constitutional question.

In *Globe Liquor Co. v. Four Roses Distillers Co.,*[467] the Delaware Supreme Court considered the question of whether that state's Fran-

462. WASH. REV. CODE § 19.100.900 (Supp. 1972) (emphasis added).
463. U.S. CONST. art. I, § 10; WASH. CONST. art. I, § 23. *See generally* Hale, *The Supreme Court and the Contract Clause* (pts. 1-3), 57 HARV. L. REV. 512, 621, 852 (1944); Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation,* 73 HARV. L. REV. 692 (1960); Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking,* 48 CALIF. L. REV. 216 (1960).
464. 423 F.2d 563 (1st Cir. 1970), *vacated,* 400 U.S. 41 (1970).
465. Fornaris v. Ridge Tool Co., 400 U.S. 41 (1970).
466. 400 U.S. at 44.
467. 281 A.2d 19 (Del. Sup. Ct. 1971).

chise Security Law, which prohibited terminations except for "just cause," could be applied to existing agreements. The court held that such application would violate the contract clause of the United States Constitution since the statute, unlike the terms of the actual agreement, imposed an obligation to deal with a franchisee indefinitely and levied penalty damages on franchisors who terminated without just cause.[468]

Section 18 of the Washington Franchise Investment Protection Act is distinguishable from the statutes examined in *Globe Liquor* and *Fornaris*. Both decisions recognized that minor alterations in existing franchise contracts imposed through exercise of the state's police power are permissible. As the federal court of appeals in *Fornaris* emphasized: "Essentially, the question is, how drastically have property rights been affected, and particularly, how great is the change viewed in the light of the reasonable expectations of the parties when the contract was entered into."[469] In addition, both decisions stressed the indefinite tenure which the two statutes appeared to grant to franchisees and the severe measure of damages imposed for improper terminations.

An examination of section 18 reveals that most of its provisions do not impose severe burdens on franchisors. The renewal and termination provisions do not grant indefinite tenure to franchisees;[470] the franchisor is free to refuse to renew or to terminate for breach of contract so long as reasonable notice is given. An obligation to repurchase materials is imposed only if the materials are of value to the franchisor and only at the fair market price. Damages can be recovered only if proven.[471] The provisions on franchisor control over sources of supply, unreasonable prices, and "kick-backs" deal with practices which are at best on the fringe of illegality under the federal antitrust

468. The court also held that penalty damages, which included both good will and a sum not less than five times annual profits, could not be imposed constitutionally on franchisors entering into agreements after the effective date of the law, since they constituted the "taking of private property without compensation and without due process of law." 281 A.2d at 24. On the other hand, both *Globe Liquor* and *Fornaris* upheld the "just cause" requirement for termination against arguments that it was unconstitutionally vague.

469. 423 F.2d at 567.

470. *See* text accompanying notes 438-57 *supra*.

471. WASH. REV. CODE §§ 19.100.190(1), 19.86.090 (Supp. 1972), discussed at notes 500-05 and accompanying text *infra*.

laws.[472] The ban on "discrimination" may present greater problems if interpreted as calling for a reduction in discriminatorily high royalty rates.[473]

In short, no wholesale judgment should be made as to the constitutionality of applying section 18 to existing franchises. Section 18 should apply to such franchises unless the franchisor can show that under the particular circumstances such application has the effect of imposing a substantial economic burden that could not reasonably have been expected at the time of execution of the contract. Such expectations must be deemed to include knowledge of the growing trend in the law to require fair treatment of franchisees and dealers.[474]

E. Remedies

1. Public Remedies

The Franchise Act authorizes the state, through the attorney general, to bring an action to restrain any conduct made unlawful by the Act.[475] Violation of an injunction carries a civil penalty of up to $25,000.[476] Furthermore, a civil penalty not to exceed $2000 can be imposed upon persons for making any untrue statement in a document filed with the director or for violating: (1) the registration requirement, (2) the requirement that an offering circular be delivered to prospective franchisees, (3) the requirement that persons offering franchises keep books and records and file records with the director, (4) any order of the director, or (5) the antifraud provision.[477] The attorney general is authorized to accept written "assurances of discontinuance" by persons. Failure to comply with such assurance is made prima facie evidence of violation of the Act.[478] Moreover, any willful violation of the Act is criminally punishable by fine up to $5000 and/or imprisonment up to 10 years.[479]

---

472. *See* text accompanying notes 182-95, 416-25 *supra.*
473. *See* text accompanying note 426 *supra.*
474. *See* text accompanying notes 137-47 *supra.*
475. WASH. REV. CODE § 19.100.210(1) (Supp. 1972).
476. *Id.* § 19.100.210(2).
477. *Id.*
478. *Id.* The provision is taken from the Consumer Protection Act. WASH. REV. CODE § 19.86.100 (Supp. 1972).
479. *Id.* § 19.100.210(3).

2. *Private Civil Remedies*

(a) *Violations in Connection with Sales of Franchises.* Section 19(2) of the Act provides that "any person who sells or offers to sell a franchise in violation of this Act shall be liable to the franchisee or subfranchisor who may sue at law or in equity for damages caused thereby for rescission or other relief as the court may deem appropriate."[480] Recoverable damages are the "actual damages sustained" which, in the court's discretion, may be increased to an amount not exceeding three times the actual damages sustained.[481] The court also has discretion to award reasonable attorneys' fees to the prevailing party.[482]

Two different types of violations in connection with the sale of franchises can trigger the remedy provision. The first occurs when an offer or sale is in violation of the Act but no misrepresentation or deception has been practiced; examples include improperly registered sales or a franchisor's failure to deliver a required offering circular.[483] In such a case, rescission is the appropriate remedy and is made available by the Act regardless of what either the defendant or the plaintiff knew or should have known.[484] In addition to rescission, section 19(2) seems to allow an alternative recovery of damages for this type of violation. It is not clear what measure of damages is intended or how a franchisee can show that this type of violation caused him damage.[485]

The second type of violation occurs when the seller has practiced some kind of misrepresentation or deception on the franchisee which

480. *Id.* § 19.100.190(2). The "at law or in equity" language presumably is intended to give the franchisee-plaintiff an unfettered choice between trial by jury or by the court.

481. *Id.* § 19.100.190(3). For possible constitutional problems created by treble damages, *see* note 468 *supra*.

482. WASH. REV. CODE § 19.100.190(3) (Supp. 1972). The Act originally provided for a mandatory award of reasonable attorneys' fees to a prevailing franchisee plaintiff with no provision for an award to a prevailing franchisor. Ch. 252, § 19(3) [1971] Wash. Laws, 1st Ex. Sess. It was changed to allow a discretionary award to either party by the 1972 amendments. Ch. 116, § 11 [1972] Wash. Laws, 2d Ex. Sess. This change seems unwise. Since a franshisor normally has greater resources than a franchisee, the prospect of being charged with the defendant's attorneys' fees undoubtedly will deter many franchisees but few franchisors from seeking access to the courts to enforce their rights.

483. WASH. REV. CODE §§ 19.100.020, .080 (Supp. 1972).

484. Rescission is the private civil remedy imposed for unlawful sales of securities under both the state and federal securities laws. 15 U.S.C. § 77*l*(1) (1970); WASH. REV. CODE § 21.20.430 (Supp. 1972).

485. Neither the state nor the federal securities laws provides a damage measure of recovery for unlawful sales.

constitutes a violation of section 17.[486] Again, rescission is available as a remedy.[487] Two defenses are provided in an action for rescission based on section 17. The defendant may prove (1) "that the plaintiff knew the facts concerning the untruth or omission" or (2) "that the defendant exercised reasonable care and did not know or if he had exercised reasonable care would not have known of the untruth or omission."[488] The inclusion of the first defense implies that reliance need not be shown by the plaintiff-franchisee in order to recover.[489] Knowledge on the part of the plaintiff of the falsity (and hence a lack of reliance) must be shown by way of defense. The second defense, lack of knowledge by the franchisor, makes the statutory remedy of rescission actually less favorable to the franchisee than the common law remedy of rescission[490] which remains available since the Act specifies that its remedies "shall be cumulative and nonexclusive and shall not affect any other remedy."[491]

As an alternative to rescission as a remedy for misrepresentation, the franchisee can seek damages—which the court may treble in its discretion. Following the existing rule in Washington,[492] damages would be measured by the "loss of bargain" rule, the difference between the actual value of what the franchisee received and the value it would have had if it had been as represented.

In view of the statutory command that the franchisee may recover such "relief as the court may deem appropriate," the courts should not view "damages" and "recission" as the sole or mutually exclusive measures of relief. A franchise transaction, involving as it does the

486. WASH. REV. CODE § 19.100.170 (Supp. 1972), discussed at notes 397-403 *supra.*

487. In view of the Franchise Act's purpose to curb sales practice abuses and provide effective relief to deceived franchisees, the statutory remedy of rescission should not be encrusted with such restrictive common law doctrines as laches and ratification. *See* text accompanying note 50 *supra.*

488. WASH. REV. CODE § 19.100.190(2) (Supp. 1972). The two exceptions are similar to section 12(2) of the federal Securities Act of 1933, the express remedy for securities sales fraud. 15 U.S.C. § 77*l*(2) (1970).

489. *Cf.* CAL. CORP. CODE § 31301 (West Supp. 1972) which requires the franchisee to prove that he was relying upon a challenged statement when he purchased the franchise.

490. *See* text accompanying notes 48-50 *supra.* With survival of common law rescission, a franchisee induced by misrepresentation has a choice of remedies: common law rescission with a reliance element, restrictive doctrines of laches and ratification but no lack of knowledge of falsity defense; and statutory rescission with no affirmative reliance element or laches-ratification but a lack of knowledge defense.

491. WASH. REV. CODE § 19.100.910 (Supp. 1972).

492. *See* note 46 *supra.*

commitment of the buyer's time as well as his assets, should not be treated like an ordinary sale of real or personal property. In the leading case of *Runyan v. Pacific Air Industries, Inc.*[493] the California Supreme Court approved an award to a defrauded franchisee which combined both rescissionary relief and consequential damages. The franchisee received the franchise fee plus the lost income which he would have earned on a job he surrendered to undertake the franchise less the gross income received under the franchise and less an allowance for the value of benefits conferred on the franchisee by the franchisor.[494] The approach of *Runyan* should be followed in applying section 19(2).

Section 19(2) unfortunately fails to particularize the persons who are liable to a franchisee for sales violations. Most comparable statutes impose liability not only on the seller but also on controlling persons; partners, officers and directors; employees and broker-dealers; and salesmen who materially aid the sale.[495] As a defense such non-sellers may show that "in the exercise of reasonable care [they] could not have known of the existence of the facts by reason of which the liability is alleged to exist."[496] Under the Franchise Act, liability is extended to those "who sell or offer to sell a franchise," a provision expanded somewhat by section 16 which subjects to the Act those persons who "engage directly or indirectly in the sale or offer to sell a franchise."[497] Since the omission of a provision particularizing the persons liable appears to have been a technical oversight, the courts should not hesitate to construe sections 16 and 19 broadly enough to impose liability for misrepresentation on all persons participating in the sale and especially upon parent corporations which engage in franchising through subsidiaries.

Since no statute of limitations is provided for actions under section

---

493. 2 Cal. 3d 304, 85 Cal. Rptr. 138, 466 P.2d 682 (1970).

494. The rule on measuring the amount of offset allowed to a franchisor for the value of benefits conferred on the franchisee does not seem to be clearly established. In *Runyan*, the court allowed no offset since it found that the franchisor had already recouped the expenditures and rental value in question. In Mr. Steak, Inc. v. River City Steak, Inc., 460 F.2d 666, 668-69 (10th Cir. 1972) the court disallowed any offset for real estate and equipment rental during the period of the franchise.

495. *See, e.g.*, WASH. REV. CODE § 21.20.430(2) (Supp. 1972) (the state securities act); CAL. CORP. CODE § 31302 (West Supp. 1972) (the California Franchise Investment Law).

496. WASH. REV. CODE § 21.20.430(2) (Supp. 1972); CAL. CORP. CODE § 31302 (West Supp. 1972).

497. WASH. REV. CODE § 19.100.160 (Supp. 1972).

19(2), the general statute of limitations for an "action for relief upon the ground of fraud" presumably applies. This statute provides for a three year limitation period with the cause of action not accruing "until the discovery by the aggrieved party of the facts constituting the fraud."[498] In this respect, the limitations period is more favorable to the franchisee than the equivalent period under the state securities act, which is three years with no extension for reasonable failure to discover the fraud.[499]

(b) Violations of the Fair Practices Section. Section 18(2) provides that a violation of its specific prohibitions shall be an "unfair or deceptive act or practice or an unfair method of competition."[500] In turn, section 19(1) provides that such unfair or deceptive acts shall constitute the same "under the provisions of chapter 19.86 of the Revised Washington Code," the state's Consumer Protection Act.[501] The Consumer Protection Act provides for civil actions for damages and/or injunctive relief.[502] A plaintiff may obtain an award for reasonable attorneys' fees, and the court may increase the award of damages up to an amount not to exceed the lesser of three times the actual damages sustained or $1000.[503] An action for damages must be commenced within four years after the cause of action accrues.[504]

The very nature of the rights and prohibitions of section 18 often will indicate the appropriateness of injunctive relief either alone or in combination with a damage award. For example, injunctive relief will be the normal remedy for an improper termination or threat of termination. Cases under the federal antitrust laws and the federal Automobile Dealers Act will provide helpful precedents in resolving questions such as the propriety of a preliminary injunction and the scope of the franchisee's obligations during the pendency of the action.[505]

3. *Arbitration Agreements*

A question apparently not considered by the legislature is the effect

498. WASH. REV. CODE § 4.16.080(4) (1959).
499. WASH. REV. CODE § 21.20.430(3); *see also* Douglass v. Glenn E. Hinton Investments, Inc., 440 F.2d 912 (9th Cir. 1971).
500. WASH. REV. CODE § 19.100.180(2) (Supp. 1972).
501. *Id.* § 19.100.190(1).
502. *Id.* § 19.86.090.
503. *Id.*
504. *Id.* § 19.86.120.
505. *See* text accompanying notes 170-72, and 198-99 *supra*.

of the Franchise Act and its remedial provisions upon agreements to arbitrate in franchise contracts. State[506] and federal[507] statutes broadly validate agreements by parties to arbitrate present or future controversies. Could an arbitration clause in a franchise agreement be enforced to compel a franchisee to submit to arbitration of a claim grounded upon misrepresentation in the sale of the franchise or a violation of the provisions of the Fair Practices Section, section 18(2)?

The closest authority is the United States Supreme Court case of *Wilko v. Swan*.[508] In *Swan*, a customer brought an action under the Securities Act of 1933 for damages based on fraud in connection with the purchase of securities committed by the defendant stockbroker. Although the defendant contended that the relationship between the parties was controlled by an arbitration agreement, the Court held that section 14 of the Securities Act,[509] which voids any provision "binding any person acquiring any security to waive compliance with any provision" of the Securities Act, invalidated the arbitration clause. Thus, the plaintiff could seek the express judicial remedy created by the Securities Act despite the existence of the arbitration clause and the United States Arbitration Act.[510] Section 22 of the Franchise Act is virtually identical to section 14 of the Securities Act of 1933.[511] If the reasoning of *Swan* is followed by the Washington courts, the judicial remedies of the Franchise Act will supersede any agreement to arbitrate.[512]

Arguably, the legislature should have considered arbitration as a desirable mechanism for resolving disputes between franchisor and franchisee—especially the kinds of disputes dealt with in the Fair

506. WASH. REV. CODE § 7.04.010 (Supp. 1972).
507. 9 U.S.C. § 2 (1970).
508. 346 U.S. 427 (1953).
509. 15 U.S.C. § 7n (1970).
510. *See also* A. & E. Plastik Pak Co. v. Monsanto Co., 396 F.2d 710 (9th Cir. 1968); Aimcee Wholesale Corp. v. Tomar Products, Inc., 21 N.Y.2d 621, 237 N.E.2d 223 (1968) (antitrust claims not arbitrable).
511. WASH. REV. CODE § 19.100.220 (Supp. 1972).
512. A delicate problem in federalism arises when a franchise agreement constitutes a contract involving interstate commerce. The United States Arbitration Act applies to such contracts, and it can be argued that that Act preempts any state law (such as the Franchise Act) which attempts to preclude arbitration. *Swan*, which relied on the parity of two federal statutes, the Securities Act and the United States Arbitration Act, would not apply where federal and state statutes appear to conflict. On this general question, *see* Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967); Bernhardt v. Polygraphic Co. of America, 350 U.S. 198 (1956); Note, *Commercial Arbitration in Federal Courts*, 20 VAND. L. REV. 607 (1967).

Practices Section of the Franchise Act. One commentator has argued that arbitration fairly conducted can be less disruptive of the continuing relationship between franchisor and franchisee than litigation, provided it is binding on both parties and not just the franchisor.[513]

CONCLUSION

Franchising as a marketing system offers both economic and social advantages as an alternative to the continued growth of large, vertically-integrated corporations. It fosters the birth of new industries and of new competition within existing industries while perpetuating local ownership and management of small business. The role of the legal system should be to create an atmosphere in which franchising can realize these fundamental advantages. A critical part of such an atmosphere is public confidence—confidence that franchise opportunities are promoted on the basis of solid value and not inflated or distorted promises, confidence that an investor in a franchise opportunity will not be subject to arbitrary or oppressive control.

The Washington Franchise Investment Protection Act is a positive step taken to assure continued public confidence in franchising. Unfortunately, the statutory scheme contains intended and unintended loopholes, gaps in coverage, and other deficiencies that may dilute or negate entirely its purpose. These flaws should be cured by legislative amendment. Further, the Washington Securities Division, charged with administration of the Act, should be given the expanded resources necessary for effective enforcement.[514] But even if these steps are taken, it appears doubtful whether state legislation can ever be an adequate approach to a national problem such as franchising. Strin-

---

513. *See* Rudnick, *Arbitration of Disputes Between Franchisors and Franchisees,* 55 ILL. B.J. 54, 62-63 (1966); *but see* Brown, *Franchising—A Fiduciary Relationship,* 49 TEX. L. REV. 650, 662 (1971).

While the bill introduced by Senator Hart in the 91st Congress on "Fairness in Franchising" provided a judicial remedy for franchise terminations not made in good faith, it also allowed binding arbitration of disputes concerning terminations so long as neither the standard of good cause nor the allowable compensation to a franchisee was less than that provided in the bill. S. 1967, 91st Cong., 2d Sess. (1969). The Hart bill could have served as a model for a similar provision in the Washington Franchise Act.

In a recent proposed complaint, the FTC announced that it was considering requiring gasoline companies to alter their station leases so that (1) they would be subject to cancellation only for good cause and (2) the question of good cause would have to be submitted to arbitration. Wall Street Journal, Nov. 7, 1972, at 2, col. 3.

514. The Securities Division was understaffed even prior to being given responsi-

gent local regulation has the laudable effect of deterring the entry of worthless and fraudulent franchise promotions. However, by raising the effective cost of doing business in the state, such regulation also may deter the entry of solid franchise opportunities at least until the markets in states without such regulation have become saturated. Needed is the development of minimum federal standards governing franchising to reduce any such competitive disadvantage. The pattern of concurrent state and federal regulation has been reasonably successful in the area of securities sales and should likewise be so in the area of franchising.

---

bility for the Franchise Act. *See* Rooks, *supra* note 313, at 192-95. Indeed, the office has tended to be a profit maker—taking in more in fees than its budget. The pattern in Washington seems to be to give new tasks to the Securities Division almost continually. *See, e.g.*, Ch. 106 [1972] Wash. Laws, 2d Ex. Sess. (statute regulating promotion of camping clubs).