Regulation of Franchising

Minn. L. Rev. Editorial Board

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Note: Regulation of Franchising

Both extolled\(^1\) and criticized\(^2\) franchising represents a significant force in the economy, accounting for approximately 134 billion dollars in annual sales—25 percent of all retail sales and over 13 percent of the gross national product.\(^3\) Moreover, franchising may encourage a desirable dispersion of control of capital resources by retarding the trend toward economic concentration in the retail sector.\(^4\) Therefore, because of the substantial effect of franchising on the economy, it is important to eliminate counterproductive practices in this form of marketing.

Although the kinds and number of abusive and destructive practices that presently exist in franchising operations are unknown, several have been identified and probably many more have yet to be exposed. The Federal Trade Commission recently began an investigation to determine whether illegal methods have been used to compel restaurant franchisees to purchase goods and services at artificially inflated prices.\(^5\) Abuses have been discovered in the form of hidden markups on capital assets and other materials that must be purchased by the franchisee from the franchisor or “approved” vendors.\(^6\) Subtle

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1. J. ATKINSON, FRANCHISING: THE ODDS-ON FAVORITE (1968). It should be noted that this book has drawn some very unfavorable comments. See SENATE SELECT COMM. ON SMALL BUSINESS, 92d CONG., 1ST SESS., THE ECONOMIC EFFECTS OF FRANCHISING (Comm. Print 1971). It has been recommended that the International Franchise Association withdraw the book from circulation because it “presents grossly inaccurate data on failure rates and would be very misleading to potential franchisees.” Id. at 66.

2. H. BROWN, FRANCHISING: TRAP FOR THE TRUSTING (1969). The author states at the outset of his recent revision of this book that he is not opposed to franchising, but that the system has serious flaws, which should be remedied. H. BROWN, FRANCHISING—REALITIES & REMEDIES vii (1973) [hereinafter cited as BROWN].

3. BROWN, supra note 2, at viii.

4. The franchise method of operation has the advantage, from the standpoint of our American system of competitive economy, of enabling numerous groups of individuals with small capital to become entrepreneurs . . . . The franchise system creates a class of independent businessmen; it provides the public with an opportunity to get a uniform product at numerous points of sale from small independent contractors, rather than employees of a vast chain. The franchise system of operation is therefore good for the economy.


6. BROWN, supra note 2, at 9. The author cites examples of exor-
forms of misrepresentation permeate the initial sale of many franchises. More than a few unsuspecting franchisees have been unpleasantly surprised to learn that to operate the business properly they must toil an average of 70 hours per week, in addition to the long hours put in by other members of their families.7

This Note will discuss the kinds of breakdowns that occur in a franchise relationship, the common-law remedies that have been applied to deal with those breakdowns, and the inability of the remedies to provide adequate relief. Similarly, the inadequacy of judicial attempts to apply existing statutory law to the franchise relationship will be discussed. The alternatives offered by the statutes of some states will then be explored to determine if they provide effective solutions to franchise problems. Finally, against this background, the Note will consider the desirability of regulation at the federal level and analyze the basic provisions that must be included in any effective federal statute.

I. GENERAL COMMON-LAW AND STATUTORY REMEDIES

Franchising is a phenomenon of the twentieth century;8 the post-World War II economic boom produced a rapid increase in this marketing method.9 Unfortunately, growth in franchise operations has outdistanced control by legislatures and courts. Except for a few recently enacted state statutes, there is very little common law or statutory law dealing with the unique problems

bitant profits some franchisors make on products that they require their franchisees to purchase: $21.50 for a spice package costing $3.00, $7.45 for chicken dip which costs $2.00, and $4.50 for a gallon of cherries normally selling for $1.50. Id. at 79-80.

7. Id. at 78. Of course, people who acquire franchised businesses differ greatly. Some purchasers are experienced businessmen with a firm grasp of the economic realities of operating a franchise. Others have always desired to own their own business but are without previous business experience. These vast differences among franchisees, which may ultimately determine the success or failure of a particular franchised operation, create problems in the drafting of effective legislation. The franchisor should not be made responsible for these differences.

8. C. ROSENFIELD, THE LAW OF FRANCHISING (1970). The years from 1910 to 1940 witnessed the growth of franchise systems. Early applications were in the automobile industry and the soft drink bottling industry.

9. Growth has continued in recent years. In 1969 franchising operations had sales of 90 billion dollars, which represented more than 20 percent of all retail sales and almost nine percent of the gross national product. By 1972 annual sales had increased to 134 billion dollars, which represented 25 percent of all retail sales and over 13 percent of the gross national product. Brown, supra note 2, at viii.
of the franchise relationship. Because of the absence of law precisely addressed to the abuses prevalent in franchising, the courts have been compelled to apply general common-law principles and those statutes that conceivably address some aspect of the franchise relationship.

A. DEFINING THE FRANCHISE RELATIONSHIP

The initial task of courts dealing with franchising abuses is to define the essential characteristics of the franchise relationship. The basic difficulty lies in the broad range of relationships that franchising entails. The franchise relationship has characteristics associated with the legal relationships of agency, employment, and independent contracting. Yet because it fits so badly into any of these traditional classifications, franchising has generally been considered sui generis. Nevertheless, the courts must continue to apply to franchise relationships the case law or statutory provisions developed with more traditional relationships in view.

B. ENTERING THE FRANCHISE RELATIONSHIP

The prospective franchisee, upon initial contact with a franchisor, will have a profusion of statistics thrust upon him. This information, willingly supplied by the franchisor, attempts to prove that success will inevitably follow if he becomes a member of the franchise group. Any unwary franchisee may easily be swept away in this flood of "sellers talk." Without any directly

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10. One view of franchising is that it is not itself an "industry" in the usual sense but a system of distribution, a technique of integrating a distribution system by contract instead of by classical chain ownership. Fels, Legal Problems in Franchising—An Overview, in BUSINESS AND LEGAL PROBLEMS OF THE FRANCHISE 7, 9 (Practicing Law Institute vol. 10, 1968). The author lists three types of franchise systems: (1) an entire retail business operation, such as a drive-in restaurant, a motel, or a car rental business; (2) a distribution system for a particular product, such as automobiles or gasoline; and (3) trademark or brand name licensing for processing plants, such as soft drink bottling plants.


12. C. ROSENFIELD, supra note 8, at 8.

13. This problem will be especially acute in those situations in which the franchisor relies heavily on the initial sale of the franchise for his profit, rather than on the continued dealing between the parties.

14. Indeed, this could be only the beginning of the franchisee'sordinate reliance on the franchisor:

This emotional dream, the desire of every American to own his own business, to be his own boss, has many pitfalls, because he is easy prey for the hot-shot promoter, and I think because the stakes are so high here, that these small businessmen very
applicable common-law or statutory regulation, the courts have been forced to apply the simple rules of fraud in the inducement of a contract when dealing with a franchisor's misrepresentations.\textsuperscript{15}

The common-law action for fraud has limited usefulness in dealing with abuses by the franchisor. It is often viewed as unsatisfactory because it affords only an "after the fact" remedy.\textsuperscript{16} In most cases when the remedy is obtained the franchise has already paid the franchise fee and may have incurred substantial losses in operating the business.\textsuperscript{17} Often, the franchisee will not even file a complaint.\textsuperscript{18} It is true that, although fraud has been difficult to prove, there has been a movement toward resolving any doubt in favor of the allegedly defrauded party.\textsuperscript{19} Intentional misstatement of a material fact upon which the franchisee relies might therefore offer the courts the opportunity to use the classical rules of deceit. But since tort recovery might be limited to cases in which the franchisee can show that the franchisor's original offer is fraudulent,\textsuperscript{20} far more effective protection would be available if an affirmative duty of full disclosure could be developed for the franchise relationship sim-

\begin{itemize}
  \item often scrape up every dime they can borrow, beg or steal . . . and put it all on one dream and hope of a franchise concept that very likely could have been misleading and misrepresentative [sic] and fraudulent.
  \item \textit{Hearings on the Impact of Franchising on Small Business Before the Subcomm. on Urban and Rural Economic Development of the Senate Select Comm. on Small Business, 91st Cong., 2d Sess. 190 (1970) (statement of John Y. Brown, Jr., president of Kentucky Fried Chicken Corp.).}
  \item Brown, \textit{supra} note 2, at 62.
  \item Id.
  \item \textit{Hearings, supra} note 14, at 595-96. California State Senator Clark Bradley gave four reasons for the failure to file complaints: (1) the typical victim is embarrassed at having been swindled and is thus reluctant to file a complaint; (2) he believes that he cannot help his cause by filing a complaint; (3) he hopes to salvage his investment, and spends more time and money trying to do so, thus incurring further losses; and (4) he feels that it is too late for recourse because of the time span between the payment of the franchise fee and the discovery of the fraud. \textit{Id.} at 597.
  \item Cf. Vasquez v. Superior Court, 4 Cal. 3d 800, 484 P.2d 964, 94 Cal. Rptr. 796 (1971) (burden of proof shifted to defendant in consumer fraud cases); Rigot v. Bucci, 245 So. 2d 51 (Fla. 1971) (precedents requiring clear and convincing evidence or another quantum of proof greater than preponderance of the evidence overruled in a case involving fraud in the sale of a publishing franchise).
\end{itemize}
ilar to the disclosure requirements in securities law. This is an area, however, in which the courts require legislative direction.

The franchise agreement could conceivably be deemed an "investment contract" within the meaning of section 2(1) of the Securities Act of 1933, and thus, subject to the registration and disclosure provisions of the securities laws. The primary issue, articulated by the United States Supreme Court in SEC v. W.J. Howey Co., is whether the franchise agreement is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promotor or a third party . . . ."25

The attempts by some courts to apply the Securities Act to franchise agreements may be viewed as a recognition of the inadequacy of more traditional remedies. The full disclosure requirements and the private enforcement provisions of the securities laws would offer the franchisee additional remedies beyond those available at common law or by the use, for example, of the antitrust statutes.26 This theory, however, has not flourished on the federal level. Nor has much optimism been in-

25. Id. at 298-99 (emphasis added).
27. See, e.g., Belhumeur v. Dawson, 229 F. Supp. 78 (D. Mont. 1964) (shareholders of corporate franchisee held not to be "security" holders
spired by the position taken by the Securities and Exchange Commission:

While the Commission has not taken the position that a franchise arrangement necessarily involves the offer and sale of a security, in the Commission's view a security is offered or sold where the franchisee is not required to make significant efforts in the operation of the franchise in order to obtain the promised return.28

This interpretation severely limits the applicability of securities law in the ordinary franchise relationship where both the franchisor and the franchisee participate actively in the venture.

The application of securities law to franchising has had only limited success at the state level. The attorney general of California has acknowledged that a franchise agreement may constitute a security within the meaning of the California Corporate Securities Law.29 While the opinion spoke of the Howey nominal involvement situation, it also contemplated an alternative, the "risk capital" situation, in which the franchisor intends to use the franchise fee to finance the goods and services he has contracted to supply.30 The latter approach disregards the amount of activity by the franchisee. But with only a few exceptions,31 the courts have not accepted this theory.32

28. Securities Act Release No. 5211 (Nov. 30, 1971). This reasoning was applied in Lino v. City Investment Co., 487 F.2d 689 (3d Cir. 1973) (franchise licensing agreement held not to be an "investment contract" within section 2(1)).


30. Id. at 127-28.

31. State ex rel. Healy v. Consumer Bus. Sys., Inc., 482 P.2d 549 (Ore. App. 1971) (franchise agreements held to be "investment contracts" where franchisor was dependent upon money paid in by its franchisees for a substantial portion of its initial capital); Hurst v. Dare To Be Great, Inc., 474 F.2d 483 (9th Cir. 1973) (applying Oregon law and following Healy).


For now at least, this court does not regard the "risk capital" theory to be so well-established as to support the conclusion that in commercial and legal circles in this nation arrangements which are not "profit-sharing" agreements or "investment contracts" are nevertheless "commonly" thought to be securities, if they fit within the scope of the "risk capital" theory.
C. The Ongoing Franchise Relationship

Many of the problems that occur after the franchise agreement has been consummated may come within the purview of the antitrust laws, under which the courts may examine the reasonableness of the controls and restrictions imposed by the franchisor in the franchise agreement. The courts have dealt with illegal price maintenance and price fixing, exclusive dealing and tying arrangements, territorial and customer restrictions, and exclusive arrangements and refusals to deal with others in a territory. Antitrust suits, however, are notoriously expensive and time-consuming. The practicing attorneys on whom the franchisee will rely for advice when contemplating the purchase of a franchise or when seeking to redress a complaint during the ongoing relationship often have little fa-

35. United States v. Sealy, Inc., 388 U.S. 350 (1967) (territorial restraints that are part of an unlawful price fixing arrangement held to be illegal per se); United States v. General Motors, 384 U.S. 127 (1966) (restraint of price competition held to be illegal when sought to be carried out by a combination or conspiracy).
36. Siegal v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971), cert. denied, 405 U.S. 955 (1972) (economic power sufficient to restrain free competition inferred from the use of tying arrangements). Contra, Susser v. Carvel Corp., 332 F.2d 505 (2d Cir. 1964), cert. dismissed as improvidently granted, 381 U.S. 125 (1965) (per se violation not found, because the franchisor did not so dominate the industry as to restrain competition).
37. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967) (territorial limitations on resales by distributors and limitations on sales by distributors to "franchised dealers" only held to be illegal).
38. Id.; Schwing Motor Co. v. Hudson Sales Corp., 138 F. Supp. 899 (D. Md. 1956), aff'd per curiam, 239 F.2d 176 (4th Cir. 1956) (franchisor allowed to exercise his independent judgment in deciding to whom to grant a franchise, but failure to renew considered illegal when it produces an unreasonable restraint of trade or a monopoly).
miliarity with federal antitrust law. Moreover, the antitrust remedy is also "after the fact," and frequently the franchisee will be insolvent or nearly so at the very time he needs to hire experienced antitrust counsel. There is not even a guarantee that the franchise will still exist. If an injured franchisee incurs substantial legal expenses, in addition to his operational losses, his successful antitrust litigation may be a Pyrrhic victory, since the defeated franchisor may be forced into bankruptcy by a treble damages judgment. On the other hand, if the franchisee does not obtain legal representation, he suffers his operating losses without possibility of recovery. It must be concluded that the antitrust laws, which do not even reach many significant franchise abuses, are ineffective in dealing with the problems encountered in the franchise relationship.

D. TERMINATING THE FRANCHISE RELATIONSHIP

Perhaps the most flagrant of all franchise abuses to which the franchisee is subject is the unjust nonrenewal or termination of the franchise relationship. Since the franchise agreement is a form contract prepared by the franchisor, and since there is no equality of bargaining power between the parties, the contract provisions are certain, to favor the franchisor. The equities in favor of the terminated franchisee are often substantial. The amount of time and money he has invested in his franchise operation may be sizable, but he may receive little or nothing for his business upon termination. The mere threat of termination may be effectively employed to force him to

39. "Franchisors rely strongly on this deficiency by going through the motions of advising a franchisee to 'consult an attorney' and they deliberately rely on the high cost of litigation to flout federal statutes." Brown, supra note 2, at 149.
40. See Loveland, Franchise Regulation: Ohio Considers Legislation to Protect the Franchisee, 33 Ohio State L.J. 643 (1972).
41. "The antitrust laws do not apply to franchisor misrepresentations, to the sale of a franchise by a bankrupt franchise company or one run by criminals, or to restrictions dealing with the transfer, renewal or termination of the franchise." State Legislation, supra note 34, at 536.
42. Senate Select Comm. on Small Business, 92d Cong., 1st Sess., The Economic Effects of Franchising 269 (Comm. Print 1971).
43. Rosenfield, Franchising and the Lawyer, 42 Fla. B.J. 17 (1968). The author concludes that if a franchisor "is willing to give away any part of its basic contract, it can only indicate a fatal weakness in the structure and philosophy of the company." Id. at 22.
44. It has been argued that the franchisee obtains a proprietary interest in the franchise and upon termination he deserves some compensation for this interest. Brown & Cohen, Franchise Misuse, 48 Notre Dame Law. 1145 (1973).
agree to the franchisor's demands even when it is not in his best interests. Yet the courts have had to struggle to offer a terminated franchisee a measure of relief.45

Professor Williston declared that in every contract there exists an implied covenant of good faith and fair dealing.46 Borrowing from the so-called Missouri doctrine of agency law,47 some courts have held, in effect, that if the franchise investment is substantial and the relationship is established for an indefinite duration, it cannot be terminated until after a reasonable period of time has elapsed.48 One commentator has suggested that when the termination of a franchise is discriminatory, the concepts of waiver49 and estoppel50 could be used to give relief. Article Two of the Uniform Commercial Code has even been proposed as a source of suitable remedies for unjust franchise terminations.51 Other commentators have sought to impose fiduciary duties upon the franchisor,52 and at least one court has adopted this theory in dealing with a franchise termination.

45. Gellhorn, supra note 20, at 468. Despite compelling evidence of gross inequity in franchise terminations, courts often invoke "freedom of contract" and hold the franchisor's conduct to only minimum levels of fairness.


47. Gellhorn, supra note 20, at 479-80.

48. What a reasonable time is depends upon the circumstances in a particular case. Among the circumstances to be considered in determining reasonable time are: The amount of preliminary and promotional expenditures, the length of time the distributorship has been in operation before notice of termination, what the prospects for forfeiture profits are, and whether it has proven profitable during actual operation. General Tire & Rubber Co. v. Distributors, Inc., 253 N.C. 459, 472, 117 S.E.2d 479, 489 (1960).

49. A franchisor could be deemed to have waived the right to terminate if the condition in the contract has not been previously enforced. Gellhorn, supra note 20, at 468.

50. A franchisor who dispenses with the performance of a contract condition could be deemed estopped from subsequently asserting that condition, if it is reasonably foreseeable that the franchisee would change his position in reliance. Id. at 487.

51. Article Two could be considered applicable by analogy to franchise agreements, to effectuate the basic policies of simplifying, clarifying, and modernizing commercial transactions. Comment, Article Two of the Uniform Commercial Code and Franchise Distribution Agreements, 1969 DUKE L.J. 959.

The courts, however, have not been willing to adopt any of these theories of relief except in isolated cases. Therefore, legislation dealing with the rights of each party is necessary before the franchisee can be adequately protected.

II. STATE FRANCHISE REGULATION

In recent years a considerable amount of state legislation has been enacted to deal specifically with the franchise relationship. At least 15 states now have broad legislation regulating franchise relationships in some manner. The scope of this statutory regulation varies significantly from state to state, but most of the statutes are primarily concerned either with full disclosure of relevant facts by the franchisor at the beginning of the relationship or with the abuses that result from unjust

53. In Mobil Oil Corp. v. Rubenfield, 72 Misc. 2d 392, 339 N.Y.S.2d 623 (N.Y. City Civ. Ct. 1972), it was held that a franchisee acquires a vested interest in the franchise, and the franchisor has a duty to deal with the franchisee in good faith throughout the relationship. That duty was breached when the franchisor sought to illegally coerce the franchisee to purchase accessories, and therefore the franchisor could not recover possession of the property by an attempted termination.

54. Franchise legislation must not forbid the necessary contract provisions that franchisors use to protect themselves. Franchisors deal with a wide assortment of franchisees. See note 7 supra. Even though most franchisors are quite careful in screening potential franchisees, it is possible that unreliable persons may be awarded franchises. The franchisor must have adequate contract provisions to enable him to quickly remedy the situation if, for example, amounts due him for goods and services are not forthcoming. In addition, the effectiveness of franchising depends greatly on the continued goodwill created by successful franchised businesses. An improperly operated franchise can have an adverse effect on the whole system.


termination of the relationship. A few states have also attempted to regulate the ongoing franchise relationship by imposing "good faith" standards of conduct upon the parties to a franchise agreement, while Arkansas has conferred upon itself a "most favored nation" status, prohibiting a franchisor from charging a royalty fee greater than the customary fee then in use elsewhere in the United States. Other states have regulated particular franchise businesses such as automobile dealerships, alcoholic beverage wholesale businesses, and petroleum products distributorships.

A. DEFINING THE FRANCHISE RELATIONSHIP

Although a number of approaches have been used by the states to regulate the franchise relationship, every statute must contain a comprehensive definitional section, carefully drafted to keep the operation of the law within reasonable bounds. Because franchising is a nebulous concept, even well-drafted legislation could include many business relationships that need not be regulated. Three basic statutory approaches have been em-


63. For example, a local retailer may be called a "franchised
ployed to define the concept of a franchise, the term on which all other definitions turn. One approach defines the franchise on the basis of the substantial control exercised by the franchisor and the substantial association with his marketing system. This might be called a “captive marketing plan” definition. A second technique is to phrase the definition of a franchise in terms of the common interest which the parties to a franchise agreement have in the success of the arrangement. The typical statutory language refers to the “community of interest” in the business arrangement. A third, the “mutual financial benefit” method of definition, requires a continuing financial interest between the parties, in addition to the licensing of a basic marketing plan.

The California Franchise Investment Law illustrates the “captive marketing plan” approach:

"Franchise" means a contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which:

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

(b) The operation of the franchisee's business pursuant to such plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising or other commercial symbol designating the franchisor or its affiliate; and

(c) The franchisee is required to pay, directly or indirectly, a franchise fee.64

Four other states have adopted almost identical language.65 The use of the word "substantial" in paragraphs (a) and (b) appears to enable a franchisor to escape the statutory definition by limiting his control over the franchise system.66 If the system is to operate successfully, however, it is imperative that the franchisor exercise control over the nature and quality of the goods and services the franchisee offers. A significant part of the for-

64. CAL. CORP. CODE § 31005 (West Supp. 1975).
65. ILL. ANN. STAT. ch. 121½, § 703(1) (Smith-Hurd Supp. 1974); ORE. REV. STAT. § 650.005(4) (1974); R.I. GEN. LAWS ANN. § 19-28-3(c) (Supp. 1974); WIS. STAT. ANN. § 553.03(4) (Spec. Pamphlet 1974). Two states have adopted parts (a) and (b) of the definition. CONN. GEN. STAT. ANN. § 42-133e (Supp. 1975); VA. CODE ANN. § 13.1-559(b) (1973).
66. See State Legislation, supra note 34, at 542.
mula which has made franchising so successful is the delivery of a uniform product to consumers in different parts of the country. In addition, franchisors are under the mandate of the Lanham Act to control the quality, appearance, and performance of the goods and services supplied by franchisees to the general public, or suffer the loss of their trademarks. Therefore, the use of "substantial" in the definition of a "franchise" does not provide an easy escape from statutory coverage.

Paragraph (c) requires payment of a franchise fee as a prerequisite to inclusion under the statute. While the California and Wisconsin statutes set no minimum amount, the Illinois, Oregon, and Rhode Island statutes require a franchise fee of 100 dollars or more. Presumably, a prospective franchisee does not need statutory protection when he is obliged to pay only a small sum. It might be possible to avoid such a franchise statute by devising a method of compensation other than the conventional franchise fee. The California statute accordingly encompasses a wide range of franchise payment methods by broadly defining a franchise fee to include "any fee or charge that a franchisee ... is required to pay ... for the right to enter into a business under a franchise agreement ... " This language, construed with the words "directly or indirectly" in paragraph (c) of the definition, results in statutory coverage based on forms of payment other than the conventional franchise fee.

67. Flynn, The Regulation of Franchise Sales, 40 J. Kan. B. Ass'n 121 (1971). The author of this article is general counsel for Pizza Hut, Inc.
71. See Woll, Sources of Revenue to the Franchisor and Their Strategic Implications, 44 J. Retailing, Winter 1968-69, at 14. The author suggests eight principal ways a franchisor might secure revenue: initial franchise fee; royalties; rental of premises; sale or lease of equipment; sale of supplies and raw materials; sale of finished franchise products; sale of territorial rights; and partial ownership. Id. at 14-18.
73. The laws of California, Illinois, Rhode Island, and Wisconsin all
The New Jersey Franchise Practices Act\textsuperscript{74} is an example of the "community of interest" definitional approach. The New Jersey definition requires the grant of a license to use a trademark, trade name, or other commercial symbol in which there is a community of interest in the marketing of goods or services.\textsuperscript{75} The "community of interest" concept is also an element of the statutory definitions in Minnesota and South Dakota.\textsuperscript{76} This concept is less definite than the "captive marketing plan" definitions, because "community of interest" is not defined in the statutes. The concept has been judicially construed, in the context of a joint venture, as "an interest common to both parties . . . in which each and all are reciprocally concerned and from which each and all derive a material benefit and sustain a mutual responsibility."\textsuperscript{77} Other courts have found that a "community of interest" creates such a relationship of trust and confidence that it is inequitable to allow one of the parties to perform any act which might prejudice the others.\textsuperscript{78} Such language could be found to create fiduciary duties in the franchise relationship. This was the result reached by one court considering the termination of a service station lease, although the decision occurred in a state without franchise legislation.\textsuperscript{79} No state with a "community of interest" statute has imposed fiduciary duties upon the parties to a franchise agreement. The statutes of those states contain fewer definitional requirements than the "captive marketing plan" statutes. This may result in a more sweeping application of the statutes, but that must await judicial interpretation.

\begin{enumerate}
\item Id. § 56:10-3(a).
\item Carboneau v. Peterson, 1 Wash. 2d 347, 376, 95 P.2d 1043, 1055 (1939).
\item Booker v. Crocker, 132 F. 7, 8 (8th Cir. 1904). See also Wheeler v. Abilene Nat'l Bank Bldg. Co., 159 F. 391, 393 (8th Cir. 1908); Jones v. Missouri-Edison Elec. Co., 144 F. 765, 771 (8th Cir. 1906).
\end{enumerate}
Washington's Franchise Investment Protection Act\textsuperscript{80} represents the "mutual financial benefit" definitional method. It is a compromise between the detailed California statute and the indefinite New Jersey definition. The Washington statute defines a "franchise" as a business engaged in offering, selling, or distributing goods or services, and involving the payment of a franchise fee, either directly or indirectly, and the licensing of a trademark, service mark, or other similar characteristic in which there is a "community interest."\textsuperscript{81} The "community interest" concept in this statute is specifically defined as a "continuing financial interest" between the parties involved in the operation of the franchised business.\textsuperscript{82} This obviates the judicial search for a suitable common-law definition, which is required in a state with a "community of interest" statute. The Washington statute also provides a more complete definition of a franchise fee, including any payment "either in lump sum or by installments of an initial capital investment fee, any fee or charges based upon a percentage of gross or net sales . . . or any training fees . . . ."\textsuperscript{83} The California statute is not as explicit in its definition of a franchise fee, but perhaps this is desirable, since a franchisor who derives his compensation solely from sales of the franchised product to the franchisee may avoid the narrower definition of the Washington statute. The numerous franchise payment devices which a franchisor might use illustrate the need to retain flexibility in the definition of a franchise fee.\textsuperscript{84}

A few states have attempted to define the franchise relationship in other terms. Arkansas defines a franchise as a "continuing commercial relationship,"\textsuperscript{85} while Florida requires the franchisee's business to be "substantially reliant" on the franchisor for its supply of basic goods.\textsuperscript{86} Delaware's law is applica-
ble only to businesses that act as middlemen between a franchisor and retail outlets. These statutes lack sufficient breadth to effectively regulate most franchise relationships.

B. ENTERING THE FRANCHISE RELATIONSHIP: DISCLOSURE PROTECTION

A prevalent abuse occurring at the inception of a franchise relationship is the subtle deceit used to induce the franchisee to join the system. A former general counsel of a large fast-food chain has reported that the industry has "grossly oversold itself with promotions that were designed to work on the unrealistic hopes... of the naive." In an effort to remedy the abuses in this area, 10 states have enacted disclosure legislation. Inherent in this legislation is a belief that a fully informed prospective franchisee will make an intelligent investment decision.

California was the first state to enact a franchise disclosure law, and it has served as a model for other disclosure statutes. The crucial section of the law sets out 22 specific items that must be disclosed in a registration statement filed with the state, including the name and business address of the franchisor; the business experience of those affiliated with the franchisor; whether any person associated with the franchisor has been convicted of a felony or is subject to any injunctive action relating to business activity; a recent financial statement; a typical franchise agreement; a statement of all fees which the franchi-

90. The California Franchise Investment Law states: California franchisees have suffered substantial losses where the franchisor or his representative has not provided full and complete information regarding the franchise-franchisee relationship, the details of the contract between the franchisor and franchisee, and the prior business experience of the franchisor. It is the intent of this law to provide each prospective franchisee with the information necessary to make an intelligent decision regarding the franchise being offered. Cal. Corp. Code § 31001 (West Supp. 1975). The effectiveness of such a statute depends on the sophistication of franchisees, which varies considerably from case to case. See note 7 supra.
see may be required to pay; and any other information which the commissioner of corporations may reasonably require.\textsuperscript{91}

Most state disclosure statutes require similar information.\textsuperscript{92} The Oregon statute, however, does not enumerate the specific information which is required to be disclosed. The Oregon corporation commissioner is granted the discretion to require persons who sell franchises within the state to file an informational report revealing to whom a franchise has been sold and the amount of proceeds received.\textsuperscript{93} The statute does not operate as a true disclosure law, since a prospective franchisee has no right to even a limited disclosure of pertinent information with which he might make a rational investment decision. This section of the statute merely provides the means to monitor the level of franchise sales within the state.

The Virginia statute requires the franchisor to supply "such relevant information as the state corporation commission may require."\textsuperscript{94} The commission has discretion to require as full a disclosure as it deems necessary. The statute, however, does not indicate whether a single standard is to be applied to all franchisors, or if the commission may vary the degree of disclosure among individual franchisors. The latter interpretation seems more consistent with the absolute discretion vested in the commission, but a uniform disclosure requirement would better protect against the undue exercise of that discretion. The interests of prospective franchisees are served, since they have a right to examine the information disclosed.\textsuperscript{95} The statute does not provide for disclosure directly to the prospective franchisee.

In states which have modeled their disclosure statutes after California's, the disclosed information is filed in a registration statement. The state can scrutinize the information to determine if the franchisor qualifies to do business in the state. If the financial arrangements appear inadequate, the state frequently may escrow the franchise fee until appropriate arrangements are made.\textsuperscript{96} Crucial to the successful protection of franchises,

\textsuperscript{91} Id. § 31111.
\textsuperscript{95} Id. § 13.1-573.
however, are the private enforcement remedies created by some of those statutes. Violations of the disclosure provisions give a franchisee a cause of action for damages.\textsuperscript{97} The franchisee may also bring an action for rescission,\textsuperscript{98} although two states require a willful violation of the statute for this type of relief.\textsuperscript{99} In Illinois, if the disclosure statement is not given to the prospective franchisee at least three days before the signing of the agreement or the receipt of consideration by the franchisor, the franchise agreement remains voidable at the option of the franchisee for 90 days.\textsuperscript{100} While the requirement of a registration statement should deter most questionable franchise schemes, it will not guarantee that a franchisor is fully disclosing all necessary information. Nevertheless, the private enforcement mechanism will assure the franchisee his day in court.\textsuperscript{101}

A possible weakness in the enforcement provisions of some of the disclosure laws is that pursuant to these statutes the franchisor has a defense if he can establish that the franchisee "knew the facts concerning the untruth or omission, or that the defendant [franchisor] exercised reasonable care and did not know, or, if he had exercised reasonable care, would not have known, of the untruth or omission."\textsuperscript{102} The Illinois, Minnesota, and South Dakota statutes do not contain such a provision.


\textsuperscript{98} WIS. STAT. ANN. § 553.51(1) (Spec. Pamphlet 1974). In three states the courts are given broad equitable powers to grant rescission or other relief which the court may deem appropriate. MINN. STAT. § 80C.17(1) (1974); S.D. COMP. LAWS ANN. § 37-5A-83 (Supp. 1974); WASH. REV. CODE ANN. § 19.100.190(2) (Supp. 1974).


\textsuperscript{100} ILL. STAT. ANN. ch. 121½, § 721 (2) (Smith-Hurd Supp. 1974).

\textsuperscript{101} Under such statutes, damages are usually limited to actual damages. See CAL. CORP. CODE § 31300 (West Supp. 1975); ILL. ANN. STAT. ch. 121½, § 721 (1) (Smith-Hurd Supp. 1974); MINN. STAT. § 80C.17(1) (1974); R.I. GEN. LAWS ANN. § 19-28-9(A) (Supp. 1974); WIS. STAT. ANN. § 553.51(2) (Spec. Pamphlet 1974). Two states, however, allow recovery "to an amount not to exceed three times actual damages sustained." S.D. COMP. LAWS ANN. § 37-5A-85 (Supp. 1974); WASH. REV CODE ANN. § 19.100.190(3) (Supp. 1974).

\textsuperscript{102} CAL. CORP. CODE § 31300 (West Supp. 1975); HAWAII REV. STAT. § 482E-9(b) (Supp. 1974); R.I. GEN. LAWS ANN. § 19-28-9(B) (Supp. 1974); WASH. REV. CODE ANN. § 19.100.190(2) (Supp. 1974); WIS. STAT. ANN. § 553.51(2) (Spec. Pamphlet 1974).
The state disclosure laws provide certain limited exemptions from the registration requirements. In California and Wisconsin, a franchisor with at least 25 franchisees and with a net worth of at least five million dollars is exempt from the registration requirement if he makes a limited disclosure in writing to the prospective franchisee at least 48 hours prior to execution of any franchise agreement.\textsuperscript{103} The assumption that a franchisor with such wealth, size, and business experience will not deceive an unsuspecting franchisee has been criticized as fallacious.\textsuperscript{104} Yet, regulation will be successful without registration if the prospective franchisee himself is supplied with sufficient information to support a rational investment decision.

The Minnesota statute exempts from both the registration requirement and the limited disclosure requirement any offer or sale of a franchise by a franchisee, provided that there has been no similar sale in the preceding 12 months; any transaction by an executor, administrator, sheriff, receiver, trustee in bankruptcy, guardian, or conservator; any offer or sale to a banking organization, financial organization, or life insurance corporation; and any offer or sale of a “franchise” registered in the state as a security.\textsuperscript{105} Presumably either the parties to these transactions are protected by their relative skill, or the disclosure requirements are deemed to be unnecessary when the sale is not in the ordinary course of business. The South Dakota and Washington statutes exempt sales not in the ordinary course of business\textsuperscript{106} and exempt some other franchise operations on the basis of size.\textsuperscript{107} Rather than provide fixed statutory criteria, the

\textsuperscript{103} CAL. CORP. CODE § 31101 (West Supp. 1975); WIS. STAT. ANN. § 553.22 (Spec. Pamphlet 1974). The 25 required franchisees must have been conducting business at all times during the five years immediately preceding the franchisor’s offer to the prospective franchisee. Hawaii has the same exemption if the franchisee must invest $100,000. HAWAI'I REV. STAT. § 482E-4(4) (Supp. 1974). One state requires only 10 franchises. R.I. GEN. LAWS ANN. § 19-28-4 (Supp. 1974).

\textsuperscript{104} State Legislation, supra note 34, at 545. Another critic has stated that this is the first time that “bigness” has been equated with “honesty.” BROWN, supra note 2, at 113.

\textsuperscript{105} MINN. STAT. §§ 80C.03, 06(5) (1974).


\textsuperscript{107} South Dakota requires operation of at least 25 franchises in the United States for the previous 25 years and a net worth of at least ten million dollars. S.D. COMP. LAWS ANN. § 37-5A-12 (Supp. 1974). Washington has three different exemptions based on the size of the franchisor: (1) a franchisor with at least 25 franchises, a net worth of at least five
Illinois statute authorizes the secretary of state to specify the disclosure requirements that will not be applied to any designated class of franchisors, if he finds that they are unnecessary to the public interest or the protection of potential franchisees. This approach avoids the inflexibility of specific statutory exemption criteria, while enabling exemptions to be granted when justified. Nor does this approach require statutory amendment to withdraw exemption status when circumstances demonstrate the need for such action.

C. THE ONGOING FRANCHISE RELATIONSHIP: STANDARDS OF CONDUCT

A number of states have enacted legislation designed to neutralize the great disparity in bargaining power between the franchisor and the franchisee. Once the franchise relationship has commenced and after the franchisee has invested large sums of his own capital in the franchise operation, the franchisee may be held by the franchisor to increasingly burdensome operating standards. In an effort to avoid such problems, some states have imposed “good faith” standards of conduct upon both parties to a franchise agreement. Presumably, if a franchisor is required to deal in “good faith” with the franchisee, he will be unable to impose unreasonably burdensome restrictions or standards of performance. Such terms as “good faith” and “fair and equitable,” however, invite litigation to determine their content; they offer no unequivocal standard on which a franchisee may rely. The Minnesota statute declares that the Commissioner of Securities of the Department of Commerce shall adopt rules defining the words “unfair and inequitable” as they relate to franchises. Because the commissioner has enforcement pow-

110. One view is that such terms are merely an expression of general legislative policy. State Legislation, supra note 34, at 554.
111. MINN. STAT. § 80C.14 (1974).
ers under the law, he might be in a better position to establish proper guidelines than the courts. Nonetheless, the propriety of the guidelines he establishes probably must await judicial interpretation.

The New Jersey Franchise Practices Act prohibits six specific practices that are deemed to be contrary to fair and equitable treatment of franchisees during the ongoing relationship. The Washington statute is supplemented with even more specific modes of conduct considered to be unfair or deceptive. The prohibited practices include restrictive purchasing agreements, discrimination between franchisees in the price charged for like goods and services, and the imposition of unreasonable conditions on the franchisee. This statute goes further than the law of any other state in establishing standards of conduct for the parties to a franchise agreement. It permits a franchisee to compare the treatment he is receiving from his franchisor with the specific practices outlawed by the statute. As additional protection for the franchisee, the statute places the burden of proof on the franchisor to show that any standard of conduct he imposes is reasonable and necessary.

D. TERMINATING THE FRANCHISE RELATIONSHIP: LIMITATIONS

The wrongful termination of a franchise agreement, or the unjust failure to renew the agreement, presents a difficult challenge to the drafters of remedial legislation. Delaware was the first state to enact termination legislation. Franchisees protected by the statute were entitled to recover damages from the franchisor for unjust termination, and to seek a mandato-

112. Id. § 80C.16.
113. A franchisor may not require the franchisee to waive the protection of the Act; may not prohibit the free association of franchisees; may not make changes in management without good cause stated in writing; may not impose unreasonable standards of performance; may not include in the franchise agreement any term that violates the Act; and may not restrict the sale or transfer of equity in the franchise to employees of the franchisee or to the heir of the principal owner as long as basic financial requirements are met. N.J. STAT. ANN. § 56:10-7 (Supp. 1975).
115. Id. §§ 19.100.180(2) (b), (c), (h).
116. Id. § 19.100.180(2) (h).
118. Franchised wholesalers were protected by the law, but franchisees who offer their goods and services directly to the general public appear to have been excluded. State Legislation, supra note 34, at 559.
119. An unjust termination was defined as one effected "without good cause or in bad faith." DEL. CODE ANN. tit. 6, § 2552(a) (1974).
ry order for renewal.\textsuperscript{120} In \textit{Globe Liquor Co. v. Four Roses Distillers Co.},\textsuperscript{121} however, the state supreme court held that the statute made substantive changes in rights and obligations under an existing franchise contract and was thus an unconstitutional impairment of the contract.\textsuperscript{122} The court also held that the damages provided by the statutes were punitive in nature and therefore impermissible, since proof of actual loss was not required.\textsuperscript{123}

To avoid the \textit{Globe Liquor} problem, the New Jersey statute, which permits termination or nonrenewal of a franchise agreement only for "good cause,"\textsuperscript{124} was drafted to apply only to franchises granted after the effective date of the act.\textsuperscript{125} The statute provides, however, that "a renewal of a franchise or an amendment to an existing franchise shall not be excluded from the application of the Act."\textsuperscript{126} To avoid a construction that would render this part of the statute unconstitutional, a New Jersey court held that all preexisting franchises were intended to be exempted from all regulatory provisions of the statute.\textsuperscript{127} Although not technically applying the act, the court did examine the nonrenewal in light of the legislative policy expressed therein, and found that the nonrenewal violated an implied covenant in the agreement not to terminate as long as the franchisee substantially performed his obligations.\textsuperscript{128}

The recently amended Connecticut statute\textsuperscript{129} attempts to recognize certain business realities that will justify the franchisor's refusal to renew a franchise agreement. The franchisor may elect not to renew an agreement that involves the lease of real property, if the franchisor then sells or leases the property to other than a subsidiary or affiliate of the franchisor, or if he

\begin{itemize}
\item \textsuperscript{120} Id. § 2553.
\item \textsuperscript{121} 281 A.2d 19 (Del.), cert. denied, 404 U.S. 873 (1971).
\item \textsuperscript{122} Id. at 21. \textit{See} U.S. Const. art. I, § 10.
\item \textsuperscript{123} 281 A.2d at 24.
\item \textsuperscript{124} "Good cause" is limited to failure by the franchisee to substantially comply with the reasonable requirements imposed by the franchisor. N.J. Stat. Ann. § 56:10-5 (Supp. 1975).
\item \textsuperscript{125} Id. § 56:10-8.
\item \textsuperscript{127} Shell Oil Co. v. Marinello, 120 N.J. Super. 357, 370, 294 A.2d 253, 260, \textit{modified on other grounds}, 63 N.J. 402, 307 A.2d 598 (1973). \textit{See also} Marinello v. Shell Oil Co., 511 F.2d 853 (3d Cir. 1975) (the New Jersey common law which protects franchisees from termination without cause was not rendered invalid by passage of the Lanham Act and application of the supremacy clause).
\item \textsuperscript{128} 120 N.J. Super. at 376, 294 A.2d at 263.
\end{itemize}
sells or leases the property to a subsidiary or affiliate for a different business purpose than that for which it was previously employed by the franchisee, or if he converts the property to a use not covered by the franchise agreement, or if the property was originally leased from a third party and such lease is terminated. Arguably, these exceptions are embraced by the general “good cause” provision, but the explicit reference to them ensures recognition that there may be times when good business judgment calls for nonrenewal of the franchise relationship even though the franchisee has complied with the obligations of the agreement. The statute does not allow a franchisor to refuse renewal and reacquire a successful franchise business for the sole purpose of operating the business himself. Upon termination of the franchise relationship for whatever reason, the franchisee is entitled to receive fair and reasonable compensation for the inventory, supplies, equipment, and furnishings purchased from the franchisor or from approved sources. The franchisee is thus assured that he will not be left with property that is utterly useless to him once the franchise relationship has ended.

The statutes of Virginia and Washington also deal with the problem of termination, although neither is intended to provide comprehensive solutions to the problem. The Virginia statute prohibits cancellation of a franchise without “reasonable cause.” This standard is not defined and it is unclear whether “reasonable cause” is a less stringent standard than “good cause.” If “reasonable cause” were construed in light of a “sound business judgment” standard, the effectiveness of the termination provision would be severely limited and it might be applicable only to reprisals against the franchisee; certainly the standard must be closer to the “good cause” standard illustrated by the Connecticut statute. On the other hand, Washington, like Connecticut, prohibits termination without “good cause.” While “good cause” includes noncompliance with material provisions of the agreement, the franchisee is given a reasonable opportunity to cure any default.

130. Id. § 42-133f.
131. Id.
132. Id. § 42-133f(b).
E. The Need for Uniform Regulation

The problems that plague the franchising industry are simply too significant to ignore. Common-law theories and existing statutory remedies not specifically applicable to franchising do not adequately deal with the complex and unique characteristics of the franchise relationship. This situation has been recognized by the 15 states that have enacted comprehensive legislation regulating the franchise relationship. The other states, however, are without such comprehensive franchise legislation, and even the statutes of those 15 states vary greatly in their applicability to franchise relationships. A few states require disclosure of relevant information, some attempt to regulate the ongoing relationship, others place restrictions on the right to terminate, and still others combine these regulatory approaches in a single statute. Even among those states that regulate similar aspects of the franchise relationship, the statutory requirements differ substantially.

This lack of uniformity places a great hardship on franchisors who operate on a national scale. A national franchise operation may come within the statutory language of one state law although it is excluded from the regulation of another. When the relevant information required to be disclosed differs from state to state, the franchisor will be forced to prepare different disclosure or registration statements. Equitable standards of conduct, such as the requirement to deal in "good faith," are dependent on judicial interpretations in various states; as a consequence, no single interpretation controls and both parties are unsure of the boundaries of "good faith" conduct. A franchisor may be prohibited from imposing certain standards upon the franchisee in one state, whereas the same practice is perfectly legal in a neighboring state. Not only has this patchwork


138. For example, the Washington statute sets out ten specifically
legislative approach impaired the effectiveness of franchise regulation, but it also has convinced the franchisors' trade association that further regulation should be pursued on the federal level, and that such uniform regulation would be a boon to the franchising industry. 139

The states themselves may also favor federal regulation. Many states may lack the necessary administrative machinery to effectively implement franchise regulation. 140 Political and economic realities may dampen a state's desire to supervise franchise relationships. The prohibitive administrative costs and the difficulties of compliance with diverse state laws imply that practical solutions to the problems of franchising must be sought at the federal level. 141

III. THE FEDERAL LEGISLATIVE APPROACH

Congress has not been unaware of the abuses that may occur in the franchise relationship. Numerous remedial bills have been introduced by members of Congress in the past ten years, 142 although very few of the proposals have ever received serious consideration. The Automobile Dealers Franchise Act 143 prohibited practices, WASH. REV. CODE ANN. § 19.100.180(2) (Supp. 1974), see text accompanying notes 114-16 supra, while the Oregon franchise statute is silent as to the standards of conduct between the parties to a franchise agreement.


140. See State Legislation, supra note 34, at 551.


143. 15 U.S.C. §§ 1221-25 (1970). Called the Automobile Dealers' Day in Court Act, this statute requires all parties to the franchise agreement to deal with each other in a "fair and equitable manner." Id. § 1221(e). A franchisee may bring a suit for damages if the franchisor fails to perform the contract in "good faith," including termination or nonrenewal. Id. § 1222. The dealer-franchisee has the burden of establishing the breach of "good faith." Southern Rambler Sales, Inc. v. American Motors Corp., 375 F.2d 932, 935 (5th Cir.), cert. denied, 389 U.S. 832 (1967). For a discussion of the political and legislative history of this law, see Macauley, Changing a Continuing Relationship Between a Large Corporation and Those Who Deal With It: Automobile Manufacturers, Their Dealers, and the Legal System (pts. 1-2), 1965 Wis. L. Rev. 483, 740.
is the only specific federal legislation enacted to date. Applicable only to franchise relationships within a particular industry, the Act reveals the limited scope of existing federal regulation. Legislation applicable to all significant franchise operations would be preferable to the present piecemeal approach. There are three possible avenues to federal regulation of franchising: (1) action by the Federal Trade Commission (FTC) under its rulemaking power, (2) federal preemptive legislation, and (3) federal nonpreemptive legislation.

A. FEDERAL TRADE COMMISSION RULEMAKING

For the past four years, the FTC has given close attention to the problems that exist in the franchising industry. Acting to prohibit unfair and deceptive trade practices pursuant to section 5 of the Federal Trade Commission Act, the FTC has proposed a trade regulation rule, which, if approved, would require franchisors to disclose certain information to a prospective franchisee prior to the signing of any binding agreement. The authority of the agency to issue such regulations has been questioned, but recently the Court of Appeals for the District of Columbia Circuit held that the Federal Trade Commission Act did confer upon the FTC the authority to promulgate trade regulation rules having the effect of substantive law. This decision should remove any doubt as to the power of the FTC to require compliance with rules regulating franchising.

The extensive hearings held by the FTC on its first proposed franchising rule in February 1972 thoroughly familiarized the agency with the problems that beset both the franchisor and the franchisee. The proposed rule would require disclosure of information directly to the prospective franchisee. This approach would be more direct than the state registration requirements, since the pertinent information would be channeled immediately to the person making the investment decision. A significant drawback to unilateral FTC action as an effective solution to franchise regulation, however, is the absence of a private enforcement provision in the Federal Trade

Commission Act. While franchisees might be somewhat protected by FTC policing efforts, the absence of a private enforcement provision would permit an injured franchisee to be made whole only under a common-law or statutory remedy not well-suited to abuses in the franchise relationship. The deterrent effect of the regulation would also be reduced by the absence of an effective self-protection provision, since the FTC could not be expected to prosecute all violations.

B. FEDERAL PREEMPTIVE LEGISLATION

Preemptive legislation offers a second approach to federal regulation of the franchise relationship. If Congress enacted preemptive legislation, state legislation could not constitutionally apply in the same area and consideration would ordinarily not be given to competing state policies in the enforcement of the federal statute. Such federal legislation could provide franchisees with the private enforcement remedy that FTC unilateral action would lack. The legislation would enable Congress to select the best provisions of the existing state regulatory schemes.

The franchisors naturally favor the federal preemptive approach when confronted with a choice between existing piecemeal state regulation and uniform federal legislative requirements. Support of a moderate federal law to supplant all state regulation offers the franchisors an opportunity to eliminate those state laws that they find too restrictive or burdensome. Federal preemptive legislation, however, is probably an unnecessarily harsh solution, especially for those states that desire to regulate the franchise relationship by means of strong legislation. Fifteen states have expressed strong protective purposes in the enactment of comprehensive franchise legislation. A less stringent preemptive federal law might undermine those purposes.

149. See text accompanying notes 8-54 supra.
150. Joan Z. Bernstein, the acting director of the FTC Bureau of Consumer Protection, has suggested that federal preemptive legislation is the best approach in dealing with the franchise relationship. 1973 Hearings, supra note 136, at 189.
153. See text accompanying notes 55-141 supra.
C. FEDERAL NONPREEMPTIVE LEGISLATION

If Congress adopted a nonpreemptive legislative approach, federal regulation of the franchise relationship could coexist with state regulation, just as it does in the securities field. Such coexistence would be possible because the supremacy clause of the Constitution could be invoked to invalidate any state legislation that conflicted with the federal legislation, although state laws that were not inconsistent with the federal statute would be permitted to stand. Nonpreemptive federal legislation would thus preserve the power of individual states to supervise the general conduct of business, by permitting states to enact stronger, but compatible, protective legislation. While non-preemptive legislation would not guarantee the complete uniformity of regulation which the franchisors strongly desire, it would provide a focal point to which state regulatory schemes might gravitate. In addition, the costs of implementation and enforcement of a comprehensive state franchise statute are such that many states might welcome federal legislation.

D. THE FEDERAL TRADE COMMISSION AS THE ENFORCEMENT AGENCY

Whichever federal statutory approach is selected, an agency must be designated to supervise compliance with the statutory standards. Clearly, costs and considerations of efficiency would discourage the establishment of a new federal agency to deal exclusively with franchising. From among the existing agencies, the Securities and Exchange Commission (SEC) and the FTC have been suggested as the most suitable candidates for enforcing a federal franchise statute. The SEC has vast experience with disclosure requirements, while the FTC constantly deals with unfair trade practices such as those which might occur in a franchise relationship. It would be inefficient to assign two supervisory agencies to the regulation of franchising. Despite the similarities between franchising and the trading of securities in the requirement for disclosure, it has been recognized that the

154. U.S. Const. art. VI, cl. 2.
155. Note, supra note 151, at 131.
securities laws are ill-suited for application to the franchise relationship.\textsuperscript{157} The SEC would thus have to operate in an area unrelated to its primary field if it were required to enforce a franchising statute. On the other hand, considering the extensive investigatory work already done by the FTC in the area of franchising\textsuperscript{158} and that agency's general experience with unfair and deceptive trade practices, the FTC is the logical choice to supervise federal regulation of the franchise relationship. Since the agency has already been exposed to the unique problems that beset the industry, a federal statute with FTC enforcement could be effective soon after enactment.

\textbf{IV. CONSIDERATIONS FOR A FEDERAL STATUTE}

The realities of the franchise relationship demonstrate the need for federal regulation. But since regulation of franchising is relatively recent and untested, action on the federal level must be carefully considered so as not to stifle future growth in franchising industries.\textsuperscript{159} Serious problems must be dealt with constructively without unreasonably restricting the franchisor's freedom to conduct his business economically. A federal non-preemptive statute enforced by the Federal Trade Commission offers an attractive source for that constructive regulation. The FTC can be given the discretionary rulemaking power to tighten or relax the regulation as needed, enabling the statute to be effective without becoming oppressive. Each problem area of the franchising statute must be closely examined, and any federal franchising statute must be carefully drafted to ensure proper treatment of those areas.

\textbf{A. DEFINING THE FRANCHISE RELATIONSHIP}

A fundamental ingredient of any legislation is the definitional section of the statute. The statutory definition of terms of art and key words and phrases—such as "franchise," "franchisor," "franchisee," "prospective franchisee," and "franchise fee"—will have major impact on the scope of franchising legislation.\textsuperscript{160} The various definitions are crucial, regardless of wheth-

\textsuperscript{157} See, e.g., Mr. Steak, Inc. v. River City Steak, Inc., 480 F.2d 666 (10th Cir. 1972).
\textsuperscript{158} See text accompanying notes 144-48 supra.
\textsuperscript{159} For example, it has been reported that five large franchisors intend to stay out of New Jersey and Washington because of the restrictive nature of the franchise statutes of those states. Wall Street Journal, Oct. 11, 1971, at 22, col. 3.
\textsuperscript{160} For a comparison of three statutory definitional approaches, see
er the statutory purpose is to cure franchise abuses by disclosure requirements, by regulation of the ongoing relationship, by limitation of the ability to terminate the franchise, or by a combination of these. The most important definition is clearly that of the term "franchise," since the meaning of most other terms will depend upon it.

Since the concept of franchising is nebulous, an umbrella definition of the term "franchise" may inadvertently encompass many conventional business relationships that do not merit statutory regulation.\textsuperscript{161} The statutory coverage must be limited to those business arrangements in which franchising abuses occur. The definition should require the business arrangement to involve some "continuing commercial relationship" in which both parties contribute in some manner to the operation of the franchised business. The statute must be drafted carefully, so that the conventional manufacturer-wholesaler-retailer chain of distribution is not subject to its restrictions.

The serious franchising problems warranting legislative attention generally involve those marketing arrangements in which the essential element is a trademark license.\textsuperscript{162} Accordingly, the definition of a "franchise" should be phrased in terms of the substantial association of the franchisee's business with the franchisor's trademark, trade name, or other commercial symbol. The important concept of the franchisor's continued control over the operation of the franchise would thus be incorporated into the definition by operation of the federal trademark laws,\textsuperscript{163} effectively eliminating the line-drawing problems in drafting the franchising statutes.\textsuperscript{164} If the definition of a

\footnotesize{\textsuperscript{161} The first proposed trade regulation contained such an umbrella definition. 36 Fed. Reg. 21607, 21609 (1971). The International Franchise Association felt that the proposed rule would cover "virtually every form of sale by one party of the goods produced by, or the services originated by, another party, if that other party exerts even the most minimal form of 'control' required by economic necessity or by the trademark laws." Statement on Behalf of International Franchise Association Before Federal Trade Commission Hearing on Proposed Trade Regulation Rule—February 14, 1972, 1973 Hearings, supra note 136, at 304.}

\footnotesize{\textsuperscript{162} See 1 J. McCarthy, Trademarks and Unfair Competition § 18:20, at 644-45 (1973).}

\footnotesize{\textsuperscript{163} See text accompanying notes 67-69 supra. For a closer look at the relationship of franchise termination legislation to trademark licensing, see Note, Franchise Termination and Refusals to Renew: The Lanham Act and Preemption of State Regulation, 60 Iowa L. Rev. 122 (1974).}

\footnotesize{\textsuperscript{164} This approach is taken by the first alternative of the revised}
franchise were framed in terms of the degree of control the franchisor exercises over the franchisee, Congress would be forced to require "substantial" control, or to establish a similar standard, and then to await judicial interpretation as to the exact scope of the provision. On the other hand, a definition framed in terms of the representations made by the franchisor and the assistance he gives the franchisee, as well as in terms of substantial association with a trademark, might avoid these problems, while still requiring the parties to be closely connected with the franchise operation.

Consideration should be given to a minimum franchise fee provision, limiting the coverage of the statute by providing an exemption for small-scale franchisors. Such a provision might also ensure that the statutory regulation does not discourage the development of new franchise systems.\textsuperscript{165} Any minimum fee provision must be carefully drafted so that a franchisor requiring a small initial fee with subsequent large payments or commitments does not escape the coverage of the statute.\textsuperscript{166}

The expenses of meeting disclosure requirements can be heavy, and termination limitations can severely restrict the franchisor's freedom. Therefore, it would be preferable to have a definition of franchise that is slightly too narrow than one that is too broad. The franchise relationship entails a great many varied business arrangements. The requirement of a continuing commercial relationship including trademark or trade name licensing would exclude many of the business relation-

\textsuperscript{FTC rule. The second alternative appears to rest the definition on the concept of "control," but does not specify the degree of control required. 39 Fed. Reg. 30360, 30362 (1974) (proposed rule).

\textsuperscript{165} The question whether franchising is a worthwhile method of product distribution is not entirely settled. See text accompanying notes 1-7 \textsuperscript{supra.} Nevertheless, statutory regulation should not erect a barrier to new franchise systems. A minimum franchise fee provision would help prevent this.

\textsuperscript{166} For the various forms of payment a franchisor might require, see note 71 \textsuperscript{supra.} The Washington Franchise Investment Protection Act contains a broad definition of a franchise fee. It includes

any fee or charge that a franchisee or subfranchisor is required to pay or agrees to pay for the right to enter into a business or to continue a business under a franchise agreement, including, but not limited to, the payment either in lump sum or by installments of an initial capital investment fee, any fee or charges based upon a percentage of gross or net sales whether or not referred to as royalty fees, any payment for the mandatory purchase of goods or services or any payment for goods or services available only from the franchisor, or any training fees or training school fees or charges . . .

\textsuperscript{WASH. REV. CODE ANN. § 19.100.010(11) (Supp. 1974).}
ships in which serious franchising abuses are not prevalent. A minimum fee provision could prevent the statute from erecting a barrier to entry into the franchising business. FTC rulemaking power under the statute could then be used to make the "fine-tuning" adjustments necessary to meet changing economic conditions.

B. ENTERING THE FRANCHISE RELATIONSHIP

Misrepresentation in the promotion of franchises is one of the most serious abuses in franchising, and a requirement of full disclosure of pertinent information is the appropriate legislative solution. The mandatory communication of specific information directly to prospective franchisees prior to entry into the franchise relationship is thus a crucial requirement of any franchising statute. For example, disclosure of the names and business addresses of those associated with the franchisor would acquaint the franchise with the persons with whom he will be doing business during the contract term. In addition, disclosure of the franchisor's balance sheets and profit and loss statements for the previous three years and information about the business experience of the franchisor and its officers and directors

167. Disclosure bills have received the most attention in Congress recently. See, e.g., H.R. 16239, 93d Cong., 2d Sess. (1974); S. 2399 & S. 2870, 92d Cong., 1st Sess. (1971).

168. It makes good business sense to inform the franchisee of what he is getting from the investment, according to most reputable franchisors. Disagreement occurs with respect to the degree of disclosure that should be required. The first set of FTC proposed disclosure requirements were substantially similar to those of the California statute. See 36 Fed. Reg. 21607, 21607-09 (1971); CAL. CORP. CODE § 31000 (West Supp. 1975). One writer felt that these rules were not entirely justified and that there were many qualified and ethical franchisors who should not have to meet such strict standards. Rosenfield, A Look at the Proposed F.T.C. Rule on Franchising, 27 Bus. Law. 907, 914 (1972). Another commentator stated that compliance with many portions of the rule would be extremely burdensome or impossible. Zeidman, Regulation of Franchising by the Federal Trade Commission: A Critique of the Proposed Trade Regulation Rule, 28 Bus. Law. 135 (1972). As a result of extensive testimony from both franchisors and franchisees, the revised FTC proposal retreated somewhat in the degree of disclosure required. Nevertheless, these regulations would greatly aid the prospective franchisee in this decisional process.

169. The revised FTC rule would require only the most recent balance sheet and profit and loss statement. The original proposed rule would have required those statements for the previous five years. California and Washington require only a recent financial statement. CAL. CORP. CODE § 31111(g) (West Supp. 1975); WASH. REV. CODE ANN. § 19.100.040(7) (Supp. 1974).
would enable the franchisee to better evaluate his chances of success in the franchise business. A right to examine the franchisor's financial position prior to investing could further protect the franchisee from making an investment without full knowledge of all relevant facts. Finally, since a prospective franchisee might not understand all the intricacies of franchise payment, a provision requiring a complete and full disclosure of all fees, compensation, or other forms of payment received by the franchisor could be included to alert the franchisee to hidden payments. This information should explain the method of computation used in determining the revenue received by the franchisor for supplying goods and services to the franchisee.\footnote{170.}{7}

Attention must be paid to the ease with which franchise systems are formed. The only prerequisites are a salable product and the ability to market the product. Naturally, this furnishes opportunities to unprincipled franchisors. Disclosure of past and pending litigation against the franchisor and its officers and directors would offer a degree of protection against this problem. The prospective franchisee would be adequately protected against unprincipled franchisors by the inclusion in this list of all operational officers and directors.\footnote{171.}{7} Additional protection might be provided if the list also included those officers and directors who had served the franchisor in the previous two years, even if they were no longer affiliated with the company.

In theory, the disclosure made by the franchisor should expose the prospective franchisee to the realities of the franchise system. To be entirely consistent with the notion of full and fair disclosure, the franchisee should be given access to the operating statements of unprofitable as well as profitable franchisees. If the franchisor presents statements about the projected future success of the operation, those statements must be clearly understood as mere estimates that should not be interpreted as fact.\footnote{172.}{7} The disclosure provisions can require proper labeling of goods or services that are greatly overpriced. The prospective franchisee should be aware that the franchisor intends to realize part of his profit from these transactions. The 1971 proposed FTC rule would have required disclosure of the "mark-ups" on such items, but the revised rule eliminated this requirement. See 36 Fed. Reg. 21607, 21608 (1971); 39 Fed. Reg. 30360 (1974).

170. A franchisor may supply goods or services that are greatly overpriced. The prospective franchisee should be aware that the franchisor intends to realize part of his profit from these transactions. The 1971 proposed FTC rule would have required disclosure of the "mark-ups" on such items, but the revised rule eliminated this requirement. See 36 Fed. Reg. 21607, 21608 (1971); 39 Fed. Reg. 30360 (1974).

171. The 1971 proposed FTC rule would have required the franchisor to include in such a summary all stockholders who owned more than 10 percent of all stock of the franchisor. 36 Fed. Reg. 21607 (1971).

172. The California and Washington statutes require the disclosure of the basis upon which estimates of earnings are obtained. Cal. Corp.
these statements to prevent misinterpretation.\textsuperscript{173}

The drafters of a federal disclosure statute must deal with the exemption question.\textsuperscript{174} The proposition that large, experienced franchisors always deal fairly and equitably with prospective franchisees cannot be assumed without question.\textsuperscript{175} The \textit{FTC} might be given discretionary power to grant exemptions to franchisors who can establish that their prospective franchisees do not require the full protection of the federal statute.\textsuperscript{176} This would avoid the necessity of devising specific exemption criteria, which would result in a blanket exemption. On the other hand, exemption provisions for franchisors who otherwise fall within the statutory definition are not an absolute necessity.\textsuperscript{177} If the definitional section is drafted carefully, to include only those business arrangements that require statutory regulation, exemptions should not be needed, although discretionary power in the \textit{FTC} to deal with highly unusual circumstances would guarantee that undue hardships were not inflicted by the statute.

A federal statute would have to designate an agency to supervise compliance with the statutory requirements. The \textit{FTC} could be given the power to promulgate the rules and regulations necessary to fully effectuate the disclosure requirements.


\textsuperscript{173} The revised \textit{FTC} rule would require the franchisor to furnish the franchisee with a copy of \textit{FTC Buyer's Guide No. 4—Franchise Business Risks} at the same time the written disclosure is furnished. 39 Fed. Reg. 30360, 30362 (1974).

\textsuperscript{174} See text accompanying notes 103-08 supra.

\textsuperscript{175} A national petroleum company once advertised a service station in a Canadian newspaper as an "excellent opportunity . . . [to] make a good income. Our research indicates strong potential." In fact, the previous five lessees had operated the station only 5 months, 34 months, 23 months, 1 month, and 58 months respectively, with the most recent dealer having been driven into bankruptcy. \textsc{Brown}, supra note 2, at 76-77 n.64.

\textsuperscript{176} The "Franchise Fair Disclosure Act of 1971," S. 2870, 92d Cong., 1st Sess. (1971), proposed a similar approach. This bill received the support of some franchising authorities. Harold Brown, a Boston attorney and author of numerous articles and books on franchising, stated: "[I]f you were to consider legislation, I would tell you very quickly, I would also support . . . S. 2870 . . . . I think it covers everything legislation in this field should cover and I would recommend it most strongly to you." 1973 \textit{Hearings}, supra note 136, at 92.

\textsuperscript{177} The revised trade regulation rule does not exempt any franchisors who meet the general definition. The Small Business Administration was especially eager to support this no-exemption approach. 1973 \textit{Hearings}, supra note 136, at 373.
of the act. Failure to comply with either the disclosure requirements or the rules and regulations promulgated thereunder could be made a violation of section 5 of the Federal Trade Commission Act. The FTC would have the power to seek injunctive relief for violations or threatened violations of the statute. A damages provision allowing private enforcement of violations would be an effective complement to ensure compliance by the franchise industry. Treble damages could be considered, but such a provision might be ineffective or unnecessarily harsh to accomplish the purposes of the statute.

For a disclosure statute to be effective, a prospective franchisee must have the opportunity to study the information and seek advice from others. The information should be provided as soon as possible after the franchisee undertakes serious consideration of the offer, or at least within some stated period, perhaps 15 days, prior to entry into the franchise relationship. If a franchisor were required to file a copy of the disclosure statement with the FTC prior to giving it to prospective franchisees, the agency could then review the statement and require additional information if necessary for the protection of prospective franchisees. The expertise of the FTC would also be a further protection against misleading or deceptive information.

C. THE ONGOING RELATIONSHIP

Certain practices in the ongoing franchise relationship deserve legislative attention. Statutory standards that require parties to a franchise agreement to deal with each other in "good faith" or in a "fair and equitable" manner can invite unnecessary litigation and upset the cooperative balance of mutual effort that should characterize the franchise relationship. Neither

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181. See text accompanying notes 40-41 supra.
183. Under the approach of the typical state disclosure law, a franchisor must register with the state before doing business within its borders. This is done by filing an extensive disclosure statement. See text accompanying notes 88-108 supra.
the parties nor the courts have any bench mark from which to measure compliance with these standards.

This does not eliminate the possibility that the federal statute might deal with the problems that beset the ongoing franchise relationship. A disclosure statute might also set out "prohibited practices," which the franchisor would be required to disclose to the franchisee as a guarantee that those practices would not be utilized. The franchisor could also be required to disclose the standards of performance he expects the franchisee to meet. The FTC could review those standards and prohibit the imposition of any standard it found to be unfair. Such limited measures should not constitute an undue interference with the franchise relationship.

D. Terminating the Franchise Relationship

Termination legislation on the state level has often run afoul of the contracts clause, while federal termination legislation has been repeatedly proposed without much success. A statute based upon a desire to prevent unjustified terminations could convert an ordinary franchise agreement into an employment contract of indefinite duration. It makes little sense to force upon the franchisor an unwanted franchisee at the end of a contract term. It is possible, however, that a franchisor might have an ulterior motive in the cancellation of a franchise and might unjustly deprive the franchisee of his livelihood. Accordingly, the federal disclosure statute might also require the franchisor to justify the nonrenewal of a franchise agreement. The original disclosure statement could be required to include the conditions under which a franchise agreement might be cancelled or renewal of the agreement refused. Those conditions would then be subject to FTC scrutiny.

Consideration might also be given to the rights of each party upon the conclusion of the franchise relationship. This could be handled statutorily without significant difficulty. For

186. An attempted cancellation would be suspicious if the franchisor sought to end the relationship with a successful franchisee in hopes of taking over the operation himself. Because of the power the franchisor wields over the franchisee, this type of action must be closely scrutinized for inequitable action. See text accompanying notes 129-32 supra.
example, a franchisee could be assured by the disclosure statement prior to his entry into the franchise relationship that he will receive reasonable compensation for his investment at the conclusion of the relationship. If the franchisor terminates the relationship, the franchisee should be compensated at fair market value for all property which he has been required to purchase from the franchisor or approved sources.\textsuperscript{187} Goodwill might be considered a component in the reasonable value of the franchise.\textsuperscript{188} The valuation of goodwill would vary with the relative success and longevity of the franchisee’s business.

V. CONCLUSION

Franchising is a vital force in the economy today, but serious problems may arise in the franchising relationship. Judicial attempts to apply common-law theories or existing statutes to the franchise relationship have met with limited success. Moreover, franchise regulation requires a degree of uniformity which state legislation cannot achieve. A comprehensive federal disclosure statute enforced by the FTC could effectively deal with many of the persistent problems. Legislation must be carefully drafted so as to address the major problem areas without unduly restricting the growth of franchising. Such legislation would help bring order to the present regulatory schemes and permit continued expansion in this important field.

\textsuperscript{187} Some or all of the physical plant may be leased from the franchisor. If that is the case, reimbursement should not be necessary. But the FTC should have the power to examine the lease agreement to ensure that it is not actually an installment contract.

\textsuperscript{188} See Brown & Cohen, Franchise Misuse, 48 Notre Dame Law. 1145 (1973).