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## LIMITATIONS ON CONTRACT TERMINATION RIGHTS—FRANCHISE CANCELLATIONS

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*The remarkable growth in recent years of franchise contracts as a means of marketing a variety of goods and services has been accompanied by an increase in litigation over franchise terminations. To date, however, the courts have provided only stopgap protections against the gravest abuses. Some courts have imposed subjective good faith limitations and a few legislatures have broached the area, but the results have not been satisfactory. Behind the franchise termination situation often lie elementary considerations of fairness which the courts in other contexts have been able to deal with by expanding established principles of contract law. The application of these principles to franchise terminations is the subject of this article.*

THE DISTRIBUTION of goods and services has undergone remarkable change in recent years. Formerly, manufacturers distributed their products by selling them to established wholesale and retail outlets or by relying upon their own distribution systems; services, other than those connected with the sale of a new product, were usually provided by independent, unaffiliated firms. Now, however, manufacturers and producers of services frequently license independently owned distributors or dealers to market their products. As a result, the obligations of the manufacturer and dealer as well as the allocation of any rewards (or losses) between them is today usually governed by a franchise rather than a sales agreement.<sup>1</sup>

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<sup>1</sup> While franchise arrangements take many different forms, "in its simplest form, franchising involves a company with a product or service which arranges for a group

The termination of a franchise agreement pursuant to a reserved or implied power<sup>2</sup> poses particularly vexing problems. In drafting the contract, the parties, apparently concentrating on questions of performance, often cover the problem of termination only cursorily or allow the drafting party to impose one-sided conditions without negotiation.<sup>3</sup> However, once the contract relationship sours, the parties, or at least the terminated party, suddenly are very interested in the question of termination rights. For the unwary terminated party it is usually too late. He may be faced with unexpected and substantial losses without any apparent remedy. The terminating party normally can justify his action under reserved or implied powers to terminate and need not establish any other defense. As a result, terminated parties often assert a claim based on some alleged foul play. A dealer who distributes a manufacturer's product at retail and who may have spent sizable sums promoting the product may assert that the termination is grossly unfair because

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of dealers to handle its distribution. The company with the product, product line or service is known as the franchisor, and the dealers who acquire the right to sell the product or service exclusively are known as franchisees." LEWIS & HANCOCK, *THE FRANCHISE SYSTEM OF DISTRIBUTION I* (1963). (Emphasis omitted.) Many franchises, however, are non-exclusive. Note, 63 HARV. L. REV. 1010, 1016-17 (1950).

The advantages of franchising can be substantial. It "permits the franchisor and the franchisee to combine the advantages of individual ownership with the efficiencies attending large-scale operations. . . . [I]ts explosive growth indicates [that] it may prove to be the most effective system yet devised to counter the market domination of the chains." *Hearings Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary*, 89th Cong., 1st Sess., pt. 1, at 8 (1965) [hereinafter cited as *Hearings I*].

It is difficult to overemphasize the size and significance of franchising. There has literally been a "franchise boom" in the last ten years. *Hearings Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary*, 89th Cong., 2d Sess., pt. 2, at 690 (1966) [hereinafter cited as *Hearings II*]; see KURSH, *THE FRANCHISE BOOM* (1962). Lewis and Hancock note "that there are hundreds of thousands of franchised businesses in the United States, and they account for a substantial volume of this nation's retail sales." LEWIS & HANCOCK, *op. cit. supra* at 87. For example, in 1963 there were 338,652 franchise outlets in thirteen major industry groupings alone; these franchises reported annual sales volume in excess of fifty-nine billion dollars. *Hearings II* at 690.

<sup>2</sup> Although the terms "right" and "power" have been used to distinguish between contract terminations where the terminating party is not subject to liability for having ended the contract and those terminations which may result in his liability, *Gibbs v. Bardahl Oil Co.*, 331 S.W.2d 614, 619 (Mo. 1960), the terms are often used interchangeably. See 3A CORBIN, *CONTRACTS* § 647 (1960) [hereinafter cited as CORBIN]; Corbin, *Rights and Duties*, 33 YALE L.J. 501, 510 (1924). Hence they will be used here without ascribing particular significance to the liability of the terminating party.

<sup>3</sup> KURSH, *op. cit. supra* note 1, at 78; see 5 CORBIN § 1058, at 339 ("When parties are making a contract, their attention is centered on the performances that are promised . . .").

he is saddled with substantial losses or deprived of potential profits or because the manufacturer reaps an unearned windfall. In addition, the dealer invariably claims that the real reason for termination was not the failure of performance alleged but personal animosity or spite. The dealer's position is usually summed up by the allegation that the termination was not made in "good faith."<sup>4</sup>

The equities supporting the terminated dealer often seem compelling. His loss may be substantial. His investment of thousands of dollars may have little value on liquidation when divorced from the franchise.<sup>5</sup> Or, the evidence of intent to injure the dealer may be overwhelming. In one case,<sup>6</sup> the dealer's evidence established that twenty-one months before the termination the manufacturer's field manager, upon whose recommendation the decision to terminate was partially based, warned the dealer that "if its [*sic*] the last thing I ever do . . . I will get you yet." In another case<sup>7</sup> the court concluded that the dealer had been mistreated when the manufacturer

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<sup>4</sup> See, e.g., *Smoky Mountains Beverage Co. v. Anheuser-Busch, Inc.*, 182 F. Supp. 326 (E.D. Tenn. 1960); *Green Bay Auto Distribs., Inc. v. Willys-Overland Motors, Inc.*, 102 F. Supp. 151 (N.D. Ohio 1951), *aff'd*, 202 F.2d 151 (6th Cir. 1953). See also *Anheuser-Busch, Inc. v. Jefferson Distrib. Co.*, 353 F.2d 956 (5th Cir. 1965); *Bruno v. Pepperidge Farm, Inc.*, 256 F. Supp. 865 (E.D. Pa. 1966).

<sup>5</sup> The testimony of Frederick Bauer, a terminated beer distributor, is illustrative: "At the time of cancellation I operated as two closed corporations, one owning real estate and motorized equipment, the other owning the inventory and related merchandising equipment. In 1946 I started out with capital amounting to \$10,000. At the time of cancellation the real estate corporation had a net worth of \$200,000, and the distributing company one of \$185,000. Over the last 10-year period of operation the net profits of the two corporations, plus the salaries that I drew from them, averaged over \$100,000 annually—that was before Federal taxes. With the cancellation, I lost the right to sell a going business for a price which such earnings would have justified. Not only did I forfeit future earnings and goodwill value of the business, but I had also to accept a fire-sale valuation for real estate and equipment. Having single-purpose warehouses and equipment, I had no alternative but to accept. Otherwise, I would have been left with nothing more than two piles of brick and mortar and a 'junk' yard of motorized equipment." *Hearings II* at 526-27.

<sup>6</sup> *Kotula v. Ford Motor Co.*, 338 F.2d 732, 736 (8th Cir. 1964), *cert. denied*, 380 U.S. 979 (1965).

<sup>7</sup> *Walker v. Ford Motor Co.*, 241 F. Supp. 526, 529-30 (E.D. Tenn. 1965). In both *Kotula v. Ford Motor Co.*, *supra* note 6, and *Walker* the court upheld the manufacturer's right to terminate. Neither case, however, directly reflects the status of contract law since the dealer in each sought relief under the Automobile Dealers' Day-in-Court Act, 70 Stat. 1125 (1956), 15 U.S.C. §§ 1221-25 (1964). The terminated automobile dealers probably relied on the federal act because the possibility of common law relief seemed remote. See Kessler, *Automobile Dealer Franchises: Vertical Integration by Contract*, 66 YALE L.J. 1135, 1149-59 (1957). Nor is the problem of "unfair" cancellation limited to automobile manufacturers. See, e.g., *Hearings II* at 531-34 (beer distributorship).

first "advised" him to make unnecessary expenditures and then terminated the franchise.

Despite such evidence courts have seldom set aside franchise terminations, examined the terminating party's conduct critically, or established any criteria of minimum levels of fairness against which termination provisions should be measured. In response to the terminated party's indignant cries of bad faith, courts have woodenly intoned the hackneyed phrases of freedom to contract theory and held that harsh result or wrongful motivation is irrelevant since under the contract termination clause the manufacturer had the "legal right" to terminate. In contrast to the familiar "interpretation" of mass standardized contracts where rules of construction are frequently corrupted, courts have only occasionally adopted indirect techniques to curb harsh effects of termination; rather, the unfortunate consequences of termination are condemned in principle but condoned in practice. The few cases which seem to adopt a good faith test are likewise devoid of analysis. Neither the effect nor effectiveness of a subjective good faith limitation on a contract termination right has been considered. And regardless of the approach adopted, the courts have not explored or developed the alternatives available.

The major factors contributing to the dealers' vulnerability are not difficult to identify. First, there usually is a substantial disparity between the bargaining power of the dealer and that of the manufacturer.<sup>8</sup> And the dominant, or at least more powerful, manufacturer has not always exercised discretion in the use of its power.<sup>9</sup>

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<sup>8</sup> 6 CORBIN § 1266, at 57; *Hearings II* at 617-18. But appearances as to the existence of substantial economic disparity between the parties can be deceptive. The automobile industry, for example, has often been cited as "a glaring example of a contract of adhesion at the time of renewal when the dealer has invested heavily in the business." Kessler, *supra* note 7, at 1156; *accord*, 70 Stat. 1125 (1956) (preamble to Automobile Dealers' Day-in-Court Act: "power [is] now heavily weighted in favor of automobile manufacturers"); Note, 70 HARV. L. REV. 1239 (1957). Compare *Ford Motor Co. v. United States*, 335 U.S. 303, 323 (1948) (Black, J., dissenting: automobile dealers are the "economic dependents of the company whose cars they sell."). On the other hand, one economist has suggested that little is really known about the determinants of the automobile dealers' bargaining position and that, from the evidence of "relatively low dealer turn-over rates and the relatively high dealer profit rates," one might properly conclude that "the automobile companies have not been too successful in overcoming the bargaining position of their established dealers." PASHIGIAN, *THE DISTRIBUTION OF AUTOMOBILES, AN ECONOMIC ANALYSIS OF THE FRANCHISE SYSTEM* 35-36 (1961).

<sup>9</sup> See, e.g., *C. Robert Ingram, Inc. v. Chrysler Corp.*, 256 F.2d 684, 687 (10th Cir. 1958) (air conditioners); *Motor Car Supply Co. v. General Household Util. Co.*, 80 F.2d 167, 171 (4th Cir. 1935) (refrigerators); 6 CORBIN § 1266, at 57.

In the manufacturers' defense, it can be said that they may have been unable, individually, to control the use of such power since the needs or demands of competition can be onerous.<sup>10</sup> Second, the dealer has been handicapped by the anomalous legal classification of the manufacturer-dealer relationship; the franchise agreement is neither a sales nor an agency contract, yet it partakes of both.<sup>11</sup> Despite the obvious analogy, the manufacturer-dealer relation has little in common with the relation between a principal and his agent. For example, neither owes a duty of loyalty to the other, and one may compete with the other.<sup>12</sup> The dealer, in addition, does not take the goods on consignment; rather, the manufacturer is a seller and the dealer is a buyer of the product involved.<sup>13</sup> Moreover, while the franchise agreement often specifically excludes an agency relation,<sup>14</sup> rules of sales law are inapposite because of the continuing relationship between the parties after the sale of the goods.<sup>15</sup> Consequently, the rules relating to franchise terminations are often haphazard and are unrelated either to the needs of the parties or to minimum standards of fairness.

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<sup>10</sup> See, e.g., *Bateman v. Ford Motor Co.*, 214 F. Supp. 222, 226 (E.D. Pa. 1963).

<sup>11</sup> *Des Moines Blue Ribbon Distribs., Inc. v. Drewrys Ltd.*, 256 Iowa 899, 906-07, 129 N.W.2d 731, 736 (1964); see *Mantell v. International Plastic Harmonica Corp.*, 141 N.J. Eq. 379, 388-89, 55 A.2d 250, 256-57 (1947).

The franchise agreement, originally labeled a sales agency, is of comparatively recent origin and fits into no recognized contract category. "Broadly the problem of the sales agency has been that encountered by every new legal relation, to adapt old rules to new kinds of contracts, to reconcile somewhat crystallized concepts with the working needs of modern business." 28 ILL. L. REV. 800-01 (1934). See generally HEWITT, *AUTOMOBILE FRANCHISE AGREEMENTS* 189-206 (1956).

<sup>12</sup> E.g., *Walpole v. Prefab Mfg. Co.*, 103 Cal. App. 2d 472, 230 P.2d 36 (Dist. Ct. App. 1951). However, the agreement precludes such competition if the manufacturer grants the dealer an exclusive franchise. E.g., *Thomas A. Edison, Inc. v. Blackman Distrib. Co.*, 66 F.2d 722, 728-29 (2d Cir. 1933); *Buckley & Scott Util., Inc. v. Petroleum Heat & Power Co.*, 313 Mass. 498, 503, 48 N.E.2d 154, 157 (1943).

<sup>13</sup> See *Silverman v. Samuel Mallinger Co.*, 375 Pa. 422, 100 A.2d 715 (1953); HEWITT, *op. cit. supra* note 11, at 190-91; LEWIS & HANCOCK, *op. cit. supra* note 1, at 9. *But see* *Parks v. Baldwin Piano & Organ Co.*, 262 F. Supp. 515 (D. Conn. 1967).

<sup>14</sup> *Hearings I* at 405, 414, 436, 446, 453 (sample franchise contracts); Brown & Conwill, *Automobile Manufacturer-Dealer Legislation*, 57 COLUM. L. REV. 219, 220 (1957); Kessler, *supra* note 7, at 1140-41 n.37.

<sup>15</sup> See LEWIS & HANCOCK, *op. cit. supra* note 1, at 8-9, 18-56. Nevertheless, some courts disregard the continuing relationship and the dependencies which arise. What are essentially franchise agreements are treated as a series of executory contracts enforceable only if performance has commenced. E.g., *C. C. Hauff Hardware, Inc. v. Long Mfg. Co.*, 136 N.W.2d 276 (Iowa 1965). Compare *Smoky Mountains Beverage Co. v. Anheuser-Busch, Inc.*, 182 F. Supp. 326 (E.D. Tenn. 1960), with *Des Moines Blue Ribbon Distribs. Inc. v. Drewrys Ltd.*, 256 Iowa 899, 129 N.W.2d 731 (1964). When the agreement is so construed, the dealer, of course, has no protection against arbitrary "termination" since he has no "right" to make future purchases from the manufacturer.

Nevertheless, in contrast to other areas of contract law, only sporadic attention has been given to the exercise of reserved or implied powers of termination, especially in connection with franchise agreements.<sup>16</sup> The revisers of the sales law sought to establish some boundaries of fair conduct and contract in connection with contracts of sale.<sup>17</sup> Similarly, Congress, in the Automobile Dealers' Day-in-Court Act,<sup>18</sup> sought to mitigate disparity of bargaining power be-

<sup>16</sup> The attention given to the question of franchise termination rights has generally been limited to automobile dealerships and the antitrust implications of franchise arrangements. The problems peculiar to each of these situations are beyond the scope of this article; they have been dealt with extensively elsewhere. Automobile franchises: see generally Freed, *A Study of Dealers' Suits under the Automobile Dealers' Franchise Act*, 41 U. DET. L.J. 245 (1964); Kessler, *supra* note 7; Macaulay, *Changing a Continuing Relationship Between a Large Corporation and Those Who Deal With It: Automobile Manufacturers, Their Dealers, and the Legal System* (pts. I-II), 1965 WIS. L. REV. 483, 740 [hereinafter cited as Macaulay]. Antitrust problems of franchises: see generally Chadwell & Rhodes, *Antitrust Aspects of Dealer Licensing and Franchising*, 62 N.W. U.L. REV. 1 (1967); Stone, *Closed Territorial Distribution: An Opening Question in the Sherman Act*, 30 U. CHI. L. REV. 286 (1963); Comment, 7 B.C. IND. & COMM. L. REV. 350 (1966). See also *United States v. Arnold, Schwinn & Co.*, 35 U.S.L. WEEK 4563 (U.S. June 12, 1967); *United States v. Sealy, Inc.*, 35 U.S.L. WEEK 4571 (U.S. June 12, 1967).

Nor is any attempt made here to catalogue the various termination techniques found in franchise agreements. Others have done so and it seems clear from their findings that such clauses are as diverse as the products and services involved. *E.g.*, KURSH, *op. cit. supra* note 1, Appendix B at 207-46; LEWIS & HANCOCK, *op. cit. supra* note 1, at 60-66.

<sup>17</sup> For example, the term "good faith" is specifically set forth in approximately 50 of the 400 sections of the UCC. But the term is used in the code in two fundamentally different senses. It is used subjectively to describe a state of mind in connection with "good faith purchase." On the other hand, it is used objectively in connection with "good faith performance." In this second sense the term has nothing to do with state of mind but rather relates to the fairness or reasonableness of the performance. It is this latter meaning which generally applies to enforcement of sales contracts, Article 2, and to the general obligation of good faith set forth in § 1-203 in the introductory section of the code. Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 667-68 (1963); see Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057 (1954).

Modern sales law also distinguishes between "terminations" and "cancellations." The former is said to occur upon the exercise of a power to end the contract for a reason other than its breach (and all executory obligations are as a result discharged); the latter describes the situation when either party ends the contract for breach by the other (and the cancelling party retains his remedy for breach). UNIFORM COMMERCIAL CODE §§ 2-106(3), 2-106(4) [hereinafter cited as UCC]. Useful as such distinctions may be in drafting statutory provisions, the courts generally use the terms interchangeably. See *Union Tank Car Co. v. Lindsay Soft Water Corp.*, 257 F. Supp. 510, 513 (D. Neb. 1966); *Schweinburg v. Altman*, 145 App. Div. 377, 384, 130 N.Y. Supp. 37, 42 (1911), *aff'd per curiam by equally divided court*, 207 N.Y. 681, 101 N.E. 1121 (1913). These terms, however, will be used here without indication of the potential remedies available to either party to the contract.

<sup>18</sup> 70 Stat. 1125 (1956), 15 U.S.C. §§ 1221-25 (1964). Similar "good faith" legislation applicable to relations between all franchisors and franchised dealers has been intro-

tween automobile manufacturers and dealers in regard to termination conditions and practices.<sup>19</sup> Both statutes impose *objective* limitations on the exercise of reserved or implied power to terminate. The Uniform Commercial Code makes limited inquiries into the fairness or reasonableness of the termination of a sales contract,<sup>20</sup> and the Dealers' Day Act, as interpreted, protects the automobile dealer from coercion.<sup>21</sup> But neither statute applies to franchises in general, and neither responds to (or considers) the needs commonly asserted by terminated dealers.<sup>22</sup>

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duced in Congress in recent years. H.R. 10113, 89th Cong., 1st Sess. (1965) (introduced by Representative Roosevelt); H.R. 11972, 89th Cong., 2d Sess. (1966) (introduced by Representative Kluczynski); H.R. 2818, 90th Cong., 1st Sess. (1967) (introduced by Representative Kluczynski). See generally *Hearings II* at 520, 536.

<sup>19</sup> H.R. REP. NO. 2850, 84th Cong., 2d Sess. 3 (1956). See generally Kessler, *supra* note 7, at 1171-75; Kessler & Stern, *Competition, Contract, and Vertical Integration*, 69 YALE L.J. 1 (1959); Macaulay 531-53. *But see* PASHIGIAN, *op. cit. supra* note 8.

<sup>20</sup> UCC § 2-309 supplies missing terms with respect to the duration of a contract involving continuing performance; it also requires reasonable notice of termination regardless of the terms selected by the parties. In addition, § 2-302 broadly designates the limits of unconscionability which apply to all contract terms. See discussion at notes 167-68 *infra*.

<sup>21</sup> Section 2 of the Dealers' Day Act grants an automobile dealer the right to bring suit against an automobile manufacturer in a federal district court "by reason of the failure of said automobile manufacturer from and after the passage of this Act [August 8, 1956] to act in good faith in performing or complying with any of the terms or provisions of the franchise, or in terminating . . . the franchise with said dealer . . ." 70 Stat. 1125 (1956), 15 U.S.C. § 1222 (1964). Upon proof of a manufacturer's violation of the act, the dealer can recover damages sustained because of the manufacturer's failure to act in "good faith." The term "good faith" is defined in § 1 (e) of the act to mean that it is "the duty of each party to any franchise, and all officers, employees, or agents thereof to act in a fair and equitable manner toward each other so as to guarantee the one party freedom from coercion, intimidation, or threats of coercion or intimidation from the other party: *Provided*, That recommendation, endorsement, exposition, persuasion, urging or arguments shall not be deemed to constitute a lack of good faith." 70 Stat. 1125 (1956), 15 U.S.C. § 1221 (e) (1964). (Emphasis in original.)

Although the question was debated in the law reviews, with the exception of two early district court opinions the courts have unanimously held that the statute does not protect the dealer from any failure of the manufacturer to act in a fair and equitable manner but rather protects the dealer only from coercion or intimidation. Macaulay 758-62 (authorities collected). *But see* Madsen v. Chrysler Corp., 261 F. Supp. 488 (N.D. Ill. 1966).

In addition, at least twenty states have adopted legislation generally limiting the right of an automobile manufacturer to cancel an automobile dealer's franchise "without due regard to the equities of said dealer and without just provocation . . ." *E.g.*, WIS. STAT. § 218.01 (3) (a) (17) (1965) (ground for suspension of manufacturer's license); see Macaulay 517-19 (table 1). Similar legislation has been adopted in approximately one-third of the states prohibiting brewers from cancelling a beer wholesaler "without due regard to the equities of such wholesaler, or without regard to just cause or provocation . . ." N.C. GEN. STAT. § 18-69.2 (2) (1965); *accord, e.g.*, IND. ANN. STAT. § 12-451a (2) (Supp. 1966); see *Hearings II* at 517, 736.

<sup>22</sup> With minor exceptions, terminated automobile dealers have uniformly failed in

For purposes of this analysis it will be assumed that the dealer's complaints are in fact true—that is, that the termination will cause him substantial losses or unjustly reward the manufacturer (or unjustly impoverish the dealer) and that the termination may be based in part on bad motives.<sup>23</sup> While it is obviously of paramount significance in the individual case to ascertain whether a particular dealer has or has not been mistreated or should be given relief, it is even more important that a rational approach be adopted to determine the appropriate areas and limits of control and relief from contract abuse. *Ad hoc* determinations which sometimes achieve just results by twisting or ignoring standard rules of contract interpretation will never be satisfactory. The legal system itself as well as occasional results should assure minimum deficiencies. It will be suggested here that the direct controls now available in contract law to limit the inequities otherwise resulting from the rigid application of common law principles are not wholly adequate. Waiver, estoppel, and tort theories seem effective for proscribing discriminatory or fraudulent terminations; but express limits on unfair provisions, especially in light of circumstances existing at the time of termination, need further development. The terminating party's motivation, on the other hand, does not seem to be a desirable or necessary subject of judicial inquiry as long as the power was exercised reasonably.

## I

### THE INTERPRETATION AND APPLICATION OF IMPLIED AND RESERVED POWERS OF TERMINATION

As first developed, franchise agreements commonly did not spell out any provision for termination; terms relating to termination

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their efforts to obtain relief under the federal act. Macaulay 742 (Table 2). Despite their earlier dismal experience with common law contract rules, terminated automobile dealers may be turning again to state courts and general contract law to obtain relief. See *DeWitt Motor Co. v. Chrysler Motors Corp.*, No. 819374, C.P. Cuyahoga County, Ohio, Oct. 4, 1965 (petition filed). A renewed reliance on general contract law may result in substantial tests of such rules since there are indications that problems are increasing among automobile dealers. See Macaulay 817-27; *Wall Street Journal*, Oct. 11, 1966, p. 10, col. 3 (Dodge dealers form group to seek changes in franchise agreement).

<sup>23</sup> Although the discussion throughout this article is concerned with the actual or potential harm to the dealer, it has equal application if the dealer is the terminating party and the termination causes harm to the manufacturer. Nor is this an unlikely possibility. In infant industries it is not uncommon for the dealer to be in a much stronger bargaining position than the manufacturer. See, e.g., HEWITT, *op. cit. supra* note 11, at 10-22.



were implied. The breach of a covenant by one party, in a substantial and material respect, of course, was treated as a cancellation of the contract excusing the other party from further performance and giving him a right to sue for the breach.<sup>24</sup> Applying rules of agency, it was usually held that when the contract was for an indefinite duration, either party had the right to terminate at will.<sup>25</sup> Cause was not required. Once notice of termination was given, the contract relationship ended.<sup>26</sup>

These rules, however, often proved to be inadequate, especially in the franchise situation. While franchise systems (and agreements) vary widely, certain problems recur. Upon termination substantial sums invested in the franchise business may be difficult or impossible to recover.<sup>27</sup> Frequently the investment is in one-purpose facilities (for example, Chevrolet dealer's showroom). Or the spare parts inventory may have no resale value (for example, Midas Muffier dealer stock). The manufacturer, on the other hand, may have staked the success or failure of its operation on the performance of its dealers as a whole.<sup>28</sup> Hence the effectiveness of each dealer is of paramount significance to it.<sup>29</sup> It is not surprising then that the

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<sup>24</sup> *George H. Hess Co. v. Dawson*, 149 Ill. 138, 36 N.E. 557 (1894); *Kennedy v. Meilicke Calculator Co.*, 90 Wash. 238, 155 Pac. 1043, 1044 (1916).

<sup>25</sup> *Meadows v. Radio Indus., Inc.*, 222 F.2d 347, 349 (7th Cir. 1955); *Joliet Bottling Co. v. Joliet Citizens Brewing Co.*, 254 Ill. 215, 218, 98 N.E. 263, 265 (1912); *Garlock v. Motz Tire & Rubber Co.*, 192 Mich. 665, 159 N.W. 344 (1916); *Fuchs v. Standard Thermometer Co.*, 178 Mich. 37, 144 N.W. 484 (1913); *Superior Concrete Accessories, Inc. v. Kemper*, 284 S.W.2d 482, 490 (Mo. 1955). See generally 1 CORBIN § 96. Compare UCC § 2-309 (2). *But cf.* *Miller v. O. B. McClintock Co.*, 210 Minn. 152, 160, 297 N.W. 724, 729 (1941) ("Courts are inclined to construe a contract so as not to allow a party to terminate at will without cause.").

<sup>26</sup> If the contract were limited to a specific term, however, termination before the expiration of that period would have to be justified by cause. See *E. H. Taylor, Jr. & Sons v. Julius Levin Co.*, 274 Fed. 275 (6th Cir. 1921); *Moran v. Standard Oil Co.*, 211 N.Y. 187, 195-97, 105 N.E. 217, 220-21 (1914).

<sup>27</sup> See *Brown & Conwill*, *supra* note 14, at 222; *Hearings II* at 526-27 (quoted note 5 *supra*). The economic effects of termination on the dealer depend on many factors, but probably the most significant is whether the franchise grants the dealer an exclusive territory or not or limits the dealer's sale of competing products. "In one type, exemplified by the radio industry, the dealer is relatively independent of any one manufacturer's product, because he sells other kinds of merchandise or because other producers of the same product compete for his orders. In the other, of which the automobile industry is the prime example, the dealer has a large investment, centered almost entirely on retailing and servicing the products of a single manufacturer." Note, 63 HARV. L. REV. 1010, 1017 (1950).

<sup>28</sup> Macaulay 504; see *Duncan, Channels of Distribution for Consumer's Goods*, in *MARKETING BY MANUFACTURERS* 142-77 (Phillips ed. 1946).

<sup>29</sup> Chrysler Corporation's recovery of a greater share of the automobile market, for example, is believed to be in part the result of improved dealerships. Sheehan, *The*

power to terminate is often expressly reserved in franchise agreements and that questions relating to its exercise are frequently before the courts.

When spelled out in the agreement, the power to terminate is usually conditioned on the happening of a specified event, such as a failure to sell (and hence failure to purchase from the manufacturer) a specified minimum number of units. The termination will be upheld when the party exercising the conditioned power shows the existence or occurrence of the fact or event constituting the condition.<sup>30</sup> For example, in *Union Tank Car Co. v. Lindsay Soft Water Corp.*,<sup>31</sup> the dealer agreed to represent the manufacturer in the sale of its water softeners in return for an exclusive franchise and the right to advertise the water softeners under their registered name. The franchise was terminable by the manufacturer if the dealer failed to meet a purchase-quota requirement of fifty water softeners each month. Thus, when the dealer sought to avoid the effects of termination by asserting that the manufacturer had no reason to terminate the contract, the court only considered whether the dealer had fulfilled his quota requirement. Since he had not, the court upheld the termination as being well within the manufacturer's rights.<sup>32</sup>

### *Freedom of Contract Theory*

Had the dealer in *Lindsay Soft Water* questioned the fairness of the termination condition or the manufacturer's motivation in terminating the franchise, it is likely that the court would have reached the same conclusion. It might also have noted its reliance on common law contract principles "that men should have the greatest possible liberty to make such contracts as they please"<sup>33</sup> and that neither the effect of the termination nor the manufacturer's motives should be considered.

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*Price of Success at Chrysler*, *Fortune*, Nov. 1965, p. 138, at 141-42; *Forbes*, September 15, 1965, p. 22.

<sup>30</sup> *Meier Dental Mfg. Co. v. Smith*, 237 Fed. 563 (8th Cir. 1916); *Dunkelbarger v. Ladd*, 204 Iowa 1208, 212 N.W. 726 (1927); 6 CORBIN § 1266; see *Jobns-Manville Corp. v. American Hair & Felt Co.*, 18 Del. Ch. 230, 158 Atl. 141 (Ch. 1931); *Nathan Elson & Co. v. H. Beselin & Son*, 116 Neb. 729, 735-36, 218 N.W. 753, 756 (1928).

<sup>31</sup> 257 F. Supp. 510 (D. Neb. 1966).

<sup>32</sup> *Id.* at 515.

<sup>33</sup> *M. Witmark & Sons v. Fred Fisher Music Co.*, 125 F.2d 949, 962 (2d Cir. 1942) (Frank, J., dissenting and criticizing the quoted phrase), *aff'd*, 318 U.S. 643 (1943).

The guiding principle underlying judicial enforcement of contracts is that they are essentially a private concern.<sup>34</sup> Paramount consideration is given to the security of the transaction.<sup>35</sup> That is, the parties' expectations are to be ascertained from the express terms of the agreement, and they are then to be enforced. Almost total reliance is placed on the self-interest of each party to protect himself from any attempt by the other to overreach. The free play of the market is relied on to correct any actual imbalance in bargaining power; the reasoning is that the parties are free to choose those with whom they will bargain.<sup>36</sup> An oppressive bargain, for example, can be avoided simply by declining to deal on the proffered basis or merely by dealing with another.<sup>37</sup> Hence neither harsh results nor improper motivation should be considered in enforcing the exercise of contract rights.<sup>38</sup> Even the exceptions applied when fraud or duress surround the formation of the contract are explained as judicial intervention to assure that the parties abide by the rules of the contest.<sup>39</sup>

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<sup>34</sup> Under classical contract theory the "unlimited freedom of making promises was a natural right." Pound, *Liberty of Contract*, 18 YALE L.J. 454, 456 (1909). The most famous statement of this view, still the emotional benchmark of the common law of contracts as applied in the United States, is that made by Sir George Jessel: "[I]f there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of Justice. . . . [Y]ou have this paramount public policy to consider—that you are not lightly to interfere with this freedom of contract." *Printing & Numerical Registering Co. v. Sampson*, 19 L.R. Eq. 462, 465 (1875); see *M. Witmark & Sons v. Fred Fisher Music Co.*, *supra* note 33, at 962-66; *Hume v. Moore-McCormack Lines*, 121 F.2d 336, 338-47 (2d Cir. 1941). *But see Meyer, Contracts of Adhesion and the Doctrine of Fundamental Breach*, 50 VA. L. REV. 1173, 1183-86 (1964).

<sup>35</sup> See Williston, *Freedom of Contract*, 6 CORNELL L.Q. 365, 366 (1921); Williston, *Mutual Assent in the Formation of Contracts*, 14 ILL. L. REV. 85 (1919); RESTATEMENT, CONTRACTS §§ 20, 51, 503 (1932). *But see id.* §§ 55, 504.

<sup>36</sup> See Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 630-31 (1943). It is also assumed that the law "cannot possibly anticipate the content of an infinite number of atypical transactions . . ." *Id.* at 629.

<sup>37</sup> See *Tamm v. Ford Motor Co.*, 80 F.2d 723, 730 (8th Cir. 1935); *Motor Car Supply Co. v. General Household Util. Co.*, 80 F.2d 167, 171 (4th Cir. 1935); *Ford Motor Co. v. Kirkmyer Motor Co.*, 65 F.2d 1001, 1006 (4th Cir. 1933).

<sup>38</sup> "However, the gain to one party or the other is not a factor in construing the contract. If the railway had the right under the contract to stop the contractor's work, its motive, whether gain or mere petulance of its officers, would not affect its right. . . . The question here is determined within the four corners of the railway's form contract . . ." *Northern Pac. Ry. v. Twohy Bros.*, 95 F.2d 220, 223 (9th Cir.), *cert. denied*, 304 U.S. 575 (1938).

<sup>39</sup> That is, freedom of contract theory requires a minimal liberty in *both* parties to choose or refuse to enter into the transaction. Llewellyn, *Book Review*, 52 HARV. L. REV. 700, 704 (1939).

*The Logical Imperative*

The undesirability of applying the absolute freedom of contract theory, especially in a present-day commercial context, has often been exposed.<sup>40</sup> Nonetheless, rigid applications of the theory beyond the scope of its premises—that the parties were “equal enterprisers” who freely negotiated the terms—abound in the case law.<sup>41</sup> Freedom of choice requires, of course, that each party be aware of the choice available; yet under common law contract theory a party is conclusively presumed (absent a showing of fraud, duress, or mutual mistake) to know the terms of a written agreement and to accept the consequences which flow from his assent to them.<sup>42</sup>

In connection with termination disputes a logical imperative has been “developed” in answer to any assertion that the terminating party acted in bad faith. Simply stated, it is that a manufacturer cannot be held liable to a dealer merely for having exercised a contract right—the right to terminate—regardless of its motives or the effects resulting from the termination.<sup>43</sup> If the power of termination

<sup>40</sup> “When we turn to the precedents we are met at once with the confusion of statement whether a covenant can be implied only if it was clearly ‘intended’ by the parties or whether such a covenant can rest on principles of equity . . . . One may perhaps conclude that in large measure this confusion arises out of the reluctance of courts to admit that they were to a considerable extent ‘remaking’ a contract in situations where it seemed necessary and appropriate so to do. ‘Intention of the parties’ is a good formula by which to square doctrine with result. That this is true has long been an open secret. . . . [A] certain sophistication must be recognized—if we are to approach the matter frankly—where we are dealing with changed circumstances, fifteen years later, with respect to a contract which does not touch this exact point. . . .” *Parev Prods. Co. v. I. Rokeach & Sons*, 124 F.2d 147, 149 (2d Cir. 1941) (Clark, J.) (citations omitted); see Dawson, *Economic Duress and the Fair Exchange in French and German Law*, 11 TUL. L. REV. 345 (1937): “The system of ‘free’ contract described by nineteenth century theory is now coming to be recognized as a world of fantasy, too orderly, too neatly contrived, and too harmonious to correspond with reality.” Nor is this skeptical view of freedom of contract theory limited to modern times. In the middle of the 19th century the theory was attacked as unsound: “It is a popular, but in my judgment a mistaken, notion that parties ought to be at liberty to enter into contracts after their own fashion.” *Mumford v. Gething*, 7 C.B. (n.s.) 305, 325-26, 141 Eng. Rep. 834, 842 (1859).

<sup>41</sup> Kaplan, Book Review, 63 YALE L.J. 1039, 1041 (1954): “Yet, especially in those areas of our economy where the old protagonists, the enterprisers of equal strength, have disappeared, contract law tends more than occasionally to work out wrong, and to furnish the wrong reasons even when it works out right.”

<sup>42</sup> E.g., *Lawrence v. Muter Co.*, 171 F.2d 380, 384 (7th Cir. 1948), cert. denied sub nom. *Metropolitan Trust Co. v. Muter Co.*, 337 U.S. 907 (1949); *Shulton, Inc. v. Rubin*, 239 Md. 669, 683, 212 A.2d 476, 484 (1965); *Ray v. William G. Eurice & Bros.*, 201 Md. 115, 125, 93 A.2d 272, 278 (1952).

<sup>43</sup> “[S]uch right to terminate was not subject to question on the ground of un-

is conditioned and the condition has been satisfied, the right to terminate is absolute; if the termination power is not conditioned (or is implied), its exercise cannot be questioned.

On the other hand, the legal right theory has been limited by holdings that a contract right cannot be exercised in an unreasonable or oppressive manner. The Supreme Court's decision in *American Bank & Trust Co. v. Federal Reserve Bank*<sup>44</sup> illustrates this limitation. There a Federal Reserve bank had adopted but not yet instituted a policy designed to force state country banks to join the federal reserve system by collecting checks drawn on such banks and by holding them for presentation en masse.<sup>45</sup> If pursued, this practice allegedly would have required the state banks to maintain larger than usual reserves, often beyond their capacity. In upholding the state banks' petition to enjoin any attempt to follow this policy, the Court rejected the argument that the holder of a check drawn for

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reasonableness, unfairness, lack of good faith, bad faith or because of motive, intent or resultant detriment to [the terminated dealer]. . . . It is beyond the power of the judiciary to engraft conditions upon the exercise of such a contractual [termination] right." *Martin v. Ford Motor Co.*, 93 F. Supp. 920, 921 (E.D. Mich. 1950). Nor is this the isolated view of only a few courts. See, e.g., *Stimpson Computing Scale Co. v. W. F. Stimpson Co.*, 104 Fed. 893, 895-96 (6th Cir. 1900); *Zaidan v. Borg-Warner Corp.*, 228 F. Supp. 669, 671 (E.D. Pa. 1964), *aff'd*, 341 F.2d 391 (3d Cir. 1965); *Rubinger v. International Tel. & Tel. Corp.*, 193 F. Supp. 711, 718 (S.D.N.Y. 1961), *aff'd*, 310 F.2d 552 (2d Cir. 1962), *cert. denied*, 375 U.S. 820 (1963); *Sharpe v. Great Lakes Steel Corp.*, 9 F.R.D. 691, 693 (S.D.N.Y. 1950); *General Elec. Co. v. N. K. Ovale, Inc.*, 335 Pa. 439, 442, 6 A.2d 835, 837 (1939); cf. 17A C.J.S., *Contracts* § 413 (1963). Some courts, moreover, have become virtually immune to questions of fairness and have deliberately chosen to remain ignorant of the effects of the termination, "without indulging in observations as to fairness or unfairness of the agreements as to either of the parties." *Myers Motors, Inc. v. Kaiser-Frazer Sales Corp.*, 178 F.2d 291, 301 (8th Cir. 1949).

Similarly, "in English law there is no overriding general positive duty of good faith imposed on the parties to a contract." Powell, *Good Faith in Contracts*, 9 CURRENT LEGAL PROBLEMS 16, 25 (1956).

<sup>44</sup> 256 U.S. 350 (1921) (Holmes, J.). For further proceedings in this case holding that the Federal Reserve bank in fact neither acted from wrongful purposes nor accumulated checks wrongfully, see *American Bank & Trust Co. v. Federal Reserve Bank*, 280 Fed. 940 (N.D. Ga.), *aff'd*, 284 Fed. 424 (5th Cir. 1922), *aff'd*, 262 U.S. 643 (1923). Compare *First State Bank v. Federal Reserve Bank*, 174 Minn. 535, 219 N.W. 908 (1928).

<sup>45</sup> The state country banks charged for "services rendered by them in paying checks drawn upon them at a distance and forwarded, generally by other banks, through the mail." 256 U.S. at 355. Federal Reserve banks, in contrast, were required to clear checks at par. It was this latter policy which the Federal Reserve sought to "force" on the state country banks by coercing membership; alternatively, the Federal Reserve wanted the state banks to open nonmember clearing accounts which would also have required them to maintain larger reserve accounts. The state banks objected because the loss of income and the diminution of their lending power would drive some of them "out of business and diminish the income of all." *Id.* at 356.

payment over the counter had an absolute right to present all checks he may hold.

[T]he word "right" is one of the most deceptive of pitfalls; it is so easy to slip from a qualified meaning in the premise to an unqualified one in the conclusion. Most rights are qualified.<sup>46</sup>

Even though the Court noted that a similar case involving private business would be more difficult to justify than where, as here, Congress had not sanctioned "this sort of warfare upon the legitimate creations of the states," the rationale of the holding that a court will interfere with the exercise of a contract right for improper motives when done in an unreasonable manner seems equally applicable to private contracts. This does not mean, however, that the contract right cannot be exercised, only that its method of exercise must be reasonable. The opinion emphasized the Federal Reserve bank's "disinterested malice" in presenting the checks, but the objectionable feature seems to have been the manner in which the contract right was exercised.<sup>47</sup> Although never expressly applying this rule to a termination situation, some courts, concluding that the manufacturer has a right to terminate, have announced in dictum that exercise of that right cannot be "contrary to equity or good conscience."<sup>48</sup>

## II

### DIRECT LIMITATIONS ON CONTRACT TERMINATIONS

Despite the simple symmetry and apparent unity of this freedom of contract theory, courts have long recognized that requiring minimum levels of fairness in contracts is not only desirable but necessary. In this connection, several direct limitations have been imposed on the parties' freedom to select the terms on which they can terminate the contract without liability. On the one hand, there are rules specifically relating to terminations such as the giving of

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<sup>46</sup> *Id.* at 358.

<sup>47</sup> The Court did not dispute the ordinary right of holders of bank checks to present them for payment. But this "right" is balanced, for example, by the knowledge that banks (as we know them) could not exist if they could not rely on averages and assume that not more than a certain fraction of their depositors' funds will be demanded on any one day. *Ibid.* Compare *Buck v. Latham*, 110 Minn. 523, 126 N.W. 278 (1910).

<sup>48</sup> *Jones v. Chester*, 363 S.W.2d 150, 155 (Tex. Civ. App. 1962); *Haley v. Nickels*, 235 S.W.2d 683, 685 (Tex. Civ. App. 1950); *Gable v. Frigidaire Corp.*, 121 S.W.2d 456, 458 (Tex. Civ. App. 1938); *Maddox Motor Co. v. Ford Motor Co.*, 23 S.W.2d 333, 338 (Tex. Comm'n App. 1930).

notice to terminate; and, on the other hand, there are rules generally affecting terminations such as those imposing tort liability for bad faith conduct which harms the terminated party. In between these extremes are the direct restraints which relate generally to contract rights. Unjust enrichment arising from misuse of superior economic power may be actionable under common law doctrines of economic duress. Discriminatory terminations may be set aside under doctrines of waiver and estoppel. And termination provisions which heavily favor one party may not be enforceable because they are deemed to be unconscionable.

### *Limitations of Reasonableness*

Unless the agreement provides otherwise, a contract of indefinite duration, whether of agency, employment, or sale (and including a franchise), is generally held to be terminable at any time.<sup>49</sup> In the employment situation this rule reflects the position of the parties; the employee usually has not invested any money in the business and is paid only for services actually performed.<sup>50</sup> A different rule applies, however, in the case of an agency coupled with an interest, which is generally held to be irrevocable.<sup>51</sup> This latter rule would seem to protect against termination a dealer who has given substantial consideration beyond the value of his services. But the opposite is true. A dealer is not protected because his interest is not the subject of the franchise but rather is only in the proceeds thereof.<sup>52</sup> The dealer's expenditures are predicated on the assumption that the continuance of the relationship will repay the investment through profits.<sup>53</sup> However, if the investment has little value on liquidation, the dealer is substantially unprotected against sudden terminations, particularly since the franchise agreement seldom specifies a minimum duration period.

Seeking to improve the dealer's precarious position, some courts have borrowed the so-called Missouri doctrine from agency law and have ruled that franchise agreements involving such a substantial in-

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<sup>49</sup> *E.g.*, *Willcox & Gibbs Sewing Mach. Co. v. Ewing*, 141 U.S. 627, 637 (1891); *Meredith v. John Deere Plow Co.*, 185 F.2d 481 (8th Cir. 1950), *cert. denied*, 341 U.S. 936 (1951); *Terre Haute Brewing Co. v. Dugan*, 102 F.2d 425, 427 (8th Cir. 1939); RESTATEMENT (SECOND), AGENCY § 118 (1958); *cf.* UCC § 2-309 (2).

<sup>50</sup> *But see* Note, 42 COLUM. L. REV. 107 (1942).

<sup>51</sup> RESTATEMENT (SECOND), AGENCY § 139 (1958).

<sup>52</sup> *Id.* § 138, comment *b.*

<sup>53</sup> *E.g.*, *Burger Brewing Co. v. Summer*, 261 F.2d 261, 262 (4th Cir. 1958).

vestment by the dealer and existing for an infinite duration cannot be terminated until after a reasonable period of time has elapsed.<sup>54</sup> In other words, the dealer is entitled to a "fair opportunity" to recoup his expenditures.<sup>55</sup> The time period which provides the dealer a reasonable opportunity necessarily varies depending on the significance of the contract relationship to each party and on the potential harm each may suffer from requiring or not enforcing a minimum period.<sup>56</sup> Corbin's suggestion that the court determine what

<sup>54</sup> Apparently originating in *Glover v. Henderson*, 120 Mo. 367, 377, 25 S.W. 175, 177 (1894), the rule has been applied often in Missouri and elsewhere. *E.g.*, *Allied Equipment Co. v. Weber Engineered Prods., Inc.*, 237 F.2d 879, 882 (4th Cir. 1956); *Beebe v. Columbia Axle Co.*, 233 Mo. App. 212, 218, 117 S.W.2d 624, 629 (1938). Compare UCC § 2-309 (2). *But see Parks v. Baldwin Piano & Organ Co.*, 262 F. Supp. 515 (D. Conn. 1967). The manufacturer, of course, retains the power to terminate for cause. *Jack's Cookie Co. v. Brooks*, 227 F.2d 935, 939 (4th Cir. 1955), *cert. denied*, 351 U.S. 908 (1956). On the other hand, the doctrine has been applied even though the manufacturer's correspondence with the dealer notes on the stationery letterhead that "Every shipment of beer or ale is an individual transaction. No contracts, agencies or franchises awarded." *Des Moines Blue Ribbon Distribs., Inc. v. Drewrys Ltd.*, 256 Iowa 899, 905-06, 129 N.W.2d 731, 737-38 (1964). *But see Smoky Mountains Beverage Co. v. Anheuser-Busch, Inc.*, 182 F. Supp. 326, 331-32 (E.D. Tenn. 1960). The Missouri doctrine has also been applied to employment contracts. See *Maybew v. Vanway*, 371 S.W.2d 90, 93-94 (Tex. Civ. App. 1963); Note, 42 COLUM. L. REV. 107 (1942).

The minimum period necessary for the dealer to have a fair opportunity to recoup his expenditures may be substantial. *Hunt Foods v. Phillips*, 248 F.2d 23 (9th Cir. 1957) (sixteen months not a reasonable time); *J. C. Millett Co. v. Park & Tilford, Distillers Corp.*, 123 F. Supp. 484 (N.D. Cal. 1954) (one year minimum); *Hall v. Hall*, 158 Tex. 95, 100-01, 308 S.W.2d 12, 16-17 (1958) (three year minimum); *cf. Freeport Sulphur Co. v. Aetna Life Ins. Co.*, 206 F.2d 5, 7 (5th Cir. 1953) (group annuity option of twenty years).

<sup>55</sup> *General Tire & Rubber Co. v. Distributors, Inc.*, 253 N.C. 459, 472, 117 S.E.2d 479, 489 (1960); see *Ansbacher-Siegle Corp. v. Miller Chemical Co.*, 137 Neb. 142, 146-47, 288 N.W. 538, 541 (1939). A similar rule is applied in regard to expenses incurred in preparation for operations under the franchise. *Goodman v. Dicker*, 169 F.2d 684, 685 (D.C. Cir. 1948). An analogous rule provides that the terminated party is entitled to compensation for performance rendered to the time of termination including commissions on subsequent sales for which he was the procuring cause. *E.g.*, *Greenspan v. Miller*, 111 Ark. 190, 195, 163 S.W. 776, 778 (1914); *Metal Structures Corp. v. Bigham*, 347 S.W.2d 270, 273-74 (Tex. Civ. App. 1961). The supporting rationale again rests on fairness: "[U]nderlying all the decisions is the basic principle of fair dealing, preventing a principal from unfairly taking the benefit of the agent's or broker's services without compensation . . ." *Reed v. Kurdziel*, 352 Mich. 287, 294, 89 N.W.2d 479, 483 (1958). *But see Ullmann v. May*, 46 Ohio L. Abs. 577, 581, 70 N.E.2d 507, 509 (App. 1946), *aff'd*, 147 Ohio St. 468, 475-76, 72 N.E.2d 63, 67 (1947); *Barton v. Farm & Home Sav. & Loan Ass'n*, 109 S.W.2d 233, 235 (Tex. Civ. App. 1937). See also *Entis v. Atlantic Wire & Cable Corp.*, 335 F.2d 759 (2d Cir. 1964).

<sup>56</sup> *General Tire & Rubber Co. v. Distributors, Inc.*, 253 N.C. 459, 472, 117 S.E.2d 479, 489 (1960): "Among the circumstances to be considered in determining reasonable time are: The amount of preliminary and promotional expenditures, the length of time the distributorship has been in operation before notice of termination, what the prospects for future profits are, and whether it has proven profitable during actual operation." See *Burger Brewing Co. v. Summer*, 261 F.2d 261 (4th Cir. 1958); *Gibbs*



is reasonable from the surrounding circumstances which exist at the *time of termination*<sup>57</sup> rather than when the contract was executed is gaining support.<sup>58</sup> This test seems preferable since the fairness of the termination to each party can be measured only in relation to the facts at the time of termination.

The dealer's protection against termination without any advance warning is greater because contracts commonly set forth both notice and notice period requirements.<sup>59</sup> Dealers have seldom complained that the notice time required or given was too short. In any case, the question of whether advance notice of termination should be implied where the parties have not spelled out any conditions on termination has been raised less frequently than the question of minimum duration. When the contract is silent, some courts require that the terminating party give notice a reasonable period in advance of the actual termination date.<sup>60</sup> The terminated dealer is entitled, these courts hold, to such time as is necessary to minimize his losses by making other arrangements. This period may be restricted, however, by the terminating party's proof of a countervailing necessity.<sup>61</sup>

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v. Bardahl Oil Co., 331 S.W.2d 614, 621 (Mo. 1960); Nathan Elson & Co. v. H. Beselin & Son, 116 Neb. 729, 735, 218 N.W. 753, 756 (1928).

<sup>57</sup> 3A CORBIN § 684, at 231. Corbin's recommendation was made in connection with indefinite contracts of employment where the parties also indicated that it was not terminable at will. His suggestion, however, would appear to have equal application to franchise terminations.

<sup>58</sup> See *Entis v. Atlantic Wire & Cable Corp.*, 335 F.2d 759, 763 (2d Cir. 1964): "[I]f the implied promise of the parties is to be reasonable with one another as to termination, this promise may well be violated by subsequent insistence on terms which might have seemed reasonable at the moment of contracting but have become unfair as the relationship developed." Cf. *Freeport Sulphur Co. v. Aetna Life Ins. Co.*, 206 F.2d 5 (5th Cir. 1953); *Bach v. Friden Calculating Mach. Co.*, 155 F.2d 361, 365 (6th Cir. 1946). *Contra*, *Hall v. Hall*, 158 Tex. 95, 102, 308 S.W.2d 12, 16-17 (1958); cf. *Cheek v. Metzger*, 116 Tex. 356, 365, 291 S.W. 860, 864 (1927).

<sup>59</sup> See, e.g., *Ken-Rad Corp. v. R. C. Bohannon, Inc.*, 80 F.2d 251 (6th Cir. 1935); *Foster-Porter Enterprises, Inc. v. DeMare*, 198 Md. 20, 81 A.2d 325 (1951); *KURSH, THE FRANCHISE BOOM* Appendix B at 207-46 (1962).

<sup>60</sup> E.g., *J. C. Millett Co. v. Park & Tilford Distillers Corp.*, 123 F. Supp. 484, 493 (N.D. Cal. 1954) (three months); *C. C. Hauff Hardware, Inc. v. Long Mfg. Co.*, 136 N.W.2d 276 (Iowa 1965); *California Wine Ass'n v. Wisconsin Liquor Co.*, 20 Wis. 2d 110, 121 N.W.2d 308 (1963) (sixty days); *Voechting v. Grau*, 55 Wis. 312, 317, 13 N.W. 230, 232 (1882) (dictum); *Irish v. Dean*, 39 Wis. 562 (1876). See UCC § 2-309(3). *But cf.* *Curtiss Candy Co. v. Silberman*, 45 F.2d 451, 453 (6th Cir. 1930). See also Note, 42 COLUM. L. REV. 107 (1942).

<sup>61</sup> If the dealer has an exclusive franchise, "the factual necessity for requiring reasonable notice is greatly enhanced." *California Wine Ass'n v. Wisconsin Liquor Co.*, 20 Wis. 2d 110, 126, 121 N.W.2d 308, 317 (1963). "The manufacturer should receive reasonable notice of termination in order to locate another distributor in the area for his products or to seek other arrangements; the distributor should have reasonable

As with the question of minimum duration, the minimum advance notice time should be determined in light of the circumstances existing at the time of termination, not at the time the agreement was executed.

The rules of reasonableness, in other words, protect a dealer only against sudden terminations (that is, against losses which might be averted upon reasonable advance notice) and, if the contract is silent, against terminations shortly after the agreement was executed. As a practical matter the protection provided by these implied conditions is minimal. In connection with the minimum duration period of the franchise, manufacturers can avoid the reasonableness limitation by inserting provisions in the agreement absolving them of any liability for dealer losses on investment<sup>62</sup> or by specifically adopting very short minimum duration times;<sup>63</sup> such exculpatory clauses have been enforced. In addition, no court appears to have extended the doctrine of reasonableness to give the dealer an opportunity to recoup any new investment, regardless of when made.<sup>64</sup>

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notice in order to make the transition from an exclusive distributor to a non-exclusive distributor or to conduct other transactions relative to his business." *Ibid.* When the dealer has only a non-exclusive franchise, the notice period may be less significant; for example, the dealer can protect himself against the effects of sudden termination by the inventory he carries and a court may rely on this fact to reduce the notice time required. See *Burger Brewing Co. v. Summer*, 261 F.2d 261, 263 (4th Cir. 1958).

<sup>62</sup> Automobile manufacturers, for example, have successfully relied on contract provisions insulating them from liability for a dealer's "expenditures . . . in preparation for performance or in performance" of the dealer's obligation. *Busam Motor Sales, Inc. v. Ford Motor Co.*, 104 F. Supp. 639, 644 (S.D. Ohio 1952), *rev'd on other grounds*, 203 F.2d 469 (6th Cir. 1953); *accord*, *Myers Motors, Inc. v. Kaiser-Frazer Sales Corp.*, 178 F.2d 291, 301 (8th Cir. 1949); *Berry v. Chrysler Corp.*, 150 F.2d 1002 (6th Cir. 1945).

<sup>63</sup> See, e.g., *Sharpe v. Great Lakes Steel Corp.*, 9 F.R.D. 691 (S.D.N.Y. 1950); *Foster-Porter Enterprises, Inc. v. DeMare*, 198 Md. 20, 81 A.2d 325 (1951); *Barish v. Chrysler Corp.*, 141 Neb. 157, 3 N.W.2d 91 (1942).

<sup>64</sup> *Bushwick-Decatur Motors, Inc. v. Ford Motor Co.*, 116 F.2d 675, 676 (2d Cir. 1940) (The "doctrine seemingly [is] not applicable where the relationship has already endured for some time.").

In addition, Kessler has argued that the Missouri doctrine should be inapplicable to modern automobile franchises because "unlike the dealership arrangements giving rise to the Missouri doctrine, a continuing selling contract presumably is selected by the dealer himself with full knowledge of its implications. To the extent he was free to choose a franchise with a definite [sic] expiration date, terminable only for cause, he should not, having decided against this kind of arrangement, be entitled to claim the best of all possible worlds." Kessler, *Automobile Dealer Franchises: Vertical Integration by Contract*, 66 YALE L.J. 1135, 1181 (1957). On the other hand, the presumption that the dealer had full knowledge of the implications of the contract provisions may not accord with reality. Similarly, it does not necessarily follow that by exercising a choice in favor of an indefinite duration contract the dealer should be held to have relinquished his right to the protection accorded him by an elemental rule of fairness.

Thus the minimum duration requirement has had no apparent effect on dealers who have been terminated suddenly some time after the franchise relationship was adopted. Nor does the inclusion of an advance notice period automatically protect the dealer against the effects of sudden termination, even if the termination occurs long after the agreement has been executed or any new investment made. The advance notice period agreed to at the time of execution, for example, may not bear any relationship to the period actually required to avoid substantial losses.

### *Tort*

Terminated dealers have had only occasional success in relying on tort theories to recover for a termination based on wrongful motives. The theoretical framework is not complex. If the wrong exists independently of the contract, even though based on a contract right, the terminated dealer can recover.<sup>65</sup> The stumbling block to greater dealer reliance on a tort theory is that recovery will be denied where the wrong is only a violation of a contract provision.

The problem is illustrated by the following example:<sup>66</sup> Suppose that *A* delivers a shirt to *B*, a tailor, to sew on some buttons. Upon acceptance of the shirt and agreement on the terms for repair, *A* and *B* have entered into a contract. But if, instead of mending the shirt, *B* negligently destroys it, *A* has an action in tort for negligent destruction of personal property. *B* has violated a duty he owes to *A*, a duty not to harm *A*'s personal property, and this duty exists regardless of the manner in which *B* acquired control of the garment or of *B*'s contractual relationship with *A* (unless the tort duty is specifically waived).<sup>67</sup> In addition, if *B* destroys the shirt intentionally by cutting it into shreds, *A* may be able to recover

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<sup>65</sup> See *Bruno v. Pepperidge Farm, Inc.*, 256 F. Supp. 865 (E.D. Pa. 1966); cf. *Rosenthal & Doucette, Inc. v. United Last Co.*, 33 F. Supp. 213, 214 (D. Mass. 1940); *Kohnle v. Paxton*, 268 Mo. 463, 472, 188 S.W. 155, 159 (1916).

<sup>66</sup> This example was relied on by the court in *Otto v. Imperial Cas. & Indem. Co.*, 277 F.2d 889, 893 (8th Cir. 1960); *Peitzman v. City of Illmo*, 141 F.2d 956, 961 (8th Cir. 1944).

<sup>67</sup> *A*, on the other hand, has a contract action not only for breach of the express agreement to repair, but also for *B*'s violation of the implied covenant "that neither party will do anything which will destroy or injure the right of the other party to receive the fruits of the contract." *Transnational Ins. Co. v. Rosenlund*, 261 F. Supp. 12, 21 (D. Ore. 1966); *accord*, *Kirke La Shelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933); *Perkins v. Standard Oil Co.*, 235 Ore. 7, 16, 383 P.2d 107, 112 (1963).

punitive damages (in addition to compensatory damages) upon proof of *B*'s wrongful motives.<sup>68</sup> Similarly, if the termination is so fraudulent as to demonstrate that the terminating party misrepresented his intentions or otherwise fraudulently induced the terminated party to enter into the contractual relation, recovery in tort may be justified on an additional theory.<sup>69</sup>

On the other hand, if *B*, in the example of the tailor's contract to repair the garment, merely fails to sew on the buttons as agreed, *A* cannot recover in tort for this violation of their agreement regardless of the motive which impels *B*'s refusal to fulfill his obligations. In that situation recovery in tort cannot be predicated on *B*'s default of his obligation to repair; *B* had no duty to mend the shirt independent of the contract with *A*. Tort actions by dealers for wrongful terminations often founder on a failure to appreciate this distinction.<sup>70</sup> For example, in *Otto v. Imperial Cas. & Indem. Co.*,<sup>71</sup>

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<sup>68</sup> In *Peitzman v. City of Illmo*, 141 F.2d 956 (8th Cir. 1944), defendants were under contract to restore and preserve the city's elevated steel water tank. It was alleged that, instead of performing such services, the defendants used the contract as a "means of gaining access to the property," and once access was gained, acted "as wreckers and destroyers [and] . . . intentionally injured and damaged plaintiff's property." *Id.* at 961. The court upheld the jury's award of compensatory and punitive damages. *Id.* at 962.

The general rule, of course, is that punitive damages are not recoverable for breach of contract. See 5 CORBIN § 1077, at 438-39.

<sup>69</sup> *Roberts v. Fore*, 231 S.C. 311, 314, 98 S.E.2d 766, 768 (1957): "To recover [punitive] damages . . . , the plaintiff must show that the breach was accomplished with a fraudulent intention, and was accompanied by a fraudulent act." See *Southern Cal. Disinfecting Co. v. Lomkin*, 183 Cal. App. 2d 431, 7 Cal. Rptr. 43 (Dist. Ct. App. 1960) (breach in pursuance of fraudulent conspiracy); *Etter v. Von Sternberg*, 244 S.W.2d 321 (Tex. Civ. App. 1951) (breach concealed by fraudulent misrepresentation).

<sup>70</sup> See, e.g., *Cadillac LaSalle Co. v. Claude Nolan, Inc.*, 118 Fla. 250, 158 So. 833 (1935); *Barish v. Chrysler Corp.*, 141 Neb. 157, 3 N.W.2d 91 (1942). Thus, "one who causes intended or unintended harm to another merely by refusing to enter into a business relation with the other or to continue a business relation terminable at will is not liable for that harm . . ." RESTATEMENT, TORTS § 762 (1939). Comment *c* to § 762 notes that this privilege "exists regardless of the actor's motive for refusing to enter business relations with the other and even though the sole motive is a desire to harm the other." Cf. *Odell v. Humble Oil & Refining Co.*, 201 F.2d 123 (10th Cir.), *cert. denied*, 345 U.S. 941 (1953) (discharge of employee in retaliation for testimony to grand jury held to involve only a breach of contract); *Christner v. Poudre Valley Co-op Ass'n*, 134 F. Supp. 115 (D. Colo. 1955), *aff'd*, 235 F.2d 946 (10th Cir. 1956); *Magnolia Petroleum Co. v. Dubois*, 81 S.W.2d 157 (Tex. Civ. App. 1935). *But see Bennett v. Storz Broadcasting Co.*, 270 Minn. 525, 134 N.W.2d 892 (1965) (protection of legal interest is a defense to a tort action for interference with prospective advantage if defendant proves that his legal interest is equal or superior to interest invaded and that he acted in good faith); *Sorenson v. Chevrolet Motor Co.*, 171 Minn. 260, 214 N.W. 754 (1927).

<sup>71</sup> 277 F.2d 889 (8th Cir. 1960).

an insurance agency alleged that its franchise had been wrongfully terminated for spurious reasons as part of a plan by the defendant insurance company "to purloin the 'block of business' generated" by the agency.<sup>72</sup> By the termination the defendant allegedly sought to garner the premiums on the renewal business which otherwise would have been paid the insurance agency. Relying on the analysis that conduct which is merely a breach of contract is not also actionable as a tort, the court ruled that

the only wrong alleged is the violation of that provision of the contract which made the expirations the property of the plaintiff. No harm independent of the contract is asserted.<sup>73</sup>

Hence the insurance agency's tort action for punitive damages was denied.

In the franchise context then, tort recovery for termination is probably limited, as a practical matter, to cases where the dealer can show that the manufacturer's original offer of a franchise was fraudulent.

### *Economic Duress*

Closely allied to this protection against fraudulent termination is the opaque doctrine of economic duress. Initially applied to restore payments or transfers made under compulsion of potential bodily harm,<sup>74</sup> the doctrine has been expanded to include restitution of value acquired by wrongful acts not otherwise proscribed by legal rules.<sup>75</sup> The primary function of the doctrine of economic duress is the prevention of unjust enrichment.<sup>76</sup> Except in a few instances where relief from duress has been granted on a tort theory,<sup>77</sup> the vic-

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<sup>72</sup> *Id.* at 890.

<sup>73</sup> *Id.* at 893; *accord*, *Sterling Colorado Agency, Inc. v. Sterling Ins. Co.*, 266 F.2d 472 (10th Cir. 1959).

<sup>74</sup> 5 WILLISTON, *CONTRACTS* § 1601 (rev. ed. 1937) [hereinafter cited as WILLISTON].

<sup>75</sup> See *Ross Systems v. Linden Dari-Delite, Inc.*, 35 N.J. 329, 173 A.2d 258, 263-64 (1961); Dalzell, *Duress by Economic Pressure* (pt. 2), 20 N.C.L. REV. 341, 361-62 (1942). *But see* Dawson, *Economic Duress—An Essay in Perspective*, 45 MICH. L. REV. 253, 287-88 & n.86 (1947). See also *Hellenic Lines, Ltd. v. Louis Dreyfus Corp.*, 372 F.2d 753 (2d Cir. 1967).

<sup>76</sup> Dawson, *supra* note 75, at 282-83.

<sup>77</sup> See *Pittman v. Lageshulte*, 45 Ill. App. 2d 207, 195 N.E.2d 394 (1963); *Slade v. Slade*, 310 Ill. App. 77, 33 N.E.2d 951 (1941); *Smith v. Blakesburg Sav. Bank*, 182 Iowa 1190, 164 N.W. 762 (1917); *Neibuhr v. Gage*, 99 Minn. 149, 108 N.W. 884 (1906); *Longbine v. Johnson*, 347 S.W.2d 772 (Tex. Civ. App. 1961) (*per curiam*).

timized party usually recovers only the value wrongfully extorted.<sup>78</sup> Whether relief is allowed depends on the "wrongfulness" of the act threatened and on the circumstances in which the threat was made.<sup>79</sup> In other words, certain pressures may not be properly applied. In a few cases, for example, relief has been granted from unduly harsh contract terms adopted because of unequal bargaining power (even though no evidence of threats of personal or economic harm was presented).<sup>80</sup> Applied to the franchise termination situation, the doctrine arguably would protect a terminated party against enforcement of harsh termination provisions which unjustly enrich the terminating party.

Nevertheless, the cases applying this doctrine are few in number, and it does not appear to have been relied on in any franchise termination case.<sup>81</sup> Hence its application in favor of terminated dealers seems more potential than real.

### *Waiver and Estoppel*

The relief afforded under the doctrines of waiver and estoppel is more substantial. The concepts of waiver and estoppel are designed, in a contract termination context, to protect a terminated party against discriminatory cancellation.<sup>82</sup> Waiver takes place when one dispenses with the performance of a condition which he has a right to exact.

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<sup>78</sup> That is, no affirmative liability is imposed on the party responsible for the coercion. 5 WILLISTON § 1626, at 4547.

<sup>79</sup> See, e.g., *United States v. Bell*, 259 F. Supp. 602, 605 (N.D. Okla. 1966); *Buhrman v. International Harvester Co.*, 150 N.W.2d 220 (Neb. 1967). See also Dawson, *Duress Through Civil Litigation: I, II*, 45 MICH. L. REV. 571, 679 (1947). See generally 5 WILLISTON § 1606 n.1.

<sup>80</sup> *Gieth v. Fidelity Trust Co.*, 93 N.J. Eq. 163, 115 Atl. 397 (Ct. Err. & App. 1921); *Berg v. Hoffman*, 275 N.Y. 132, 9 N.E.2d 806 (1937), *reversing* 249 App. Div. 913, 292 N.Y. Supp. 721 (1937). See also *Ira S. Bushey & Sons v. W. E. Hedger Transp. Corp.*, 167 F.2d 9 (2d Cir.), *cert. denied*, 335 U.S. 816 (1948); RESTATEMENT, CONTRACTS § 493, comment *e* (1932).

<sup>81</sup> See *Buhrman v. International Harvester Co.*, 150 N.W.2d 220 (Neb. 1967). On the other hand, the concept of economic duress underlies statutory and common law doctrines prohibiting combinations in restraint of trade. For example, a manufacturer or distributor of products or services usually has the right to select the outlets or persons with which it wishes to deal. *United States v. Colgate & Co.*, 250 U.S. 300 (1919). But if a distributor exercises a contract "right of cancellation" for the purpose of eliminating a competitor, that exercise may violate the antitrust laws and may be enjoined. See *Poller v. Columbia Broadcasting System, Inc.*, 368 U.S. 464, 468-69 (1962).

<sup>82</sup> See 3A CORBIN § 752; *cf. Goodman v. Dicker*, 169 F.2d 684 (D.C. Cir. 1948).

[It] occurs where one in possession of any right, . . . with full knowledge of the material facts, does or forbears to do something, the doing of which or the failure or forbearance to do which is inconsistent with the right or his intention to rely upon it.<sup>83</sup>

In the termination situation, estoppel involves the additional factor of reasonable reliance. That is, the party who dispensed with the performance of the condition will be estopped to assert the condition if he had reason to foresee that the other party would materially change his position in reliance and this in fact occurred.<sup>84</sup>

Applied to a franchise termination situation, questions of waiver and estoppel often arise in the following context: Under the terms of the franchise agreement, the manufacturer usually has the right to terminate the dealer upon the occurrence of any of several conditions.<sup>85</sup> If the dealer's business is a highly personal one, for example, the franchise may be terminable on the death of or transfer of stock by the major stockholder of the franchise who also manages the business.<sup>86</sup> If relative performance is significant, the manufacturer may reserve the power to terminate the dealer if his sales fall below the average sales of those dealers in his area who are similarly situated.<sup>87</sup> Or, if the dealer's success depends in part on his ability to display the manufacturer's wares—that is, on his facilities and in-

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<sup>83</sup> Ford v. Culbertson, 158 Tex. 124, 138-39, 308 S.W.2d 855, 865 (1958), quoted with approval in Surko v. Harrison, 391 S.W.2d 115, 120 (Tex. Civ. App. 1965).

<sup>84</sup> Nathan Miller, Inc. v. Northern Ins. Co., 42 Del. 523, 528, 39 A.2d 23, 25 (Super. Ct. 1944). For example, in Lavery v. Hawkeye Sec. Ins. Co., 140 N.W.2d 83 (Iowa 1966), a contract of automobile insurance could not be cancelled for late payment because of the insurer's custom of accepting delayed payment of premiums, a practice known to and relied upon by the insured. Estoppel, the court pointed out, is based on the idea that where one has relied on the conduct of the other party the latter should not be permitted to change his position to the prejudice of the former.

Waiver, in other words, is premised upon the voluntary action of the promisor. Poray v. Royal Globe Ins. Co., 90 N.J. Super. 454, 460, 217 A.2d 916, 919 (1966). Estoppel, in contrast, requires action or forbearance by both parties. Nathan Miller, Inc. v. Northern Ins. Co., *supra*. This distinction also affects the restoration of a condition which has been waived or which a party is estopped from asserting. The party waiving a condition can restore it by giving notice to the other; an estopped party, however, cannot re-establish the condition without the concurrence of the other party. See 3A CORBIN §§ 752, 764.

<sup>85</sup> See generally KURSH, *op. cit. supra* note 59; *Hearings I* at 403-55, 458-59. 403-55, 458-59.

<sup>86</sup> See Chrysler Corp. v. Quimby, 51 Del. 264, 144 A.2d 123 (1958); Macaulay 568 n.449.

<sup>87</sup> See Milos v. Ford Motor Co., 317 F.2d 712 (3d Cir.), *cert. denied*, 375 U.S. 896 (1963); Sam Goldfarb Plymouth, Inc. v. Chrysler Corp., 214 F. Supp. 600 (E.D. Mich. 1962); Macaulay 566-67.

ventory—the franchise agreement may permit termination whenever the dealer's net working capital falls below a specified amount.<sup>88</sup> The possibilities are as endless as the potential conditions upon which termination can hinge. Whatever the condition, if the manufacturer seeking to terminate has not enforced its right when these conditions previously "occurred"—either in connection with the dealer to be terminated or in regard to other dealers similarly situated—an argument can be made that the manufacturer has waived its right to terminate or is estopped from asserting the right.

The waiver contention relies almost entirely on the discriminatory aspect of the manufacturer's conduct. Even though the dealer can show no change of his position because of the manufacturer's earlier failure to exercise the right, nevertheless, he relies on the unfairness of allowing the manufacturer to enforce the right against him in the present situation. For example, the dealer may offer proof that the manufacturer has not required him to meet his assigned quota in the past or that he has not forced other dealers to do so.<sup>89</sup> As a practical matter, however, such arguments have seldom been accepted because the courts have been unwilling to find that the manufacturer's prior action or inaction was "inconsistent" with the exercise of the right.<sup>90</sup> The courts have also been reluctant to grant the dealer relief, fearing that they might become involved in an unmanageable investigation of the relationships between the manufacturer and all of its other dealers.<sup>91</sup>

Although the ground rules of estoppel are similar to those of waiver, its application does not necessarily involve the same problems. When the terminated dealer alleges that the manufacturer is estopped

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<sup>88</sup> See *Globe Motors, Inc. v. Studebaker-Packard Corp.*, 328 F.2d 645, 648 (3d Cir. 1964); *Garvin v. American Motors Sales Corp.*, 318 F.2d 518 (3d Cir. 1963); *Augusta Rambler Sales, Inc. v. American Motors Sales Corp.*, 213 F. Supp. 889 (N.D. Ga. 1963); Macaulay 567-68.

<sup>89</sup> *Madsen v. Chrysler Corp.*, 261 F. Supp. 488, 492 (N.D. Ill. 1966); cf. *Union Tank Car Co. v. Lindsay Soft Water Corp.*, 257 F. Supp. 510, 513 (D. Neb. 1966). Similar reasoning supports the application of waiver principles in requiring, upon breach of a covenant, that "a party to a contract should promptly exercise a right to terminate a contract." *Zelinger v. Uvalde Rock Asphalt Co.*, 316 F.2d 47, 53 (10th Cir. 1963); *Nathan Elson & Co. v. H. Beselin & Son*, 116 Neb. 729, 734-35, 218 N.W. 753, 755-56 (1928); 3A CORBIN § 755; 3 WILLISTON § 688; RESTATEMENT, CONTRACTS § 309 (1932).

<sup>90</sup> See, e.g., *Globe Motors, Inc. v. Studebaker-Packard Corp.*, 328 F.2d 645, 648 (3d Cir. 1964); 3 WILLISTON § 678, at 1958-59.

<sup>91</sup> This attitude is evident in *Smoky Mountains Beverage Co. v. Anheuser-Busch, Inc.*, 182 F. Supp. 326, 331 (E.D. Tenn. 1960); *Des Moines Blue Ribbon Distrib., Inc. v. Drewrys Ltd.*, 256 Iowa 899, 914, 129 N.W.2d 731, 740 (1964).



from terminating the contract on the ground asserted, the question of proof revolves around whether the terminated dealer can show (1) that he changed his position<sup>92</sup> in reliance on the manufacturer's conduct and (2) that such reliance was reasonable.<sup>93</sup> The difficulty of proving that the manufacturer has taken an "inconsistent" position, often an insurmountable roadblock for the dealer asserting a waiver defense, may be overcome by evidence that the manufacturer knew of the dealer's change of position and failed to object.

Thus, a manufacturer seeking to terminate a dealer for failure to meet a minimum sales quota may be estopped from asserting the dealer's inadequate sales on the ground that the manufacturer discriminated against the dealer in allocating products.<sup>94</sup> Likewise, a dealer's inability to meet a net working capital requirement may not create a condition supporting termination despite explicit provisions in the franchise agreement to the contrary. The manufacturer's representatives may have assured the dealer that this contract requirement need not be met. Proof that the dealer reasonably relied on such assurances and therefore did not seek additional capital would prevent the manufacturer from asserting the working capital condition as a justification for termination.<sup>95</sup>

Although this analysis has concentrated on express conditions, the rules of waiver and estoppel have equal application to implied termination conditions. In any case, when examined together, the rules of waiver and estoppel appear to be effective judicial checks on discriminatory terminations. They do not, however, impose any other limits of fairness on franchise terminations.

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<sup>92</sup> A change of position, of course, includes any failure to take action or to protect an interest because of assurances, express or implied, that such action is necessary. *Triple Cities Constr. Co. v. Maryland Cas. Co.*, 4 N.Y.2d 443, 448, 151 N.E.2d 856, 858 (1958); *Moar v. Beaudry*, 62 Wash. 2d 98, 105-06, 381 P.2d 240, 245 (1963).

<sup>93</sup> 3 WILLISTON § 692. *Shinabarger v. United Aircraft Corp.*, 262 F. Supp. 52, 63 (D. Conn. 1966): "Conduct sufficiently inequitable to warrant invoking the doctrine of equitable estoppel need not amount to actionable fraud or deceit." See *id.* at 63 n.24 (collecting authorities).

<sup>94</sup> *Southern Rambler Sales, Inc. v. American Motors Corp.*, 375 F.2d 932, 935-36 (5th Cir. 1967); *Blenke Bros. Motors, Inc. v. Chrysler Corp.*, 189 F. Supp. 420, 422-23 (N.D. Ill. 1960) (dictum). Or, if market quotas for different dealers were determined by different standards under the same contract language, the manufacturer might be estopped from terminating the dealer for failure to meet such a quota. See *Milos v. Ford Motor Co.*, 317 F.2d 712, 716-17 (3d Cir.), *cert. denied*, 375 U.S. 896 (1963).

<sup>95</sup> Cf. *Chrysler Corp. v. Quimby*, 51 Del. 264, 273-74, 144 A.2d 123, 128-29 (1958). Compare *Alfieri v. Willys Motors, Inc.*, 227 F. Supp. 627, 629 (E.D. Pa. 1964).

*Unconscionability*

Historically, courts of equity have refused, under the label of unconscionability, to enforce contract terms "such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other."<sup>96</sup> But few contracts sink to such madman levels, and the doctrine of unconscionability is seldom applied in a commercial context.<sup>96a</sup> Instead of venturing to expand the coverage of the doctrine as business mores have improved, courts have tended to recite freedom of contract theory while recognizing economic realities only in some cases by construing terms so as to limit the worst forms of unfairness.<sup>97</sup> As a result, the doctrine of unconscionability has been little more than a generic concept applicable to various fact situations.<sup>98</sup> Another consequence is that the courts have not developed either minimum standards of fairness or rational rules for the application of any standards,<sup>99</sup> particularly in regard to dealings between manufacturers and dealers.

Only in the area of standardized contracts offered by dominant sellers on a take-it-or-leave-it basis have the courts even started to reflect the persistent suggestions of several commentators<sup>100</sup> that some

<sup>96</sup> *Earl of Chesterfield v. Janssen*, 2 Ves. Sen. 125, 155, 28 Eng. Rep. 82, 100 (Ch. 1750); see *Hume v. United States*, 132 U.S. 406, 415 (1889).

<sup>96a</sup> See Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 428-41 (1967).

<sup>97</sup> Note, 57 YALE L.J. 1161, 1163 (1949); see Llewellyn, Book Review, 52 HARV. L. REV. 700, 702 (1939).

<sup>98</sup> The oppressive terms are seldom the sole basis for decision; usually some species of fraud, duress, misrepresentation, mistake, incapacity, undue influence or gross inadequacy of consideration has also been found and relied upon. See, e.g., *Pope Mfg. Co. v. Gormully*, 144 U.S. 224 (1892); *Campbell Soup Co. v. Wentz*, 172 F.2d 80, 83-84 (3d Cir. 1948); *Globe Woolen Co. v. Utica Gas & Elec. Co.*, 224 N.Y. 483, 121 N.E. 378 (1918).

Moreover, it cannot be said definitely whether unconscionability was recognized as a defense at law. Compare *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 448-50 (D.C. Cir. 1965), with *United States v. Bethlehem Steel Corp.*, 315 U.S. 289, 325-30 (1942) (Frankfurter, J., dissenting), and *Hume v. United States*, 132 U.S. 406, 414-15 (1889). See 1 CORBIN § 128; Stevens, *A Plea for the Extension of Equitable Principles and Remedies*, 41 CORNELL L.Q. 351, 366-69 (1956). See also Note, 45 IOWA L. REV. 843, 846-47 (1960); 54 GEO. L.J. 703, 704 (1966); 41 WASH. L. REV. 621, 622 (1966).

<sup>99</sup> LLEWELLYN, *THE COMMON LAW TRADITION—DECIDING APPEALS* 364-65, 367 (1960).

<sup>100</sup> *Id.* at 365-71; Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943). See also Meyer, *Contracts of Adhesion and the Doctrine of Fundamental Breach*, 50 VA. L. REV. 1178, 1180 (1964). See generally Wilson, *Freedom of Contract and Adhesion Contracts*, 14 INT'L & COMP. L.Q. 172 (1965). Suggestions for the enforcement of minimum standards, moreover, have not disregarded the substantial advantages and desirable aspects of standardized contracts. Llewellyn, Book Review, 52 HARV. L. REV. 700, 701 (1939).

standards of fair dealing should be enforced. But only gross forms of unfairness are affected, and relief is usually limited to relieving unsuspecting consumers or uninformed sellers who have been tricked by the unscrupulous.

Thus, in the leading case of *Campbell Soup Co. v. Wentz*,<sup>101</sup> the court refused to order specific performance of an agreement to supply carrots where the canner had, by clever draftsmanship, allocated virtually all risks to an economically inferior grower. By the agreement the grower sought security against a severe drop in prices. In fact the agreement shielded only the canner against this contingency since the canner was not obligated to purchase carrots if it was unable to receive or handle them "because of any circumstances beyond [its] . . . control."<sup>102</sup> The canner, in other words, had not agreed to buy carrots if demand declined and production dropped (which would normally occur when prices fell), and the grower was still vulnerable to the very hazard against which he had sought protection.<sup>103</sup> This, according to the court, went "too far," especially in light of other one-sided terms which characterized the agreement.<sup>104</sup> Similarly, in the recent but already well-known decision in *Henningsen v. Bloomfield Motors, Inc.*,<sup>105</sup> a state court refused to sanction a unilateral attempt by automobile manufacturers to limit their liability in the standard contract of sale offered new car buyers by severely limiting their express warranty and disclaiming all others.<sup>106</sup>

<sup>101</sup> 172 F.2d 80 (3d Cir. 1948).

<sup>102</sup> *Id.* at 83 n.11.

<sup>103</sup> See Note, 58 YALE L.J. 1161, 1167 & n.28 (1949).

<sup>104</sup> The court emphasized the following one-sided provisions: "Carrots are to have their stalks cut off and be in clean sanitary bags or other containers approved by Campbell . . . .

. . . .

"The next paragraph allows Campbell to refuse carrots in excess of twelve tons to the acre. The next contains a covenant by the grower that he will not sell carrots to anyone else except the carrots rejected by Campbell nor will he permit anyone else to grow carrots on his land. Paragraph 10 provides liquidated damages to the extent of \$50 per acre for any breach by the grower. There is no provision for liquidated damages . . . for breach of contract by Campbell." 172 F.2d at 83.

<sup>105</sup> 32 N.J. 358, 161 A.2d 69 (1960).

<sup>106</sup> Both *Henningsen* and *Campbell Soup* can, of course, be distinguished from the usual situation when a franchise agreement is before the courts. *Henningsen* involved a disclaimer of liability in a consumer sales contract whereas a franchise agreement invariably is between two merchants. *Campbell Soup*, on the other hand, was an action for specific performance, and the court specifically noted that, had the action been at law, its decision would have been different; equitable defenses, however, are of little aid to the dealer since he will usually be the applicant for relief. See note

The *Campbell Soup* decision is, on the other hand, an example of why courts are often justifiably reluctant to expand the scope of the unconscionability doctrine. As applied, the doctrine has a tendency to over-correct the evil; in *Campbell Soup* its effect is more accurately described as "overkill." Denial of specific performance of an output contract for agricultural products was likely to cause irreparable harm to the buyer;<sup>107</sup> hence limiting the canner's remedies to a damage recovery was likely to be as unfair to the canner as the original contract was to the grower.<sup>108</sup> A more reasonable solution, consistent with the intentions of the parties, would have been to "rewrite" the contract to protect the grower against a fall in prices yet assure the canner of a source of supply. This could have been accomplished simply by striking the one-sided terms and enforcing the contract as modified.<sup>109</sup>

In any case, the doctrine of unconscionability has not generally been applied to limit the harsh effects of franchise terminations. When termination provisions are challenged, courts invariably find them "fair and reasonable," even when such provisions theoretically empower the manufacturer to dismiss fifty per cent of its entire dealer force at any time.<sup>110</sup> While perhaps not sinking to madman

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108 *infra*. Nevertheless, these decisions do seem significant as an indication of increased judicial liberality in finding unconscionability.

<sup>107</sup> Annot., 87 A.L.R.2d 732, 779-82 (1963). See *Hunt Foods, Inc. v. O'Disho*, 98 F. Supp. 267 (N.D. Cal. 1951); *Paullus v. Yarbrough*, 219 Ore. 611, 643, 347 P.2d 620, 635 (1959).

<sup>108</sup> The court's observation that the contract was not illegal and that the canner could maintain an action at law for damages seems misleading. The contract applied to fifteen acres of land and involved approximately 100 tons of carrots. The liquidated damages provision of the contract limited damages to fifty dollars per acre; thus the ceiling on the canner's damage recovery was 750 dollars. But the canner's losses were much greater. If his damages are the difference between the contract price (thirty dollars per ton) and the market price (ninety dollars per ton) at the time of delivery (*i.e.*, the time of breach), see *RESTATEMENT, CONTRACTS* § 329 & comments *b, d* (1932), his damages were approximately 6,000 dollars. Nor is this result—that denial of equitable remedies is, in effect, a denial of relief—unique. See *Frank & Endicott, Defenses in Equity and "Legal Rights,"* 14 LA. L. REV. 380 (1954).

<sup>109</sup> See Note, 63 YALE L.J. 560, 566 n.34 (1954); UCC § 2-302 & comment. Following the New Jersey court's decision, the canner apparently modified its contracts with growers and eliminated all provisions which had been found objectionable. Thus, when the canner sought specific performance three years later under the revised contract, another court granted the relief sought. *Campbell Soup Co. v. Diehm*, 111 F. Supp. 211 (E.D. Pa. 1952).

<sup>110</sup> *E.g.*, *Victory Motors of Savannah, Inc. v. Chrysler Motors Corp.*, 357 F.2d 429 (5th Cir. 1966); *Milos v. Ford Motor Co.*, 317 F.2d 712 (3d Cir.), *cert. denied*, 375 U.S. 896 (1963); *Sam Goldfarb Plymouth, Inc. v. Chrysler Corp.*, 214 F. Supp. 000 (E.D. Mich. 1962); *A. F. L. Motors, Inc. v. Chrysler Motors Corp.*, 183 F. Supp. 56

levels, it can be questioned whether judicial approval of such provisions meets minimum concepts of fairness. Moreover, by restricting the doctrine of unconscionability to the contract terms rather than its effects, courts have not directly considered its application where termination provisions reasonable when executed cause unexpectedly harsh results.

### III

#### INDIRECT LIMITATIONS ON CONTRACT TERMINATIONS

When the rules of contract law fail to provide relief from the harsh results of freedom of contract theory, courts have often gone beyond expressions of "grave concern" and used (or misused) rules of construction to aid the abused party.<sup>111</sup> Llewellyn, for example, has spelled out the extensive judicial reliance on indirect methods to reach just results in regard to contracts of adhesion.<sup>112</sup> In enforcing the boilerplate of mass standardized or form-pad contracts, courts have constantly relied on such "semi-covert techniques" as misconstruing patently clear language (by the discovery of ambiguity which is then construed against the dominant party), finding inconsistencies (which are then decided against the drafting party by throwing out the clause favoring him), and artificially applying the doctrines of mutuality and consideration.<sup>113</sup>

In contrast to these interpretations of contracts of adhesion, however, termination powers in franchise agreements have seldom been subjected to such methods of construction even when the manufacturer has in fact dictated all of the terms.<sup>114</sup> At one time courts did rely on the requirement of mutuality to find a failure of consid-

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(E.D. Wis. 1960). *Contra*, Madsen v. Chrysler Corp., 261 F. Supp. 488, 506 (N.D. Ill. 1966). See text accompanying notes 181-85 *infra*.

<sup>111</sup> "[W]e owe a great debt to the empiricism and lack of clear thinking of judges which have saved us from some of the logical consequences of their professed principles [of freedom of contract]." Kaplan, Book Review, 63 YALE L.J. 1039, 1040 (1954).

<sup>112</sup> LLEWELLYN, THE COMMON LAW TRADITION—DECIDING APPEALS 362-71 (1960); Llewellyn, Book Review, 52 HARV. L. REV. 700 (1939).

<sup>113</sup> See Note, 109 U. PA. L. REV. 401, 408-13 (1961); Note, 58 YALE L.J. 1161, 1163-64 & nn.8-11 (1949); *cf.* Note, 78 HARV. L. REV. 1212, 1215-16 (1965).

<sup>114</sup> The automobile franchise cases prior to the 1956 federal law (see note 21 *supra* and accompanying text) are the clearest illustration of this anomaly. Strictly applying common law contract principles, the courts invariably upheld the manufacturers' terminations of their dealers. See, *e.g.*, Note, 70 HARV. L. REV. 1239, 1241-42 (1957). *But cf.* Buono Sales, Inc. v. Chrysler Motors Corp., 363 F.2d 43 (3d Cir.), *cert. denied*, 385 U.S. 971 (1966).

eration, especially when the franchise agreement was terminable at will.<sup>115</sup> But more often than not the application of this rule was invoked by manufacturers to avoid obligations under the contract; hence it tended to work to the detriment of the terminated dealer.<sup>116</sup> In any case, the doctrine has little application today because of the willingness of the courts to find consideration and because of the general practice of conditioning termination rights on the occurrence of specified events.<sup>117</sup>

A few courts have employed a rule of construction which can favor terminated parties and which provides that the ostensible reason given for exercising the power of termination cannot be changed.<sup>118</sup> For example, if a franchise agreement is terminable on any of several grounds, the manufacturer cannot notify the dealer that he is being terminated for inadequate sales and, when challenged, assert instead that the termination was justified under a contract provision permitting termination upon failure to provide exclusive representation.<sup>119</sup> Analytically, this approach is unsound.<sup>120</sup> It is based on fairness to the terminated party, yet fairness as such is unrelated to a change of reason. The original reasons given would appear immaterial so long as the terminated party has not relied upon them.<sup>121</sup> Moreover, if the reason given relates to performance

<sup>115</sup> E.g., *Superior Motor Co. v. Chevrolet Motor Co.*, 112 Kan. 522, 212 Pac. 100 (1923); Note, 31 COLUM. L. REV. 830 (1931); 28 ILL. L. REV. 800 (1934).

<sup>116</sup> See 28 ILL. L. REV. 800, 804-06 (1934).

<sup>117</sup> The turning point on the question of mutuality appears to have been the argument of Professor Corbin that the provisions of the franchise agreement and the acts of the parties were consistent only with a contract imposing reciprocal conditions and binding the parties to some extent. Corbin, *The Effect of Options on Consideration*, 34 YALE L.J. 571, 585-89 (1925). By 1940 most courts rejected the argument that the contract was void for lack of mutuality even if it was terminable at will. E.g., *Bushwick-Decatur Motors, Inc. v. Ford Motor Co.*, 116 F.2d 675, 676 (2d Cir. 1940); *Buggs v. Ford Motor Co.*, 113 F.2d 618, 620 (7th Cir. 1940); *Kane v. Chrysler Corp.*, 80 F. Supp. 360, 362 (D. Del. 1948); *Stern & Co. v. International Harvester Co.*, 148 Conn. 527, 172 A.2d 614 (1961). But see *Parks v. Baldwin Piano & Organ Co.*, 262 F. Supp. 515, 518-19 (D. Conn. 1967).

<sup>118</sup> "When a party to a contract elects to cancel it under one or more alternative provisions conferring such a privilege, he should assign his cause and abide by it. He cannot assign one cause and cancel it, then, after being sued for wrongful cancellation, come into court and say he may have erred in respect of the cause assigned, but another cause does exist, and he is not liable." *Chevrolet Motor Co. v. Gladding*, 42 F.2d 440, 445 (4th Cir. 1930); accord, *Kiker v. Bank Sav. Life Ins. Co.*, 37 N.M. 346, 23 P.2d 366 (1933).

<sup>119</sup> *Chevrolet Motor Co. v. Gladding*, *supra* note 118.

<sup>120</sup> See RESTATEMENT (SECOND), AGENCY § 454, comment a (1958).

<sup>121</sup> 3A CORBIN § 762, at 524-26.

and the agreement confers upon the terminated party an opportunity to cure any failure in performance, established principles of estoppel protect against an unreasonable change of grounds.<sup>122</sup> In addition, this rule of construction is easily avoided by the draftsman. The termination clause can be rewritten to eliminate the requirement that the terminating party spell out in the notice the basis for its decision; notice is all that is then required.<sup>123</sup>

As the history of mutuality and the description of the "changing grounds" rule illustrate, a terminated dealer can find little comfort in indirect judicial techniques to control termination abuse. Termination clauses have not generally been misconstrued or found to be inconsistent with other provisions in the contract for the purpose of protecting the weaker, terminated party. In fact, when challenged, the terminating party has usually been the victor regardless of his motive or of the effect of the termination on the parties.

#### IV

##### THE GOOD FAITH TEST AS A SUBSTITUTE FOR RULES DESIGNED TO LIMIT UNFAIR BARGAINS

As a logical aftermath of their failure to prevent unfair results within the confines of freedom of contract theory or under either direct or indirect techniques for controlling termination abuse, terminated parties have argued that a good faith limitation should be imposed on the exercise of reserved and implied powers of termination. Disregarding the comforts of the legal right approach and not bothering to consider the remedies available under other rules, a few courts have agreed.<sup>124</sup> Good faith is used subjectively in this context.<sup>125</sup> It would apply to terminations for wrongful motives

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<sup>122</sup> *E.g.*, *Brush-Swan Elec. Light Co. v. Brush Elec. Co.*, 41 Fed. 163 (S.D.N.Y. 1890).

<sup>123</sup> See *Wood Motor Co. v. Nebel*, 238 S.W.2d 181 (Tex. 1951).

<sup>124</sup> See, *e.g.*, *Busam Motor Sales, Inc. v. Ford Motor Co.*, 85 F. Supp. 790, 796 (S.D. Ohio 1949), *appeal dismissed*, 185 F.2d 531 (6th Cir. 1950); *R. J. Cardinal Co. v. Ritchie*, 218 Cal. App. 2d 124, 145-46, 32 Cal. Rptr. 545, 558-59 (Dist. Ct. App. 1963); *Chrysler Corp. v. Quimby*, 51 Del. 264, 284, 144 A.2d 123, 134, *rehearing denied*, 51 Del. 295, 297, 144 A.2d 885, 886-87 (1958); *Quick v. Southern Churchman Co.*, 171 Va. 403, 417, 199 S.E. 489, 495 (1938).

<sup>125</sup> The term "good faith" is often used in the interpretation and enforcement of contracts. For example, "every contract implies good faith and fair dealing between the parties to it." *Simon v. Etgen*, 213 App. Div. 589, 595, 107 N.E. 1066, 1067 (1915). Thus, each party must perform fairly and in good faith. *Henry G. Meigs, Inc. v. Empire Petroleum Co.*, 171 F. Supp. 888, 892-93 (E.D. Wis. 1959), *aff'd*, 273 F.2d 424 (7th Cir. 1960); *Brassil v. Maryland Cas. Co.*, 210 N.Y. 235, 242, 104 N.E. 622, 624 (1914).

which cause the terminated party to suffer substantial losses or to lose profits or which result in unearned windfalls to the terminating party. As such it would be a substitute (or additional weapon) for other direct controls on harsh bargains.

Before such a substitute is adopted, however, two questions must be considered. First, is the proposed limitation likely to redress the wrongs suffered by the terminated parties? That is, would application of a good faith test protect terminated parties against the unfair consequences of bad faith terminations? Second, even if such a test were effective, is a more attractive alternative available? For example, can the same objectives of preventing unfair terminations be obtained by wider enforcement of the doctrine of unconscionability; or, if that doctrine is inadequate, could it be modified so as to fulfill this need?

A review of the good faith cases is a necessary predicate to this analysis. The question of whether a terminating party acted in good faith appears to have been raised first in connection with the criteria adopted in enforcing employment contracts and later in connection with sales or service contracts. Currently the good faith dispute seems to be centered in the area of franchise agreements. The issue has arisen in both employment and sales contracts where clauses requiring performance to the "satisfaction" of the employer or buyer require interpretation. The question, simply stated, is: How should the terminating party's lack of satisfaction be proved—by asking the terminating party merely to express his judgment or by requiring him to be honestly (that is, subjectively) or reasonably (that is, objectively) dissatisfied?

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And recovery for substantial performance (as contrasted with strict performance) is granted only when the claimant made a good faith effort to perform. *E.g.*, *Handy v. Bliss*, 204 Mass. 513, 519, 90 N.E. 864, 865 (1910); *Ashley v. Henahan*, 56 Ohio St. 559, 569, 47 N.E. 573, 575 (1897); *Garland Grain Co. v. Bailey*, 393 S.W.2d 945, 948 (Tex. Civ. App. 1965). But except in connection with the concept of good faith purchase and negotiable instruments, see *Gilmore, The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057 (1954); Note, 51 VA. L. REV. 1342 (1965), or in regard to dealings where one party stands in a fiduciary relation to the other, *Austrian v. Williams*, 103 F. Supp. 64, 75 (S.D.N.Y.), *rev'd on other grounds*, 98 F.2d 697 (2d Cir.), *cert. denied*, 344 U.S. 909 (1952); compare Note, 74 YALE L.J. 338 (1964), good faith is usually measured by objective standards. See cases cited note 124 *supra*. So strong is this approach that even in cases of unilateral mistake the courts have commonly resorted to a doubtful application of the mutual mistake doctrine to avoid the harsh results of an objective approach to mutual assent. Note, 23 N.Y.U.L. REV. 143 (1948).



*Satisfaction as a Contract Condition*

The cases involving satisfaction terms, as covenants or conditions, are legion and the results often irreconcilable.<sup>126</sup> Corbin, for example, suggests that the interpretive test to be adopted may depend on whether the covenant or condition is discharged either when performance has not been "satisfactory" or when it has not met the terminating party's "personal satisfaction."<sup>127</sup> But most decisions rely on other criteria for construing satisfaction terms. The approach selected depends more on the type of contract involved than the specific satisfaction terms of the contract.

Employment contracts typically are for an indefinite term, but continued employment is often subject to the satisfaction of the employer. In this situation the question of how to interpret the satisfaction condition has revolved around whether to adopt the subjective test. Some jurisdictions hold that the employer is the sole judge of his dissatisfaction;<sup>128</sup> others conclude that the trier of fact should determine whether the lack of satisfaction was honestly held.<sup>129</sup> Under the first approach, the employer's expressed judgment cannot be questioned by court or jury; under the second, the employer's judgment must be upheld unless it is found that his dissatisfaction was feigned. Under either test the termination need not be reasonable, although the unreasonableness of the employer's dissatisfaction may be some evidence that it was contrived.

Different standards have been applied to test the promisee's lack of satisfaction as a condition for terminating a sales or service contract. Such contracts are common. Merchandise, for example, is often sold with a privilege of return if "the buyer is not satisfied"

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<sup>126</sup> For a collection of some of the satisfaction cases, see Annot., 6 A.L.R. 1497 (1920) (non-professional employment contracts); Annot., 81 A.L.R. 1058 (1932) (option to renew lease); Annot., 167 A.L.R. 411 (1947) (sales conditioned upon third-party approval); Annot., 44 A.L.R.2d 1114 (1955) (private building or construction); Annot., 47 A.L.R.2d 455 (1956) (title or land sale contracts); Annot., 86 A.L.R.2d 200 (1962) (sale of goods).

As used in these discussions, "satisfaction" contracts include agreements using similar terms to express a satisfaction condition. *E.g.*, *Wilbur v. Bingham & Phelps*, 3 OHIO C.C.R. 459, 2 Ohio C.C. Dec. 262 (1888) (goods to "suit" buyer); *Hartford Sorghum Mfg. Co. v. Brush*, 43 Vt. 528 (1871) (buyer to "like" goods).

<sup>127</sup> 3A CORBIN § 644.

<sup>128</sup> *E.g.*, *Comerford v. International Harvester Co.*, 235 Ala. 376, 178 So. 894 (1938); *Crawford v. Mail & Express Publishing Co.*, 163 N.Y. 404, 57 N.E. 616 (1900).

<sup>129</sup> *E.g.*, *Edwards v. Doherty*, 74 So. 2d 686 (Fla. 1954); *Hazen v. Cobb*, 96 Fla. 151, 117 So. 853 (1928).

or if the goods "are not satisfactory." Service contracts are similarly conditioned. The test of satisfaction in these circumstances depends not on whether the contract involves sales or services, but rather on the availability of commercial standards. If the purchaser of an artist's portrait is not satisfied, his personal judgment is usually controlling.<sup>130</sup> But the motives of the allegedly dissatisfied watch repair customer are irrelevant in testing his lack of satisfaction. The promisee is deemed to be satisfied if a reasonable man would have been satisfied with the operation of the watch.<sup>131</sup> The common thread of these cases is that a subjective test of satisfaction is usually applied when the condition involves personal taste, and objective criteria control when the existence of the condition is measurable by commercial standards.<sup>132</sup>

Despite substantial differences in the various situations in which subjective criteria are applied, terminated franchisees invariably have relied upon these cases to argue that a good faith limitation requiring pure motives by the terminating party should be imposed on the right to terminate.<sup>133</sup> This reliance seems misplaced. The adoption of a subjective test in the employment situation appears to be the result of various factors: the personal nature of the employment relation; the lack of acceptable objective standards; and a judicial reluctance to allow the trier of fact to substitute his judgment for that of the employer as to what the needs of the business require. Nor do the sales and service contract cases support a dealer good faith argument since they demonstrate that subjective tests are applied only when commercial standards are unavailable.

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<sup>130</sup> *E.g.*, *Wolff v. Smith*, 303 Ill. App. 413, 25 N.E.2d 399 (1940); *Bowen v. Buckner*, 183 S.W. 704 (Mo. Ct. App. 1916).

<sup>131</sup> See *McKendrie v. Noel*, 146 Colo. 440, 362 P.2d 880 (1961) (sale of automatic rug cleaners).

<sup>132</sup> See, *e.g.*, *Ard Dr. Pepper Bottling Co. v. Dr. Pepper Co.*, 202 F.2d 372 (5th Cir. 1953); *Furmsmidt v. Hotel Abbey Holding Corp.*, 10 App. Div. 2d 447, 200 N.Y.S.2d 256 (1960). Compare *Wynkoop Hallenbeck Crawford Co. v. Western Union Tel. Co.*, 268 N.Y. 108, 196 N.E. 760 (1935), with *Schneider v. Viotor*, 208 App. Div. 624, 203 N.Y. Supp. 897 (1924). See generally 3 WILLISTON § 675.

<sup>133</sup> Even though the relationship between manufacturer and dealer is commercial, one factor which may have caused dealers to rely on authorities suggesting a subjective good faith standard was the fact that many franchise agreements contained satisfaction clauses. See, *e.g.*, *E. I. Du Pont De Nemours & Co. v. Claiborne-Reno Co.*, 64 F.2d 224, 227 (8th Cir. 1933); *Mills-Morris Co. v. Champion Spark Plug Co.*, 7 F.2d 38, 39 (6th Cir. 1925); *Tennessee & S.E. Coal Co. v. Schwitzer-Cummins Co.*, 173 Tenn. 524, 121 S.W.2d 553 (1938); *Macaulay* 565 & n.435 (before 1956 some automobile dealer franchises required the dealer to sell to the manufacturer's satisfaction).

### *The Good Faith Cases*

The good faith argument has had only sporadic success when applied to franchise or franchise-type agreements. The two cases most often relied on as establishing the good faith principle were both decided in 1931.

The first decision, *J. R. Watkins Co. v. Rich*,<sup>134</sup> involved termination of a sales agent one month after execution of the contract. In an action against the sales agent's sureties, the Supreme Court of Michigan ruled that the unexplained termination by the manufacturer so soon after entering into the contract, which was terminable at will without cause, demonstrated that the sureties' signatures had been fraudulently secured. The manufacturer's only purpose in executing the contract, according to the court, was to obtain the sureties' guarantee and then collect immediately on the agent's debt, most of which had been incurred under an earlier contract. The holding in *Rich*, therefore, can be viewed as nothing more than a reaffirmation of the well-established doctrine that "a contractual promise made with the undisclosed intention of not performing it is a fraud."<sup>135</sup>

Had the Michigan court said no more it seems questionable whether *Rich* would ever have been given any prominence.<sup>136</sup> But the court preceded its conclusion by imposing what seemed to be a constructive good faith condition on the power to terminate when it commented:

A provision in a contract for termination at the option of a party is valid. But where the relationship is commercial and does not involve fancy, taste, sensibility, judgment, or other personal features, the option may be exercised only in good faith.<sup>137</sup>

This dictum seems wholly unreliable, however. The court applied tests adopted in sales and service satisfaction cases (in *reverse* of their usual application) even though the manufacturer relied on its power

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<sup>134</sup> 254 Mich. 82, 235 N.W. 845 (1931).

<sup>135</sup> RESTATEMENT, CONTRACTS § 473 (1932). Cf. *id.* §§ 475-76; Note, 38 COLUM. L. REV. 1461 (1938).

(1932); Note, 38 COLUM. L. REV. 1461 (1938).

<sup>136</sup> For a comparable holding involving similar facts and a suit by the dealer in tort for fraud, see *Patterson-Pope Motor Co. v. Ford Motor Co.*, 66 Ga. App. 41, 16 S.E.2d 877 (1941). The *Rich* decision gained additional notoriety because it applied Michigan law, which was also stipulated to be the law governing most automobile dealer franchises—the most commonly litigated franchise agreement.

<sup>137</sup> 254 Mich. at 84-85, 235 N.W. at 846.

to terminate at will. None of the authorities relied on by the Michigan court supports a general good faith limitation;<sup>138</sup> in fact, other Michigan decisions seem to contradict any application of a constructive good faith term.<sup>139</sup> Moreover, if a general limitation were intended, the sales agent as well as the sureties should have been relieved of liability.<sup>140</sup>

The second case, *Philadelphia Storage Battery Co. v. Mutual Tires Stores*,<sup>141</sup> also seems difficult to accept. There the manufacturer of Philco radios terminated one of its jobbers without giving advance notice under an agreement which required only that the jobber be advised of the termination in writing. Upon receipt of the termination letter the jobber stopped payment on a check mailed to the manufacturer for materials received. In an action on the check, Philco demurred to the jobber's answer and counterclaim which asserted that the jobber had made a substantial investment in the business and that the termination was ineffective because it was part of a conspiracy to replace the jobber and wreck his business. The Supreme Court of South Carolina conceded that Philco had the

<sup>138</sup> The court relied on the following authorities: *Bishop v. Bloomington Canning Co.*, 307 Ill. 179, 138 N.E. 597 (1923); *Brown v. Board for Educ.*, 117 Kan. 256, 231 Pac. 72 (1924); *Holton v. Monarch Motor Car Co.*, 202 Mich. 271, 168 N.W. 539 (1918); *Brucker v. Manistee & G.R. R.R.*, 166 Mich. 330, 130 N.W. 822 (1911); *Commer v. Butts*, 40 Mich. 332 (1879); 13 C.J. *Contracts* § 632 (1917). None of these authorities supports the imposition of a subjective good faith test where the relationship between parties is commercial—and in *Rich* the court held that the relationship between the manufacturer and sales agent was commercial. These authorities are also inapposite since all involve satisfaction contracts or performance tests such as "good cause" or "reasonable grounds" (which are measured by the same tests applied in the satisfaction cases), whereas the agreement in *Rich* between the manufacturer and sales agent as well as the suretyship agreement was terminable at will. Moreover, the Michigan court had long adopted the personal-commercial distinction generally applied in interpreting satisfaction contracts which would have required application of objective criteria here. See, e.g., *Wood Mach. Co. v. Smith*, 50 Mich. 565, 15 N.W. 906 (1883).

<sup>139</sup> The Michigan court had previously held sales agency contracts without fixed terms terminable at will without proof that the termination was made in good faith. *Garlock v. Motz Tire & Rubber Co.*, 192 Mich. 665, 159 N.W. 344 (1916); *Fuchs v. Standard Thermometer Co.*, 178 Mich. 37, 144 N.W. 484 (1913); accord, *Bushwick-Decatur Motors, Inc. v. Ford Motor Co.*, 116 F.2d 675, 677 (2d Cir. 1940); *Martin v. Ford Motor Co.*, 93 F. Supp. 920, 921 (E.D. Mich. 1950).

<sup>140</sup> Since the sales agent did not appeal from the trial court's judgment, the Michigan Supreme Court was not actually faced with the question of his liability. On the other hand, the court affirmed the trial court's judgment and quoted extensively from its opinion; if a good faith limitation was intended, the trial court's judgment against the sales agent seems erroneous. Thus, the trial court and supreme court judgments and opinions are reconcilable only if viewed as a refusal to enforce a fraudulent promise.

<sup>141</sup> 161 S.C. 487, 159 S.E. 825 (1931).

right under the agreement to terminate the jobber at will. Nevertheless, it held that the answer and counterclaim set forth a defense and claim because, if proved, the jobber's allegations showed (1) that Philco had induced the jobber "to buy heavily of its merchandise, for the payment of which it holds [the jobber, while] . . . it now relieves itself of the obligation to fulfill the warranties of its goods, and the service to be furnished to the purchasers of them . . ."; and (2) that Philco's "intent and purpose" was "to wreck the business of defendant."<sup>142</sup> Thus, *Philadelphia Storage Battery* holds no more than that a franchisee (who has invested in the business) can be terminated only after he has had a reasonable opportunity to recoup his investment; a manufacturer does not relieve itself of contractual warranty obligations by exercising the power to terminate; and intentional injury of another's business may give rise to an action in tort.

Once again, had the court gone no further it seems doubtful whether this case would have achieved any significance. But the court supported its decision by asserting that a "necessary corollary" to the doctrine that an option to cancel will be enforced only if not contrary to equity and good conscience<sup>143</sup> is the rule that an agreement "may not be terminated, if the manner of its termination be against equity and good conscience."<sup>144</sup> In emphasizing the manner of termination, the court obviously was referring not to Philco's failure to give advance notice but rather to its bad motives, including its over-reaching, which was to make it no stranger to the courts.<sup>145</sup>

As noted earlier, neither *Rich* nor *Philadelphia Storage Battery* has gained much acceptance. Both cases can be explained by other rules of contract law, and, possibly, as examples of semi-covert attempts to prevent gross misuse of economic power. A federal court when faced with the South Carolina court's decision, followed it reluctantly and observed that it was "different from the rule prevailing in most American jurisdictions."<sup>146</sup> No Michigan court has

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<sup>142</sup> *Id.* at 492, 159 S.E. at 827.

<sup>143</sup> See note 48 *supra* and accompanying text.

<sup>144</sup> 161 S.C. at 490, 159 S.E. at 826.

<sup>145</sup> See *Philadelphia Storage Battery Co. v. Kelley-How-Thomson Co.*, 64 F.2d 834 (8th Cir. 1933).

<sup>146</sup> *Gaines W. Harrison & Sons v. J. I. Case Co.*, 180 F. Supp. 243, 253 (E.D.S.C. 1960).

interpreted *Rich* as requiring a constructive good faith condition on termination rights; only isolated cases have accepted it.<sup>147</sup>

Probably the single most important event in the general rejection of a good faith condition was the Second Circuit's decision in *Bushwick-Decatur Motors, Inc. v. Ford Motor Co.*<sup>148</sup> There the issue of good faith was clear-cut. A terminated automobile dealer alleged that Ford's termination of him was "malicious, in bad faith, and contrary to the custom of the trade, and therefore wrongful";<sup>149</sup> the manufacturer responded that the dealer's allegations were of no consequence, because it had an "unqualified power to terminate, irrespective of its reasons for doing so."<sup>150</sup> Applying Michigan law, as required by the franchise agreement, the court held that it did not require imposition of a good faith limitation. *Rich*, the court said, applied good faith only as a test of the manufacturer's original intention to offer the dealer a fair opportunity to perform and recoup his original debts and investment.<sup>151</sup>

However, the Second Circuit went on to examine whether a good faith test should be applied. Adhering closely to classic rules of freedom of contract theory, it reasoned that when the contract specifically provides for termination at will, the parties can hardly be viewed as

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<sup>147</sup> The two courts which have so applied *Rich* have had to reverse themselves later. In *Busam Motor Sales, Inc. v. Ford Motor Co.*, 85 F. Supp. 790, 796 (S.D. Ohio 1949), *appeal dismissed*, 185 F.2d 531 (6th Cir. 1950), Judge Druffel cited *Rich* as authority for the proposition that under Michigan law an option to terminate at will must be exercised in good faith; hence he granted defendant's motion for a new trial since the evidence did not sustain the jury verdict based on a finding that the manufacturer had not acted in good faith. Following the retrial, however, the case came before the court a second time and this time Chief Judge Nevin held that the "right to terminate was not subject to question on grounds of unreasonableness, unfairness, lack of good faith, bad faith or because of motive, intent or resultant detriment to plaintiff." 104 F. Supp. 639, 643 (S.D. Ohio 1952), *rev'd on other grounds*, 203 F.2d 469 (6th Cir. 1953). A similar change of view is reflected between the court's first opinion in *Chrysler Corp. v. Quimby*, 51 Del. 264, 284-85, 144 A.2d 123, 134 (1958), and its ruling on denial of defendant's petition for a rehearing in 51 Del. 295, 297, 144 A.2d 885, 886-87 (1958).

<sup>148</sup> 116 F.2d 675 (2d Cir. 1940) (Clark, J.), *affirming* 30 F. Supp. 917 (E.D.N.Y. 1940). Despite their general lack of success, terminated dealers have continued to argue that the court should impose a constructive good faith condition on the power to terminate. *E.g.*, *Zaiden v. Borg-Warner Corp.*, 228 F. Supp. 669, 670 (E.D. Pa. 1964), *aff'd*, 341 F.2d 391 (3d Cir. 1965); *Smoky Mountains Beverage Co. v. Anheuser-Busch, Inc.*, 182 F. Supp. 326 (E.D. Tenn. 1960); *Sharpe v. Great Lakes Steel Corp.*, 9 F.R.D. 691 (S.D.N.Y. 1950); see *Rubinger v. International Tel. & Tel. Corp.*, 193 F. Supp. 711 (S.D.N.Y. 1961), *aff'd*, 310 F.2d 552 (2d Cir. 1962).

<sup>149</sup> 116 F.2d at 676.

<sup>150</sup> *Ibid.*

<sup>151</sup> *Ibid.*

having intended to insert a good faith limitation. This proposition seems indisputable. More questionable is the court's analysis of why good faith conditions should not be imposed as a matter of public policy. The court argued as follows:

Such a limitation can be read into the agreement only as an overriding requirement of public policy. This seems an extreme step for judges to take. . . . [T]he dealers are not misled or imposed upon, but accept as nonetheless advantageous an agreement in form bilateral, in fact one-sided. 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*.<sup>152</sup>

Whatever the validity of this analysis in 1940, the rationale seems questionable today. Enforcement of minimum standards of fairness is not such an innovative step that it can be taken only as an overriding matter of public policy or after legislative mandate. Economic duress, for example, has long been recognized as a basis of preventing unjust enrichment; it "treats the reasonableness of contract terms as a matter of concern for the courts."<sup>153</sup> Courts, in addition, are constantly called upon to weigh economic factors and to determine economic needs—tasks imposed by statute and assumed under common law practice.<sup>154</sup> Finally, reliance solely on legislative direction for establishment of tests of valid exercises of termination powers likewise seems neither realistic nor desirable; the problem of develop-

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<sup>152</sup> *Id.* at 677. (Emphasis added.) Compare Judge Clark's views on freedom of contract one year later in *Parev Prods. Co. v. I. Rokeach & Sons*, 124 F.2d 147, 149 (2d Cir. 1941) quoted at note 40 *supra*.

<sup>153</sup> Dalzell, *Duress by Economic Pressure: II*, 20 N.C.L. REV. 341, 361 (1942). See Dawson, *Economic Duress—An Essay in Perspective*, 45 MICH. L. REV. 253, 288-89 (1947): "[T]he modern American law of duress reflects the convergence of several lines of growth . . . . This conflict and confusion must be attributed in part to the fact that the processes of growth are still continuing and the effects of earlier history are not yet dissipated. In part, however, they are due to the complex issues of ethics and economic policy that constantly intrude themselves and on which courts, like other agencies of organized society, must take a positive stand.

" . . . Above all, where judicial review is refused the decision should not depend on a formula inherited from the thirteenth century but on a conscious evaluation of the factors that make judicial review impracticable or unwise." *But see Hale, Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603, 625 (1943).

<sup>154</sup> The antitrust laws and their common law antecedents are the most obvious example. Sherman Act, §§ 1-2, 26 Stat. 209 (1890), as amended, 15 U.S.C. §§ 1-2 (1964); see *United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271 (6th Cir. 1898).

ing minimum fairness standards is particularly appropriate for case-by-case adjudication.<sup>155</sup>

Even if the development of such standards can be viewed as consistent with freedom of contract theory it does not automatically follow that good faith limitations which concentrate on the terminating party's motives are either appropriate or desirable. The justification generally asserted for the imposition of a good faith condition as a matter of policy is that it is necessary to mitigate the effects of a harsh bargain or to prevent an improper windfall.<sup>156</sup> Both considerations were apparently present, for example, in *Philadelphia Storage Battery*. While there can be little controversy that some protection is desirable to insure that elemental fairness is observed, in no case has the question been asked: Would the imposition of a good faith test be effective in protecting the terminated party against over-reaching or in preventing unjust enrichment?

Analytically, the terminating party's motives are unrelated to the harshness of the bargain or of its effect. Motives have no relationship to the parties' relative bargaining power. Nor would the application of a good faith test be affected either by whether the dominant party was misusing its power or by whether termination would have unduly harsh effects on the terminated party. Rather, its application would be determined by the extent to which such misuse was disclosed by improper motives. The assumption, in other words, seems to be that fairness can be assured (or fundamental unfairness prevented) by attention to the motives upon which a party acts. Not only is empirical support for this assumption lacking, but it also seems contrary to common sense. There is no evidence that a weaker party would be protected adequately by requiring the dominant party to exhibit proper motives in exercising the power to termi-

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<sup>155</sup> "[Legislation] has a serious disadvantage. It does away with the flexibility without which only very few trades can do. It enlarges the businessman's risk and does not allow him to take measures against its increase, measures which only he can devise and which must be applied rapidly. Legislative compulsion works best where a trade has grown into a quasi-governmental function, as, e.g., insurance or traffic; it is almost impossible in all other branches." PRAUSNITZ, *THE STANDARDIZATION OF COMMERCIAL CONTRACTS IN ENGLISH AND CONTINENTAL LAW* 145 (1937); see Llewellyn, *Book Review*, 52 *HARV. L. REV.* 700, 705 (1939); 52 *COLUM. L. REV.* 669 (1952). Compare Peck, *The Role of the Courts and Legislatures in the Reform of Tort Law*, 48 *MINN. L. REV.* 265 (1963).

<sup>156</sup> 45 *HARV. L. REV.* 378 (1931); cf. 17 *CORNELL L.Q.* 479 (1932). See also Note, 31 *COLUM. L. REV.* 830, 840-42 (1931).



nate.<sup>157</sup> For example, would a termination for the sole purpose of furthering the economic self-interest of the terminating party be evidence of lack of good faith? Probably not. But it cannot be seriously questioned that such a termination may nevertheless have substantial unfair effects on the terminated party's business. Conversely, bad faith motives may not result in any unfairness to the terminated party. On the other hand, the case against good faith conditions is easily overstated. At least in the cases in which it has been applied, there is little question that but for the good faith limitation the terminations would have caused the terminated parties to suffer substantial losses.

Aside from consideration of the effectiveness of a good faith test, it is also questionable whether, as a matter of policy, subjective terms should be imported into contracts unless absolutely necessary. Interpretation of certain satisfaction contracts may present no alternative, especially if the parties have clearly expressed their intention that a subjective test is to be applied. But legal tests involving subjective motivation generally have created troublesome problems, particularly in the law of contracts.<sup>158</sup> Thus, unless fundamental fairness cannot be assured the terminated party by other means, a subjective good faith condition dependent upon the terminating party's motives has little to recommend it.

## V

### THE DOCTRINE OF UNCONSCIONABILITY AS AN ALTERNATIVE— A RECOMMENDATION

From this survey it seems fair to conclude that if assuring fairness is a proper objective, and both direct and indirect limitations are applied on the premise that it is, then the dealer is not protected adequately against termination abuse. The defects of the indirect

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<sup>157</sup> See Macaulay 509.

<sup>158</sup> See 3A CORBIN § 644, at 82; Littlefield, *Good Faith Purchase of Consumer Paper: The Failure of the Subjective Test*, 39 SO. CAL. L. REV. 48 (1966); Note, 23 N.Y.U.L. REV. 143 (1948). Compare Ames, *How Far An Act May Be A Tort Because of The Wrongful Motive of The Actor*, 18 HARV. L. REV. 411 (1905); Dupont, *Disinterested Malevolence as an Actionable Wrong*, 22 FORDHAM L. REV. 185 (1953); Comment, *The Employers "Good Faith" Bargaining Duty—A Troublesome Test in the Taft-Hartley Act*, 17 W. RES. L. REV. 1390 (1966). Thus, where it is doubtful whether words mean personal (*i.e.*, subjective) satisfaction or reasonable (*i.e.*, objective) satisfaction, the latter standard is usually applied. See RESTATEMENT, CONTRACTS § 265 (1932).

techniques of construction are obvious. They are seldom relied upon in the termination situation; and even when they are, the effect is not always desirable. Reliance on semi-covert methods distorts rules of construction and the distortions carry over to other contexts. Moreover, application of rules of construction depends not on the level of unfairness but on the craftsmanship of those drafting the termination clause—and there is no necessary correlation between the two.

Some direct restraints on termination abuse, however, have similar shortcomings. Except for barriers to discriminatory and fraudulent terminations, a dealer's protection against unfair or unnecessarily harsh terminations may be easily evaded or be available only against the worst abuses. Express agreement can avoid the Missouri doctrine; tort recovery in a termination context protects against little more than outright fraud; economic duress is an obscure doctrine which has traditionally afforded only restitutionary relief; and unconscionability has been used only hesitatingly and against occasional gross unfairness.

With the traditional channels of judicial relief seemingly closed and with the courts unwilling to alleviate the dealers' complaints, the problem would seem to require legislative solution. Llewellyn, however, in a related context, has counseled that "an approach by statute seems to me dubious, uncertain, and likely to be both awkward in manner or deficient and spotty in scope."<sup>159</sup> Other thoughtful commentators have agreed.<sup>160</sup> Furthermore, legislation at this stage seems unlikely. As a practical matter the dealers are too diffuse a group to exert sufficient political pressure. There are hundreds of companies distributing their products through dealers in scores of fields, including such diverse operations as cemetery stone sales, dance studios, tax and accounting recordkeeping services, and theft prevention.<sup>161</sup> The manufacturers, by contrast, would probably be able to organize effectively since many, if not most, might view any "tampering" with termination rights as destructive of their businesses. Even such a highly organized, politically powerful, and homogeneous group as the automobile dealers had to expend years of effort and considerable sums of money to obtain

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<sup>159</sup> LLEWELLYN, *THE COMMON LAW TRADITION—DECIDING APPEALS* 370 (1960).

<sup>160</sup> See note 155 *supra*.

<sup>161</sup> See KURSH, *THE FRANCHISE BOOM* Appendix B at 207-46 (1962).

generally unsatisfactory federal and often ineffective state legislation.<sup>162</sup> This very diversity might also prevent specific legislation from being successful. The requirements of minimum fairness, rather, need to be worked out under the demands of practical application. Thus the problem of developing minimum standards of fairness for termination of a dealer is peculiarly suited to case-by-case adjudication. Nonetheless, legislation would seem appropriate and desirable if it were to incorporate flexible standards and provide an equitable framework for dealer protection.<sup>163</sup> Such standards are suggested below and the virtue of their codification would be the prod which they might then provide for reticent courts currently mired in antiquated and inapplicable rules of contract law.

On the other hand, the problem does not necessarily require radical revision of present doctrines.<sup>164</sup> Viewed from the angle

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<sup>162</sup> The long struggle on the part of automobile dealers is recounted in Macaulay 512-54. As to the success of their struggle, compare Macaulay 817-40, with Freed, *A Study of Dealers' Suits Under the Automobile Dealers' Franchise Act*, 41 U. DET. L.J. 245, 256-61 (1964), and Comment, 74 YALE L.J. 354, 356 (1964).

<sup>163</sup> See notes 178-80 *infra* and accompanying text. The issue is presently before Congress. A "good faith" bill modeled after the Automobile Dealers' Day-in-Court Act and applicable to all franchise agreements has been introduced into the House. H.R. 2818, 90th Cong., 1st Sess. (1967). The staff of the Senate Subcommittee on Anti-trust and Monopoly is also drafting a bill to guard against arbitrary cancellation of franchises. Letter From Senator Philip A. Hart to the author, February 9, 1967.

Puerto Rico, on the other hand, has already adopted the legislative approach in the Dealer's Act of 1964, which provides that a dealer has a tort action against a manufacturer who terminates, refuses to renew, or impairs an existing franchise relationship without "just cause." The statutory test of just cause applies "[n]otwithstanding the existence in a dealer's contract of a clause reserving to the parties the unilateral right to terminate the existing relationship" or of a clause automatically ending the relationship after a specific time period. P.R. LAWS ANN. tit. 10, § 278 (1964), as amended, P.R. Acts 1966, No. 105. By rigidly proscribing all terminations except for judicially determined "just cause," this legislation can be condemned as incorporating all the defects inveighed by Llewellyn and Prausnitz. For example, a manufacturer seemingly cannot effectively limit the franchise grant to a specific term; except for cause it runs in perpetuity. Arguably, the manufacturer cannot even appoint an additional dealer in an existing dealer's sales territory. See *United Medical Equip. Corp. v. S. Blickman, Inc.*, 260 F. Supp. 912 (D.P.R. 1966).

<sup>164</sup> It has been suggested that in the adhesion contract situation the English doctrine of "fundamental breach" should be adopted. Simply stated, this doctrine would deny judicial enforcement of warranty disclaimers and other exculpatory contract clauses when such enforcement is inconsistent with the primary purposes and obligations of the contract. Meyer, *Contracts of Adhesion and the Doctrine of Fundamental Breach*, 50 VA. L. REV. 1178 (1964). See also Devlin, *The Treatment of Breach of Contract*, 1966 CUMB. L.J. 192. Adoption of this approach in the termination context, however, would not appear to provide any useful guideline as to when a power to terminate should be enforceable; substantial breach is at least the equivalent of "just cause."

On the other hand, the civil law has long recognized the notion of good faith in

of potential rather than actual relief, the doctrine of unconscionability would seem ideally suited as a vehicle for establishing minimum requirements of fairness. The doctrine cannot be eluded by express agreement. It was created originally for the purpose of avoiding unscrupulous bargains; its utilization as a means of imposing minimum standards of fairness would be a substantial but consistent extension. In addition, the doctrine has been undergoing significant change in recent years as a result of agitation for its application to inconsistent standardized contract terms which were not negotiated and because of its inclusion in the Uniform Commercial Code. But since the inertia of freedom of contract theory is substantial, the tentative suggestions made here deliberately involve no new departures; each is borrowed from an existing contract doctrine.<sup>165</sup> Finally, the lessons implicit in the ineffectiveness of the indirect and direct limitations on termination abuse should not be

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the enforcement of contract rights under the title of "abuse of rights." Without attempting to detail its many applications, it is sufficient to note that the abuse of rights approach has been plagued by confusion over whether objective or subjective tests of good faith should be applied. Rosenberg, *The Notion of Good Faith in the Civil Law of Quebec*, 7 MCGILL L.J. 2, 19-23 (1960); Note, 109 U. PA. L. REV. 401, 415-18 (1961). See generally Angus, *Abuse of Rights in Contractual Matters in the Province of Quebec*, 8 MCGILL L.J. 150 (1962). See also Gutteridge, *Abuse of Rights*, 5 CAMB. L.J. 22 (1933); Powell, *Good Faith in Contracts*, 9 CURRENT LEGAL PROBLEMS 16 (1956). The result has often been unsatisfactory uncertainty in the application of the doctrine and only limited protection for the dealer since many of the protections can be evaded by careful drafting of the franchise agreement. See Hannon, *Cancellation of Distributorship and Sales Agency Agreements in Europe: The French Example*, 41 L.A. BAR BULL. 222 (1966).

<sup>165</sup> Although the proposal made here is evolutionary rather than revolutionary, it does not avoid the "defect" asserted by some commentators against the adoption of § 2-302 of the Uniform Commercial Code—that too much power is given the courts to alter private agreements and that this poses a threat to commercial stability. See, e.g., King, *Suggested Changes in the Uniform Commercial Code—Sales*, 33 ORE. L. REV. 113, 115-16 (1954); California State Bar Committee on the Commercial Code, *The Uniform Commercial Code*, 37 CALIF. ST. B.J. 119, 135-36 (1962) (recommendation not to adopt § 2-302). But see Latty, *Sales and Title and the Proposed Code*, 16 LAW & CONTEMP. PROB. 3, 19 n.78 (1951). Being unwilling to sacrifice minimum standards of elemental fairness to the desire for stability, the approach recommended here sides with the draftsmen of the Code. However, the suggestion of specific measures of fairness is intended to minimize any unstabling effects.

It should be noted that the concern here is with fairness of the franchise agreement's terms and effects (which have been labelled "substantive" unconscionability) rather than with the process of contracting (which has been denominated "procedural" unconscionability). See Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 487 (1967). A finding of the latter is arguably a prerequisite to holding of unconscionability under § 2-302 of the code. *Id.* at 489-508. But, as noted below (see note 178 *infra*), franchise agreements are seldom negotiated and hence, the serious questions concern "substantive" unconscionability.

ignored. If the protection afforded by a new doctrine of unconscionability is to be effective in guaranteeing fairness, judicial scrutiny of termination abuse must focus on three areas: (1) the terms of the agreement; (2) the effects of the termination; and (3) the relief ordered. These facets of the problem are considered seriatim.

### *The Terms*

It seems indisputable that the ancient madman test as well as the measure of gross unfairness is too narrow a definition of unconscionability to protect a dealer against unfair termination. Both reflect the business standards of the past rather than the present. As a result, changes have often been called for in the scope and meaning of the doctrine. Llewellyn, for example, suggested that in testing the fairness of standard form contracts, courts should view the agreement as two contracts; the agreement on the negotiated terms and the supplementary boilerplate.<sup>166</sup> He contended that the latter "agreement" should be enforced only if it is reasonable and consistent with the negotiated terms. But in the termination context this approach may work against the party whom the rule is designed to protect. For example, if the termination provision is unenforceable because it was not negotiated and is inconsistent with the negotiated terms, a termination power is implied—and in the franchise situation this normally means that either party may terminate at will (subject only to the limitations of the Missouri doctrine, if followed). Thus, if the dealer has recently made a new investment but the franchise has been in effect for some time, the dealer is at the mercy of the manufacturer, who can terminate the relationship at any time as long as adequate notice is given the dealer.

The most significant change in the doctrine of unconscionability probably has been effected by the recent departure of the framers of the Uniform Commercial Code, who specifically incorporated the doctrine into modern sales law for the first time. The actual terms of section 2-302,<sup>167</sup> however, are disappointing to one seeking

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<sup>166</sup> LLEWELLYN, *THE COMMON LAW TRADITION—DECIDING APPEALS* 370-71 (1960).

<sup>167</sup> (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result. (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting,

the advancement of minimum standards. No attempt was made to define unconscionability. The framers disclaimed any intention of seeking to disturb risk allocation because of superior bargaining power. The section was supposedly designed only to prevent "oppression and unfair surprise."<sup>168</sup> Nonetheless, by specifically setting out the doctrine as a basis for relief, attention is called to its availability. Moreover, procedures are spelled out for the proof of unconscionability. A terminated party to a sales contract, for example, now has a "right" to attack the unreasonableness of the terms by submission of proof of their "commercial setting, purpose and effect."

More importantly, the impact of the doctrine in sales situations is beginning to be felt.<sup>169</sup> In *Williams v. Walker-Thomas Furniture Co.*,<sup>170</sup> a court recently adopted the Code's approach to unconscionability in considering the enforceability of a furniture store's "add-on" or consolidated installment sales contract, even though the Code was not in effect in the jurisdiction at the time the contract was signed. While the court remanded the case for taking of evidence of possible unconscionability, it did establish that in finding the doctrine applicable two elements should be considered: (1) was there "an absence of meaningful choice on the part of one of the parties"; and (2) were the "contract terms . . . unreasonably favorable to the other party."<sup>171</sup> Lack of meaningful choice—which is arguably nothing more than another phrasing of Llewellyn's suggestion of negotiated terms—includes those situations where one party either has no choice as to the inclusion of a particular term or is unaware of its presence or effect. Obviously the relative bar-

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purpose and effect to aid the court in making the determination." UCC § 2-302. See generally Leff, *supra* note 165, at 485 (1967) (critically examining the drafters' failure to spell out relevant factors which a court should consider in determining unconscionability).

<sup>168</sup> UCC § 2-302, comment 1.

<sup>169</sup> Courts have historically applied the policies of the uniform acts beyond the subject-matter of the act where reason and policy require. UCC § 1-102, comment (cases collected); see Leff, *supra* note 165, at 486 n.4 (collecting authorities). *But see In re Elkins-Dell Mfg. Co.*, 253 F. Supp. 864, 873 n.4 (E.D. Pa. 1966).

<sup>170</sup> 350 F.2d 445 (D.C. Cir. 1965). Not surprisingly, defendant's sales contract was apparently no stranger to the courts. See *W. T. Walker Furniture Co. v. Dyson*, 32 App. D.C. Cir. 1908. See also *American Home Improvement, Inc. v. MacIver*, 105 N.H. 435, 201 A.2d 886 (1964); *State v. ITM, Inc.*, 52 Misc.2d 39, 275 N.Y.S.2d 303 (Sup. Ct. 1966).

<sup>171</sup> 350 F.2d at 449.

gaining power of the parties will be significant here. And where such choice was absent, the court held that the reasonableness of the terms was to be determined by reliance on Corbin's test of whether the terms were unacceptable according to "the mores and business practices of the time."<sup>172</sup>

Application of the test laid down in *Williams*, however, would not necessarily provide sufficient protection for a terminated dealer. First, the test seems internally inconsistent. If the dealer is offered a choice of terms by the manufacturer or other manufacturers, the *Williams* rule would not protect him even if the terms were grossly unfair, because the dealer was free to select another manufacturer. But if the dealer has no choice, the prevalent business practice setting the standard of minimum fairness might be the very uniform terms to which the dealer is objecting. Second, even if a broader commercial setting is considered in ascertaining the business mores against which the contract is measured, such a test seems little more than judicial approval of the lowest common denominator of business practices without regard to the parties' relative needs or the fairness of the contract terms. Questionable terms, established as business mores because of competitive requirements, might thus become judicial tests of fairness. Nor is it uncommon for whole industries to persuade themselves that matters of convenience are an economic necessity.<sup>173</sup>

This criticism of the negotiated terms or business mores approach espoused by Llewellyn, Corbin, and the *Williams* court does not go to the purpose or essence of these proposals. Rather it is concerned with the probable ineffectiveness of such tests in applying sanctions against unfair terminations of a dealer. If applicable, however, they should not be ignored.

On the other hand, the suggestion that contract termination provisions meet minimum standards of fairness is not wholly without precedent in the law of contracts. In enforcing liquidated damage provisions, courts follow the rule that such a term is enforceable (and the amount collectible) only if, at the time the contract was entered into, the damages arising from breach were difficult to ascertain and the stipulated amount bore a reasonable relation-

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<sup>172</sup> *Id.* at 450; *accord*, *Mandel v. Liebman*, 303 N.Y. 88, 93-94, 100 N.E.2d 149, 152-53 (1951); 1 CORBIN § 128.

<sup>173</sup> See, e.g., Macaulay 547.

ship to the anticipated loss.<sup>174</sup> Even though the liquidated damages test is usually stated in terms of the intention of the parties—did they make a bona fide attempt to estimate the damages or was the stipulated figure adopted for its *in terrorem* effect<sup>175</sup>—courts have ignored form and concentrated on the proportionality of the amount stipulated to the losses which could be reasonably expected.<sup>176</sup>

A similar test would seem feasible in measuring the fairness of contract termination provisions where the negotiated-terms, business-mores tests prove inadequate.<sup>177</sup> In other words, where it appears that the termination conditions seem unfair even though they meet the business practices of the industry and were negotiated, their fairness could be tested by requiring 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.*<sup>178</sup> This proposed test necessarily includes the requirement of the Missouri doctrine in connection with

<sup>174</sup> *Better Food Markets, Inc. v. American Dist. Tel. Co.*, 40 Cal. 2d 179, 253 P.2d 10 (1953); RESTATEMENT, CONTRACTS § 339 (1932).

<sup>175</sup> *Cf. Atkinson v. Pacific Fire Extinguisher Co.*, 40 Cal. 2d 192, 253 P.2d 18 (1953); *H. J. McGrath Co. v. Wisner*, 189 Md. 260, 55 A.2d 793 (1947); *Anderson v. Cactus Heights Country Club*, 80 S.D. 417, 125 N.W.2d 491 (1963); 5 CORBIN §§ 1058, 1059.

<sup>176</sup> 5 *id.* §§ 1057-60. See generally Fritz, "Underliquidated" Damages as Limitation of Liability, 33 TEXAS L. REV. 196 (1954). Again, judicial efforts to avoid unfair results have created a gap between freedom of contract rhetoric and reality. Comment, 72 YALE L.J. 723, 746 (1963).

<sup>177</sup> In fact, the line between a valid termination and an unenforceable forfeiture is often difficult to draw. Compare *Ace Flying Service, Inc. v. Colorado Dep't of Agriculture*, 141 Colo. 467, 348 P.2d 962 (1960), with *Kahn v. Janowski*, 191 Md. 279, 60 A.2d 519 (1948). See *Jones v. Chester*, 363 S.W.2d 150 (Tex. Civ. App. 1962).

<sup>178</sup> Just as liberal applications of the doctrine of unconscionability have occurred most frequently where the bargaining position of the parties was substantially out of balance, in applying this proposed test courts should question whether the risk and benefit imbalance really exists when the parties appear to have similar economic strength. Relative bargaining power or negotiated terms probably is not a serious question in most franchise termination situations since, except in infant industries, it is invariably the franchisor who drafts all contract terms and who holds the power which can be used in this situation. See generally *Hearings II* at 497-98, 696-99 (statement of Senator Hart); KURSH, THE FRANCHISE BOOM (1962). In most cases, for example, the franchisor is well established in the business.

A test comparable to that suggested here was adopted by the court in a bankruptcy proceeding: "[T]o prove unconscionability there must be a showing, not only that the terms of the contract are onerous, oppressive, or one-sided, but also that the terms bear no reasonable relation to the business risks. This is a showing that depends on the commercial environment and cannot be made from the fact of a contract alone." *In re Elkins-Dell Mfg. Co.*, 253 F. Supp. 864, 873 (E.D. Pa. 1966). See also *Consumers Time Credit, Inc. v. Remark Corp.*, 259 F. Supp. 135, 137-38 (E.D. Pa. 1966).



advance notice and minimum duration, for the time at which a termination power can be exercised is intimately connected with risk allocation.<sup>179</sup> However, under this proposal, the terminating party would not be denied enforcement merely because he cannot prove an exact balance of risks and benefits; rather it would be the burden of the party seeking to avoid termination to show that the imbalance is *unreasonably disproportionate*.<sup>180</sup>

Such a test seems desirable and workable for several reasons. First, a similar test has worked satisfactorily in connection with liquidated damages. Although the problem of whether liquidated damages should be enforced is not identical with the question of whether a franchise termination condition is unconscionable, both do involve the issue of fairness. Second, the proposed test concentrates on those elements of a termination condition which relate directly to fairness. That is to say, a condition is obviously unfair if all the risks are borne by one party while the benefits go to the other. For example, a termination condition in a franchise to sell heavy road machinery (where purchase commitments must be made long in advance) may be unfair unless the terminated dealer is paid the profits he would have earned on such sales had he continued to be the dealer less the cost of fulfilling the dealer's service obligations which would have reduced the dealer's profits on the sales. Thus by requiring the risk allocation of the termination condition to be proportional or to bear some reasonable relationship to the benefits received, this tentative test seeks to rely on the constituent elements of the concept of fairness. Third, this proposed test makes no attempt to do more than provide a framework for measuring fairness. While case applications of this proposed addition to the unconscionability doctrine must remain the acid and necessary test, a few illustrations will demonstrate its flexibility.

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<sup>179</sup> Application of the Missouri doctrine in the context of this proposed test should also extend to new investments made after the contract relationship had been entered into.

<sup>180</sup> A similar solution was adopted by the framers of the code in defining "good faith" tenders of output or requirement demand when an output or requirement contract does not expressly impose specific limits. In order to impose a more specific limit than that comprehended by the concept "good faith," § 2-306(1) of the UCC specifies "that no quantity *unreasonably disproportionate* to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded." (Emphasis added.) See Note, 78 HARV. L. REV. 1212, 1217 (1965). See also *HML Corp. v. General Foods Corp.*, 365 F.2d 77, 81 (3d Cir. 1966).

Franchisers often seek to minimize their risk by charging a specified period fee for use of a trade-name, know-how, etc. This assures the franchisor a certain income. Barring other factors, a termination condition in such a fixed-fee franchise agreement which is based solely on the sales volume or other indicia of the franchisee's business activity would seem unwarranted since the dealer, not the franchisor, bore the risks of substandard sales. Similarly, a termination condition in a franchise agreement relating to a new product or service should be unenforceable if based solely on sales performance where the dealer bears all risks of introducing the new product on the market (such as advertising, maintenance, and warranty), unless the manufacturer can show that the risks it assumed were roughly commensurate with those accepted by the dealer.

Or, to consider a widely used provision, automobile dealer franchise agreements commonly provide that a dealer must sell a quota of cars equal to the average number of cars sold by dealers of the same make of car in his region who are similarly situated.<sup>181</sup> If the dealer fails to meet this quota, the manufacturer can terminate him on ninety-days notice.<sup>182</sup> Several courts have specifically found this condition "fair and reasonable."<sup>183</sup> This would also probably be the result under the two-element test applied in *Williams*. The termination conditions were not the result of negotiation between the parties (and the dealer had no meaningful choice other than not to enter the business), but rather reflect the standardized terms imposed by the manufacturer; nevertheless, the terms do reflect a common, acceptable practice in the automobile and other franchise industries and hence would probably be held reasonable. But this finding seems questionable under the proposed risk-allocation, benefits-conferred test. It gives the manufacturer the power (assuming a normal frequency distribution<sup>184</sup>) to terminate one-half of the dealer force at any time. But do the benefits conferred on the dealer by the

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<sup>181</sup> E.g., *Victory Motors of Savannah, Inc. v. Chrysler Motors Corp.*, 357 F.2d 429, 430-31 (5th Cir. 1966).

<sup>182</sup> E.g., *Sam Goldfarb Plymouth, Inc. v. Chrysler Corp.*, 214 F. Supp. 600, 601 (E.D. Mich. 1962).

<sup>183</sup> See cases cited note 110 *supra*.

<sup>184</sup> When the frequency distribution is normal, one-half of the dealers will perform above the mean and one-half below. JOHNSON & JOHNSON, *INTRODUCTION TO STATISTICAL METHODS* 182-92 (1953). The latter group of dealers would be terminable on ninety-days notice under these contracts.

franchise or the risks borne by the manufacturer justify such a condition? Unless the manufacturer can show that the dealer's rate of return on his investment is substantially in excess of other industries, that the dealer's risks of loss are relatively low and the manufacturer's high, or that competitive conditions are so onerous that the manufacturer may be forced out of business unless it retains this right, the condition seems unconscionable.<sup>185</sup> That is, unless the benefits granted by the agreement so favor the dealer that a balance is maintained only if the manufacturer has the power to dismiss half its dealer force at any time, the condition should not be enforced. On the other hand, a condition providing for termination if a dealer's performance is substantially below the average dealer's performance in his region—for example, if the dealer's sales are twenty-five per cent below a reasonable quota—would seem to meet the test. The manufacturer then would bear the risk of a regional or nationwide decline in sales whereas the dealer would bear the risk of a significant individual lapse. This tentative test, in other words, has the elements of a workable measure of fairness. However, it will be acceptable to manufacturer and dealer alike only if limited to disproportionate allocations of risk or benefits. In addition, even if a termination condition is held unenforceable, the court should not hesitate to exercise its broad remedial powers and authorize termination on reasonable terms. And, of course, each party should still be free to terminate for what is usually termed "just cause"—that is, for noncompliance with reasonable terms of the agreement.

Finally, one might inquire why the fairness of termination terms need be considered if the effects of the termination will also be tested. This question, however, ignores the substantial coercive effects of contract provisions even though legal sanctions have not been in-

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<sup>185</sup> In *Madsen v. Chrysler Corp.*, 261 F. Supp. 488 (N.D. Ill. 1966), the court relied upon a similar analysis as a ground for finding such a termination provision "arbitrary, coercive and unfair" and therefore in violation of the Dealers' Day-in-Court Act. The evidence had shown that "some 40% of all Chrysler dealers fail to achieve the sales figure imposed by the MSR [quota] formula and thus, [these dealers] are theoretically subject to immediate termination." *Id.* at 492. On the other hand, the court also emphasized the manufacturer's failure to adjust the quota formula because of local conditions as the franchise agreement required. Perhaps because of the statutory requirements, the court did not evaluate (nor apparently hear evidence from the manufacturer on) the terminating party's economic needs which necessitated inclusion of this termination condition. Compare *Volkswagen Interamericana, S.A. v. Rohlsen*, 360 F.2d 437, 442 (1st Cir.), *cert. denied*, 385 U.S. 919 (1966).

voked.<sup>186</sup> Moreover, whether or not actual unfairness results, the legal system should not assist a franchisor's or franchisee's attempt to take advantage of basically unfair terms.

### *The Effects*

Another difficulty then, somewhat unrelated to specific standards of fairness, is the usual restriction of the unconscionability doctrine to situations where the terms are too harsh at the time the parties entered into the contract. The Llewellyn suggestion that terms which have not been negotiated should be subjected to a special test of consistency and reasonableness, in addition, does not avoid unnecessarily harsh or unfair results. If fairness is the concern, the effect, actual as well as expected, of non-negotiated terms on the parties should also be a measure of their enforceability. Disregarding inequalities in negotiating ability, later events not foreseen may also cause negotiated provisions to operate unfairly.<sup>187</sup> Nor is it any answer to contend, as a freedom of contract theory exponent might, that where the parties have freely allocated the risks, the terminated party should "live with the bargain he has made" and not be the beneficiary of special judicial relief. Such medieval notions of justice or fairness are no longer justifiable, even if the enterprisers have equal bargaining power and ability. At least some consideration ought to be given to the relative burdens imposed on each of the parties by enforcing or refusing to enforce the termination provision at that time.

The framers of the Uniform Commercial Code gave limited recognition to this concern when they expanded the doctrine of unconscionability in section 2-302 by specifying that the fairness of the terms was to be determined, *inter alia*, by consideration of their "effect."<sup>188</sup> Undoubtedly, this concern reflects the views of most contracting parties who are necessarily more concerned with the

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<sup>186</sup> See Macaulay 560-62; Macaulay, *Non-Contractual Relations in Business; A Preliminary Study*, 28 AM. SOC. REV. 55 (1963); Macaulay, *The Use and Non-Use of Contracts in the Manufacturing Industry*, *Prac. Law.*, Nov. 1963, p. 13.

<sup>187</sup> Where the subsequent events are foreseeable, however, it is more questionable whether effects should be considered; rather fairness should be measured under the risk allocation test applied to the contract terms.

<sup>188</sup> See note 167 *supra*. But § 2-302 is applicable only if the contract clause is offensive "at the time it was made": hence the evidence of effect is seemingly determined without the aid of hindsight. *Cf.* *Better Food Mkts., Inc. v. American Dist. Tel. Co.*, 40 Cal. 2d 179, 185, 253 P.2d 10, 14 (1953).

actual rather than the potential effect of the termination provisions. Courts would probably agree. One reason the doctrine of unconscionability may not have been applied liberally in the past is that the losses to the terminated party often have not seemed severe, especially when compared to the potential losses to the manufacturer if the termination provision were not enforced. Courts, in other words, are naturally reluctant to refuse enforcement of terms which, though harsh on their face, have not been applied oppressively.<sup>189</sup> Conversely, it seems anomalous to hold the doctrine inapplicable, even though the effect of termination is oppressive, only because the termination clause is not unreasonable in light of the facts known at the time of execution.<sup>190</sup>

There is, in addition, solid precedent for testing fairness at the time of termination. As noted already, limitations of reasonableness relating to the minimum period of duration and to advance notice time before termination are now being applied in light of the actual effects of termination. Again, the rules relating to liquidated damages are instructive. As Corbin observed,

Frequently the amount of the payment or of the forfeiture is in excess of the loss actually suffered by reason of the breach of contract. When such is the case the courts are disinclined to enforce the provision. It has seemed to them that, in case of breach of contract, justice requires nothing more than compensation measured by the amount of the harm suffered. Penalties and forfeitures are not so measured. Therefore, the courts have created a limitation upon freedom of contract . . . .<sup>191</sup>

The liquidated damages provision in the Uniform Commercial Code likewise measures the "reasonableness" of a liquidated damages agreement by reference, in part, to the "anticipated or actual harm caused by the breach."<sup>192</sup>

Adapted to the termination situation, the test of unconscionability at the time of termination might be *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*

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<sup>189</sup> Despite their broad contract powers to cancel dealers and the number of dealers in "technical default," automobile manufacturers, for example, have terminated only a small fraction of their dealer force. See Macaulay 504 n.67.

<sup>190</sup> Compare notes 57-58 *supra* and accompanying text.

<sup>191</sup> 5 CORBIN § 1057, at 333-34.

<sup>192</sup> UCC § 2-718 (1).

likely to result to the terminating party if the provision is not enforced. Again, equivalence of harm is not the test; only *disproportionate* harm is censured. This test would be applied in light of the facts known at the time of actual or proposed termination.<sup>193</sup> And the "harm" referred to in the test is that detriment which proximately follows from enforcement of the termination condition (or refusal to enforce the condition).<sup>194</sup> For example, if the termination would force a dealer out of business, the losses he is likely to suffer can be calculated with reasonable accuracy (for example, lost profits less return on capital salvaged from the business and invested elsewhere). Under the proposed test this harm would then be compared to that harm which the manufacturer is likely to sustain if the dealer is continued (for example, lost profits—that is, the profits which the franchisor could be expected to earn on larger volume sales to the replacement dealer—plus the indirect costs of retaining substandard dealers). If the costs of termination to the dealer are disproportionate, the termination condition would not be enforceable. Fairness, however, would probably also compel the court not to refuse enforcement, but only to modify the termination condition so that the dealer could reduce his losses on termination by phasing

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<sup>193</sup> In other words, the harm to be considered in applying this test is limited to that directly resulting from the termination or from a refusal to enforce the power to terminate. The test should not be affected by whether the terminated dealer is, because of other business interests, in a difficult financial position which will reach crisis proportions on termination of the franchise. Likewise the financial strength of the manufacturer should not be the basis for requiring it to retain a dealer merely because the harm it would suffer from denying the termination is insubstantial in comparison to its other assets (although proportional to the harm caused the dealer by termination).

<sup>194</sup> A similar suggestion has been made in connection with the application of § 2-302 to profitable bargains which, because of unforeseen or other events, reach gross proportions: "It is conceivable that external factors may so affect the contract that the extent of the benefit to one party was never remotely contemplated at the time the contract was made. It is also possible that economic circumstances coerced a party into the only agreement possible at the moment . . . . In such cases, a court might be inclined to modify the contract to approximate more nearly that which the parties could have reasonably anticipated or demanded, on the grounds that to allow a grossly excessive profit or an unreasonably lengthy contract period would be unconscionable. This approach would still uphold the profitable bargain within reasonable limits." Note, 109 U. PA. L. REV. 401, 415 (1961). "Particularly suspect under the [Automobile Dealers' Day-in-Court] act are conditions which benefit only, or primarily, the manufacturer—for example, requirements that a dealer purchase large stocks of vehicles, spare parts, special tools or advertising matter—as distinguished from requirements that would tend to work to the mutual advantage of both parties . . . ." Volkswagen Interamericana, S.A. v. Rohlsen, 360 F.2d 437, 442 (1st Cir.), cert. denied, 385 U.S. 919 (1966). See Berry Bros. Buick, Inc. v. General Motors Corp., 257 F. Supp. 542, 546 (E.D. Pa. 1966).

out his business. In other words, this test of termination effects is designed to be a buffer against unnecessarily harsh effects of termination, not a barrier to terminations just because some economic loss results from termination.

This proposed test of termination seems both appropriate and practicable. Again, it has proved effective in the liquidated damages area. In addition, comparing the harm each party to the franchise agreement would sustain seems to be the only relevant method for determining fairness of effects. It also seems particularly appropriate in the franchise situation to insert a check on fairness at the time of termination since these agreements commonly are long-term arrangements, the terms of which cannot take account of all changes arising after the agreement was executed; surrounding circumstances may radically alter the consequences of otherwise fair termination conditions.<sup>195</sup> Finally, this test has the advantage of flexibility. Applied in connection with the elastic remedy powers suggested in the succeeding section, the courts could alleviate the harsh effects dealers often complain of while freeing the manufacturer from an unwanted continuing relationship.

Some examples will illustrate these points. Despite substantial investments in merchandise, special tools, and equipment and spare parts inventory, franchise agreements often contain no inventory buy-back provisions. Unfortunately such investments by the dealer may have little value on the open market yet be of almost cost value to that particular manufacturer. A Holiday Inn sign, for example, probably would be of value only to other franchisees—or to the franchisor for sale or lease to them. Allowing a franchisor to terminate a franchisee under such conditions without an inventory or advertising assets buy-back provision would seem unfair. Under the proposed test, the court could refuse enforcement of the termination condition unless the franchisor re-purchased the inventory at cost (or wholesale) prices. Similarly, a franchisee's motel business may be seasonal. Termination of the motel franchise shortly before the tourist season (and too late for the franchisor to appoint another motel franchisee to serve that area) may produce a disproportionate harm to the franchisee—unless the franchisor can show that a forced continued relationship with the motel operator would cause him similar harm such as injury to the trade name or good will. As these

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<sup>195</sup> Cf. *Parev Prods. Co. v. I. Rokeach & Sons*, 124 F.2d 147 (2d Cir. 1941).

examples demonstrate, the proposed test, if properly applied, could provide the courts with a means of enforcing franchise termination conditions while, at the same time, mitigating their harshest effects.

### *The Remedy*

In the past, when a contract provision was held unconscionable, the relief ordered often over-compensated the abused party. The injustice of such results may not have been disturbing when the doctrine was limited to madman contracts or even when only gross unfairness was involved. But if the doctrine is to apply when the termination provisions or the effect of termination cause a disproportionate loss to the terminated party, it is imperative that the courts be empowered to design flexible remedies meeting the particular needs of the case before them. Otherwise it can be safely predicted that the courts will permit the doctrine of unconscionability to remain in desuetude.

Once again, the framers of the Code have marked the proper path. Formerly, application of the unconscionability doctrine meant that the dominant party might not obtain specific enforcement of the contract or that the disadvantaged party may have had a defense at law. But under the Code, courts now can (1) refuse to enforce the contract, (2) strike an unconscionable clause and enforce only the remainder, or (3) limit the operation of the unconscionable clause so as to eliminate its objectionable character. Courts are, in effect, now authorized to rewrite the contract if necessary. The impact of these provisions should not be limited to sales law.

This flexibility is important to terminated dealers because many terminations are self-operative once notice has been given. Since the terminating party need not enforce its decision by appeal to the courts, the terminated party is often the supplicant for relief and hence is not aided by the traditional equitable defense.

### CONCLUSION

The expansion in the doctrine of unconscionability proposed here to protect terminated dealers is modest. Each suggestion is grounded in recognized contract practices which seem to have equal application to termination situations. Termination provisions would be enforceable only if they bear a reasonable relationship to the risks allocated under the contract. This would mean that an investing



dealer must be given an opportunity to recoup his investment and that he cannot be terminated suddenly, regardless of the contract's provisions, unless the terminating party can show a compelling countervailing necessity. Measurement of the effect of the termination terms would be elevated to the level of a test of unconscionability even when the terms seem fair on their face. The effect of enforcing termination provisions must bear a proportional relationship to the effect of denying enforcement. Finally, the remedial tools available to the courts when unconscionability is found should not stop short of the power to rewrite the contract because nothing less will suffice if a fair bargain rather than punishment is to be imposed. Equivalence, on the other hand, would not be applied as the measure of fairness under any of these tests; rather fairness would depend on commercial realities. Nevertheless, requiring that the termination conditions have some relationship to the interests of both parties would seem to be a significant step toward filling in the outlines of "minimum decencies" in a termination context.

The recurring proposals that the right to terminate a franchised dealer be limited by a subjective good faith test—that is, that the terminating party act only from "pure" motives—seems analytically unsound and practically unwise. It is analytically unsound because there is no necessary correlation between bad motives and unfair terminations; such a test does not insure that the burdens placed on the terminated party are commensurate with the losses which the terminating party might suffer if it were forced to continue the relationship. The terminated dealer seeks relief against the harsh effects of termination which may be unfairly placed on him, not against the manufacturer's ill-will. Commercial realities also favor an objective test of the relative burdens. As franchise businesses increase in size the relationship between the dealer and manufacturer becomes more impersonal. The manufacturer's right to terminate should not be subject to the possibility that some personal animosity may exist between a dealer and the manufacturer's agents.<sup>196</sup> Rather, the relevant facts are whether the termination was commercially justifiable (and permitted by the contract) and whether the relative burdens resulting from it are so disproportionate as to be unfair.

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<sup>196</sup> See Macaulay 777 n.650, quoting from the brief of Ford Motor Company in *Kotula v. Ford Motor Co.*, 338 F.2d 732 (8th Cir. 1964), *cert. denied*, 380 U.S. 979 (1965).