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C H A P T E R 8

Franchising

HAROLD BROWN

A. FRANCHISING — A FIDUCIARY RELATIONSHIP

§8.1. **Introduction: Review, problems and proposals.** In *Franchising: Trap for the Trusting*,¹ this writer was extremely critical of both the abuses and opportunities for such abuse which prevail in franchising. Although franchising had its inception over a century ago when brewers licensed beer gardens for distribution purposes, followed by wide use in the automobile, oil and other retail industries, it is quite significant that only since World War II, and more particularly in the past ten years, has franchising achieved recognition as a distinct marketing method, no doubt because of the visible prominence of the “fast food” franchise. While franchising now accounts for over \$90 billion in annual sales, over 10 percent of the gross national product and more than 25 percent of all retail sales, *franchise* is still defined in *Corpus Juris Secundum* as “the right to vote.”²

It is therefore not surprising that franchisee’s counsel is confronted with state remedies which have only begun to develop and federal regulation which only collaterally may apply. Except in the antitrust field, there are but few reported decisions on the law of franchising, treatises are nonexistent,³ and law review and similar materials are scarce and difficult to find. Other than the Auto Dealer’s Act,⁴ itself of limited utility,⁵ franchise legislation is generally lacking, though numerous measures are pending or have recently been enacted in

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§8.1. ¹ H. Brown, *Franchising: Trap for the Trusting* (1969, 1970 Appendices) [hereinafter cited as Brown].

² 37 C.J.S. *Franchises* §1 (1943).

³ Aside from Brown, see *The Franchising Sourcebook* (2 Pract. L. Inst. Commercial Law and Practicing Sourcebook Series, J. McCord ed. 1970) [hereinafter cited as *The Franchising Sourcebook*]; *Franchising — Today’s Legal and Business Problems* (2 Pract. L. Inst. Commercial Law and Practice Transcript Series, L. Ratner ed. 1970); *The Realities of Franchising: A Guide for the Practicing Attorney* (Mass. Continuing Legal Education, Inc. ed. 1970) [hereinafter cited as *Realities of Franchising*]; *Primer on Unlawful Restraints in Marketing and Distribution*, Proc. N.E. Antitrust Conf. (1967); 36 ABA Antitrust Section 63 (1968); Van Cise, *Understanding the Antitrust Laws* (Pract. L. Inst. rev. ed. 1970).

⁴ 15 U.S.C. §§1221-1225 (1964).

⁵ See Brown 77-86. See also *The Realities of Franchising* 117-121.

Congress⁶ and the states.⁷ The combination of a massive industry, rampant with abuses and opportunities for abuse, devoid of significant statutory or common law, presents a unique opportunity for classical exercise of the “king’s conscience.”

Before exploring the intricacies of franchising and the applicability of equitable principles, a few definitions are in order. Franchising itself has been aptly described by United States Senator Philip A. Hart as a “preferred method of distribution by companies of all sizes” providing “an easy and efficient distribution system at little cost and with little of the irritations and responsibilities of an integrated system.”⁸ Many have labeled franchising as the last frontier of the independent businessman, with an inherent appeal to such groups as the 185,000 annual retirees from the armed services, the 12 percent of the population whose black heritage has foreclosed them from meaningful participation in the mainstream of business,⁹ and the millions of ordinary citizens — “Mom and Pop” — whose life savings of \$5000 to \$25,000 are captiously available to “acquire a business of your own.” The newest group to which franchising has been offered as a panacea is that of the American Indian, sponsored with equity funds provided by the Bureau of Indian Affairs.¹⁰

⁶ Principally Senator Hart’s proposed federal Franchise Competitive Practices Act of 1967 (S. 2321, 91st Cong., 1st Sess. (1969)) reintroduced in 1969 (S. 1967, 91st Cong., 2d Sess. (1970)), rejected by the Senate Committee on the Judiciary, 1970; Senator Williams’s proposed Franchise Disclosure Act (S. 3844, 91st Cong., 2d Sess. (1970)) stalled in committee with low priority; see Senate Select Comm. on Small Business, *The Impact of Franchising on Small Business*, S. Rep. No. 91-1344, 91st Cong., 2d Sess. (1970) (issued November 13, 1970), recommending (a) consideration of S. 3844; (b) FTC power to seek preliminary injunctive relief; (c) hearings on franchisor buy-backs; and (d) the need for an effective franchising code of ethics.

⁷ California Franchise Disclosure Act, 1970 Laws c. 1400, amending Cal. Bus. & Prof. Code §10177 (West 1964), and to amend Cal. Corp. Code §§25019 and 25212 (West 1964), and to add division 5 (commencing §31000) to title 4 of Cal. Corp. Code; Delaware Acts, 57 Del. Laws c. 693, adding a new subchapter IV to Del. Code tit. 6 §2501, prohibiting unjust terminations or failure to renew, defined as “without good cause” or “in bad faith”; Puerto Rico Dealers’ Act, P.R. Laws Ann. tit. 10, §§278 et seq., granting a damage action for termination “without just cause,” a phrase of civil law origin akin to “good faith,” held unconstitutional as to retroactive application in *Fornaris v. Ridge Tool Co. and Commonwealth of Puerto Rico*, 423 F.2d 563 (1st Cir. 1970), *rev’d*, 400 U.S. 41 (1970) (per curiam reversal on ground of abstention); proposed Massachusetts Franchise Fair Dealing Act, House Bill 2279 (1970), set forth in full with commentary in Brown, Appendix G at 160-177, and reintroduced in substantially identical form in the 1970 legislative session as Senate Bill 110. A number of states have enacted bills for auto dealers, Massachusetts having adopted the most pervasive in Acts of 1970, c. 814, effective Jan. 1, 1971, creating new G.L., c. 93B; see Brown, A Bill of Rights for Auto Dealers, 12 B.C. Ind. & Com. L. Rev. 757 (1971). Many states are actively considering franchise controls, particularly New York, Massachusetts, Virginia, Texas and California.

⁸ See Brown, foreword by Senator Philip A. Hart.

⁹ Sayre, *Franchising in the Ghetto*, 25 *Business L. S-73*; Korot, *Making Franchises Available to Ghetto Businessmen*, *id.* at S-91.

¹⁰ See *Continental Franchise Review*, Oct. 5, 1970, at 5.

Powerful lobbies of such organizations as the International Franchise Association have contended that the principal complaints against franchising concern practices which have now been abandoned or which emanate from the criminal fringe that may be found in any business community.¹¹ If such were the case, then relief could be found in local criminal process or in prosecutions for using the mail to defraud.¹² Simple actions for fraud or breach of contract would suffice.

Such a defense of franchising might apply to the Carolina franchisee who paid \$90,000 in cash to a Wisconsin franchisor for the "exclusive territorial rights" to grow and sell Christmas trees in Virginia. It might refer to the Ohio engineer who gave up his job to invest \$12,000 in a "success motivation" franchise, but found himself totally deficient in the very "product" he was supposed to sell to others;¹³ or it could encompass the Indiana businessman who sold his home to invest \$12,000 for a "turnkey"¹⁴ computer academy in Phoenix, Arizona, spent months without being able to obtain fulfillment of the franchisor's promised aid, obtained the franchisor's assent to moving the franchise to San Diego, California, and was then informed that "it's a new ball game" — that the franchisor could not provide any support for purchase, lease or financing of the "turnkey" facility. Each of these franchisees lost every cent, was thoroughly demoralized,¹⁵ and could find no public or private agency to secure any relief. Such instances could be documented with distressing regularity.¹⁶

¹¹ See statement of P. Zeidman, Washington counsel for the IFA in January, 1970, Hearings on the Impact of Franchising on Small Business Before the Subcomm. on Urban and Rural Economic Development of Senate Select Comm. on Small Business, 91st Cong., 2d Sess., pt. 1, at 143 (1970).

¹² 18 U.S.C. §1341 (1964).

¹³ See FTC complaint in Success Motivation Institute, Inc., 1970 Trade Cas. ¶19,306.

¹⁴ In a "turnkey" franchise, the franchisor undertakes to provide a complete business package, ready for the franchisee to start operations.

¹⁵ Although no valid statistics or reports are available, the traumatic consequences of business failures among franchisees seem to be far worse than in the case of ordinary businessmen. The impact of inordinate working hours over a long period, of the financial loss of their "nest egg" by those unfamiliar with the risks for venture capital, and of the betrayal of the faith which inexperienced franchisees are induced to repose in the franchisor, can wreak havoc, this writer having incidentally noted the extremely high rate of broken homes among the hundreds of complaints received since publication of his book, *Brown*. To a great extent, franchisees are in their middle years, come from a sedate and sheltered existence and appear to be totally unprepared for such a violent change in their life pattern; see J. Curry, *Partners for Profit* (1966), for comment on the distressing psychological effect of the constantly available threat of termination. From the opposite perspective, numerous franchisors have stated that their franchisees are like children, demanding constant discipline and control. Franchising may well warrant analysis by professional psychologists.

¹⁶ Although fraud in the sale of franchises is not an essential part of this discussion, that problem can be categorized in several ways, from the record of "thousands of people . . . being bilked of hundreds of thousands of dollars by

On the other hand, the protestations of leading franchisors would hardly condone the current practices of large corporations in leading industries, most of whom are listed on the major stock exchanges. Further, it will be seen that neither criminal process nor common law claims of fraud or breach of contract will provide a remedy for dealings which are unfair, overbearing, in bad faith or even unconscionable. Although many such practices may constitute anticompetitive violations of the antitrust laws,¹⁷ it would seem that this fiduciary

glib salesmen and misleading literature selling worthless franchises" including "boiler room salesmen, driven out of securities sales and installment land sales, turning to selling flimsy franchises in order to reap quick and easy profits" to the more startling conclusion "that in almost every instance, the franchise offering literature was either inadequate, misleading, wholly lacking or blatantly false as to material facts necessary to make an intelligent investment decision." (Statement of Sept. 28, 1970, by N.Y. Atty. Gen. Lefkowitz to N.Y. Legislative Committee on Franchise Licensing). See Staff Report on Franchising to N.Y. Atty. Gen., Jan. 7, 1970, set forth in Brown 191-198; see also the statement of R. Dias, President of the National Association of Franchised Businessmen in Hearings on the Impact of Franchising on Small Business Before the Subcomm. on Urban and Rural Economic Development of Senate Select Comm. on Small Business, 91st Cong., 2d Sess., pt. 1, at 111-116 (1970). Numerous legislative efforts are pending to require full disclosure in the sale of franchises, e.g., S. 3844, 91st Cong., 2d Sess. (1970), and, in Massachusetts, House Bill 2279 (1970); such a measure was enacted Sept. 15, 1970, in California (see note 7 *supra*). Strong arguments have been offered to classify a franchise as an investment contract and therefore a security under existing securities laws; see 49 Op. Atty. Gen. (Cal.) 124 (so ruling); Goodwin, Franchising in the Economy: The Franchise Agreement as a Security under Securities Acts, including 10b-5 Considerations, 24 Business L. 1311 (1969); but cf. *Mr. Steak, Inc. v. River Steak, Inc.*, — F. Supp. — (D. Colo. 1970). Since the FTC has recently focused attention on fraud in the sale of franchises (see *Meal or Snack System, Inc.*, 1969 Trade Cas. ¶18,671 (fast food); *Success Motivation Institute, Inc.*, 1970 Trade Cas. ¶19,306 (academy); *Universal Credit Acceptance Corp.*, 1970 Trade Cas. ¶19,371 (credit card); *Century Brick Corp. of America*, 1970 Trade Cas. ¶—) through the declared illegality of "unfair or deceptive acts or practices" in §5 of the Federal Trade Commission Act (15 U.S.C. §45(a)(1) (1964)), it may well be suggested that the FTC now use its extensive rulemaking powers to accomplish the same result (15 U.S.C. §46(g) (1964)).

¹⁷ *Albrecht v. Herald Co.*, 390 U.S. 145 (1968) (in addition to fixed and minimum pricing, resale price maintenance encompasses maximum pricing); *United States v. General Motors Corp.*, 384 U.S. 127 (1966) (combination of factory and dealers in restraint of trade); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) (per se violation to impose any customer or territorial restraint on alienation of goods purchased by dealers); *United States v. Sealy, Inc.*, 388 U.S. 350 (1967) (horizontal (dealers) and vertical (with factory) territorial limitations); *Klor's v. Broadway-Hale Stores*, 359 U.S. 207 (1959) (boycott by wholesaler, regardless of quantity); *Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495 (1969) (extension of credit as tying product; see dissent regarding use in franchising); *Northern Pacific Ry. v. United States*, 356 U.S. 1 (1958) (per se tying violation, land as tying product); *FTC v. Brown Shoe Co.*, 384 U.S. 316 (1966) (incipient violation by major manufacturer in requiring preferential purchase of its goods by dealers); *Atlantic Refining Co. v. FTC*, 381 U.S. 357, *rehearing denied*, 382 U.S. 873 (1965) (kickbacks obtained from third party vendors of tires, batteries, and accessories (TBA)); *FTC v. Texaco, Inc.*, 393 U.S. 223 (1968) ("kickback" from third party vendors prohibited; even in absence of overt direction, dealer induced through dominant economic power); *FTC v. Fred Meyer, Inc.*, 390 U.S. 341 (1968) (price discrimination where

relationship should be primarily governed by common or statutory law in the same fashion as other business vehicles, such as corporations, partnerships, joint ventures and even the master-servant relationship. It could hardly be suggested that the status of the latter should have been left solely to the principles of contract and fraud. A review of some of the principal complaints of franchisees in various leading industries should demonstrate that there is an abiding need for the development of such law.

Complaints against the "Big Three" automobile manufacturers¹⁸ encompass such operating abuses as wholly inadequate reimbursement for pre-delivery and warranty work provided by the dealers,¹⁹ inequitable delivery of vehicles, forced purchase of unwanted models or vehicles with excessive accessories, forced participation in nationally-advertised "sales" without a pro rata reduction in the dealer's cost,²⁰ and forced purchase at inflated prices of parts, accessories and supplies,²¹ portions of which are euphemistically referred to as "captured" parts.²² In a broader frame of reference, such dealers com-

retailers cannot obtain same quantity discounts or allowances as "wholesaler-retailer"); *Perkins v. Standard Oil Co. of California*, 395 U.S. 642 (1969) (damages for price discrimination; liability through several corporate distributor layers); *Perma Life Mufflers, Inc. v. Intl. Parts Corp.*, 392 U.S. 134 (1968) (unclean hands held no defense); *Susser v. Carvel Corp.*, 332 F.2d 505 (2d Cir. 1964), *cert. denied as impro. granted*, 381 U.S. 125 (1965) (in extreme circumstances, franchisor's exclusive supply and tying sales might be justified, i.e., not a per se violation); *Siegel v. Chicken Delight, Inc.*, 311 F. Supp. 847 (N.D. Cal. 1970) (franchisor's tradename as tying product); *Semmes Motors, Inc. v. Ford Motor Co.*, 429 F.2d 1197 (2d Cir. 1970) (because of uniqueness of asset, issuance of temporary injunction against termination does not depend on demonstration of likelihood of success); cf. *Miller Plymouth Center, Inc. v. Chrysler Motors Corp.*, 286 F. Supp. 529 (D. Mass. 1968). Significantly, in the last twelve antitrust appeals, the Supreme Court has reversed the circuit court of appeals, deflating the assertion of dynamic developments for the increasing protection of the injured party.

¹⁸ See Brown, *Bill of Rights for Massachusetts Auto Dealers*, 12 B.C. Ind. & Com. L. Rev. 757 (1971); Hearings Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business, 91st Cong., 1st Sess. (1969); see complaint in *DiCostanzo v. Chrysler Corp.*, Civil No. 70-3331 (E.D. Pa. 1970).

¹⁹ See FTC Staff Report on Automobile Warranties (Nov. 1968), decrying the unjustified "5 year — 50,000 mile" warranty introduced as a selling point despite the fact that the increasing shortage of qualified mechanics and the 50 percent increase in the production of cars caused serious deterioration in the finished product, with dealers claiming that labor-rate reimbursement for pre-delivery and warranty work was substantially below actual cost.

²⁰ See proposed FTC trade regulation rule covering new car pricing practices of manufacturers and dealers in support of Automobile Information Disclosure Act (1970 Trade Reg. Rep. 488 Supp. at 4, Oct. 19, 1970).

²¹ For such a captive market, prices should be substantially below competitive prices since such a seller does not bear the inventory risks of the ordinary wholesaler; see *FTC v. Texaco, Inc.*, 393 U.S. 223 (1968) (discussion of comparable problems confronting the gasoline station dealers vis-à-vis the major oil companies).

²² This probably refers to parts and accessories manufactured by captive suppliers who apparently contract not to deal directly with the dealers; see *Klor's v. Broadway-Hale Stores*, 359 U.S. 207 (1959) (per se boycott violation of antitrust laws).

plain bitterly of the subsidies to leasing and fleet buyers through which vehicles are sold at hundreds of dollars below the cost to dealers.²³ Perhaps more basically, automobile dealers have found themselves in direct retail competition with stores owned or effectively controlled by the factory in spite of a minority interest owned by an independent person.²⁴ Such competition is pregnant with every type of abuse, ranging from price-cutting and excessive advertising to the unlimited capacity to provide better facilities and inventories of both vehicles and parts, regardless of the effect on "retail" profits.²⁵

At the capital level, the automobile manufacturers deny that the dealer has any goodwill in his business, all such attributions supposedly emanating from the contributions of scale provided by the factory, including design, engineering, manufacturing, marketing, warranty and servicing.²⁶ For such reasons, dealers are prohibited from making a charge for goodwill in the sale of a dealership,²⁷ have minimal control over selection of a successor, and are precluded from capitalizing their businesses in the many ways available to others.²⁸

²³ Such subsidies take the form of cash allowances, advertising contributions, guaranteed repurchase price, favored treatment in reimbursement for warranty work, recommencement of the warranty at time of resale, and floor-plan financing when reacquired; generally, see Robinson-Patman Act on price discrimination, 15 U.S.C. §13(a) (1964); *FTC v. Fred Meyer, Inc.*, 390 U.S. 341 (1968); although such subsidies have been renounced by the Big Three commencing with the 1971 model year, there is no assurance against back-sliding; several dealer antitrust class suits are pending; collaterally, several cities, counties and states are seeking treble damages and injunctions because of the alleged combination by the Big Three for resale price maintenance in the renunciation of such subsidies (*City of Philadelphia v. General Motors Corp.*, Civil No. 70-2753 (E.D. Pa. 1970); *City of New York v. General Motors Corp.*, C.A. No. 70 Civ. 4245 (S.D.N.Y. 1970)).

²⁴ This practice would appear of doubtful validity under the antitrust laws; see *United States v. New York Great Atlantic & Pacific Tea Co.*, 173 F.2d 79 (7th Cir. 1949); see denial of "fair trade" exemption from Sherman and Robinson-Patman Acts in case of "dual distribution" (15 U.S.C. §§1, 13 (1964)).

²⁵ Factory operation of "company" store, including subsidization of operating retail losses by capital gifts, free loan of executives, and advertising allowances could constitute "predatory price-cutting in one locality, subsidized by adventitious resources" and therefore an attempt or conspiracy to monopolize under §2 of the Sherman Act, 15 U.S.C. §2 (1964); See *Mt. Lebanon Motors, Inc. v. Chrysler Corp.*, 283 F. Supp. 453, 459 (W.D. Pa. 1968), *aff'd*, 417 F.2d 622 (3d Cir. 1969).

²⁶ See 1970 prepared statement of General Motors to (Mass.) Joint Committee on Government Operations, in opposition to House Bill 2279 (1970), concluding that any value given to the dealer's goodwill would constitute a "total windfall."

²⁷ See *Pierce Ford Sales, Inc. v. Ford Motor Co.*, 299 F.2d 425 (2d Cir. 1962), for a supposed justification for the manufacturer's refusing to allow the transferee to pay for goodwill, in which the manufacturer's refusal to assent to such a transfer was held justified because of doubts as to the transferee's ability or financial resources to be a successful dealer. The court thus ignored the fact that the transferring dealer was compelled to forfeit the value of the goodwill in his dealership.

²⁸ Each of these practices is now prohibited by the Massachusetts Motor Vehicle Business Practices Act (Acts of 1970, c. 814, creating new G.L., c. 93B) as a statutory extension of the §5 prohibitions of the Federal Trade Commission Act (15 U.S.C. §45(a)(1) (1964)), incorporated by reference into the Mass. "Baby" FTC Act.

In the nation's second largest industry, the major oil firms have their gasoline station dealers in virtual bondage hinged on the short-term renewal of their contracts, and subject to total domination through their knowledge of what the franchisor expects.²⁹ Although some may be shocked to learn that of the 225,000 station dealers, the annual attrition ranges from 25 percent to 40 percent, such decimation would appear predictable from the conditions that prevail. Starting with the gross proliferation of stations and the decade-old policy decision of the major oil companies to forego price competition, the dealer is buffeted by compulsory purchase of tires, batteries and accessories; forced participation in costly prize games and giveaway premiums; price discounts of 5 to 14 cents per gallon to nonbrand stations and fleet-users; direct competition of company stores in the same retail market area; and even by the latest ploy of company-owned stores selling nonbrand name gasoline at 8 cents below the normal retail price.³⁰

Comparably with "autos" and "oil," brewers of beer rest their dominance on short-term distributorships, cancellable on 30 days' notice with little or no provision for the dealer's goodwill. Again, the dealer has a large investment in warehouse facilities to handle a bulky product, a fleet of delivery trucks, financing to cover cash-on-delivery purchases and extension of credit to customers, and the long-term marketing expense of developing retail distribution routes. Added to this disdain for the dealer's welfare are such brazen practices as the setting of retail prices as well as forced purchase of year-end products. On termination, some distributors are subject to the brewer's option to purchase their rolling stock on the straight-line method of depreciation, in one instance even using the double declining balance method permitted by the Internal Revenue Code.³¹

As for most manufacturers' distributors, it is common practice to offer one-year contracts, terminable on 30 days' notice, thus re-

²⁹ *FTC v. Texaco, Inc.*, 393 U.S. 223 (1968) (sustaining finding of unfair competition under §5 of Federal Trade Commission Act in compulsory purchase of tires, batteries and accessories even in absence of overt directions by franchisor); *Atlantic Refining Co. v. FTC*, 381 U.S. 357, *rehearing denied*, 382 U.S. 873 (1965); *Lee Natl. Corp. v. Atlantic Richfield Co.*, 308 F. Supp. 1041 (E.D. Pa. 1970), 1970 Trade Cas. ¶73,093, the motion for leave to file a petition for cert. denied, 39 U.S.L.W. 3247 (U.S. Dec. 8, 1970) (whether TBA sales commission plan an antitrust violation or merely a violation of §5 of Federal Trade Commission Act in *Atlantic Refining Co. v. FTC*, *supra*.)

³⁰ See letter of Aug. 14, 1970 from Senator Hart to the FTC (1970 Trade Reg. Rep. ¶50,286) reporting on July 14-16, 1970 hearings of Senate Antitrust and Monopoly Subcommittee, particularly raising question as to propriety of requiring divestiture of stations by major oil companies; see governmental injunctive suit allegedly price-fixing and TBA violations against major oil company and its "commission managers" (*United States v. Standard Oil Co.*, 1970 Trade Cas. ¶45,070); see FTC Report on Marketing in Gasoline (1967); Gasoline Marketing Report to Alberta (Can.) Legislature, Jan. 1969.

³¹ Int. Rev. Code of 1954, §167.

serving to the factory total power to pre-empt the distributor's goodwill in the building up of his territory. In fact, it is almost axiomatic that, if a distributor's annual income exceeds the \$35,000 to \$50,000 level, the factory will replace him with a direct salesman. If the distributorship is for a longer term, the same result can be accomplished by wholly unrealistic increases in the distributor's quota, such having been particularly acute in the magazine distribution field.³²

Such a pattern of total control provided ample guidelines for the rapid surge of franchising in the retail distribution of services and products following World War II, led by the remarkable success of some restaurant operations. For example, one of the leaders in that field obtained its income from the franchisees, not from the modest charge of \$1000 for the franchise,³³ but from its profit on the 700 or more items sold to its franchisees at unilaterally set and inflated prices.³⁴ With this franchisor's ironclad supervision of its franchise operations it has been immaterial whether franchisees are contractually required to buy such items from the franchisor or otherwise compelled to do so. Through such price-gouging, after one generation, a majority of its franchises have now been reacquired by the franchisor.

Man's ingenuity soon developed a whole array of both express and hidden payments with which to fleece the franchisee. First, the capital charge for the franchise can be as high as the traffic will bear, though the appeal to the little man has generally placed that figure in the \$5000 to \$25,000 bracket. Generally, there is a royalty in the form of a percentage of gross sales,³⁵ together with a similar charge for

³² See statement of Cong. Fred Rooney (Pa.) whose search for the reasons behind the high pressure sales techniques of magazine salesmen led him to the incredible annual increase in distributors' quotas by Cowles Publishing Co., pushing the distributors to such fraudulent excesses in a futile effort to survive. (116 Cong. Rec. 12,098-12,103 (daily ed. Dec. 10, 1969); 116 Cong. Rec. 11, 150-52 (daily ed. Dec. 29, 1969).) See *Mt. Lebanon Motors, Inc. v. Chrysler Corp.*, 283 F. Supp. 453 (W.D. Pa. 1968), *aff'd*, 417 F.2d 622 (3d Cir. 1969), involving claim that quota for all dealers was so high that none could achieve.

³³ This has recently been increased to \$25,000, but the company now actually discourages sales of new franchises; with its ample funds, it now concentrates on company stores.

³⁴ See statement of Brown in Hearings of Subcommittee on Urban and Rural Economic Development of the Senate Select Committee on Small Business (91st Cong., 2d Sess., pt. 1, at 2-14 (1970)).

³⁵ The royalty on gross sales, rather than net profit, can make the break-even point so high that the franchisee cannot avoid losses without working inordinate hours, often with the aid of his unpaid wife. The royalty on gross sales may be hidden in the form of additional rental on the sublease. In either case, an excessive royalty percentage can produce the same result as an excessive quota. Another form of the quota is the effort to make the franchisee remain open for business 7 days a week, 24 hours a day, regardless of the operating losses such hours may entail. The latter is particularly exacerbating in gasoline stations where the demand at such hours may be minimal, labor costs excessive, and the risk of robbery accentuated.

advertising.³⁶ There then follow hidden mark-ups on every capital asset, including the usual sublease, building, equipment and signs. Every product or service required in the operation of the franchise can be a source of profit, either by making the franchisee purchase from the franchisor at unilaterally set prices or through "kickbacks" from so-called approved vendors. With little or no investment of its own, the franchisor can obtain all the necessary capital as well as future profits from its franchisees. It can even accelerate the process by selling sub-franchising rights to so-called area franchisees. With such lures, there is little wonder that so many have flocked to the feast, perhaps heedless of the genuine function which franchising can serve.³⁷

At the core of all franchising is the licensing of a trademarked product or service. Under the Lanham Act, such a licensor must exercise quality control over the licensee or risk the loss of the trademark.³⁸ But since that very statute precludes condonation of anti-trust violations,³⁹ the franchisor may well face a dilemma in trying to satisfy the requirements of both laws. The command of the Lanham Act⁴⁰ is at the root of the economic and legal problems in franchising, since "quality" and its usual companion of "uniformity" appear to condone subjective standards for the "control" required by the statute. On the other hand, the very combination of subjective quality standards and control may evoke fiduciary requirements in their exercise. In a violent collision of concepts, franchisors basically maintain that a franchise is merely an embellished license and therefore revocable at will, while franchisees contend that a franchise is a license coupled with an interest, thus restricting the unlimited control claimed by franchisors.

Legislative draftsmen have therefore had much difficulty in defining a "franchise," ranging from the five-section, page-long definition in Senator Hart's bill⁴¹ to the following generic definition in this writer's proposed bill,⁴² namely:

. . . an oral or written arrangement for a definite or indefinite period in which a person grants to another person a license to use

³⁶ While such advertising contributions should evoke strict accountability, many franchisors in fact use the fund to advertise for more franchisees or as a source to charge-off overhead and other miscellaneous expenses.

³⁷ See Brown 10-18.

³⁸ 15 U.S.C. §§1055, 1064(e)(1), 1127 (1964).

³⁹ 15 U.S.C. §1115(b)(7) (1964). See also *Developments in the Law — Trademarks and Unfair Competition*, 68 Harv. L. Rev. 814, 816-819, 895-906 (1955).

⁴⁰ See note 36 *supra*.

⁴¹ S. 1967, §2(b), 91st Cong., 2d Sess. (1970); see critical comment by J. Curtin in *Realities of Franchising* 123-124.

⁴² House Bill 2279, §1(a) (1970).

a tradename . . . and in which there is a community of interest in the marketing of goods or services. . . .⁴³

Such a definition avoids the need to prescribe the extensive rights and duties in this complex relationship. By circumventing the risk of evasion, it eliminates the misplaced solace which most franchisors find in such formalistic defenses as “sanctity of contract,” “free enterprise,” and “caveat emptor,” all of which have suffered substantial erosion in the twentieth century, principally to protect the weak in complex transactions. Instead of depending on a definition for the delineation of rights, an analysis of the realities of franchising discloses the propriety of legal and equitable protection.

Although franchising is used in dozens of industries with myriad variations in contract terms and practices, perhaps a typical “fast-food” franchise will serve for discussion. Putatively, the franchisor may provide a whole range of expertise including such matters as:

- (1) market research to develop the unit
- (2) a standardized product or service together with a trademark⁴⁴
- (3) general and specific real estate selection
- (4) pledge of credit for land or construction
- (5) design, financing and arrangements for construction, signs and equipment
- (6) intensive national and local advertising procedures and campaigns
- (7) preparation of training courses and manuals
- (8) supervision and guidance in all aspects of operations
- (9) quality control and purchasing economies
- (10) money-handling, bookkeeping, and accounting services.

⁴³ Substantially adopted in FTC Ad Hoc Comm. Rep. to FTC, 1970 Trade Reg. Rep. 444 Supp. at 5-8.

⁴⁴ Many thorny problems revolve about the obligations of both the franchisor and franchisee concerning the tradename. Since the tradename has been recognized as a tying product under the antitrust laws (see *Susser v. Carvel Corp.* and *Siegel v. Chicken Delight*, note 17 *supra*), it would appear incumbent on the franchisor to have a valid tradename and certainly one that is not merely a misappropriation of a name in the public domain. Similarly, the franchisor should vigorously defend its misuse by third parties. *Burger King v. Hoots, d/b/a Burger King*, 403 F.2d 904 (7th Cir. 1968); *McDonald's Corp. v. Moore*, 243 F. Supp. 255 (S.D. Ala. 1965), *aff'd*, 363 F.2d 435 (5th Cir. 1966). Even though business justification might exist the franchisor should be severely limited in its power to change the tradename or any significant part of the logo, not only because of the inherent change in the major item in the franchisee's purchase, but even more tangibly in the severe expense to the franchisee in changing all the signs. Although the franchisee cannot sell other products under the franchisor's name (*Susser v. Carvel Corp.*, note 17 *supra*, prohibiting sale of Christmas trees by soft ice cream franchisee), it is to be doubted that the franchisor can conceal “kickbacks” from third party vendors merely through the affixing of its name to their products.

On the other hand, the franchisor may fail to provide these, may err in its judgment, or may merely utilize items of an ordinary nature. It may exact an excessive price for all or any. And although most franchisors widely advertise their accomplishments, they seldom covenant to provide them. In theory, the franchisee need not be experienced and need only provide a capital investment and be able and willing to work hard.

Almost every franchise relationship is couched in terms of a revocable license to use the franchisor's logo, with a variety of specified conditions. Little effort is therefore made to satisfy the general contract laws, because the franchisor wants the license to be revocable at will. Consider that the usual franchise reserves to the franchisor the sole right to occasionally change prices, to approve vendors, to change quotas, to approve transfers and to prescribe intimate and detailed regulations on how the franchise shall be operated. Such purely subjective standards make it doubtful that there is a contract at all, though the franchisor is usually quite careful to make the franchisee's obligations sound like a contract. The latter is particularly true as to the noncompetition covenant which is almost universally to become operative "regardless of the reason for termination." Most courts blindly enforce that covenant as a matter of "contract,"⁴⁵ heedless of the consequent forfeiture of the franchisee's equity.

In franchising, the usual requirements of the contract are impossible to attain, so that it may well be said that all franchisees are always in default.⁴⁶ But even if the franchisor does not actually terminate, it always has the weapon of the threat of termination at its disposal. And therein lies the whole secret of the relationship: the threat of termination. That threat is, of course, buttressed by the standard covenant not to compete, together with one or more complementary pre-emptive rights, all designed to ensure that the franchisee will not terminate for fear of losing his investment and equity.⁴⁷ The franchisor may have an option to acquire the equipment at depressed

⁴⁵ See Brown 38-41.

⁴⁶ Aside from the subjective controls reserved to the franchisor, including the right to change at any time, many franchises contain generic standards impossible of attainment. An example of the latter is the requirement that the franchisee must at all times be in compliance with all federal, state, and local laws and ordinances. Some franchises provide that the "threat" of a default shall constitute a default and a few expressly state that the determination of a default shall be in the franchisor's "sole and absolute discretion."

⁴⁷ Although many "fast-food" franchises provide for terms of 15 to 20 years, often with options to renew, such durability is merely intended to give to the franchisee a false sense of security. The recent trend to extend automobile and gasoline station dealerships from the "one to two year period" to a "three to five year" period, supposedly represents the ensuring of such confidence as prompted by a series of Supreme Court decisions (e.g., *FTC v. Texaco, Inc.*, 393 U.S. 223 (1968)), although in fact such extensions are implicitly deceptive.

value; in a leading doughnut franchise, the franchisee covenants not to use the confidential list of equipment for any purpose other than under the franchise. Additional control over the franchisee's equity is assured through arbitrary control over the right to transfer, a right of first refusal in case of sale, arbitration of all disputes at the franchisor's home office⁴⁸ and even compulsory resale under a one-sided formula.

Since the franchisor always drafts the franchise agreement and adamantly declines to assent to any change, his counsel has an untrammelled opportunity to promote and protect unfair preferences for his client.⁴⁹ Merely to illustrate, the right of first refusal is aided by a prohibition of advertising the sale of the franchise until after the franchisor has refused the offer. Although the franchisee cannot transfer without the franchisor's approval, the latter often provides that, upon its own assignment and assumption by the assignee, the original franchisor is relieved of all further obligations. Although a mortgagee may provide stringent measures for debt collection, in franchising, the franchisee's equity is at all times in jeopardy against unliquidated obligations which are impossible to achieve and which may at any time be changed at the whim of the franchisor. In case of termination, the franchisor can depress the price with a view toward resale at a profit or operation as a company store, and free itself of any obligation to account to the franchisee for the proceeds.

With such power to control and with the franchisee's constant fear of losing his investment of money and efforts, the franchisor can freely take advantage of the franchisee at every turn. In addition to the original capital fee and royalty based on a percentage of gross income, the franchisor can overcharge for every product or service. Frequently, the franchisor will also prescribe resale prices through printed menus. Caught in the grind of discount prices, overcharges on every service and royalty based on gross sales (not net profits), the franchisee can be whipped into exorbitant hours of labor barely to make ends meet.

Since most franchisors ultimately turn to a program of company store operations, they can harass franchisees by engaging in direct competition at the retail level in the same market area or by swamping the territory with an excessive number of stores with a view to depressing their value for reacquisition purposes either for operation as a company store or for resale at a profit. The same results are ob-

⁴⁸ Although an arbitration covenant would not bar an antitrust suit (*A. & E. Plastik Pak Co., Inc. v. Monsanto Co.*, 396 F.2d 710 (9th Cir. 1968)), nor a securities fraud claim (*Wilko v. Swan*, 346 U.S. 427 (1953)), it would appear effective even against a claim of fraud (*Prima Paint Corp. v. Flood and Conklin Mfg. Co.*, 388 U.S. 395 (1967) (strong dissent)), at least where contracting parties are of equal bargaining power (*id.* at 403).

⁴⁹ See *Semmes v. Ford Motor Co.*, 429 F.2d 1197 (2d Cir. 1970), requiring strict construction against drafter of franchise.

tainable at time of renewal or request for transfer. The best sites can be pre-empted for company stores or, based on analyses of franchisees' operations, the best locations can be subjected to so much abuse that the franchisee will be induced to quit or to sell at a bargain price. Given the straitjacket controls and economic squeeze to which franchisees are subject, most franchisees operate as marginal enterprises prone to failure in any general economic recession. When recaptured by the franchisor, such stores may be profitably operated since they are no longer subject to the franchisor's economic overbearing.

Perhaps through indoctrination, but more so because of a lack of business sophistication and liquid assets, few franchisees are in a position to litigate their rights. The franchisor's power of attrition not only smothers complaints during the going relationship, but even after termination. At the root of the relationship is the gross imbalance which exists between the franchisor and its franchisees, not merely in the financial sense, with the implicit advantages of skilled financial, marketing, statistical, accounting and legal techniques, but more so in the economic and legal logistics. The heart of the matter was thus summarized:

There is a marked, intentional, and constantly emphasized disparity in the positions of the parties—the franchisor combining the roles of father, teacher, and drill sergeant, with the franchisee relegated to those of son, pupil, and buck-private, respectively. At the core of the franchise relationship is the contractual control exercised by the franchisor over every aspect of the franchisee's business. Starting with the advertisement which calls for no experience, the franchisor inculcates the franchisee with the necessity of being taught, guided, and controlled not only during the initial training period but throughout the existence of the franchise. The franchisor controls the site, commissary purchases, purchases from other vendors, method of business operations, labor practices, quality control merchandising, and even record keeping. This control is buttressed by the contractual requirement that the franchisee must obey the commands of the Operating Manual as expounded by the franchisor's supervisor, on pain of losing the franchise if he disobeys them and under constant threat of such termination. And upon termination, or failure to renew, the franchisee is confronted with the covenant not to compete and forfeiture of his equity in the business.⁵⁰

It is in the light of such conditions that the fiduciary relationship must be considered. As a matter of trial technique, it should be emphasized that most judges will have little familiarity with such conditions so that counsel must make a painstaking exposition of the facts in the particular case. Without such effort, the franchisee's com-

⁵⁰ Brown 41.

plaint will run into a stone wall of incredulity. Perhaps for that very reason, except in the antitrust field, the few litigated cases in state courts have reflected a doctrinaire approach, based on sanctity of contract, unless fraud could be shown in the inducement.⁵¹ These courts have ignored the question of whether such one-sided agreements are unconscionable or whether they can be contracts in view of the numerous substantive areas wherein the franchisor may act on purely subjective standards. With franchisors claiming that a franchise is nothing but an embellished license, revocable at will, franchisees claim that such licenses are coupled with an interest and therefore not revocable without compensation for their equity. In the vernacular, it is also suggested that franchising is a partnership for profit, a characterization of a status with mutual fiduciary obligations.

In any case, this writer proposes that since the franchising relationship is characterized by such pervasive power or control, the following principles should apply:

- (1) Where one has power to control another, a fiduciary obligation exists.
- (2) A fiduciary's duty is coextensive with his power to control.
- (3) Where the power to control another is abused by preference of self, equity will intervene.

It should immediately be conceded that no reported American case has applied such propositions to franchising; at the same time, no case has been found in which the theories were considered and rejected.⁵² From time immemorial, the courts have declined to adopt rigid definitions of certain broad principles, lest the ingenuity of man should circumvent them. That standard has not only applied to such terms as "fraud" and "good faith" but also to more specific words such as "security" where the definition would carry with it the broad antifraud standards of the federal securities laws.⁵³ For that reason, the cases for application of fiduciary obligations have also been left open for dynamic development.⁵⁴

It is somewhat significant that the theory has been informally espoused by the Federal Trade Commission, the administrative agency perhaps most intimately familiar with franchising and statutorily con-

⁵¹ See *Gifford v. Gifford*, 354 Mass. 247, 248, 236 N.E.2d 892, 893 (1968).

⁵² As late as 1969, the editorial staff of *Lawyers Cooperative Publishing Co.* confirmed the absence of such case law, while reportedly agreeing with the principles so propounded.

⁵³ See *Tcherepnin v. Knight*, 389 U.S. 332, 335 (1967); cf. *Mr. Steak, Inc. v. River City Steak, Inc.*, — F. Supp. — (D. Colo. 1970) (fast food franchise not a security).

⁵⁴ See *Broomfield v. Kosow*, 349 Mass. 749, 212 N.E.2d 556 (1965); *Meinhard v. Salmon*, 249 N.Y. 458, 467, 164 N.E. 545 (1928); *Pound, Progress of the Law*, 33 *Harv. L. Rev.* 420 (1920). See *Cann v. Barry*, 293 Mass. 313, 316, 199 N.E. 905, 906 (1936): "the circumstances which may create a fiduciary relationship are so varied and so difficult to foresee that it is unwise for courts to attempt to make comprehensive definitions."

cerned through its obligation to prevent "unfair methods of competition."⁵⁵ The General Counsel of that agency has stated:

... franchisors frequently speak of their relationship with their franchisees as being one of trust and confidence. It is truly a fiduciary relationship.⁵⁶

And the commission itself is reported as endorsing the expression of Commissioner MacIntyre before the May, 1969 Conference of the International Franchise Association that:

... not only must the franchisor give accurate information about his system, but ... he also has the affirmative duty to reveal any unfavorable news concerning the system.

Unfortunately, most fiduciary relationships have been so long established in the law that there have been few occasions to analyze the basis of their inception. Such would apply to the cases of partners, attorney-client, employer-employee, trustee-beneficiary, and, more recently, the officer-director-majority stockholder of a corporation. It is submitted that, in each such instance, the courts have in fact relied upon the three above-stated propositions. Such standards are based on the pervasive powers held by franchisors, the gross disparity of the parties in a complex transaction usually of long duration and the rampant opportunities for abuse, particularly through clandestine self-preference. In many franchises, the entire gross receipts of the franchisee are transmitted to the franchisor for disbursement. In almost all franchises, the franchisee is required to disclose his most intimate operations and confidential records to the franchisor. Although the handling of another's funds⁵⁷ and access to confidential records⁵⁸ would appear to be classical cases for application of fiduciary obligations, it is submitted that, even without them, the usual power of the franchisor to inspect, supervise, dictate to and discipline the franchisee would suffice. Although such control may be beneficently exercised, the franchisee is constantly at the mercy of the franchisor with the latter retaining the power of termination for the slightest infraction. In sub-

⁵⁵ 15 U.S.C. §45(a)(1) (1964).

⁵⁶ Statement of John V. Buffington, General Counsel, on January 27, 1970, to U.S. Senate Subcommittee on Urban and Rural Economic Development, Select Committee on Small Business (91st Cong., 2d Sess. 1970).

⁵⁷ See Scott, Trusts §§404.1, 404.2 (3d ed. 1967).

⁵⁸ Barry v. Covich, 332 Mass. 338, 124 N.E.2d 921 (1955) (constructive trust impressed "where information confidentially given or acquired was used to the advantage of the recipient"). The seldom used common law tort of unfair competition to protect the franchisor's manual of operations as a trade secret would appear equally available to guard the franchisee's confidential records and inner operations (McDonald's Corp. v. Moore, 243 F. Supp. 255, 258 (S.D. Ala. 1965), *aff'd*, 363 F.2d 435 (5th Cir. 1966)).

stance, courts may well have to draw the line for particular franchises, making the fiduciary obligation coextensive with the power to control in the particular case.

Perhaps discussion of analogous precedents will open the door to unwarranted attack on these simple statements of basic law as applied to a novel relationship. At the same time, it will disclose the constant availability of equity to prevent injustice⁵⁹ and its standard application in areas akin to the principal functions in franchising. For example, in a recent Massachusetts case,⁶⁰ the issue involved the finding of a fiduciary obligation not after the contract had been signed but at its very signing. There the Supreme Judicial Court found such an obligation to exist where trust and confidence were reposed in a defendant who had knowledge of plaintiff's reliance. Although that case involved a claim by a nursing home operator against a lender-builder, the theory is directly applicable to franchising in its reliance on the great disparity of the parties, the intimacy of their relationship, and the complexity of the transaction.⁶¹ The Court concluded as follows:

In redressing an abuse of trust and confidence, equity will review such factors as the relation of the parties prior to the incidents complained of, the plaintiff's business capacity or lack of it contrasted with that of the defendant, and the readiness of the plaintiff to follow the defendant's guidance in complicated transactions wherein the defendant has specialized knowledge. Equity will, in sum, weigh whether unjust enrichment results from the relationship.⁶²

In similar circumstances, the Supreme Judicial Court found an affirmative duty of disclosure to exist where a specialist had taken advantage of an aged inventor in the handling of his patents.⁶³

Many courts have stated that, in the absence of an intent to violate some provision of the antitrust laws, there is nothing to preclude the termination of a franchise in accordance with its terms.⁶⁴ Such cases

⁵⁹ See Pound, *The Progress of the Law*, 33 *Harv. L. Rev.* 420 (1920).

⁶⁰ *Broomfield v. Kosow*, 349 *Mass.* 749, 212 *N.E.2d* 556 (1965).

⁶¹ The Court gave much weight to statements in *Bogert, Trusts and Trustees* §481 (2d ed. 1969) and *Scott, Trusts* §468 (3d. ed. 1967); see *Restatement of Restitution* §166.

⁶² 349 *Mass.* 749, 755, 212 *N.E.2d* 556, 560 (1965).

⁶³ *Reed v. A. E. Little Co.*, 256 *Mass.* 442, 152 *N.E.* 918 (1926). See *Scott, Trusts* §462.2 (3d ed. 1967); *Restatement of Restitution* §201.

⁶⁴ *Division of Triple T Service, Inc. v. Mobil Oil Corp.*, 304 *N.Y.S.2d* 191, 60 *Misc.2d* 720 (1969); *Ford Motor Co. v. Webster's Auto Sales, Inc.*, 361 *F.2d* 874 (1st Cir. 1966); *Ace Beer Distributing Co. v. Kohn, Inc.*, 318 *F.2d* 283 (6th Cir. 1963); *Scanlan v. Anheuser-Busch Inc.*, 388 *F.2d* 918 (9th Cir. 1968); *Amplex of Maryland Inc. v. Outboard Marine Corp.*, 380 *F.2d* 112 (4th Cir. 1967), *cert. denied*, 389 *U.S.* 1036; *Ricchetti v. Meister Brau, Inc.*, 431 *F.2d* 1211 (9th Cir. 1970).

reflect the standard common law view that there is no "good faith" obligation in the performance of a contract.⁶⁵ Yet without much discussion of its radical departure from that view, a recent Massachusetts case awarded damages for the "bad faith" termination of an exclusive territorial distributorship where secret negotiations for a sale in the dealer's territory had commenced prior to the termination.⁶⁶

The standard fiduciary obligations of an agent would seem to arise not only from the franchisor's assumption of the duties of a purchasing agent for the franchisee's needs, but also from its absolute control of the standards and specifications for all such purchases.⁶⁷ Through a reversal of roles, in spite of the usual contractual term that the franchisee shall not be regarded as the agent of the franchisor, the latter has been held liable for torts of the franchisee or on the franchisee's premises, based on "ostensible" rather than "apparent" or "actual" authority, a category of liability described by Professor Warren Seavey as flowing from the power of the principal rather than from any contractual terms.⁶⁸ Permeating such considerations are the close identity of the franchisor and franchisee not only through the trade-name and methods systems, but also the control factor in a daily relationship extending over a long period of time. Despite the usual effort of franchisors to negate an agency relationship in the franchise agreement, the law may preclude such a general disclaimer either when it is inconsistent with the effective relationship established by the bundle of specific rights or when it is offensive to public policy.⁶⁹ For example, it is doubtful that, by contract, the president of a corporation could shed his trust obligations to the corporation and its stockholders,⁷⁰

⁶⁵ *Graf v. Hope Bldg. Corp.*, 254 N.Y. 1, 171 N.E. 884 (1930); see *Division of Triple T Service, Inc. v. Mobil Oil Corp.*, note 64 *supra*, recognizing requirement of "good faith" during the contract; 9 Williston, *Contracts* §1017A (3d ed. 1967); 5A Corbin, *Contracts* §1229 (1964); Hewitt, *Termination of Dealer Franchises and the Code*, 22 *Business L.* 1075 (1967).

⁶⁶ *RLM Associates, Inc. v. Carter Manufacturing Corp.*, 1969 *Mass. Adv. Sh.* 1006, 248 N.E.2d 646.

⁶⁷ *Berenson v. Nirenstein*, 326 *Mass.* 285, 289, 93 N.E.2d 610, 612, 20 *A.L.R.2d* 1136 (1950), where "full and complete relation of principal and broker" had existed, supposedly distinguishing it from the absence of a fiduciary relation where there was a "mere engagement" to buy in behalf of another, *Salter v. Beal*, 321 *Mass.* 105, 71 N.E.2d 872 (1947).

⁶⁸ Note, *Liability of a Franchisor For Acts of the Franchisee*, 41 *So. Cal. L. Rev.* 143 (1968).

⁶⁹ See Uniform Commercial Code for statutory limitation on disclaimer of express warranties unless reasonable. G.L., c. 106, §2-316(1).

⁷⁰ Where officers or directors have perpetrated a fraud or acted in self-interest, there are severe limitations even on the ratification of such acts (see 19 C.J.S., *Corporations* §763) and acts against public policy may be beyond such ratification (*Loft, Inc. v. Guth*, 23 *Del. Ch.* 138, 2 *A.2d* 225 (1938), *sustained*, *Guth v. Loft, Inc.*, 23 *Del. Ch.* 255, 5 *A.2d* 503 (1939)).

that partners could negate their mutually fiduciary obligations⁷¹ or that an attorney could so provide in a contract with his client.⁷²

In a different frame of reference, most jurisdictions impose fiduciary obligations on a foreclosing mortgagee, both with regard to his conduct of the sale and his accounting for the proceeds to junior lienholders and the mortgagor.⁷³ This analogy is particularly acute since the franchisor who terminates a franchise never feels obliged to honor the usual requirements of a foreclosure proceeding⁷⁴ or to account to the franchisee for the proceeds resulting from a resale of the franchise.⁷⁵

Perhaps the greatest erosion of the principles of sanctity of contract and caveat emptor have appeared in recent statutes. Though hardly enacted with franchising in mind, it has been suggested that the Uniform Commercial Code might be the source of relief in its requirements of "good faith" and "conscionability" in contracts for the supplying of all of a buyer's requirements and the standard of "best efforts" by a seller in exclusive dealing requirements⁷⁶ as well as "reasonable notice" before termination of such arrangements.⁷⁷ Yet while decrying the inequity of the situation and dramatically sup-

⁷¹ "There is no stronger fiduciary relation known to the law than that of a partnership, *where one man's property and property rights are subject to a large extent to the control and administration of another.*" (Emphasis supplied.) *Salhinger v. Salhinger*, 56 Wash. 134, 137, 105 P. 236, 237 (1909); 68 C.J.S. Partnership §209 (1950).

⁷² The newly adopted ABA Code of Professional Responsibility makes it an unethical practice for an attorney even to attempt to obtain exoneration from liability to his client (DR 6-102A).

⁷³ 41 C.J.S., Mortgages §64 (1949).

⁷⁴ The normal mortgage requirements of notice, public advertisement, public auction, acquisition by mortgagee, "chilling" of the bidding, and accounting for any surplus are completely foreign to franchise practices. See UCC requirements as to foreclosure of security interests in personal property (§9-504), particularly that "the method, manner, time, place and terms must be commercially reasonable." (§9-504(3).) See *Keene Lumber Co. v. Leventhal*, 165 F.2d 815 (1st Cir. 1948), involving the tort of interference with advantageous relations arising out of abuse in mortgage foreclosure. Query whether the self-help termination procedures of franchisors may be a denial of due process under the Fourteenth Amendment; see *Sniadach v. Family Finance Corp. of Bay View*, 395 U.S. 337 (1970) (lack of due process in wage garnishment prior to court hearing); *Fuentes v. Faircloth*, 317 F. Supp. 954 (S.D. Fla. 1970), *prob. juris. noted*, — U.S. — (Feb. 21, 1971). *Contra*, *Laprease v. Ray Mours Furniture Co.*, 315 F. Supp. 716 (N.D.N.Y. 1970); see also Comment, 12 B.C. Ind. & Com. L. Rev. 700 (1971); with most franchisors retaining site control through subleases or collateral pledge of leases, it is significant that regardless of the terms of a tenancy, almost all jurisdictions prohibit eviction through self-help procedures.

⁷⁵ It is, in fact, accepted procedure that upon reacquisition, the franchisor will usually resell the franchise at a handsome profit. See Fine, in *Realities of Franchising* 10.

⁷⁶ UCC §§2-302 and 2-306.

⁷⁷ *Id.* §2-309(2)(3); see Leff, *Unconscionability and the Code — The Emperor's New Clause*, 115 U. Pa. L. Rev. 485 (1967); Hewitt, *Termination of Dealer Franchises and the Code*, 22 *Business L.* 1075 (1967).

porting the need for remedial legislation, a New York court recently held such statutory provisions inapplicable to the termination of a gasoline dealership because of its indivisibility from the lease of the premises, holding the UCC applicable only to the sale of personal property.⁷⁸ The court was apparently unaware of the fact that site control is a prime weapon of franchisors, whether through sublease or collateral pledge of the lease, and that such property rights should be subordinate to the claim of the franchisee to whom the franchisor sold a right to do business. Equity should properly rule that, in good conscience, the legal title to the real estate is held in trust for the benefit of the franchisee, since otherwise there would be a forfeiture of valuable rights to the advantage of the very person who had sold such rights. Such a rule is universally applied where title to real estate is given as security for a debt.⁷⁹

Subordination of the property rights to the primary dealership contract would also be consonant with the rule that the seller of a business will be barred from competing with the buyer even in the absence of an express noncompetition covenant.⁸⁰ That equitable rule is grounded on the theory that the buyer would otherwise be deprived of the benefit of his bargain by the very person who had made the sale. Throughout all franchising runs the same issue, namely, whether equity will allow the forfeiture of the franchisee's goodwill to the dominant franchisor.

In order to protect that goodwill, Puerto Rico adopted a statute prohibiting the termination of a dealership except for "just cause," a phrase of civil law import rather comparable to "good faith."⁸¹ Ignoring the declared purpose of the legislature and the comparable penal features of the American antitrust laws because of the strong public policy involved,⁸² the United States Court of Appeals for the First Circuit has held that law unconstitutional as applied to a pre-existing dealership that was terminable at will.⁸³ In so doing, the

⁷⁸ Division of Triple T Service, Inc. v. Mobil Oil Corp., 304 N.Y.S.2d 191, 60 Misc. 2d 720 (1969).

⁷⁹ Shadman v. O'Brien, 278 Mass. 579, 583, 180 N.E. 532, 533 (1932) ("not based merely upon oppression by a creditor," but "out of the situation of confidence and of quasi-fiduciary relationship, where actual fraud is not present," plaintiff having carelessly been involved with "a supposed friend"). See statement of Cardozo, J., "When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee." Beatty v. Guggenheim Exploration Co., 225 N.Y. 380, 386, 122 N.E. 378, 380 (1919).

⁸⁰ Tobin v. Cody, 343 Mass. 716, 180 N.E.2d 652 (1962).

⁸¹ Puerto Rico Dealers' Act, P.R. Laws Ann. tit. 10, §§278 et seq.

⁸² See 15 U.S.C. §§15 and 26 (1964), prescribing treble damages as well as costs and attorneys' fees, and injunctive relief; the United States may recover single (15 U.S.C. §15(a)) or double (31 U.S.C. §231) damages if the violation involved government funds.

⁸³ Fornaris v. Ridge Tool Co., 423 F.2d 563 (1st Cir. 1970), *rev'd*, 400 U.S. 41 (1970) (per curiam reversal on ground of abstention).

court ignored any consideration that the common law itself may have required "good faith" and that the relationship was more of a status than a contract. In anticompetitive situations, rather than being bound by such formal defenses as the extent of the burden on a pre-existing contract, the United States Supreme Court has repeatedly held that, in interpreting the antitrust laws, "we must look at the economic reality of the relevant transactions."⁸⁴ Although the principal decision has now been reversed on the ground of abstention, with mild criticism of the ambiguity in the court of appeals' reasoning, the cloud of constitutional doubt will remain.

In the area of fraud, the strict common law rules have been expanded to require full disclosure and the banning of manipulative and deceptive practices in the sale of securities.⁸⁵ It has been strongly urged that a franchise is a security and therefore entitled to the benefit of such protection.⁸⁶ The Federal Trade Commission has adopted the same standards for the sale of franchises under the statutory prohibition of "unfair and deceptive acts or practices."⁸⁷ Pending federal⁸⁸ and state⁸⁹ legislation would require extensive disclosure in the form of a prospectus. In California, the first such law has been enacted,⁹⁰ though the extent of the legislative compromise needed for that achievement is disclosed in its exemption of any franchisor with a capital of \$5 million or 25 existing franchisees,⁹¹ perhaps the first time that "bigness" has been equated with honesty.

⁸⁴ *United States v. Concentrated Phosphate Export Assn.*, 393 U.S. 199, 208 (1968).

⁸⁵ Securities and Exchange Act of 1934, 15 U.S.C. §78j (1964), and SEC Rule 10b-5, 17 C.F.R. §240.10b-5; see Bromberg, *Securities Law: Fraud: SEC Rule 10b-5* (1968); Loss, *Securities Regulation* (2d ed. 1961, Supp. 1969). Anyone buying a stock interest or other "security" in a corporation owning a franchise is clearly entitled to the benefit of such statutory protection.

⁸⁶ See note 16 *supra*.

⁸⁷ See May 1969 statement of FTC Commissioner Everette MacIntyre: "[N]ot only must the franchisor give [to a prospective franchisee] accurate information about his franchise system but . . . he also has the affirmative duty to reveal any unfavorable news concerning his system" (such as pending lawsuits or FTC actions or the fact that the franchisor competes in his own systems). (1969 Trade Reg. Rep. ¶50,240). Although the Federal Trade Commission Act is not designed to obtain recovery for private claimants, recently proposed findings would require refunds to deceived franchisees (*FTC v. Universal Electronics Corp.*, 1970 Trade Reg. Rep. ¶19,390). It may be suggested that under its very broad rule-making power (15 U.S.C. 46(g) (1964)), the FTC should adopt regulations prescribing in detail the disclosure requirements which all franchisors must present to prospective franchisees.

⁸⁸ S. 3844, 91st Cong., 2d Sess. (1970) (sponsored by Senator Harrison A. Williams, Jr.). Although the bill may not receive consideration in the pending session, its reintroduction has been predicted.

⁸⁹ Senate Bill 110 introduced for consideration by the 1971 legislature. Similar legislative proposals are expected in New York, Texas and Virginia.

⁹⁰ Chapter 1400 of 1970 Cal. Laws, amending §10177 of the Business and Professions Code and to amend §§25019 and 25212 of, and to add division 5 (commencing §31000) to, title 4 of the Corporation Code.

⁹¹ 1970 Cal. Laws, part 2, ch. 1, §3110(a) and (b).

As for the statutory limitation on termination and its equivalent of the right to renew, there has been a veritable groundswell of proposals that would require "due cause," "just cause," "good faith" or their equivalent,⁹² including the first such statute, in Delaware, for all franchisees⁹³ and in numerous other states for auto dealers.⁹⁴ These requirements of "good faith" should be contrasted with the federal Auto Dealers Act⁹⁵ where "good faith" was incredibly defined solely in terms of "coercion and intimidation or the threat of either," to the utter dismay of both the automobile dealers and the courts.

When a court finds that a fiduciary relationship exists, it would have complete power to provide relief from all manifestations of self-preference, including:

- (1) imposition of an affirmative duty of disclosing all significant matters to the franchisee, including such matters as extra charges for rental, fixtures, equipment and commissary purchases⁹⁶
- (2) prohibition of overreaching or overbearing in any of its charges, particularly prohibiting such practices as "kickbacks," whether secret or not⁹⁷
- (3) refusing to enforce unfair terms against the franchisee, including restrictions on transfer, the covenant not to compete, and termination penalties;⁹⁸ in particular, compelling the

⁹² See Sen. Hart's Bill, note 41 *supra*.

⁹³ Late in 1970, Delaware adopted a similar law (ch. 693, vol. 57 Del. Laws (1970), adding a new subchapter IV to Del. Code tit. 6, §2501), prohibiting unjust terminations of failure to renew, defined as "without good cause" or "in bad faith."

⁹⁴ Mass. Acts of 1970, c. 814, creating G.L., c. 93B; Wis. Stat. §218.01(3)(a)17 (1957); Minn. Laws, ch. 626 (1955); Iowa Code §322.3(5) (1966); Fla. Stat. Ann. §320.64(8) (1968); N.C. Gen. Stat. §20-305 (1965); Pub. Laws of R.I., 1950, ch. 2595, art. VIII; N.Y. Gen. Bus. Law §197, as amended by Laws, 1970 ch. 582, §2; 1963 Colo. Gen. Laws ch. 77 (see *General Motors Corp. v. Blevins*, 144 F. Supp. 381 (D. Colo. 1956)). In Massachusetts, a generic statute has just been adopted for auto dealers (Acts of 1970, c. 814, creating new G.L., c. 93B) broadly extending the provisions of the "Baby" FTC Act. See Brown, A Bill of Rights for Auto Dealers, 12 B.C. Ind. & Com. L. Rev. 757 (1971).

⁹⁵ 15 U.S.C. §1221(e) (1964); see note 5 *supra*.

⁹⁶ The duty of full disclosure has long been applied in partnership transactions: *Sher v. Sandler*, 325 Mass. 348, 90 N.E.2d 356 (1950); *Reed v. A. E. Little Co.*, 256 Mass. 442, 449, 152 N.E. 918, 920 (1926) ("When confidence is reposed and accepted, the person trusted is liable for expressing dishonest opinions. . .").

⁹⁷ *Jirna, Ltd. v. Mister Donut of Canada, Ltd.*, Superior Ct., Toronto, Can., No. 250 of 1970 (being appealed).

⁹⁸ Courts have long recognized that any covenant not to compete is offensive to public policy and have almost universally confined its application to what is both reasonable and necessary, regardless of the terms of the express covenant. *New England Tree Expert Co. v. Russell*, 306 Mass. 504, 28 N.E.2d 997 (1940); see *Syntex Laboratories Inc. v. Norwich Pharmacal Co.*, 315 F. Supp. 45 (S.D.N.Y. 1970), 1970 Trade Cas. ¶73,372 (noncompeting covenant by seller of ethical drug product and trademark not violative of Sherman Act where ancillary to sale of whole or part of business and reasonably limited to time and territory).

franchisor who wants to repurchase a franchise to offer the franchisee the fair value of his business, with no compulsion on the franchisee to sell, and permitting the franchisee who wants to sell or make a gift of his franchise to do so to a person of his own choice, who need be no more qualified than he was when he entered into the franchise agreement⁹⁹

- (4) requiring a high degree of care in the selection of supervisors, in policing their actions, and in requiring fair and reasonable procedures for the franchisee's complaints in respect to the conduct of supervisors¹⁰⁰
- (5) requiring that the franchisor disclose the fact it has insulated itself from legal and financial liability by interposing a wholly owned subsidiary between itself and the franchisee and striking the compulsory novation effort to evade responsibility¹⁰¹
- (6) denying to the franchisor all compensation, even though otherwise reasonable, if there has been a serious abuse of fiduciary obligations¹⁰²
- (7) barring compulsory purchases from the franchisor at prices unilaterally determined by it, veto power over suppliers, and restrictions on equipment purchases¹⁰³

⁹⁹ Although reformation of contract should be sparingly applied by courts, respect for the franchisee's property right in his equity would appear to justify restraint against possible forfeiture.

Since *Coke on Littleton*, the law has always frowned on restraints on alienation (see *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); see opinion of Rufus E. Wilson, head of the FTC Bureau of Restraint of Trade, in *Ad Hoc (FTC) Committee Report on Franchising*, Trade Reg. Rep. 444 Supp. at 48, suggesting that such restraint on the franchisee's right to dispose of his franchise might well constitute a per se violation of the antitrust laws, with no consequent need to show its economic effect.)

¹⁰⁰ In antitrust matters, policing has long been recognized as an adjunct to anticompetitive practices.

¹⁰¹ This principle emanates from the developing law on "piercing the corporate veil," particularly where there are elements of fraud. Cf. *My Bread Baking Co. v. Cumberland Farms, Inc.*, 353 Mass. 614, 233 N.E.2d 748 (1968); *Centmont Corp. v. Marsch*, 68 F.2d 460, 464-465 (1st Cir. 1933), cert. denied, 291 U.S. 680 (1934); *Pennsylvania R.R. v. Naam Looze Vennoot Schap*, 248 U.S. 566 (1918); *Ballantine, Corporations* §§134-138 (rev. ed. 1946); *Douglas and Shanks, Insulation from Liability through Subsidiary Corporations*, 39 *Yale L.J.* 193, 195-210 (1930); Note, *Alternative Methods of Piercing the Corporate Veil in Contract and Tort Cases*, 48 *B.U.L. Rev.* 123 (1968); Note, 71 *Harv. L. Rev.* 1122 (1958); Annotation, 7 *A.L.R.3d* 1343 (1966). In line with its declared policy of examining the economic realities in antitrust matters (*United States v. Concentrated Phosphate Export Assn.*, 393 U.S. 199, 208 (1968)) the Supreme Court has found no difficulty in establishing liability through several levels of distribution, regardless of the degree of corporate ownership (*Perkins v. Standard Oil Co. of Calif.*, 395 U.S. 642 (1969)). In *Siegel v. Chicken Delight*, note 17 *supra*, the Court has postponed a determination of the liability of the franchisor's parent, pending franchisor's appeal.

¹⁰² Because of such aggravated abuse, in *Broomfield v. Kosow*, 349 Mass. 749, 212 N.E.2d 556 (1965), the Supreme Judicial Court disallowed the \$10,000 fee which the trial court had allowed the builder as reasonable compensation.

¹⁰³ These principles reflect the same balancing of equities which the antitrust

- (8) in case of termination, requiring the franchisor to account to the franchisee for the proceeds of any resale and requiring payment to the franchisee of the full fair market value of his business as a going enterprise if retained by the franchisor for operation as a company store¹⁰⁴
- (9) requiring the franchisor to return to the franchisee all overcharges for rental, equipment and inventory, as well as an accounting for all "kickbacks";¹⁰⁵ and
- (10) rescission, including a reasonable charge for the franchisee's use of the franchise and an allowance for the value of the franchisee's services.¹⁰⁶

Perhaps the most intriguing aspect of recognizing a fiduciary relationship in franchising lies in its connection with existing federal laws. Whether or not a federal common law is developing in spite of *Erie v. Tompkins*,¹⁰⁷ determinations under federal law cannot be made in a sterile fashion ignoring common law principles. Inversely, decisions under federal statutes necessarily imply common law conclusions.

For example, a fiduciary relationship is necessarily implied in recent determinations by the National Labor Relations Board that certain franchisees were "employees" within the National Labor Relations Act¹⁰⁸ and therefore entitled to collective bargaining rights.¹⁰⁹ Similar

laws have used to permit the fulfillment of the Lanham Act requirements by requiring that wherever possible, the franchisor use standards and specifications for all of the franchisee's purchases. See *Susser v. Carvel Corp.*, 332 F.2d 505 (2d Cir. 1964), cert. denied at impro. granted, 381 U.S. 125 (1965); *Siegel v. Chicken Delight Inc.*, 311 F. Supp. 847 (N.D. Cal. 1970) (appeal pending).

¹⁰⁴ Compare the standards required of a foreclosing mortgagee; see note 74 *supra*.

¹⁰⁵ See note 97 *supra*.

¹⁰⁶ *Runyan v. Pacific Air Industries, Inc.*, 2 Cal. 3d 304, 466 P.2d 682, 85 Cal. Rptr. 138 (1970). Since it is presumed that the franchisor has violated its fiduciary duties, any doubt should be resolved against the malfasant lest it profit from such action and for the same reason it should also bear the burden of proof. Restatement of Trusts Second §§172, 244-245; *Scott, Trusts* §§172, 244-245.2 (3d ed. 1967). See *Samia v. Central Oil Co. of Worcester*, 339 Mass. 101, 158 N.E.2d 469, 484 (1959) (corporate directors bear burden of proving propriety of their expense accounts). For comparable antitrust rule, see *Bigelow v. R.K.O. Radio Pictures, Inc.*, 327 U.S. 251, 256 (1946) and Note, *Private Treble Damage Antitrust Suits: Measure of Damages for Destruction of All or Part of a Business*, 80 Harv. L. Rev. 1566 (1967). Borrowing further from antitrust principles, it may be suggested that "unclean hands" be not recognized as a defense, but rather be given comparable weight through possible mitigation of damages. (*Perma Life Mufflers v. Intl. Parts Corp.*, 392 U.S. 134 (1968)).

¹⁰⁷ 304 U.S. 64 (1938); Note, *The Federal Common Law*, 82 Harv. L. Rev. 1512 (1969); Friendly, *In Praise of Erie—and of the New Federal Common Law*, 39 N.Y.U.L. Rev. 385 (1964).

¹⁰⁸ 29 U.S.C. §151 (1964).

¹⁰⁹ *Mister Softee of Indiana, Inc. v. Oil Chemical and Atomic Workers International Union, AFL-CIO*, 162 N.L.R.B. 354 (1966); *News Syndicate Co. v. Newspaper Guild of New York, Local 3, American Newspaper Guild*, 164 N.L.R.B. 422 (1967); cf. *The Southland Corp. d/b/a/ Speedee 7-Eleven v. Retail Store Employees Union*, 170 N.L.R.B. 159 (1968).

rights were granted in 1970 by the Swedish Labor Court to the gasoline station dealers of Esso, based on the oil company's dominant economic power and the dealers' dependence on the oil company for the continuity of supplies. Employing the same principles, the United States Supreme Court has confirmed a finding of "unfair methods of competition" under §5 of the Federal Trade Commission Act against Texaco, Inc., with regard to the compulsory purchase of tires, batteries and accessories, in spite of the complete absence of any evidence of overt directions by the oil company.¹¹⁰ The decision was based on the "dominant economic power" of the company and the dealers' knowledge of the fact that unless they purchased such "TBA," their short-term dealerships would not be renewed.

In mid-1970, the Federal Trade Commission instituted a complaint against a "transmission repair" franchisor for allegedly deceptive sales practices used by its franchisees to obtain repair jobs.¹¹¹ Among the deceptive practices are claims that the franchisees would not reassemble transmissions for customers who refused to authorize further work, and that they failed to disclose when repairs were made with used parts. Pertinent to the issue of a fiduciary relationship is the FTC claim that the franchisor is responsible for such practices of its franchisees because it controls the "business strategy" of its franchisees and the franchisees who fail to comply with its prescribed methods of operation may have their franchises terminated. In substance, there is a tacit allegation that such control makes the franchisees agents of the franchisor in the perpetration of fraudulent acts. It is submitted that such federal action implicitly recognizes the existence of a fiduciary relationship.

In the broadest frame of reference, over a half century of applying the "rule of reason"¹¹² to the statutory prohibitions of "combinations in restraint of trade"¹¹³ and "unfair methods of competition"¹¹⁴ has patently involved the standards of good faith and conscionability in commercial transactions.¹¹⁵ By definition, however, the scope of such inquiry has been limited to practices having an anticompetitive effect.¹¹⁶ For example, in the absence of such an effect, the simple termination of a franchise has repeatedly been held not actionable under the antitrust laws.¹¹⁷ Unfortunately, that implicit limitation of the antitrust laws has generated the erroneous conclusion that, unless so prohibited, the simple termination or failure to renew a franchise

¹¹⁰ *FTC v. Texaco, Inc.*, 393 U.S. 223 (1968).

¹¹¹ *Aamco Automatic Transmissions, Inc.*, 3 Trade Reg. Rep. ¶19,283 (1970).

¹¹² *Standard Oil Co. v. United States*, 221 U.S. 1, 66 (1911).

¹¹³ 15 U.S.C. §1 (1964).

¹¹⁴ 15 U.S.C. §45(a)(1) (1964).

¹¹⁵ See notes 3 and 17 *supra*.

¹¹⁶ "It is competition, not competitors, which the Act protects." *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962).

¹¹⁷ *E.g., Ricchetti v. Meister Brau, Inc.*, 431 F.2d 1211 (9th Cir. 1970).

is therefore legal so long as it conforms with simple contract law.¹¹⁸ The full recognition of common law fiduciary concepts would provide the appropriate standard against which to test the propriety of such terminations. While the threat of such termination presently provides the basic leverage for the enforcement of repressive practices, the fiduciary concept would severely restrict the use of such a weapon.

Inversely, in future antitrust litigation, the issue should be whether a fiduciary, such as a franchisor, has engaged in unfair competitive practices such as resale price maintenance,¹¹⁹ territorial limitations,¹²⁰ tying sales,¹²¹ exclusive supply,¹²² direct or indirect competition at the same level in the relevant market¹²³ or any other such prohibited activities.¹²⁴ Such competitive acts by a fiduciary against its own beneficiaries would appear to call for more strenuous rules if open competition is to be fostered.¹²⁵

¹¹⁸ Without question, such an assumption laid the basis for the highly questionable decision of the First Circuit Court of Appeals in *Fornaris v. Ridge Tool Co.*, note 82 *supra*.

¹¹⁹ Including minimum and maximum price setting. *L. J. Albrecht v. The Herald Co.*, 390 U.S. 145 (1968).

¹²⁰ *United States v. Sealy, Inc.*, 388 U.S. 350 (1967) (including both horizontal and vertical territorial allocations).

¹²¹ *Fortner Enterprises v. U.S. Steel Corp.*, 394 U.S. 495 (1969) (extension of credit as tying product; see dissent regarding application to franchising); see note 103 *supra*.

¹²² 15 U.S.C. §14 (1964); *FTC v. Brown Shoe Co.*, 384 U.S. 316 (1966) (incipient violation of §5 of Federal Trade Commission Act by major shoe manufacturer in requiring preferential purchase of its goods by dealers).

¹²³ See note 24 *supra*.

¹²⁴ Where a third party vendor agrees with the franchisor not to deal directly with its franchisees, there may well be a boycott (*Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959) (boycott by wholesaler, regardless of smallness of quantity) as well as price discrimination (*FTC v. Fred Meyer, Inc.*, 390 U.S. 341 (1968))).

¹²⁵ Given the many abuses in franchising offensive to the antitrust laws, the paucity of litigation has been surprising, particularly in view of the treble damages intended to encourage private enforcement and the somewhat newly available class action (new Fed. R. Civ. P. 23, effective July 1, 1966, 28 U.S.C. §23 (1964)). Aside from the fear of retribution among existing franchisees and even the risk of unfavorable publicity for the trademark system of which the franchisee is a part, perhaps the more stringent deterrents are the lack of counsel familiar with such laws and the exceedingly high costs of such litigation. Recognition of the latter led Senator Philip A. Hart, as chairman of the Senate Subcommittee on Antitrust and Monopoly, to recommend to the Small Business Administration that it amend its rules to permit loans to small businessmen to support meritorious antitrust litigation. Efforts of franchisees to raise funds among other members of the class have been met with counterclaims of a combination in restraint of trade (*Merit Motors, Inc. v. Chrysler Corp.*, Civil No. 2000-70 (E.D. Pa. 1970)) and of improper solicitation sufficient to warrant the disallowance of class status as well as the dismissal of suit (*Halverson v. Convenience Food Mart, Inc.*, Civil No. 70C-499 (N.D. Ill. 1970)). In order to prevent such practical limitations from making antitrust relief illusory, it has been recommended that the Federal Rules of Civil Procedure and Federal Rules for Multidistrict Litigation be amended to permit early notice of suit to each

Although no United States case has considered the applicability of fiduciary obligations in franchising, an Ontario court, in a case of first impression, has recently done so.¹²⁶ Significantly, without the aid of the American antitrust laws, the Ontario court was constrained to address itself to basic equitable concepts. Although the Canadian decision is not that of an appellate court, nor at all binding in the United States, its reasoning has suggested a course which many courts are likely to follow. That court had little difficulty in finding the existence of fiduciary duties and constructive fraud in the franchisor's secret retention of commissions and rebates from the vendors with whom the franchisees were required to deal. While relying on such cases as *Meinhard v. Salmon*¹²⁷ and *Broomfield v. Kosow*¹²⁸ the court found "nothing new in the principles sought to be imposed." It concluded:

In this particular type of relationship, it appears to me that franchisor and franchisee are bound together over a very long period of years in a relationship which in many respects is almost as close as that of master and servant. While of course, it is not the same, nevertheless the relationship is so close that confidence is necessarily reposed by the one in the other.¹²⁹

The abuse of that confidence through self-preference was held actionable by the confiding party.

Perhaps equity will at long last acknowledge the basic principle that, when a franchisor either sells or grants a franchise to which the franchisee devotes his capital and labor, the franchisee is entitled to obtain a reasonable opportunity to succeed. Such a principle would require that the franchisor fulfill its function of developing and maintaining a franchise system reasonably capable of fulfilling such an implicit representation to the prospective franchisee. Within reasonable limits, it would impose restraints upon the capital charge for a franchise, the amount of the royalty in the form of a percentage on gross sales, and all other charges, based on the underlying requirement that there should be a sufficient remainder for the franchisee to obtain a fair return for his investment and effort. Although the franchisee should not expect a guaranty of success, the franchisor should be prepared to demonstrate reasonable proof of sound concepts and empirical testing. While the franchisee should then expect to be subject to the normal competition of the marketplace, he should be totally free from both direct and indirect competition emanating from the very franchisor from whom he acquired his business opportunity. Finally, sub-

member of the class, including proposals for joint effort to share the costs of litigation, subject to court supervision.

¹²⁶ *Jirna, Ltd. v. Mister Donut of Canada, Ltd.*, Superior Ct., Toronto, Can., No. 250 of 1970 (being appealed).

¹²⁷ 249 N.Y. 458, 164 N.E. 545, 62 A.L.R. 1 (1928).

¹²⁸ 349 Mass. 749, 212 N.E.2d 556 (1965).

¹²⁹ See note 125 *supra*.

ject to reasonable controls by the franchisor in the operation and disposition of the franchise, it must be recognized that the franchisee is the owner of an independent business, entitled to the full protection of that asset which the law affords to every other businessman.

In conclusion, it is submitted that the franchisor's pervasive power of control, the gross disparity of the parties both contractually and economically, the complexities of the relationship, the franchisee's universal fear of retribution, and the extensive risk of self-preference and abuse all militate toward a clear recognition of fiduciary obligations. It would hardly appear necessary to document the extent to which such a relationship has succumbed to the greed of those possessing such plenary powers.¹³⁰ Given the extent of such exposure and the delays which court recognition of such rights may entail, it would appear that legislative recognition of such "good faith" requirements may be the only viable answer.

B. BILL OF RIGHTS FOR MASSACHUSETTS AUTO DEALERS

§8.2. **General Laws, Chapter 93B.** Upon enactment of G.L., c. 93B,¹ the auto dealers of Massachusetts obtained a true "Bill of Rights" to govern their relationship with the automobile manufacturers. At the heart of the act are the prohibitions against terminating or failing to renew a dealership except for due cause² and engaging "in any action which is arbitrary, in bad faith, or unconscionable."³ Although legislation directly affecting but a few hundred businesses⁴ might appear rather specialized, it can be anticipated that the impact will be far broader. Narrowly viewed, the statute, historically regarded as the first in the nation, may set a precedent for the entire automobile industry.⁵ As a possible forerunner of legislation

¹³⁰ Although it has been reported that organized crime is now deeply involved in the franchising of vending machines, mobile homes, mini-theaters, motels and restaurants (Statement of N.Y. Atty. Gen. Lefkowitz given Sept. 28, 1970, to N.Y. Legislative Committee), recent legislative disclosures and a veritable flurry of litigation against major franchisors all indicate that the so-called pillars of propriety have led the way. For the involvement of "name" personalities in franchising, see Goodwin, *The Name of the Franchising Game Is: The Franchise Fee, The Celebrity, or Basic Operations*, 25 *Business L.* 1403 (1970).

§8.2. ¹ Acts of 1970, c. 814, inserting G.L., c. 93B, effective Jan. 1, 1971.

² *Id.* §4(3)(c).

³ *Id.* §4(1).

⁴ It is generally accepted that there are approximately 800 auto dealers in the state and that over 90 percent of their sales are vehicles manufactured by the "Big Three," namely, General Motors, Ford and Chrysler.

⁵ Although the statute is not the first in the nation affecting automobile dealers, particularly with regard to termination or failure to renew the franchise, it goes far beyond that crucial issue in the relationship. Aside from the federal Automobile Dealers' Day in Court Act, 15 U.S.C. §§1221-1225 (1964), referred to *infra*, the following states have enacted auto dealer legislation:

for all franchisees, it may affect a marketing system covering over 10 percent of the gross national product and 25 percent of all retail sales. But because it has been demonstrated that the forces exercised by franchisors on their franchisees are directly equated to a franchisee's dealings with his customers, the statute may be expected to have repercussions extending into every home with a car.

A full appreciation of the statutory provisions requires an exposition of the business practices of which auto dealers have complained for decades.⁶ With such background information, the entire legal community should be aided in the guidance of counsel as well as in the judicial interpretation of numerous new concepts. In the technical

(1) Wisconsin: Wis. Stat. §218.01(3)(a)17 (1967). This statute prohibits an automobile manufacturer from cancelling or failing to renew a franchise "unfairly, without due regard to the equities of the dealer and without just provocation." It has been held on its face "to be a proper exercise of the police power." *Forest Home Dodge, Inc. v. Karns*, 29 Wis. 2d 78, 138 N.W.2d 214 (1965); *Kuhl Motor Co. v. Ford Motor Co.*, 270 Wis. 488, 71 N.W.2d 420 (1955).

(2) Minnesota: Minn. Laws c. 626 (1955). This statute makes it unlawful for any automobile manufacturer "to cancel or refuse to renew the franchise . . . without just cause." Its constitutionality has been sustained in *Willys Motors v. Northwest Kaiser-Willys*, 142 F. Supp. 469 (D. Minn. 1956).

(3) Iowa: Iowa Code §322.3(5) (1966). This statute prohibits an automobile manufacturer from terminating or failing to renew any franchise "without just, reasonable and lawful cause." Criminal sanctions are provided.

(4) Florida: Fla. Stat. Ann. §320.64(8) (1968). Under this statute, an auto manufacturer's license may be denied if it has cancelled a franchise "unfairly or without regard to the equities of a motor vehicle dealer or without just provocation."

(5) North Carolina: N.C. Gen. Stat. §20-305 (1965). This renders it unlawful for an auto manufacturer "unfairly without due regard to the equities of the dealer, and without just provocation to cancel the franchise of such dealer."

(6) Rhode Island: Pub. Laws of R.I., 1950, ch. 2595, art. VIII.

(7) New York: N.Y. Gen. Bus. Law §197 (McKinney 1956), as amended by Chapter 582 of the 1970 Laws, prohibiting termination "except for cause" and restricting nonrenewal "except in good faith."

(8) Colorado: 1955 Colo. Sess. Laws ch. 77, tit. 198 through 205, adding Colo. Rev. Stat. §§13-11-14(9), 13-11-14(10), and 13-11-14(10)e, which used the same language as the North Carolina and Florida statutes, was held unconstitutionally vague in *General Motors Corp. v. Blevins*, 144 F. Supp. 381 (D. Colo. 1956). The present legislation dealing with the management-dealer relationship is Colo. Rev. Stat. §13-11-11(3) (1963).

(9) Tennessee: Tenn. Code Ann. ch. 17, §59-1714(h)(4), prohibiting "unfair" cancellation "without due regard to the equities of" the dealer and "without just provocation."

Some jurisdictions have enacted similar laws affecting franchisees in general, such as:

(1) Puerto Rico: Dealers' Act, P.R. Laws Ann. tit. 10, §§278 et seq., granting a damage action for termination "without just cause," a phrase of civil origin akin to "good faith."

(2) Delaware: Del. Laws ch. 693 (1970), adding a new subchapter IV to Del. Code tit. 6, §2501, prohibiting unjust terminations or failure to renew defined as "without good cause" or "in bad faith."

⁶ Hearings Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business, 91st Cong., 1st Sess. (1969).

sphere, there must be considered the federal "Dealers' Day in Court Act,"⁷ the antitrust laws,⁸ the Federal Trade Commission Act,⁹ the "Baby" FTC Act,¹⁰ and common law principles, chiefly in equity, for each of these is intimately involved in the specific terms of the new statute. Even more fundamentally, extensive constitutional doubts were raised by the United States Court of Appeals for the First Circuit.¹¹ Having thus outlined the scope of the factual and legal problems, it should be evident that not more than an initial analysis is possible, it being incumbent upon counsel to exhaust the source materials for specific issues. To compound this challenge, it must be conceded that but few practitioners or even state judges have had the opportunity to obtain broad experience on many of these issues.

There is little need to provide statistics to show that the principal auto manufacturers are economic giants and that the industry is dominated by the "Big Three" as an oligopoly.¹² The total dependence of the auto dealers on but a few factories for their continued source of supply severely limits their scope of trading power in the general market.¹³ Although franchisees in general may complain of the excessive control by their franchisors and the abuses to which they are subject,¹⁴ in the auto industry such factors are implicit. Although in varying degrees, each of the auto manufacturers has been the object of numerous dealer complaints,¹⁵ loosely categorized as "operating" and "capital" in nature.

In the "operating" class are such matters as (1) adequate and prompt payment for predelivery work performed by the dealer as the last step in the manufacturing process and (2) reimbursement for labor and parts supplied to satisfy the manufacturer's express warranty to the consumer. In each instance, dealers have long contended that, in order to continue to function, they must provide the funds and do such work, but then find themselves at the mercy of the factory in the allowance of the claim, the standard of payment, and actual receipt of the funds. Even in 1970, it is claimed that in order to show a modest interim profit, one major factory has inexcusably held up the processing of

⁷ 15 U.S.C. §§1221-1225 (1964), enacted in 1956.

⁸ Generally including the Sherman Act, the Clayton Act, the Robinson-Patman Act and related measures (15 U.S.C. §§1 et seq. (1964)).

⁹ *Id.* §§41-58.

¹⁰ G.L., c. 93A, §§1-10.

¹¹ See *Fornaris v. Ridge Tool Co.*, 423 F.2d 563 (1st Cir. 1970), *rev'd*, 400 U.S. 41 (1970) (per curiam reversal on ground of abstention).

¹² *Mt. Lebanon Motors, Inc. v. Chrysler Corp.*, 283 F. Supp. 453, 456 (W.D. Pa. 1968), *aff'd*, 417 F.2d 622 (3d Cir. 1969). The figures are literally staggering—nine million new vehicles sold annually, tens of millions more on the roads, and close to 30,000 automobile dealers.

¹³ See *FTC v. Texaco, Inc.*, 393 U.S. 223 (1968) (discussion of comparable problems confronting the gasoline station dealers vis-à-vis the major oil companies).

¹⁴ See H. Brown, *Franchising: Trap for the Trusting* (1969, 1970 Appendices) [hereinafter cited as Brown].

¹⁵ *Id.* at 77.

almost one million claims for warranty reimbursement.¹⁶ For years, it was fairly well established that the reimbursement rate for labor was grossly below the dealer's actual costs¹⁷ and even now the parts reimbursement is at the dealer's wholesale cost with only an arbitrary but moderate allowance for handling.

With regard to predelivery work performed by the dealer before the sale to a customer, there has been a wide discrepancy between the scope of the work expected of the dealer as compared with the modest \$25 to \$50 per car allowance, compounded by the increasing frequency of manufacturing deficiencies or even damage in transit.¹⁸ Some factories even provide that the dealer is to obtain reimbursement only when the vehicle is sold to a consumer.

It is not difficult to relate these abuses to their effect on consumers. Where auto dealers are financially pressed just to break even on predelivery and warranty work, it should provide no surprise that consumers may find themselves shortchanged by the dealer. Hard pressed economically by rapidly increasing costs and perhaps buffeted by the economic recession, such a dealer has little choice but to cut corners with his customers or even to file fraudulent claims with the factory for reimbursement.¹⁹ While such practices by marginal dealers are hardly excusable, their remedy may not lie in further punishment of the dealer, but rather in their proper attribution to the abusive factory practices.

Another principal complaint concerns the subsidies granted to leasing and fleet buyers. Although such subsidies have technically been channeled through dealers, with a modest allowance to the dealer for processing each vehicle, the economic reality stems from the factory. Such allowances per car have been difficult to evaluate since they include a few hundred dollars in cash below the dealer's cost; a semi-fictitious allowance for advertising contribution with favored leasing companies; a guaranteed repurchase price;²⁰ preferential processing of reimbursement for warranty parts and labor; preferential resale value through recommencement of the warranty period at the time of resale; and preferential floor-plan financing of such cars when repurchased. Although the "Big Three" have now renounced such subsidies commencing with the 1971 model year, such action is a clear admission of past practices, contains no assurance against such back-sliding as oc-

¹⁶ See Car Dealers Newsletter, Aug. 24, 1970.

¹⁷ See Brown 84 et seq.; FTC Staff Report on Automobile Warranties (1968).

¹⁸ See FTC Staff Report, note 17 *supra*, outlining the increasing shortage of skilled workers and the industry's unpreparedness for a 50 percent increase in annual production from 1965 to the present. The scope of the dealer's predelivery obligations may also affect questions of product liability to the consumer. See *Necktas v. General Motors Corp.*, 1970 Mass. Adv. Sh. 843, 259 N.E.2d 234.

¹⁹ *Semmes Motors, Inc. v. Ford Motor Co.*, 429 F.2d 1197 (2d Cir. 1970).

²⁰ One factory utilizes a six-month lease, rather than a sale and repurchase guarantee, though each method is economically equivalent.

curred a decade ago, and does not precisely disclose whether all forms of the subsidy will be discontinued.

Again, because 10 percent of all vehicles are sold at discount to the leasing and fleet buyers, the general public has to make up for such subsidies. For example, when such vehicles are resold each six months, their prices are usually far below the market value for comparable used cars. Every car owner thus loses some value on his trade-in, thereby paying his pro rata share of the subsidy to preferred buyers.

In daily operations, each dealer is perhaps most concerned with the finished product received from the factory. At one end of the spectrum, favored dealers may receive unfair allotments of the most desirable merchandise. Conversely, the factory may seek to unload excessive production in certain lines, mistakes in production²¹ and vehicles "loaded" with high-profit extra equipment; or it may merely seek to guarantee early distribution of the entire end-run in a model year.²²

As for parts, accessories and supplies, this seldom-discussed subject may well involve more problems than any other area, hinged on the obvious fact that each manufacturer has a pre-emptive position on replacements for its own products. Here again, there can be extremes at both ends, with some manufacturers insisting that the dealer carry an excessive inventory and at least one manufacturer having deliberately failed to provide any replacement parts for the 1970 models until six months into the year, having opted to devote all production to new vehicles.²³ Capricious price changes during the model year have left dealers with higher priced parts, with only a theoretical chance to avoid losses through a cumbersome return procedure. For many parts, accessories and supplies, the manufacturers exercise varying degrees of pressure to compel or induce their dealers to purchase from the factory even though alternate sources of supply are equally available. Perhaps worst of all, each manufacturer has an extensive list of "captured" parts, items which can be purchased only from the factory even though manufactured by third parties. Suffice it to say that this particular subject is so complex and rampant with competitive abuse that the FTC is in the process of an extensive survey to sort out its ramifications, particularly in relation to the independent body repair shops.²⁴

Both as to the vehicles and parts so supplied by the factories, the dealers are obviously helpless except to pass on to the consumers the

²¹ See Louis, Chrysler's Private Hard Times, *Fortune*, Apr., 1970, at 102, particularly with reference to the several thousand luxury models erroneously manufactured with standard shifts.

²² This is accomplished by requiring all closing orders for the model year to be received by May 1, with the dealer taking the risk of unwanted styles, etc., or else foregoing a normal supply for inventory.

²³ See *Car Dealers Newsletter*, May 26, 1969, at 3.

²⁴ See 1970 Trade Reg. Rep. ¶460 at 9-10, outlining statement of Mar. 18, 1970, by FTC Chairman Caspar W. Weinberger to U.S. Senate Subcommittee on Antitrust and Monopoly; see *FTC v. Parts, Inc.*, 1970 Trade Cas. ¶19,336.

same conditions as the factories impose on the dealers. When consumers complain of having to buy models "loaded" with expensive accessories or to pay ever-increasing charges for repair parts, the dealer can hardly be blamed when he is merely a conduit.

Although not so readily visible, the more basic complaints emanate from "capital" matters, each of which relates directly to the dealer's equity in his business. The extremity of the factory's disdain is reflected in the legislative statement presented by General Motors in opposition to this very legislation, in which it simply declared that the factory designs, engineers and manufactures the vehicle; delivers a complete product; teaches the dealer how to advertise, merchandise and service the car; makes available financing for floor-planning and consumer credit; provides an express warranty to the consumer; trains mechanics, develops repair equipment, provides repair manuals and supplies the parts; and thus performs every service comprised in the term "goodwill." It therefore concluded that any recognition of a dealer's goodwill would constitute a complete windfall.

While conceding such contributions of scale, basic to the entire concept of franchising, it would seem evident that the factory is compensated for its efforts in annual net profits that exceed one billion dollars. It is also offensive to common sense to evaluate at zero the dealer's capital investment in physical facilities; purchase of product on a C.O.D. basis; molding of an efficient work force of salesmen, mechanics and administrative personnel; local advertising; servicing of a clientele by honest selling and efficient servicing; and survival in a highly inter- and intra-competitive market.

This dichotomy is basic to an appraisal of the factory's unlimited right to terminate or fail to renew a dealership; its outright prohibition against a dealer's making a charge for goodwill in the sale of his dealership; the imposition of any unreasonable restraint on the dealer's right to sell, transfer or capitalize his dealership; and the extent to which a dealer may be subjected to competition in the relevant market area either by a factory-owned retail outlet or by the factory's granting of a competing dealership. To the extent that franchisees are led or are entitled to believe that their ultimate efforts are directed to "building a nest egg," all such competitive factors can only lead to frustration. To fully comprehend the immediate impact of such pervasive control, it should be emphasized that the implicit threat of their potential use is indeed sufficient to arrogate to the franchisor day-to-day superiority in all dealings with its franchisees.

On the whole, it would seem evident that fair dealing between the factory and the dealer on such capital matters would not directly impinge on consumers' protection. To the contrary, by guaranteeing reasonable security, continuity and independence for the dealers, it would result in economic stability enhancing the dealers' ability to fulfill their customers' requirements.

Rather than attempt the impossible task of presenting all the laws

which governed this relationship prior to enactment of the Massachusetts law, perhaps it may suffice to review them descriptively, with punctuated analysis of certain highlights.

At common law, it was fairly well established that mere termination or failure to renew a dealership was not actionable so long as the contractual terms were observed.²⁵ Such cases reflect the standard common law view that there is no "good faith" obligation in the performance of a contract.²⁶ Yet without much discussion of its radical departure from that view, a recent Massachusetts case awarded damages for the "bad faith" termination of an exclusive territorial distributorship where secret negotiations for a sale in the dealer's territory had commenced prior to the termination.²⁷ As stated earlier, it has been suggested that the Uniform Commercial Code might be the source of relief in its requirements of "good faith" and "conscientiousness" in contracts for the supplying of all a buyer's requirements and the standard of "best efforts" by a seller in exclusive dealing requirements²⁸ as well as "reasonable notice" before termination of such arrangements.²⁹

In the realm of federal law, almost every one of the dealer's complaints may eventually be found to constitute a violation of the anti-trust laws, the Federal Trade Commission Act, or the Auto Dealers' Day in Court Act.³⁰ Unfortunately, the basic statutes are hardly revealing on their face, their full development having been left almost entirely to evolution by case law.³¹ Although several pending cases will determine whether various auto factory practices constitute actionable violations,³² final determinations may be a decade or more

²⁵ *Ford Motor Co. v. Webster's Auto Sales, Inc.*, 361 F.2d 874 (1st Cir. 1966); *Ford Motor Co. v. Kirkmyer Motor Co.*, 65 F.2d 1001 (4th Cir. 1933); see Brown 79 n.4; for one of the most recent cases (gasoline station dealer), see Division of Triple T Service, Inc. v. Mobil Oil Corp., 60 Misc. 2d 720, 304 N.Y.S.2d 191 (1969).

²⁶ *Graf v. Hope Bldg. Corp.*, 254 N.Y. 1, 171 N.E. 884, 70 A.L.R. 984 (1930); 9 Williston, Contracts §1017A (3d ed. 1957); 5A Corbin, Contracts §1229 (1964); Hewitt, Termination of Dealer Franchises and the Code, 22 Business L. 1075 (1967).

²⁷ *RLM Associates, Inc. v. Carter Mfg. Corp.*, 1969 Mass. Adv. Sh., 248 N.E.2d 646.

²⁸ UCC §§2-302, 2-306.

²⁹ *Id.* §2-309(2)(3); see Leff, Unconscionability and the Code—The Emperor's New Clause, 115 U. Pa. L. Rev. 485 (1967); see Hewitt, Termination of Dealer Franchises and the Code, 22 Business L. 1075 (1967).

³⁰ *Ibid.*

³¹ For discussion of these laws as applied to franchising, see Brown 45-69, and particularly as to the automobile industry at 77-86; The Franchising Sourcebook (2 Pract. L. Inst. Commercial Law and Practicing Sourcebook Series, J. McCord ed. 1970); The Realities of Franchising: A Guide for the Practicing Attorney (Mass. Continuing Legal Education, Inc. ed. 1970); Primer on Unlawful Restraints in Marketing and Distribution Proc. N.E. Antitrust Conf. (1967). For general discussion of antitrust laws, see 36 A.B.A. Antitrust Section 63 (1968); Van Cise, Understanding the Antitrust Laws (Pract. L. Inst. rev. ed. 1970).

³² E.g., resale price maintenance arising from compulsory discounts through inadequate warranty reimbursement; compulsory forfeiture of goodwill without fair compensation through restraints on alienation; discrimination in price and

away.³³ As for the 15-year-old Auto Dealers' Day in Court Act,³⁴ its requirement of "good faith" in performance or in the termination or nonrenewal of the franchise³⁵ was almost completely emasculated through the statutory definition of "good faith" solely in terms of "coercion, intimidation or threats [of either]."³⁶

Relating these federal statutes to Massachusetts, only recently there was enacted a so-called "Baby" FTC Act using the precise terminology of the federal statute and importing its interpretation by rulings of the Federal Trade Commission as well as the federal courts.³⁷ Even as the federal statute is administered solely by the commission with no direct right of relief, the administration of the Massachusetts version was originally confined to the attorney general both through rule-making power and through court suits.³⁸ In 1969, that highly remedial legislation was broadened by granting a direct right of enforcement to consumers, providing for injunctive relief, class actions and damages, including reasonable attorney's fees, double damages and even triple damages in aggravated cases.³⁹

It is against this resumé of the factual, economic, common law and statutory background that the new Massachusetts statute must be appraised. For it will be seen that, in essence, the statute has codified what existing law may very well ultimately be determined to have been, not only in the realm of "good faith," but more particularly in the proscriptions of Section 5 of the Federal Trade Commission Act and its Massachusetts counterpart, concerning "unfair methods of competition" and "unfair or deceptive acts or practices."⁴⁰

In its general pattern, the new auto dealers' statute is basically an extension of the "Baby" FTC Act,⁴¹ with further specification of practices which will constitute "unfair methods of competition." After

service allowances involved in subsidies; boycott through restrictions on "captured" parts; exclusive supply tying sales, full-line forcing and excessive quotas; barring of competitive products; and any one or more of these singly or in combination being sufficient to constitute a "combination in restraint of trade" (§1 of Sherman Act, 15 U.S.C. §1 (1964)); an exclusive supply contract (§3 of Clayton Act, 15 U.S.C. §14 (1964)); a discriminatory practice under the Robinson-Patman Act (15 U.S.C. §13 (1964)); or an "incipient" violation of any of the federal antitrust laws and thus a violation of §5 of the Federal Trade Commission Act prohibition of "unfair methods of competition" (15 U.S.C. §45(a)(1) (1964)).

³³ After 12 years of litigation and two favorable rulings by the Supreme Court, the Simpson case has just reached a conclusion through settlement. *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964). Such attrition through litigation defies the imagination, let alone the expense and delay.

³⁴ 15 U.S.C. §§1221-1225 (1964).

³⁵ *Id.* §1222.

³⁶ *Id.* §1221(e); see *Brown* 79-82.

³⁷ G.L., c. 93A.

³⁸ *Id.* §2c, 4-8.

³⁹ *Id.* §§9-10.

⁴⁰ 15 U.S.C. §45(a)(1) (1964); G.L., c. 93A, §2(a).

⁴¹ G.L., c. 93A.

sections on definitions⁴² and "long-arm" jurisdiction over nondomiciliaries,⁴³ the act restates the prohibitions of the Federal Trade Commission Act,⁴⁴ the power of courts to rely on the interpretations of the federal statute,⁴⁵ and the grant to the attorney general of rule-making power consistent with FTC and federal court interpretations of the Federal Trade Commission Act.⁴⁶ It is thus made incumbent upon counsel to become familiar with the whole line of activity under the Federal Trade Commission Act, including not only cease and desist orders and court rulings on FTC injunction suits but also regulations and advisory opinions issued by the FTC.

Although the Federal Trade Commission Act is not technically part of the antitrust laws,⁴⁷ the commission may use as guidelines recognized violations of such statutes.⁴⁸ The definition of "unfair methods of competition" is nevertheless flexible, may be adapted through consideration of the myriad of business practices,⁴⁹ and may be used to proscribe antitrust violations which are only incipient.⁵⁰

Of equal importance is the second portion of the Federal Trade Commission Act declaring unlawful "unfair or deceptive acts or practices."⁵¹ Although this standard has been primarily employed against deceptive advertising of products and services, of late it has been effectively used in franchising, not only against deceptive advertising in the sale of franchises,⁵² but more recently to attack fraudulent practices of franchisees toward consumers, including a claim that the franchisor is responsible for the program.⁵³

In view of the regulation-making authority granted to the attorney general both under the "Baby" FTC Act and the Auto Dealers' Act, it may well be appropriate to recommend that he consider the pro-

⁴² *Id.*, c. 93B, §1.

⁴³ *Id.* §2; see also G.L., c. 223A (Mass. "long-arm" statute).

⁴⁴ *Id.*, c. 93B, §3(a), incorporating 15 U.S.C. §45 (1964).

⁴⁵ G.L., c. 93B, §3(b).

⁴⁶ *Id.* §3(c).

⁴⁷ See 15 U.S.C. §12 (1964).

⁴⁸ *Atlantic Refining Co. v. FTC*, 381 U.S. 357, *rehearing denied*, 382 U.S. 873 (1965).

⁴⁹ *FTC v. Colgate-Palmolive Co.*, 380 U.S. 374 (1965); *LaPeyre v. FTC*, 366 F.2d 117 (5th Cir. 1966); *Shell Oil Co. v. FTC*, 360 F.2d 470 (5th Cir. 1966), *cert. denied*, 385 U.S. 1002 (1966); *Sperry and Hutchinson Co. v. FTC*, 432 F.2d 146 (5th Cir. 1970).

⁵⁰ *FTC v. Brown Shoe Co.*, 384 U.S. 316 (1966).

⁵¹ 15 U.S.C. §45(a)(1) (1964).

⁵² See *Meal or Snack System, Inc.*, 1969 Trade Cas. ¶18,671 (fast food); *Success Motivation Institute, Inc.*, 1970 Trade Cas. ¶19,306 (academy). See also May 1969 legislative statement of FTC General Counsel Everette MacIntyre: "[N]ot only must the franchisor give [to a prospective franchisee] accurate information about his franchise system but . . . he also has the affirmative duty to reveal any unfavorable news concerning his system" (such as pending lawsuits or FTC actions, or the fact that the franchisor competes in his own systems). 1969 Trade Reg. Rep. ¶50,240.

⁵³ *Aamco Automatic Transmissions, Inc.*, 1970 Trade Reg. Rep. ¶19,283.

mulgation of specific standards for disclosure by all franchisors to prospective franchisees, modeled on the detailed prospectus disclosures prescribed in a recent California statute⁵⁴ and proposed in federal,⁵⁵ New York⁵⁶ and Massachusetts legislation.⁵⁷ Such regulations could go further to require prior filing with the attorney general. There is ample precedent for such advertising regulations in the extensive exercise of such powers by the FTC.

It should be noted that this incorporation by reference of all the antitrust and federal trade decisions under the federal acts is not limited to decisions in the automobile industry. Fortunately, most appellate decisions in this field are quite lengthy in their recapitulation of prior decisions, so that a review of the more recent Supreme Court decisions in various categories will go far toward coverage of the field.⁵⁸

⁵⁴ Chapter 1400 of Cal. 1970 Laws, amending §10177 of the Business and Professions Code, prospectively amending §§25019 and 25212 of the Corporation Code, and to add division 5 (commencing §31000) to title 4 of the Corporation Code.

⁵⁵ S. 3844, 91st Cong., 2d Sess. (1970), sponsored by New Jersey Senator Harrison A. Williams, Jr. Although the bill may not receive consideration in the pending session, its reintroduction has been predicted.

⁵⁶ S. 3188 (Feb. 10, 1969); S. 8403B and 5767B (Feb. 17, 1969); and S. 4726 (Feb. 20, 1969), all of which failed of passage. The Committee on Licensing Franchising has held three hearings in 1970 with a view toward submission of new proposals in the 1970-1971 legislative sessions.

⁵⁷ House Bill 2279 (1970); a similar proposal is to be submitted to the 1971 session.

⁵⁸ See *Albrecht v. Herald Co.*, 390 U.S. 145 (1968) (in addition to fixed and minimum pricing, resale price maintenance encompasses maximum pricing); *United States v. General Motors*, 384 U.S. 127 (1966) (combination of factory and dealers in restraint of trade); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) (per se violation to impose any customer or territorial restraint on alienation of goods purchased by dealers); *United States v. Sealy, Inc.*, 388 U.S. 350 (1967) (horizontal (dealers) and vertical (with factory) territorial limitations); *Klor's Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959) (boycott by wholesaler, regardless of quantity); *Fortner Enterprises, Inc. v. U.S. Steel Corp.*, 394 U.S. 495 (1969) (extension of credit as tying product; see dissent regarding use in franchising); *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958) (per se tying violation, land as tying product); *FTC v. Brown Shoe Co.*, 384 U.S. 316 (1966) (incipient violation by major manufacturer in requiring preferential purchases of its goods by dealers); *Atlantic Refining Co. v. FTC*, 381 U.S. 357, *rehearing denied*, 382 U.S. 873 (1965) (kickbacks obtained from third party vendors of tires, batteries and accessories); *FTC v. Texaco, Inc.*, 393 U.S. 223 (1968) (kickback from third party vendors prohibited; even in absence of overt direction, dealer induced through dominant economic power); *FTC v. Fred Meyer, Inc.*, 390 U.S. 341 (1968) (price discrimination where retailers cannot obtain same quantity discounts or allowances as "wholesaler-retailer"); *Perkins v. Standard Oil Co. of Calif.*, 395 U.S. 642 (1969) (damages for price discrimination; liability through several corporate distributor layers); *Perma Life Mufflers v. Intl. Parts Corp.*, 392 U.S. 134 (1968) (unclean hands no defense); *Susser v. Carvel Corp.*, 332 F.2d 505 (2d Cir. 1964), *cert. denied as improv. granted*, 381 U.S. 125 (1965) (in extreme circumstances, franchisor's exclusive supply and tying sales might be justified, i.e., not a per se violation); *Siegel v. Chicken Delight*, 311 F. Supp. 847 (N.D. Cal. 1970) (franchisor's tradename as tying product; failure to sustain burden of proving that specifying tied products for purposes of sub-

Although the Federal Trade Commission Act does not provide a forum for private litigants in adversary proceedings, the "Baby" FTC Act of Massachusetts has recently been amended to grant such rights to consumers⁵⁹ and the Auto Dealers' Act confers identical rights on motor vehicle dealers.⁶⁰ Both of these classes of private litigants have thus achieved broader private rights than are presently obtainable under the federal acts.⁶¹

The real innovations of the Massachusetts act are then provided in a further refinement of the Federal Trade Commission Act prohibitions, as described in the following subsections:⁶²

(1) This subsection prohibits a manufacturer or an auto dealer from engaging "in any action which is arbitrary, in bad faith, or unconscionable and which causes damage to any of said parties or to the public."⁶³ For the very first time, these equitable principles are now expressly the standard under which the factories and dealers must conduct themselves. If they appear rather broad, it should be understood that courts have always avoided specific definitions in order to prevent ingenious means of evading the high standard of conduct which these terms require.⁶⁴

stitution was too complex); *Semmes Motors, Inc. v. Ford Motor Co.*, 429 F.2d 1197 (2d Cir. 1970) (because of uniqueness of asset, issuance of temporary injunction against termination does not depend on demonstration of likelihood of success); cf. *Miller Plymouth Center, Inc. v. Chrysler Motors Corp.*, 286 F. Supp. 529 (D. Mass. 1968). Significantly, in the last 12 antitrust appeals, the Supreme Court has reversed the United States courts of appeals, grounding the assertion of dynamic developments for the protection of the injured party.

⁵⁹ G.L., c. 93A, §§9-10.

⁶⁰ Id., c. 93B, §12, specifically incorporating by reference §§9 and 10 of Chapter 93A.

⁶¹ In the only such decision to date, the First Circuit Court of Appeals has permitted the use of a final FTC cease and desist order as evidence of violation in a private damage suit (*Farmington Dowel Products Co. v. Forster Mfg. Co.*, 421 F.2d 61 (1st Cir. 1970); *Lee Natl. Corp. v. Atlantic Richfield Co.*, 308 F. Supp. 1401 (E.D. Pa. 1970), *aff'd.* — F.2d — (3d Cir. 1970), 1970 Trade Cas. ¶73,093, *petition for cert. denied*, 400 U.S. 940 (1970) (whether TBA sales commission plan had been held antitrust violation or merely violation of §5 of Federal Trade Commission Act in *Atlantic Refining Co. v. FTC*, 381 U.S. 357, *rehearing denied*, 382 U.S. 873 (1965)). Under even more stringent conditions, pending federal legislation would grant direct rights to consumers under the Federal Trade Commission Act (S. 3074 and H.R. 18056, 91st Cong., 2d Sess. (1970)).

⁶² G.L., c. 93B, §4, numbered and lettered as in the text.

⁶³ The dealers' obligations to the manufacturer should be considered in the light of *Semmes Motors, Inc. v. Ford Motor Co.*, 429 F.2d 1197 (2d Cir. 1970), in which the dealer was terminated for allegedly filing false warranty claims and claimed that the manufacturer illegally sought to question the dealer's customers. Strictly construing the contract against the draftsman and recognizing the imbalance of parties, the court impliedly recognized that contract could be used as weapon in unfair competition, especially if there were factory stores in the relevant market area.

⁶⁴ The extensive power of the courts to devise avenues of relief for violation of these standards are of general knowledge, including rescission, modification, restitution and damages. See Brown 41-44, including exposition of the principle

(2) This subsection prohibits a manufacturer from using coercion or attempted coercion on an auto dealer to order unwanted autos, parts or accessories (subsections (a) and (c)) or any special features not included in the publicly advertised list price of the vehicle (subsection (b)).⁶⁵

(3) In this subsection, the auto dealer is given a true "Bill of Rights" against the manufacturer, by specifically including all of the following as violations of Section 3:

- (a) refusal to deliver a vehicle within a reasonable time
- (b) coercion or attempted coercion to enter into an agreement or to do any act prejudicial to a dealer by threatening to cancel a franchise⁶⁶
- (c) without due cause, to terminate or fail to renew a franchise, including an automatic 60-day freeze subject to a court order⁶⁷
- (d) any false or misleading advertising
- (e) the sale of (or offer to sell) a new vehicle at a price below that offered to all dealers, including such indirect ruses as equipment allowances or any device such as a sales promotion plan or program (this prohibition of subsidies to leasing and fleet buyers does not apply to sales to federal or state agencies or for ultimate use in a driver education program)⁶⁸
- (f) the sale or lease of a vehicle similarly equipped, at a lower actual price than that charged to a dealer, or the use of any device to accomplish such price discrimination⁶⁹
- (g) the sale of parts or accessories at a lesser actual price than that charged to a dealer (except for sales to a genuine wholesaler for resale to retail outlets)⁷⁰
- (h) interference with the dealer's capital structure or financing,

that, because of the franchisor's pervasive power of control in complex transactions, all franchising relations are fiduciary in character; see also *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928); *Broomfield v. Kosow*, 349 Mass. 749, 212 N.E.2d 556 (1965); *RLM Associates, Inc. v. Carter Mfg. Corp.*, 1969 Mass. Adv. Sh. 1006, 248 N.E.2d 646; *Jirna, Ltd. v. Mister Donut of Canada, Ltd.* (No. 250 of 1970, decided by Superior Court of Toronto, Canada, July 28, 1970, the first reported case applying such a theory to franchising, now being appealed).

⁶⁵ This prohibition derives from antitrust cases on "tying sales," "exclusive supply," and "full-line forcing." *United States v. Loew's Inc.*, 371 U.S. 38 (1962); *Hanover Shoe, Inc. v. United Shoe Machine Co.*, 377 F.2d 776 (1st Cir. 1967).

⁶⁶ Cf. 15 U.S.C. §§1221(e) and 1222 (1964).

⁶⁷ It has been suggested that any unreasonable restraint on alienation of a franchise may constitute a per se violation under *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); see comments of Rufus E. Wilson, head of FTC Bureau of Restraint of Trade, in FTC Ad Hoc Committee Report on Franchising, Trade Reg. Rep. 444, Supp. at 48.

⁶⁸ See generally Robinson-Patman Act, 15 U.S.C. §13(a) (1964); *FTC v. Fred Meyer, Inc.*, 390 U.S. 341 (1968).

⁶⁹ *Ibid.*

⁷⁰ *Ibid.*

- subject to reasonable standards agreed by the parties and excluding any change in executive management control⁷¹
- (i) interference with the sale or transfer of a dealership, subject to the manufacturer's approval, such approval not to be "unreasonably withheld"⁷²
 - (j) obtaining any kickback from suppliers with whom the dealer does business⁷³
 - (k) competition with a dealer in the relevant market area (not applicable where an independent person has a bona fide minority interest and a reasonable expectation to acquire the entire dealership)⁷⁴
 - (l) granting a competitive franchise in the relevant market area to an independent dealer or to a bona fide minority dealer, subject to arbitration if objection is made⁷⁵ and
 - (m) requiring the dealer to assent to giving up any of his rights.

⁷¹ See note 62 *supra*.

⁷² *Ibid*.

⁷³ See *Atlantic Refining Co. v. FTC*, 381 U.S. 357, *rehearing denied*, 382 U.S. 873 (1965); *FTC v. Texaco, Inc.*, 393 U.S. 223 (1968).

⁷⁴ This provision will prohibit a franchisor from directly competing with its own franchisee. Although this prevalent practice would appear of doubtful validity under the federal antitrust laws (*United States v. N.Y. Great A. & P. Tea Co.*, 173 F.2d 79 (7th Cir. 1949)), it clearly violates the general principles of equity under which any purchaser of a business is entitled to have the full benefit of his bargain. Direct competition by a franchisor at the same economic level as its franchisees is pregnant with every type of economic abuse, particularly when combined with pervasive control over the activities of the franchisees. See *FTC v. Texaco, Inc.*, 393 U.S. 223 (1968). When the factory operates a "company" store and subsidizes its operating retail losses by capital gifts, free loan of executives and advertising allowances, it has been held that "predatory price-cutting in one locality, subsidized by adventitious resources," could constitute an attempt or conspiracy to monopolize under §2 of the Sherman Act (15 U.S.C. §2 (1964)). *Mt. Lebanon Motors, Inc. v. Chrysler Corp.*, 283 F. Supp. 453, 459 (W.D. Pa. 1968), *aff'd*, 417 F.2d 622 (3d Cir. 1969). See denial of "fair trade" exemption from Sherman and Robinson-Patman Acts in case of dual distribution (15 U.S.C. §§1, 13 (1964)).

⁷⁵ This paragraph would prohibit a secondary aspect of such competition where the franchisor swamps a given territory with an excessive number of franchises. When a franchisor sells a franchise, the buyer should be given a reasonable opportunity to succeed, dependent on competition with independent third persons, but free from competition provided directly or indirectly by his own franchisor. In contrast with the strict construction of a former employee's express covenant not to compete, equity will even imply such a covenant to protect the buyer of a business from the seller's competition (*Tobin v. Cody*, 343 Mass. 716; 180 N.E.2d 652 (1962)). Under antitrust law, where the dealer is adequately serving the relevant market area, it may be suggested that the granting of a new dealership would constitute a combination by the factory and the new dealer in restraint of trade under §1 of the Sherman Act (15 U.S.C. §1 (1964)); see *Gamco, Inc. v. Providence Fruit Produce Bldg.*, 194 F.2d 484 (1st Cir. 1952) (combination by lessor and produce dealer to exclude another such dealer from the local produce market in Providence, R.I.); *Braun v. Berenson*, 432 F.2d 539 (5th Cir. 1970); *United States v. General Motors*, 384 U.S. 127 (1966) (classical resale price maintenance conspiracy between automobile factory and several Los Angeles dealers directed toward other local dealers; a fortiori where the offending dealership is owned or controlled by the factory).

- (4) This subsection prohibits a motor vehicle dealer from:
- (a) requiring a purchaser to buy equipment or accessories not desired or requested, unless such features were already installed when the car was received by the dealer and the customer was so informed
 - (b) representing as a new car any demonstrator or otherwise used vehicle and
 - (c) using false or misleading advertising.⁷⁶

It should readily be seen that each of these statutory provisions relates directly to the serious complaints of all dealers against practices which may already constitute anticompetitive practices under the antitrust laws and other federal acts, but as to which express rulings have not yet materialized. As with other anticompetitive regulations, these standards are to be applicable regardless of any contractual provisions, the Supreme Court having repeatedly ruled that, in interpreting the antitrust laws, "we must look at the economic reality of the relevant transactions."⁷⁷

The remaining substantive provisions of the act concern predelivery and warranty matters. Under Section 5, the manufacturer must specify the dealer's delivery and preparation obligations together with a compensation schedule. Copies must be delivered to the attorney general; the compensation must be reasonable; and the work shall constitute the limit of the dealer's product liability as between the dealer and the manufacturer. Unless so specified, the dealer need not do any necessary work and, presumably, can refuse to accept a vehicle requiring other work. This provision will clearly define the dealer's obligations on finishing the manufacturer's work and will assure full and fair compensation.

As to warranty work, under Section 6, the manufacturer must properly fulfill its warranty agreement, including adequate and fair compensation to the dealer for labor and parts.⁷⁸ Claims must be acted

⁷⁶ These specific protections for automobile buyers should be considered in the general context of the extensive rights granted in 1969 to all consumers under §§9 and 10 of the "Baby" FTC Act, G.L., c. 93A, the remedial provisions of which have been substantially and rather surprisingly ignored. Reference should also be made to the newly enacted amendment to §2-316 of the Uniform Commercial Code (G.L., c. 106) denying both to any seller or manufacturer the right to limit implied warranties to consumers (Acts of 1970, c. 90, discussed in Chapter 9 *infra*). Even now, the FTC and state legislatures are investigating the abuse of express warranties to deny consumers the substantial benefit of their bargain. See proposed Consumer Warranty Act of 1970, H.R. 18056 and S. 3074, 91st Cong., 2d Sess. (1970), 1970 Trade Reg. Rep. ¶486 at 8. See proposed FTC trade regulation rule covering new car pricing practices of manufacturers and dealers in support of Automobile Information Disclosure Act (1970 Trade Reg. Rep. ¶488 at 4).

⁷⁷ *United States v. Phosphate Export Assn.*, 393 U.S. 199, 208 (1968).

⁷⁸ The 1968 amendment to the Tennessee Motor Vehicle Sales License Act (Chapter 426 of Pub. Acts 1968, c. 426, adding §§59-1714(h)(5) to Tenn. Code Ann. ch. 17) requiring that the labor rate for warranty reimbursement be no less

on within 30 days, with specification of grounds if rejected. Claims under this section and under Section 5 (for predelivery work) must be paid within 30 days of approval. This section should eliminate most of the dealers' complaints as to inadequate compensation, endless delays in approval, and cash payment rather than long waits or even having to look to the customer for payment. Perhaps more so than any other provision, these requirements will be aided by the general prohibition of arbitrary, bad faith or unconscionable conduct in Section 4(1).

Before proceeding to the numerous and important adjective provisions, it is fair to comment that the very length of these specific prohibitions is ample reflection of the principal claims of abuse which auto dealers, as well as franchisees in general, have raised against their franchisors. Although it is not possible to legislate specifically on every existing or potential opportunity for abuse,⁷⁹ the generic requirements of the statute remain as standards to be vigorously applied by the courts. As for auto dealers in particular, the Massachusetts statute is in sharp contrast with the elusive relief which had supposedly been provided fifteen years earlier by federal legislation.⁸⁰

As distinguished from the foregoing substantive regulation of competitive practices, Sections 7 through 11 prescribe specific areas in which all contract dealings between the auto factories and their dealers are subordinated to such competitive principles, even including an express declaration of that public policy in Section 13. To counterbalance the gross disparity of the parties, Section 7 prohibits unreasonable restrictions on numerous general matters, including transfer, sale, right to renew, termination, discipline, noncompetition covenants, site control and other sources of leverage which have individually and in concert consigned franchisees to subservience. Section 8 specifically extends the statute to all dealings between the

than that charged to a retail customer, is presently under constitutional attack by the "Big Three" and International Harvester Co., *Ford Motor Co. v. Noles*, Civil No. 5056 (C.D. Tenn., filed Apr. 29, 1968); *Chrysler Motor Corp. v. McCanless*, Civil No. 5065 (C.D. Tenn., filed May 10, 1968); *General Motors Corp. v. Tennessee Motor Vehicle Commn.*, Civil No. 5107 (filed Apr. 29, 1968, in W.D. Tenn. as case No. C-68-112; transferred to C.D. Tenn. June 21, 1968); *International Harvester Co. v. McCanless*, Civil No. 5078 (filed Apr. 18, 1968 in E.D. Tenn. as Civil No. 5255, transferred to C.D. Tenn. May 22, 1968).

⁷⁹ The abuse of quotas ("MSR" for "minimum sales requirements") as a standard for termination would come into question as to reasonableness under the requirement of "due cause" for any cancellation or failure to renew a dealership. See *Mt. Lebanon Motors, Inc. v. Chrysler Corp.*, 283 F. Supp. 453 (W.D. Pa. 1968), *aff'd*, 417 F.2d 622 (3d Cir. 1969), involving a claim that the MSR for all dealers was so high that almost none could satisfy the quota requirements. Under general antitrust principles, any termination in aid of any violation of such laws, would itself be actionable. See also *Amplex of Md., Inc. v. Outboard Marine*, 380 F.2d 112 (4th Cir. 1967), *cert. denied*, 389 U.S. 1036; Wade, *Some Antitrust Problems in Terminating Franchises*, 44 St. John's L. Rev. 23 (1969).

⁸⁰ See 15 U.S.C. §§1221-1225 (1964) and comment in Brown 79-82.

parties ranging from the "franchise offering"⁸¹ to all agreements of any nature.

To avoid any possible doubt, Section 9 provides that if, without due cause, the manufacturer fails to renew a dealership, terminates, or restricts a transfer, the dealer must "receive fair and reasonable compensation for the value of the business." As simple as the justice of this formula would appear, it will bring to an end the incredible practice of the manufacturers in not only ignoring the dealer's contribution to the goodwill of the dealership, but even prohibiting the dealer from making a charge for such value. "Goodwill" is universally recognized as a very real, though intangible, asset of any going business. This section will go far to protect that valuable asset if the manufacturer acts "without due cause."

Under Section 10, dealers are given the right of free association for any lawful purpose, thus providing substantial approval for independent collective bargaining activity. The right to associate, to select a collective bargaining agent, and to negotiate with franchisors is based on principles established in both federal and state labor relations acts. Although similar types of associations have been held an illegal combination of independent businessmen in restraint of trade by some lower courts or agencies,⁸² it would appear essential to encourage such relationships. Among other anticompetitive problems, one of the more prominent is that of an illegal boycott.⁸³ But as in labor relations, it would seem impossible to legislate for every conceivable business, and litigation does not provide a suitable remedy for a dynamic and continuing joint enterprise. If necessary, an exemption from the antitrust laws may be called for, as was done for the handling

⁸¹ Factually, the disclosures in this article create serious doubt as to whether there has been full disclosure in the grant or renewal of automobile dealerships. Aside from the new statutory prohibition of "unfair or deceptive practices" (G.L., c. 93B, §3(a)) and the broad definition of "fraud" (G.L., c. 93B, §1(m)), this specific reference to the "franchise offering" expressly lays the foundation for antifraud protection for prospective franchisees similar to that presently afforded to a purchaser of a security under the federal securities acts (15 U.S.C. §§78a et seq. (1964), particularly 15 U.S.C. §78j(b) and SEC Rule 10b-5, 17 C.F.R. §240.10b-5) and to franchisees in general under the recently enacted California statute (note 54 *supra*) and under proposed federal legislation (note 55 *supra*). See Brown 70-76 regarding the question of whether a franchise is an "investment contract" and therefore a "security." See Goodwin, *Franchising in the Economy: The Franchise Agreement As A Security Under Securities Acts, Including 10b-5 Considerations*, 24 *Business L.* 1311 (1969). This issue is now being widely litigated; see, e.g., *Mr. Steak, Inc. v. River City Steak, Inc.*, — F. Supp. — (D. Colo. 1970), holding fast food franchise not a "security" under federal securities acts. Where the auto factory sells a fractional interest in an auto dealership under some form of a dealer development program, there would appear to be no doubt as to the applicability of SEC Rule 10b-5.

⁸² See *In re Natl. Assn. of Women's and Children's Apparel Salesmen, Inc.*, 1969 *Trade Cas.* ¶19,016.

⁸³ See *Klor's v. Broadway-Hale Stores*, 359 U.S. 207 (1959).

of labor disputes in Section 6 of the Clayton Act.⁸⁴ But even without such Congressional action, it is doubtful that the United States Supreme Court would prove insensitive to the strong public policy behind state statutes granting such basic rights.

This first legislative effort to provide a semblance of collective bargaining power for franchisees to counterbalance the dominant economic power of franchisors, and particularly of the auto giants, is in sharp contrast with the charges of common law conspiracy leveled against gasoline station dealers in California. That disaster is to be contrasted with the collective bargaining rights recently granted to the gasoline station dealers of Esso by the Swedish Labor Court, based on the franchisor's dominant economic power and the franchisees' continued dependence on the franchisor as a source of supply. Indeed, while disregarding the contractual provisions of the franchise agreement and looking to the economic substance of the franchisees' status, the NLRB has classified some franchisees as "employees" within the definition of the Wagner Act.⁸⁵

In addition to enforcement by the attorney general, each dealer is given the right to obtain damages, including attorneys' fees, double damages and treble damages for aggravated cases.⁸⁶ Specific sanction is also given for class suits, a very substantial procedure to equalize the litigation power of the parties.⁸⁷ Final orders in government proceedings are to be recognized as prima facie evidence of a violation.⁸⁸ Except in case of concealment, lawsuits must be brought within four years.⁸⁹ This is suspended while a federal or state suit is pending, but suit must then be brought within one year thereafter.⁹⁰ Of greater importance, these penalties, patterned after the federal antitrust laws, establish the strong public policy behind these anticompetitive regulations, assuring broad interpretation by the courts.

For reasons not readily apparent, on the question of subsidies, the statute exempts from the prohibition sales to the federal or state governments or any political subdivisions,⁹¹ merely requiring that, as to sales to the state or political subdivisions, the factory notify all dealers in the relevant market area and make equally available to

⁸⁴ 15 U.S.C. §17 (1964).

⁸⁵ *Mister Softee of Indiana Inc. v. Oil, Chem. and Atomic Workers Intl. Union*, 162 N.L.R.B. 22 (1966); *News Syndicate Co., Inc. v. Newspaper Guild of N.Y., Newspaper Guild*, 164 N.L.R.B. 69 (1967).

⁸⁶ G.L., c. 93B, §12, incorporating by reference §§9, 10 of Chapter 93A; see 15 U.S.C. §16(a) (1964).

⁸⁷ *Ibid.* See also Fed. R. Civ. P. 23.

⁸⁸ *Ibid.*

⁸⁹ G.L., c. 93B, §14, based on identical provisions in the federal antitrust laws, 15 U.S.C. §16(b) (1964); *Braun v. Berenson*, 432 F.2d 539 (5th Cir. 1970), 1970 Trade Cas. ¶73,333 (as to date of accrual).

⁹⁰ G.L., c. 93B, §14.

⁹¹ G.L., c. 93B, §4(3)(e).

such dealers the offer on which any inducement would be based.⁹² An interesting twist, with the "Big Three" having responded to intense dealer pressure by publicly announcing the abandonment of the discount structure for state and local governments, is that various cities, counties and states have instituted treble damage antitrust class suits against the Big Three, including prayers for injunctive relief, all complainants alleging a resale price maintenance combination.⁹³ In the face of the "classical combination" found by the United States Supreme Court when General Motors responded in similar manner against discounting dealers at the prodding of its regular dealers,⁹⁴ it may be interesting to observe the ultimate response of the Court to the claim of the dealers that continuation of the governmental subsidy would constitute quantity price discrimination against the dealers under the Robinson-Patman Act.⁹⁵ As distinguished from the earlier case, in this instance, dealers are left completely free in their pricing policies on governmental sales.

The severability clause of the enabling act⁹⁶ may be of crucial importance in view of a recent decision of the First Circuit Court of Appeals holding unconstitutional under the federal "due process" clause the retroactive application of a 1964 Puerto Rico statute prohibiting the termination of a dealership except for "just cause," a phrase of civil law import rather comparable to "good faith."⁹⁷ Ignoring the declared purpose of the legislature and the comparable penal features of the federal antitrust laws because of the strong public policy involved, the First Circuit Court of Appeals has held that law unconstitutional as applied to a pre-existing dealership that was terminable at will.⁹⁸ In so doing, the court ignored any consideration that the common law itself may have required "good faith" and that the relationship was more of a status than a contract. Although that holding has now been reversed by the Supreme Court on the ground of abstention, with mild criticism of the ambiguities in the circuit opinion, the static cloud of constitutional doubt remains.

A similar attack is now before a statutory three-judge court in Hawaii in a proceeding by General Motors to enjoin enforcement of the Hawaiian auto dealer licensing statute.⁹⁹ If these efforts should be

⁹² *Id.* §11.

⁹³ *City of Philadelphia v. General Motors Corp.*, Civil No. 70-2753 (E.D. Pa., filed Oct. 7, 1970); *City of New York v. General Motors Corp.*, Civil No. 70 Civ. 4245 (S.D.N.Y., filed Sept. 30, 1970); *Car Dealers Newsletter*, Oct. 12, 1970, at 2.

⁹⁴ *United States v. General Motors*, 384 U.S. 127 (1966).

⁹⁵ 15 U.S.C. §13 (1964).

⁹⁶ Acts of 1970, c. 814, §2.

⁹⁷ Law 75, 1964 Laws of Puerto Rico, 4th Sess. at 231.

⁹⁸ *Fornaris v. Ridge Tool Co.*, 423 F.2d 563 (1st Cir. 1970), *rev'd*, 400 U.S. 41 (1970).

⁹⁹ *General Motors Corp. v. Burns*, 316 F. Supp. 803 (D. Hawaii 1970), issuing temporary injunction and convening three-judge court, Aug. 14, 1970 (attack on federal constitutionality of Hawaii's Motor Vehicle Industry Licensing Act under the due process, equal protection and commerce clauses) (Hawaii Rev. Stat. §§437-1

successful, there will be a tragic frustration of all efforts by Congress and the states to provide protection for the close to one million existing franchisees. On the other hand, the existence of such a risk should impel prompt legislative action to safeguard all future franchisees.

Finally, the statute applies only in Massachusetts. Unless similar action is adopted under existing or future legislation either federally or by other states, there is a strong possibility that the factories can evade the impact of the law, particularly with regard to subsidies to leasing companies and fleet buyers. There are, of course, many pending and expected controls which could develop from both litigation and legislation, as well as from the impact of public opinion. For example, although there is no assurance of continuity or extent, the Big Three have now publicly announced their intention to cease all subsidies commencing with the 1971 model year. Hopefully, the Massachusetts statute may serve as a sounding board for others, both courts and legislatures.

through 437-42, as amended by Act 263, Fifth Leg. and House Bill 2112-70 signed into law June 13, 1970). The licensing system of regulating the auto industry has been used in several states (see note 5 *supra*) and it should be contrasted with the Massachusetts statute which was drafted as a further refinement of the anti-competitive practices proscribed in the "Baby" FTC Act.