COMMENTS AND NOTES

ARTICLE TWO OF THE UNIFORM COMMERCIAL CODE AND FRANCHISE DISTRIBUTION AGREEMENTS

A growing body of case law and commentary has analyzed the legal relations created by franchise distribution agreements. The possibility has been raised that various provisions of Article Two of the Uniform Commercial Code could be beneficially employed by both franchisees and franchisors during litigation. This comment analyzes these possibilities in light of the technical limitations, imposed on the purview of Article Two. It argues for the utilization of these provisions, if there is a proper respect for the internal limitations of the Code and the standards governing the analogical use of any statute. It also provides examples of several suggested uses in a hypothetical franchise situation.

Recently it has been suggested that Article Two of the Uniform Commercial Code, now a legal reality in 49 states, is relevant to the economic phenomenon known generically as "franchising." This comment will seek to examine both the sources of Article Two's relevance to and the potential extent of its impact on, the franchise method of distributing goods and services.

Ten percent of the gross national product and 25 percent of the

¹ R. NORDSTROM & N. LATTIN, PROBLEMS AND MATERIALS ON SALES AND SECURED TRANSACTIONS IX (1968). Louisiana is the only state that has not adopted the Code. It is in effect in the District of Columbia, 28 D.C. Code § 1-101 (1967), and the Virgin Islands, 11A V.I. Code Ann. § 1-101 (1965).

² See Ellinghaus, In Defense of Unconscionability, 78 Yale L.J. 757, 808-12 (1969); Hewitt, Termination of Dealer Franchises and the Code—Mixing Classified and Coordinated Uncertainty with Conflict, 22 Bus. Law. 1075 (1967).

³ The Code has engendered a plethora of commentary, largely concerned with statutory construction in settings where the Code is evidently applicable. See Squillante, Uniform Commercial Code Bibliography, 73 Com. L.J. 371 (1968); Squillante, Uniform Commercial Code Bibliography, 72 Com. L.J. 218 (1967); Squillante, Uniform Commercial Code Bibliography, 71 Com. L.J. 253 (1966). The basic purpose of this comment is to examine the bases for the assumed applicability of Article Two to franchise distribution, rather than to serve as another exegesis of the Code's text.

retail sales in the United States are generated by marketing through the franchise system,⁴ which has developed primarily during the last two decades.⁵ The various forms of franchising have established themselves as the predominant method of distribution in such industries as automobile sales and rental, gasoline service stations, soft ice cream and roadside restaurants, swimming pool sales and installation, carpet and upholstery cleaning services, and coinoperated laundries and dry cleaning establishments.⁶ The franchise system has been variously hailed as the last frontier of the individual entrepreneur,⁷ a panacea for the anti-competitive evils of vertical integration,⁸ a vehicle for low income group participation in commerce,⁹ and a weapon against the ubiquity of the chain store.¹⁰ Ideally, this marketing technique allows small companies to compete in a national marketplace as franchisors and offers small businessmen, who wish not to become employees, an entrepreneurial

⁴ S. 2507, 90th Cong., 1st Sess. § 2(a) (1967).

⁵ Notwithstanding the early uses of franchising by the automobile industry, Rexall, Howard Johnson, Ben Franklin, and Western Auto, franchising did not flourish until the years following World War 11. See H. Kursh. The Franchise Boom 4 (1962); E. Lewis & R. Hancock, The Franchise System of Distribution 1,10 (1963) (reprinted in Hearings on S. Res. 40 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 89th Cong., 1st Sess., pt. 1, at 279-381 (1965); Rudnick & Rudnick, Some Solutions to the Problems of Maintaining Quality Standards, Eliminating Unethical Practices, Supervising Promotions, and Ensuring Successful Management of Franchised and Non-franchised Retail Outlets, 11 Antitrust Bull. 509, 511 (1966).

⁶ E. LEWIS & R. HANCOCK, supra note 5, at 10.

⁷ See H. Kursh, supra note 5, at 1; Wilson, An Emerging Enforcement Policy for Franchising, 15 N.Y.L.F. 1 (1969).

^{*&}quot;If it is a national economic and social policy that our economy continue to provide opportunity for the small businessman, franchising is to be preferred over vertical integration." Rudnick & Rudnick, supra note 5, at 515-16; "In order to strengthen their competitive viability, many corporate enterprises, unable to establish their own vertically integrated distribution systems, have devised a variety of distribution techniques in the postwar period, frequently loosely referred to under the generic term franchising, which are hailed by many as the independent businessman's answer to vertical integration and as the only viable answer to the growth of concentration in this country." Jones, The Growth and Importance of Franchising and the Role of Law. 12 Antitrust Bull. 717, 720-21 (1967). See Pollock, Antitrust Problems in Franchising, 15 N.Y.L.F. 106, 107 (1969).

⁹ See Hearings on S. Res. 40 Before the Subcom. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 89th Cong., 1st Sess., pt. 1, at 94-100 (statement of Franklin D. Roosevelt, Jr., Under Secretary of Commerce) [hereinafter cited as 1965 Hearings]; id. at 476-95 (report to Secretary Luther H. Hodges entitled: Franchise Companies—Business Opportunities for Minority Groups). "Operating a franchised business offers minority group members a leg up in going into business for themselves." Id. at 478.

¹⁰ See Hall, Franchising—New Scope for an Old Technique, 42 HARV. BUS. REV. 60-61 (1964); Wilson, supra note 7, at 1-2.

alternative as franchisees.¹¹ Furthermore, franchising is itself an industry,¹² displaying many of the usual incidents of a business reality, including a trade association,¹³ trade publications,¹⁴ and franchising consultants.¹⁵ There is a lively national market in which individuals seek a franchise as a method of entering business, without necessarily desiring to distribute a particular product or service.¹⁶ The franchise system can unequivocally be described as popular¹⁷ and generally profitable.¹⁸

[&]quot;See e.g., Handler, Statement Before the Small Business Administration, 11 ANTITRUST BULL. 417, 419-20 (1966); Hewitt, supra note 2, at 1075-76; Jones, supra note 8, at 724-725; Slater, Franchising and Dual Distribution, 11 ANTITRUST BULL. 517, 519 (1966); Zeidman, Small Business Concerns—Franchising and Its Antitrust Problems, 29 ALA. LAW. 460, 461-62 (1968).

¹² "There are franchise companies, franchise consultants, franchise sales organizations—each vertical and horizontal outgrowth has developed to create an industry of the 60's." Rosenfield, Franchising and the Lawyer, 42 Fla. B.J. 17, 17 (1968) (emphasis added). Contra, Shuman, The Future of Franchising and Trade Regulation, 14 How. L.J. 60, 63, 64 (1968).

¹³ The International Franchise Association was formed in 1960. See H. Kursh, supra note 5, at 112-17; E. Lewis & R. Hancock, supra note 5, at 13; 1965 Hearings, supra note 9, at 47 (statement of Monte E. Pendleton, president, International Franchise Association); Hearings on S. 2507 and S. 2321 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 90th Cong., 1st Sess., at 165-66 (statement of Harry L. Rudnick, general counsel, International Franchise Association) [hereinafter cited as 1967 Hearings].

It has been observed that the formation of such a trade association is "the one true measure of arrival on the U.S. economic scene." Hall, *supra* note 10, at 60.

¹¹ See H. Kursh, supra note 5, at 53; E. Lewis & R. Hancock, supra note 5, at 13.

¹⁵ See H. Kursh, supra note 5, at 137-47. Kursh lists thirteen firms of professional franchise consultants. *Id.* at 146-47.

¹⁶ See E. Lewis & R. Hancock. supra note 5, at 11-13. The National Franchise Reports, "the clearing house of franchise information," has, since 1963, served as "a medium through which franchisors may publicize their offerings. In turn, it serves as a source of information to prospective franchises..." Id. at 11.

¹⁷ Franchising has been expansively complimented. E.g., "[w]e have given a factual demonstration of how typical everyday democracy works . . . in helping young Americans make a dream come true, a dream to operate a business of their own," H. Kursh, supra note 5, at 45 (statement of Pat Shlafer, president, Parts Unlimited, Inc.); a franchisee "is the type of person who struggles to maintain his individuality, who doesn't want to be a payroll card number in a vast organization, and who is willing to take a chance on his own abilities," 1965 Hearings, supra note 9, at 63 (statement of Robert L. Grover, executive vice-president, Snap-on Tool Corp.); "[t]he rash of merger activity over the last 10 years has created a definite vacuum of small businesses on the American scene. Keen competition from giant chain operations and the increasing complexity of business operations brought about through advancing technology and Government requirements has sharply increased the rate of business failures, making it virtually impossible for entrepreneurs to fill the small business vacuum unassisted. It is my feeling that the above problem can best be solved through aggressive franchise marketing organizations who have carefully designed programs to

The great diversity among franchise agreements19 has often led

eliminate most of the pitfalls facing the independent entrepreneur," id. at 44 (statement of Monte E. Pendleton, president, Sun-X International and International Franchise Association).

In addition to the self-serving compliments of industry spokesmen, franchising has received judicial accolades. "The franchise method of operation has the advantage, from the standpoint of our American system of competitive economy, of enabling numerous groups of individuals with small capital to become entrepreneurs. . . . If our economy had not developed that system of operation these individuals would have turned out to have been merely employees. The franchise system creates a class of independent businessmen; it provides the public with an opportunity to get a uniform product at numerous points of sale from small independent contractors, rather than from employees of a vast chain. The franchise system is therefore good for the economy." Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962), aff'd, 332 F.2d 505 (2d Cir.), cert. granted, 379 U.S. 885 (1964), cert. dismissed, 381 U.S. 125 (1965). "It is unnecessary to discuss the development of franchises in the American business world. It is a fact of business life and by and large its effects are wholesome and it furnishes a means for enterprising individuals and businesses to continue developing our competitive society along with all the bigness of business." United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 334-35 (N.D. III. 1965), rev'd, 388 U.S. 365 (1967).

One commentator has metaphorically remarked that: "Franchising is the natural outgrowth of technological evolution. It is the legitimate progeny of a marriage between small and big business, which both, like the male black widow spider, have accomplished the act of conception at the price of their own extinction. True to the fashion of mutation in the evolutionary process, franchising has inherited from each of its ancestors those features which will make it hest suited for its environment. It has the ability to amass capital and 'the broad representation and distribution of vertical integration and the initiative and aggressiveness of open marketing' all combined in a system of contractual integration. Thus, franchising will truly emerge as the model citizen in what has been described by John Kenneth Gailbraith as the 'new industrial state.'" 1967 Hearings, supra note 13, at 356 (statement of Professor Jerome Shuman).

The development of franchise distribution after World War II "touched off a boom which may continue unabated for years, altering traditional American marketing patterns." H. Kursh, supra note 5, at 5, "The franchise agreement has become one of the most successful marketing devices in the contemporary commercial world. McDonald's Hamburgers, the numerous \$1.29 steakhouses, and the gasoline and automobile industries all utilize this mode of distribution in presenting their products to the public. The success of the Holiday Inns of America, Inc. and the Howard Johnson franchise systems has caused the giants of the hotel industry, the Hilton Corporation and the Sheraton Corporation, to announce recently that some of their hotels are to be constructed under franchise agreements." Coleman, A Franchise Agreement: Not a "Security" Under the Securities Act of 1933, 22 Bus. Law. 493, 493 (1967). "Nearly all conceivable food establishments from Chinese food to doughnuts, hamburgers, pancakes, pizzas, chicken, enchiladas, ice cream, are the subject of franchising. The Hertz or Avis car you rent; the Manpower or Kelly girl you hire; the drugstore you visit; the Ford dealer you bought your car from; the gas station you filled it up at; the man you called to clean your rug; all are the subject of franchises." Slater, supra note 11, at 519.

¹⁹ This diversity is of a dual nature. The term "franchise" has been applied to a variety of marketing techniques, and the terms of individual franchise agreements differ greatly from others of the same general type. Compare Axelrad, Franchising and Dual Distribution, 11 ANTITRUST BULL. 533, 533 (1966) and Jones, supra note 8, at 721 with Coleman, supra note 18, at 493.

commentators to conclude that franchising as an economic concept virtually defies precise definition.²⁰ In broadest terms, however, a franchise distribution agreement can be defined as the arrangement between one commercial unit, the franchisor, which produces a good or organizes a service, and another commercial unit—independent of the franchisor and known as the franchisee—which distributes the good or service to consumers.²¹ Indeed, a more precise verbal formulation having universal applicability may be as much impractical as impossible, and functional descriptions may be more helpful.

Franchising can be said to exist in four basic commercial relationships:²² (1) manufacturer-retailer;²³ (2) manufacturer-

For other definitions and descriptions of franchising see H. Kursh, supra note 5, at 14-15; 1965 Hearings, supra note 9, at 78 (statement of Paul Rand Dixon, Chairman, Federal Trade Commission). But see Wilson, supra note 7. As a word, "franchise," is said to have been "diluted to the point of meaninglessness."

²² Hall, supra note 10, at 62-63. Another commentator includes manufacturer-retailer, manufacturer-wholesaler, and wholesaler-retailer franchising within the first part of a dichotomy with the second portion describing service sponsor-retailer franchising. "Franchise arrangements can take a wide variety of forms, but generally they are divisible into two categories: (1) the issuance of a franchise to a distributor or dealer who may handle other products as well as those of the franchisor and customarily does business under his own trade name; and (2) the franchising of entire business enterprises in which the franchisee operates his business under the franchisor's trade name, is identified as a member of a select group of dealers, and generally is required to follow standardized or prescribed methods of operation." Handler, supra note 11, at 418.

²⁰ 1965 Hearings, supra note 9, at 6 (statement of Eugene P. Foley, Administrator, Small Business Administration); Wilson, Some Problems Relative to Franchise Arrangements, 11 ANTITRUST BULL. 473, 473 (1966).

²¹ E. LEWIS & R. HANCOCK, supra note 5, at 1. The proposed Franchise Distribution Act of 1967 defined "franchise" as "every aspect of the relationship created between a franchisor and franchisee by an . . . agreement . . . which involve[s] . . . a continuing commercial relationship by which a franchisee is granted or permitted to offer, sell, or distribute the goods . . . manufactured . . . by the franchisor, or the right to offer or sell services established, organized, directed, or approved by the franchisor." S. 2507, 90th Cong., 1st Sess. (1967) (emphasis added). The proposed Franchise Competitive Practice Act of 1967 also offered a definition. "[T]he term 'franchise' means a contract, agreement, or understanding between two persons that involves a continuing commercial relationship between them and that grants to one person . . . 'the franchisee,' the right to offer, sell, and distribute goods, services, or commodities manufactured, processed, distributed or (in the case of services) organized and directed by the other person, . . . 'the franchisor' 'S. 2321, 90th Cong., 1st Sess. (1967) (emphasis added). The International Franchise Association defines franchising as "a continuing relationship in which a franchisor provides a licensed privilege to do business, plus assistance in organizing, training, merchandising, and management NATIONAL BETTER BUSINESS BUREAU, INC., FACTS ABOUT FRANCHISING (rev. 1965), as quoted in Jones, supra note 8, at 722 n.9 (emphasis added). It is evident that these definitions place great emphasis on the relationship that arises after the parties execute the franchise distribution agreement.

wholesaler;²⁴ (3) wholesaler-retailer;²⁵ (4) service sponsor-retailer.²⁶ Although these relationships have many common economic and legal attributes,²⁷ the fourth category is the primary concern of this comment, since it is the area of the greatest current franchise growth²⁸ and seems destined to present many problems of legalistic classification.²⁹

²² This relationship occurs in two forms. The manufacturer of such goods as appliances or televisions may franchise his brand as part of a department in a retail store or the goods may constitute the entirety of the retail outlet, such as an automobile dealership. Hall, supra note 10, at 62. The automobile industry developed this form of franchising and was using it extensively by 1910-1911. E. Lewis & R. Hancock, supra note 5, at 10.

Limitations were imposed on the termination of automobile dealer franchises by the Automobile Dealers' Day-in-Court Act, 15 U.S.C. §§ 1221-25 (1964). The Dealers' Day Act and the various state statutes regulating the automobile manufacturer-dealer relationship are analyzed from the perspective of their history and their measurable impact on the industry in S. Macaulay, Law and the Balance of Power—The Automobile Manufacturers and Their Dealers (1966). See also Comment, The Automobile Dealer Franchise Act of 1956—An Evaluation, 48 Cornell L.Q. 711 (1963); Comment, The Elusive Measure of Damages for Wrongful Termination of Automobile Dealership Franchises, 74 Yale L.J. 354 (1964). Other authorities discussing the Dealers' Day Act and automobile dealer franchises are collected in Gellhorn, Limitations on Contract Termination Rights—Franchise Cancellations, 1967 Duke L.J. 465, 470 n.16.

The various state automobile dealer franchise acts are collected at 9 S. WILLISTON, CONTRACTS § 1017AA (3d ed. 1967).

For general analyses of the automobile dealer-manufacturer relationship see C. HEWITT, AUTOMOBILE FRANCHISE AGREEMENTS (1956); B. PASHIGIAN, THE DISTRIBUTION OF AUTOMOBILES, AN ECONOMIC ANALYSIS OF THE FRANCHISE SYSTEM (1961).

²⁴ The most prevalent example of this relationship is the soft drink industry. The manufacturer franchises independent bottlers who wholesale the drinks to many retail outlets. Hall, *supra* note 10, at 62-63.

²⁵ This relationship exists in two forms. In the "cooperative" form, such as Associated Grocers and Certified Grocers of America, retailers organize and buy or create the wholesale unit. In the "voluntary" form, independent retailers affiliate themselves with privately owned wholesalers such as Independent Grocers Alliance (IGA) and National Automotive Parts Association (NAPA). Hall, *supra* note 10, at 63.

²⁵ This is the relationship which pervades the industries of soft ice cream drive-ins, hamburger stands, and many other retail outlets where a business serving customers in a specialized area is built around a product, such as food. See Hall, supra note 10, at 63; note 30 infra and accompanying text.

It is this relationship that Lewis and Hancock term "the franchising system of distribution—where an entire business enterprise is franchised" E. Lewis & R. Hancock, supra note 5, at 7. However, because this phrase could easily be applied to all four of these franchise relationships, the Hall terminology will be employed in this comment,

²⁷ The sale of consumer goods and services is an important aspect of all four of the basic relationships where franchising can be found, and all four relationships involve the conveyance of a similar legal right, the right either to distribute the franchisor's product or distribute goods through a system produced by the franchisor.

2x See Hall, supra note 10, at 63; notes 5 and 18 supra and accompanying text.

²⁹ Illustrative of these difficulties is Gowdey v. Commissioner, 307 F.2d 816 (4th Cir. 1962), which involved a Dairy Queen franchise. "There is a scarcity of precedent upon the

The service sponsor-retailer franchise relationship exists where the franchisee has acquired a conditional right to conduct a business, usually of a specialized variety, according to a detailed pattern developed and marketed by the franchisor.³⁰ It is through a franchise distribution agreement, which is usually an enforceable contract, that this right is acquired, but the business activities that follow the contract constitute a significant element of the relationship. The franchisor may provide managerial assistance, enforce restrictive terms of the initial agreement, and sell inventory to the franchisee.³¹

Predictably, the rapid growth of this unique commercial arrangement has spawned significant legal questions. The restraints placed upon franchisees to achieve uniformity and preserve territorial integrity have raised a number of antitrust questions, which have been extensively litigated and commented upon.³²

point of the legal stature of such franchises. For assistance in the resolution of the issues here we must first go to resemblant instruments. The principles governing transfers of rights of use have been generally enunciated in litigation of patents, copyrights, secret processes and insurance agency contracts. While the privileges . . . [of a franchise] are neither patent rights nor one of the other classes, all involve intangibles and have additional common qualities. While far from perfect analogues and not completely controlling, the other instances are helpful in our determination of the status of the [f]ranchise [a]greement" Id. at 818.

30 See E. Lewis & R. Hancock, supra note 5, at 8. See also Handler, supra note 11, at

³¹ See E. Lewis & R. Hancock, supra note 5, at 31-33, 35-51.

32 See, e.g., Perma Life Mufflers, Inc. v. International Parts, Corp., 392 U.S. 134 (1968); United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967); United States v. Sealy, Inc., 388 U.S. 350 (1967); FTC v. Brown Shoe Co., 384 U.S. 316 (1966); White Motor Co. v. United States, 372 U.S. 253 (1963); Sandura Co. v. FTC., 339 F.2d 847 (6th Cir. 1964); Susser v. Carvel Corp., 332 F.2d 505 (2d Cir.), cert. granted, 379 U.S. 885 (1964), cert. dismissed, 381 U.S. 125 (1965); Snap-on Tools Corp. v. FTC., 321 F.2d 825 (7th Cir. 1963); Franchise Competitive Practice Act of 1967, S. 2321, 90th Cong., 1st Sess. (1967); Averill, Sealy, Schwinn and Sherman One: An Analysis and Prognosis, i5 N.Y.L.F. 39 (1969); Borowitz, Pricing Problems in Distributor and Franchise Systems, 38 U. Cin. L. Rev. 258 (1969); Groenke, What's New in the Antitrust Aspects of Selecting and Terminating Distributors, 13 ANTITRUST BULL. 131 (1968); Handler, supra note 11; Jones, supra note 8; Keck, Alternative Distribution Techniques-Franchising, Consignment, Agency, and Licensing, 13 Antitrust Bull. 177 (1968); Henderson, Remarks by James Mcl. Henderson, 11 ANTITRUST BULL. 489 (1966); McLaren, Marketing Limitations on Independent Distributors and Dealers-Prices, Territories, Customers, and Handling of Competitive Products, 13 ANTITRUST BULL. 161 (1968); Pollock, supra note 8; Rahl, Overseas Distribution, Franchising, and Licensing-Comparison with Domestic Techniques, 13 ANTITRUST BULL. 193 (1968); Rudnick, The Pathology of the Franchise Relationship, 1967 INT'L FRANCHISE ASS'N LEGAL BULL. 244, 244-52; Slater, supra note 11; Wilson, supra note 20; Zeidman, supra note 11; Schwinn and Sealy, 1967 INT'L FRANCHISE ASS'N LEGAL BULL. 138, 139-58; 13 VILL. L. REV. 192 (1967).

Additional areas of contention include the possibility of capital gains treatment for the sale of the franchise by the franchisee,³³ the liability of the franchisor for acts of the franchisee,³⁴ the necessity for the franchisor to qualify to do business in the franchisee's state as a foreign corporation,³⁵ and the protection by the franchisor of his trademark.³⁶ The possibilities have also been raised that a

The areas of franchising from which questions of restraint of trade arise include: (1) exclusive buying restrictions (2) exclusive selling restrictions (3) customer and territorial restrictions and (4) quality control of trademarked products, including price maintenance. Pollock, supra note 8, at 109-17. The reasonableness of these restraints, imposed upon the franchisee by the franchisor, has been hotly debated, and the question remains fluid to some extent. Most of this antitrust litigation has involved manufacturer-retailer, manufacturer-wholesaler, and wholesaler-retailer franchising. It has been suggested that the antitrust aspects of service sponsor-retailer franchising differ markedly because of the statutory duty and economic need for control that the licensor of a trademark must exercise over his licensee's products. See Jones, supra note 8, at 736-37 (the author is a Commissioner of the Federal Trade Commission); Wilson, supra note 7, at 6, 13. See generally Note, Quality Control and the Antitrust Laws in Trademark Licensing, 72 YALE L.J. 1171 (1963).

The See, e.g., United States v. Werentin, 354 F.2d 757 (8th Cir. 1965); Moberg v. Commissioner, 310 F.2d 782 (9th Cir. 1962); Gowdey v. Commissioner, 307 F.2d 816 (4th Cir. 1962); Moberg v. Commissioner, 305 F.2d 800 (5th Cir. 1962); Dairy Queen v. Commissioner, 250 F.2d 503 (10th Cir. 1957); Comment, The Dairy Queen Cases: A Suggested Approach to the Taxation of Franchise Sales, 34 U. Chi. L. Rev. 884 (1967); 80 Harv. L. Rev. 455 (1966); 52 Va. L. Rev. 367 (1966).

This question has been litigated primarily in the context of transactions between Dairy Queen territorial franchisees and subfranchisees; however, the issue could be equally relevant to the conveyance by any franchisee of his interest to another franchisee. The various circuits have reached divergent results, but the common issue is whether the conveying party has parted with sufficient control over the franchisee's business for there to be a sale rather than a licensing arrangement. The finding of "sale" is one of the prerequisites for capital gains treatment of the proceeds from such a transaction. It has generally been assumed that the other prerequisite was met, that the subject of the transaction was a "capital asset." "The critical question for the courts has been whether conditions imposed in the contracts between . . . [territorial franchisees] and subfranchisee[s] transform purported sales into licensing agreements and thus require that gains be taxed at ordinary rates." 34 U. Chi. L. Rev., supra at 885.

²⁴ See Staples v. Arthur Murray, Inc., 253 Cal. App. 2d 507, 61 Cal. Rptr. 103 (1967); Porter v. Arthur Murray, Inc., 249 Cal. App. 2d 410, 57 Cal. Rptr. 554 (1967); Nichols v. Arthur Murray, Inc., 248 Cal. App. 2d 610, 56 Cal. Rptr. 728 (1967); Beck v. Arthur Murray, Inc., 254 Cal. App. 2d 976, 54 Cal. Rptr. 328 (1966); Vowels v. Arthur Murray Studios of Michigan, Inc., 12 Mich. App. 359, 163 N.W.2d 35 (1968); Rudnick, supra note 32, at 255-56; Note, Liability of a Franchisor for Acts of the Franchisee, 41 S. Cal. L. Rev. 143 (1968). But see Patenanda v. Anderson, 5 UCC Rep. Serv. 1174 (Mass. App. Div. 1968); Kaniewski v. Warner, 12 Mich. App. 355, 163 N.W.2d 34 (1968).

²³ See Rudnick, supra note 32, at 252-55. The amenability of parties to a franchise contract to substituted service of process under a state "long-arm" statute, as litigated in Kastan v. Kastan, 222 So. 2d 55 (Fla. 1969), is an analogous question.

³⁶ See Burger King v. Hoots Burger King, 403 F.2d 904 (7th Cir. 1968); McDonald's Corp. v. Moore, 363 F.2d 435 (5th Cir. 1966); Burger King v. Brewer, 244 F. Supp. 293

franchise is a security, to which the appropriate regulatory laws would apply,³⁷ and that the relationship of franchisee and franchisor should be governed by the rules surrounding fiduciary relations.³⁸ Franchise termination litigation has often involved traditional notions of contract law such as freedom of contract, waiver, estoppel, and good faith.³⁹

The increased significance of franchising has also prompted several, as yet unsuccessful, legislative proposals designed to impose federal regulation. The proposed Franchise Distribution Act of 1967 would have provided the franchisee with a formidable legal arsenal by making it unlawful for a franchisor to: "fail to act in a fair, equitable, and nondiscriminatory manner;" "coerce, intimidate, threaten, or restrain any franchisee;" "act dishonestly;" or "fail to act in accordance with reasonable standards of fair dealing." In addition to regulating various other

(W.D. Tenn. 1965); Arnold & Durkee, Trademark and Unfair Competition Considerations in Franchised Business Operations, 15 N.Y.L.F. 80 (1969); Gilson, Anatomy of a Franchise Agreement—Trademark Law Aspects, 1967 INT'L FRANCHISE ASS'N LEGAL BULL. 212.

The Lanham Act, 15 U.S.C. §§ 1051-1127 (1964), provides for the licensing of trademarks if the licensor adequately controls the quality of his licensee's product. The exercise of this control, however, may be in violation of the antitrust laws. Several authorities discussing this issue are collected at 41 S. Cal. L. Rev., supra note 34, at 147 n.17. See also Treece, Trademark Licensing and Vertical Restraints in Franchising Arrangements, 116 U. Pa. L. Rev. 435 (1968); 72 Yale L.J., supra note 32. See generally Comment, Trademark Licensing: The Problem of Adequate Control, 1968 Duke L.J. 875. The exercise of this control may also render the franchisor liable as a principal for the acts of his franchisees. See 41 S. Cal. L. Rev., supra note 34.

³⁷ See Coleman, supra note 18; Note, Franchise Regulation Under the California Corporate Securities Law, 5 SAN DIEGO L. Rev. 140 (1968); note 76 infra.

The Attorney General of California has determined that in some circumstances a franchise agreement would constitute a security, which would be governed by the state's Blue Sky Law. See 49 Op. CAL. ATT'Y GEN. 124 (1967).

²⁸ See Brown, The Realities of Franchising, 73 Com. L.J. 371, 372-74 (1968). See also Bromberg v. Holiday Inns of America, 388 F.2d 639, 645-46 (7th Cir. 1967).

³⁹ See Gellhorn, supra note 23, at 472-95; Henderson, Promissory Estoppel and Traditional Contract Doctrine, 78 YALE L.J. 343, 363-64 (1969).

A case of great potential is Hoffman v. Red Owl Stores, Inc., 26 Wis. 2d 683, 133 N.W.2d 267 (1967) where promissory estoppel was employed to correct injurious reliance incurred during aborted franchise negotiations.

⁴⁰ The recent legislative proposals are collected and reviewed in Fels, *The Beginning and the End of the Franchise Agreement—Some Collateral Problems*, 1967 INT'L FRANCHISE ASS'N LEGAL BULL. 222, 235; Gellhorn, *supra* note 23, at 470-71 n.18; Zeidman, *supra* note 11, at 480-81; Zeidman, *Legislative Supervision of the Franchise Contract: Throwing Out the Baby with the Bath Water?* 15 N.Y.L.F. 19 (1969).

⁴¹ S. 2507, 90th Cong., 1st Sess., § 4 (1967).

aspects of the franchise relationship,⁴² the Act would have required the franchisor, upon termination without the consent of the franchisee, to purchase at their fair market value all land, buildings, and equipment used in the franchise, to buy back inventory at its fair market value, and to pay the franchisee the fair market value of the franchise, including good will.⁴³

Implicit in all of these proposals and questions is the tension that frequently exists between old rules and new forms of contractual relations.⁴⁴ Questions and confusion have arisen as franchise agreements are unsuccessfully assimilated into existing legal concepts.

Into this legal maelstrom⁴⁵ the proposition has been interjected that the "classified and coordinated uncertainties" of the Uniform Commercial Code control the termination of franchise relationships.⁴⁶ There has been, however, no analysis of why the

⁴² Franchisors would have been prohibited from engaging in the following activities: (1) selling goods or rendering services in unfair competition with any franchisee; (2) selling to one franchisee at prices or on terms different from those for other franchisees; (3) selling to anyone else at prices lower than to franchisees; (4) acting dishonestly or not in accordance with reasonable standards of fair dealing with respect to the franchisee's right to dispose of his business. The proposed penalty for violation was double the damages that resulted from the franchisee's injury, including loss of capital, loss of past or future profits, and increased costs of doing business. *Id.* §§ 6-9, 11.

⁴³ Id. § 9(b).

[&]quot;As was said of the primordial franchising form, the sales agency, the franchise system of distribution has met the problem that the legal system must "adapt old rules to new kinds of contracts, to reconcile somewhat crystallized concepts with the working needs of modern business." Note, The Necessity for "Mutuality" and the Right of Termination in Sales Agencies, 28 ILL. L. Rev. 800, 800-01 (1934).

⁴⁵ "The only certain thing regarding much of the law of franchising is that it is uncertain." Zeidman, *supra* note 11, at 460.

⁴⁶ See Hewitt, supra note 2. After listing the Code provisions which he feels are relevant to franchise distribution, Professor Hewitt concludes that "[t]he Code is likely to cause many franchisors to change some of their franchising strategies and their franchise terms. Counsel responsible for controlling the legal risks of franchising will have to take into account the fact that many unexpressed obligations may be now implied by the Code." Id. at 1085. The question of the Code's applicability to franchising has been explicitly discussed in apparently only one reported opinion. See Mastrian v. William Freihofer Baking Co., 45 Pa. D. & C. 2d 237 (C.P. Luzerne County 1968); notes 60-69 infra and accompanying text.

Intimations of this proposition have been made. See Tele-Controls, Inc. v. Ford Industries, Inc., 388 F.2d 48 (7th Cir. 1967); Massachusetts Gas & Electric Light Supply Corp. v. V-M Corp., 387 F.2d 605 (1st Cir. 1967); Eskimo Pic Corp. v. Whitelawn Dairies, Inc., 284 F. Supp. 987 (S.D.N.Y. 1968); Warner Motors, Inc. v. Chrysler Motors Corp., 5 UCC Rep. Serv. 365 (E.D. Pa. 1968); Sinkoff Beverage Co. v. Joseph Schlitz Brewing Co., 51 Misc. 2d 446, 273 N.Y.S.2d 364 (Sup. Ct. 1966); Weilersbacher v. Pittsburgh Brewing Co., 421 Pa. 118, 218 A.2d 806 (1966). Professor Gellhorn introduces his discussion of limitations on

Code's Article Two does or should apply to franchise distribution agreements. Rather it has been assumed *sub silentio* that franchise agreements fall within the subject matter to which Article Two ostensibly applies.⁴⁷ In view of the commercial significance of franchise distribution, a discussion of this fundamental question seems necessary. Furthermore, in whatever areas of franchising the Code is relevant, some indication of its potential impact can be gained by an analysis of the Code provisions in relation to practical problems of franchising as a trade and a method of distribution.

FRANCHISE AGREEMENTS WITHIN THE LANGUAGE AND THE SPIRIT OF THE CODE

The contractual elements of different franchise distribution agreements vary according to the needs of the trade involved and the expectations of the parties. Nevertheless some similarities are evident, including the following terms: the licensing of a registered trademark;⁴⁸ the granting of an exclusive territorial market;⁴⁹ restrictions of inventory supply sources, including buying arrangements specifying minimum quantities;⁵⁰ a provision for consideration based upon a percentage of the franchisee's receipts;⁵¹ stated conditions controlling termination of the relationship;⁵² and the imposition of standards of quality and physical appearance

franchise contract termination rights by stating that "[t]he Uniform Commercial Code makes limited inquiries into the fairness or reasonableness of the termination of a sales contract. and the Dealers' Day Act, as interpreted, protects the automobile dealer from coercion. But neither statute applies to franchises in general..." Gellhorn, supra note 23, at 471 (emphasis added). See also id. at 508-17. After quoting from the articles of Professors Gellhorn and Hewitt, another commentator concluded that "[t]here is good reason to suspect that the courts may pay heed to suggestions that the 'unconscionability' tests of the Code be extended beyond sales—to franchising and termination clauses in franchise agreements." Fels, supra note 40, at 235. For perhaps the earliest suggestion that 2-302 of the Code would have an impact on franchise distribution, see Note, Dealer Franchise Agreements, 63 HARV. L. Rev. 1010, 1019 (1950).

- ⁴⁷ See Hewitt, supra note 2; note 3 supra. But see Mastrian v. William Freihofer Baking Co., 45 Pa. D. & C. 2d 237 (C.P. Luzerne County 1968).
- ⁴⁸ See, e.g., H. Kursh, supra note 5, at 207-08 (Mister Donut Dealer's Franchise Agreement); 1965 Hearings, supra note 9, at 403-04 (Midas, Inc. Franchise).
- ⁴⁹ See, e.g., H. Kursh, supra note 5, at 220 (Parts Unlimited, Inc. Franchise Agreement). See E. Lewis & R. Hancock, supra note 5, at 22-24.
- ⁵⁰ See, e.g., 1965 Hearings, supra note 9, at 408 (The Dog House, Inc. Operator's Agreement), 423 (Application and Agreement for a Duraclean Dealership).
 - ⁵¹ See E. Lewis & R. Hancock, supra note 5, at 28-31.
- ⁵² See, e.g., H. Kursh, supra note 5, at 233 (Atlas National Bonded Brakes, Inc. Franchise Agreement). See E. Lewis & R. Hancock, supra note 5, at 60-66.

which produce national uniformity.⁵³ It should be apparent that such an agreement may deal with both intangible rights and tangible chattels. To assess fully the relevance of Article Two to franchise agreements, it is necessary to understand clearly that both things are involved; then the Code's relationship to them individually and collectively, as they form the entirety of an agreement, can be viewed.

The Sale of Goods Within the Franchise Relationship

While the primary thrust of this comment will be directed at the Code's applicability to intangible distribution rights, it should be obvious that the language of the Code applies directly to the equipment and inventory which is sold to the franchisee by the franchisor. Clearly, such items fall within 2-105(1) as Code goods.⁵⁴ This commerce is economically significant,⁵⁵ and litigation arising from it may raise significant Code issues.⁵⁶ Indeed, every aspect of Article Two, from warranties⁵⁷ to remedies,⁵⁸ governs these sales. These problems will be discussed only as they bear upon the application of the Code to the intangible elements of the franchise relationship and not as they arise from the sale of goods alone.

Is Article Two Directly Applicable to the Intangible Elements of Franchise Distribution Agreements?⁵⁹

ss See, e.g., Susser v. Carvel Corp., 332 F.2d 505, 508-09 (2d Cir.), cert. granted, 379 U.S. 885 (1964), cert. dismissed, 381 U.S. 125 (1965) (description of Carvel Corp. Standard Operating Procedure Manual); H. Kursh, supra note 5, at 241-43 (Chicken Delight, Inc. Agreement). See E. Lewis & R. Hancock, supra note 5, at 36-41.

⁵⁴ See Uniform Commercial Code § 2-105(1) [hereinafter cited as UCC].

⁵⁵ See Susser v. Carvel Corp., 332 F.2d 505, 509 (2d Cir.), cert. granted, 379 U.S. 885 (1964), cert. dismissed. 381 U.S. 125 (1965); Engbrecht v. Dairy Queen Co., 203 F. Supp. 714, 717-18 (D. Kan. 1962); E. Lewis & R. Hancock, supra note 5, at 28-31. In 1957 Carvel Corporation sold to its franchisees supplies, equipment, and machinery totaling \$5,532,396. Susser v. Carvel Corp., supra at 509.

⁵⁶ See notes 198-203 and 219-21 infra and accompanying text.

⁵⁷ See UCC §§ 2-312 to 2-318.

⁵⁸ See UCC §§ 2-701 to 2-725.

⁵⁹ The dichotomy between "direct" and "analogous" application of the Code is artificial to some extent. Once a particular section is "applied" by a court, it makes little difference whether it found the contract within the subject matter of the statute or whether it found the policies of the statute to be relevant to the contract. The significant difference in the two approaches is, however, that when a section of the Code is applied directly, the parties to the

This question has apparently been directly answered only once by a court of record, and it was there answered in the affirmative. In Mastrian v. William Freihofer Baking Co.,60 the defendantfranchisor contended that the "reasonable notice" provision of 2-309(3) was inapplicable because it related "only to sales of goods as . . . defined in § 2-102."61 He further argued that "a 'sales distribution' arrangement" was "not within the purview of the Uniform Commercial Code "62 In finding that 2-309(2) was applicable, the court relied on Weilersbacher v. Pittsburgh Brewing Co., 63 where the Pennsylvania Supreme Court employed 2-309(2) in a decision concerning a beer distributorship.64 lt is arguable that 2-309(2) affects franchise agreements only coincidentally, because it is directed at the sale of goods through a continuing relationship.65 However, the Mastrian court's employment of 1-107 in discussing the defendant's contention of mutual rescission,66 made manifest its view that the Code was directly applicable. This basic question of the Code's scope was also presented by the facts of Eskimo Pie Corp. v. Whitelawn Dairies, Inc.67 Eskimo had granted one subsidiary of Allstate Dairies the right to manufacture products bearing "Eskimo" wrappers and granted another subsidiary the "non-exclusive" right to purchase products from either Eskimo or an authorized manufacturer. In seeking to show by parol evidence

agreement and others to similar agreements can expect other sections of the statute to govern future activities. If a provision is applied analogically, other provisions will be applied only if the policies of other sections are equally valid in franchise contexts. See Sawyer v. Pioneer Leasing Corp., 244 Ark. 943, 957, 428 S.W.2d 46, 54 (1968) where 2-316(2) was held to be applicable to leases whose provisions were analogous to a sale. "[T]his holding has no effect on any other provisions in the code . . . "244 Ark. at 957-58, 428 S.W.2d at 54.

^{60 45} Pa. D. & C. 2d 237 (C.P. Luzerne County 1968).

⁶¹ Id. at 239.

⁶² Id.

⁴²¹ Pa. 118, 218 A.2d 806 (1966).

⁶⁴ Id.

cs Thus, Weilersbacher and the widely cited decision of Sinkoff Beverage Co. v. Joseph Schlitz Brewing Co., 51 Misc. 2d 446, 273 N.Y.S.2d 364 (Sup. Ct. 1966), discussed infra at notes 199-201 and accompanying text, would not seem to be true Code-franchise cases. Nevertheless, one premise of Sinkoff has been said to be "that section 2-302 is applicable to distributorship agreements (and, presumably, to others like them)" Ellinghaus, supra note 2, at 811. Indeed, the distinction between the termination of the sale of goods and the termination of a franchise may be purely academic in the wholesaler-distributor context, such as Sinkoff, but the distinction may be a real difference in the service sponsor-retailer context, where the goods sold the franchisee are not the principal elements of the relationship.

^{66 45} Pa. D. & C. 2d at 240-41.

^{67 284} F. Supp. 987 (S.D.N.Y. 1968).

that "non-exclusive" meant that Eskimo would solicit franchises in metropolitan New York only from national companies that it served in other parts of the country, the franchisee relied on 2-202. Although the court held that the transaction predated the effective date of the Code and decided the question using a case law formulation of the parol evidence rule, it did not question in any manner the applicability of the Code to these intangible rights, and it even discussed the manner in which the same result would be reached under the Code. if

Mastrian and Eskimo Pie notwithstanding, Article Two's perimeters of applicability are seemingly drawn by 2-102: "Unless the context otherwise requires, this Article applies to transactions in goods..." If franchise distribution agreements are to be "directly" governed by Article Two, they must at least come within the Code's own descriptions of "transaction" and "goods."

Despite the other obstacles that must be overcome to find Article Two directly applicable, a franchise agreement would seem to have no problem in establishing itself as a "transaction." Little can be said about this broad, undefined verbal territory except that it is not defined by the Code⁷¹ and that it would appear to be broader in scope than "sale," the title of Article Two.⁷²

The other element of 2-102, the Code's concept of "goods," is a far more formidable barrier. The definition provided in 2-105(1) indicates that Code goods must have a quality of tangibility, since "'[g]oods' means all things... which are movable at the time of identification to the contract for sale... "73 Neither the system

⁶⁸ Id. at 992-95. Similarly, in Cyclo Floor Machine Corp. v. National Housewares, Inc., 296 F. Supp. 665, 681-82 (D. Utah 1968) the court noted the chronolgoical inapplicability of the Code but gave no indication that the nature of the contract excluded it from coverage.

^{69 284} F. Supp. at 992.

⁷⁰ UCC § 2-102 (emphasis added).

⁷¹ Epstein v. Giannattasio, 25 Conn. Supp. 109, 111, 197 A.2d 342, 344 (C.P. 1963); Annot., 17 A.L.R.3d 1010, 1047 (1968).

⁷² "Clearly, a 'transaction' encompasses a far wider area of activity than a 'sale,' and it cannot be assumed that the word was carelessly chosen." Hertz Commercial Leasing Corp. v. Transportation Credit Clearing House, 6 UCC Rep. Serv. 132, 136 (N.Y. Civ. Ct. Feb. 20, 1969). "The use of the word 'transactions' is clearly intentional, and it is a broader word than 'sale.' "R. Duesenberg & L. King. Sales and Bulk Transfers Under the Uniform Commercial Code § 3.02, n.16 (1968); accord, Annot., 17 A.L.R.3d 1010, 1047 (1968). See generally General Elec. Co. v. Pettingell Supply Co., 347 Mass. 631, 199 N.E.2d 326 (1964); Şkinner v. Tober Foreign Motors, Inc., 345 Mass. 429, 187 N.E.2d 669 (1963).

⁷³ UCC § 2-105(1) (emphasis added). The Comment to this definition affirms this connotation of tangibility. "The definition of goods is based on the concept of movability

of business operation under a trademark of the franchisor, which is the subject matter of a service sponsor-retailer agreement, or the grant of an exclusive selling right, which is often involved in any type of franchise agreement, can fit naturally into the Code's category of goods.⁷⁴ Even assuming that franchises are "property," an abstract characterization of them as Code goods would torture a critical concept unnecessarily.⁷⁶

75 See Gowdey v. Commissioner, 307 F.2d 816, 818 (4th Cir. 1962); note 33 supra.

Furthermore, it is arguable that since 2-105(1) expressly excludes investment securities from direct coverage by Article Two, franchises are thereby excluded. See UCC § 2-105(1). However, it is noted in the Comment that "[i]t is not intended by this exclusion . . . to prevent the application of a particular section of this Article by analogy to securities" UCC § 2-105, Comment 1. A security under the Code is an instrument which "evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer." UCC § 8-102(1)(a)(iv) (emphasis added). The Comment indicates that this definition was not intended to include anything "which is not either 'of a type commonly dealt in upon securities exchanges or markets,' or 'commonly recognized . . . as a medium for investment." UCC § 8-102, Comment (emphasis added). The possibility that a franchise which is procured only as a medium for investment is an investment contract has been raised in the contexts of the Securities Act of 1933 and state Blue Sky laws. The analysis of franchising and the 1933 Securities Act is by Coleman, supra note 18. The author points out that some franchisees view a franchise as "an investment from which . . . [they expect] to receive a profit while remaining free to pursue the work of . . . [their] chosen field." Id. at 493. Under the standard of SEC v. W.J. Howey Co., 328 U.S. 293 (1946), an

^{....} It is not intended to deal with things which are not fairly identifiable as movables before the contract is performed." UCC § 2-105, Comment 1.

[&]quot;It seems that the present question has not received judicial attention. Indeed, "[t]here is a dearth of case law construing" this provision. Epstein v. Giannattasio, 25 Conn. Supp. 109, 111, 197 A.2d 342, 344 (C.P. 1963). The definition of Code goods has arisen when it was disputed whether the subject-matter of a transaction was a good or a service. See id. (beauty parlor treatment is not a sale of goods); Lovett v. Emory Univ., Inc., 116 Ga. App. 277, 156 S.E.2d 923 (1967) (blood transfusion is not a sale); Jackson v. Muhlenberg Hospital, 96 N.J. Super. 314, 232 A.2d 879 (1967), rev'd and remanded for additional evidence, 53 N.J. 138, 249 A.2d 65 (1969) (blood transfusion is a sale); Carter v. Inter-Faith Hospital, Misc. 2d _____, 304 N.Y.S.2d 97 (Sup. Ct. 1969) (blood bank is merchant with respect to goods of that kind); Cheshire v. Southampton Hosp. Ass'n, 53 Misc. 2d 355, 378 N.Y.S.2d 531 (Sup. Ct. 1967) (surgical insertion of a defective pin constitutes a cause of action in warranty, but plaintiff has to prove that this was a sale). See also cases cited note 79 infra. Several cases construing the Code definition of goods are collected at Annot., 17 A.L.R.3d 1010, 1048 (1968). Other cases include: Foster v. Colorado Radio Corp., 381 F.2d 222 (10th Cir. 1967) (broadcast license and real estate involved in sale not goods); In re Midas Coin Co., 264 F. Supp. 193 (E.D. Mo. 1967) (when used as a commodity money is a good), aff'd per curiam sub nom. Zuke v. St. Johns Community Bank, 387 F.2d 118 (8th Cir. 1968); Lunsford v. Wilson, 113 Ga. App. 602, 149 S.E.2d 515 (1966) (furniture and fixtures in liquor store assumed to be goods); Recchio v. Manufacturers & Traders Trust Co., 55 Misc. 2d 788, 286 N.Y.S.2d 390 (Sup. Ct. 1968) (mobile home is a good).

⁷⁶ The Code definition of "goods" is used repeatedly in other provisions, e.g., §§ 2-103(1)(d), 2-104(1), 2-106(1), 2-107.

An examination of "transaction" and "goods," the elements of 2-102, would not seem to be exhaustive, however, of the reasons for excluding intangible franchise rights from the direct application of the Code. The concept of "sale" is worthy of some attention. Many provisions of Article Two refer to a "contract for sale," including the definition of goods. Under the Code, "[a] 'sale'

investment contract under the 1933 Act is defined by the dual test that there must be a common enterprise between the parties to the agreement and profits accruing to the investor are to result solely from the efforts of others. *Id.* at 301. Coleman concludes that if "solely" is to be given its literal meaning, the franchisee which he described would not come within the 1933 Act. Coleman, *supra* note 18, at 503. Indeed, virtually all discussions of franchising contemplate an individual entrepreneur who participates directly in the production of profit. *See, e.g.*, H. Kursh, *supra* note 5, at 3.

The Attorney General of California has determined that franchises come within the purview of that state's Blue Sky law in the following two situations:

Where the franchisee participates only nominally in the franchised business in exchange for a share of the profits.

Where the franchisee participates actively in the franchised business and where the franchisor agrees to provide certain goods and services to the franchisee, but where the franchisor intends to secure a substantial portion of the initial capital that is needed to provide such goods and services from the fees paid by the franchisee or franchisees.

However, "[w]here the franchisee participates actively in the franchised business and where the franchisor agrees to provide certain goods and services to the franchisee," the franchise is not governed by the state statute. 49 Ops. Cal., ATT'Y GEN. 124, 124-25 (1967). See 5 SAN DIEGO L. Rev., supra note 37. But the definitional scope of all other statutes may be irrelevant to construction of 8-102. See UCC § 8-102, Comment. It does not appear that any Code case construing 8-102's definition of security has considered a franchise. See, e.g., E.F. Hutton & Co. v. Manufacturer's Nat'l Bank, 259 F. Supp. 513, 516 (E.D. Mich. 1966) (stock warrants attached to corporate debentures are securities); Traverse v. Liberty Bank & Trust Co., 5 UCC Rep. Serv. 535 (Mass. Super. Ct., 1967) (convertible debentures are within 8-102); Cohn, Ivers & Co. v. Gross, 56 Misc. 2d 491, 289 N.Y.S.2d 301 (App. T. 1968) (call option is not a security under 8-102); Previti v. Rubenstein, 3 UCC Rep. Serv. 882 (N.Y. Sup. Ct. 1966) (limitations on the transfer of stock do not take it out of 8-102). Speculatively, a franchise might for some reason of public policy, such as the prevention of fraud, be included within the terms of regulatory legislation, but the general relevance of Article Eight to franchising seems minimal, since "[i]t may be likened . . . to a negotiable instruments law dealing with securities." UCC § 8-101, Comment. Nevertheless, the language of 8-102(1)(a) could conceivably exempt franchises from 2-105(1). It is arguable that in the Dairy Queen cases, notes 87-94 supra and accompanying text, the territorial franchisors had acquired their franchises primarily for the purpose of subfranchising or investment. See 34 U. Chi. L. Rev., supra note 33, at 900-04.

⁷⁷ See, e.g., §§ 2-105(1), 2-201(1), 2-305(1), 2-401(1), 2-609(1), 2-701.

The "title" provisions of § 2-401 seem clearly to contemplate tangible objects, and the direct application of them to franchise agreements would be cumbersome. "Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the *physical delivery* of the goods" UCC § 2-401(2) (emphasis added).

The Code definition has been called "a constricted construction of the word as employed in a specific area of the law." State v. Weissman, 73 N.J. Super. 274, 281, 179 A.2d 748, 752 (Super. Ct. App. Div. 1962).

consists in the passing of title from the seller to the buyer for a price . . . "78 The application of this definition of sale to franchise distribution agreements has not been judicially considered, except for the reference in *Mastrian.* An analysis of franchising and the Code definition of "sale" must recognize the importance of trademark licensing in the franchise relationship. The franchisor's trademark is the element that lends the franchisee the national identity which is a major source of his strength, so and one commentator has observed that trademark licensing is the "major premise of the franchise system of distribution." While

⁷⁸ UCC § 2-106(1). It is strange that the Code, which minimizes the common law concept of "title," should define the core concept of sale in terms of title. See UCC § 2-401. It may be, however, that the concept of sale is not central to Article Two, which looks at the step by step performance of the parties. See William F. Wilke, Inc. v. Cummins Diesel Engines, Inc., 6 UCC Rep. Serv. 45, 49-50 (Md. Ct. App. Mar. 20, 1969); Hertz Commercial Leasing Corp. v. Transportation Credit Clearing House, 6 UCC Rep. Serv. 132, 136 (N.Y. Civ. Ct. Feb. 20, 1969); UCC § 2-401, Comment 1.

⁷⁹ Cases construing the Code's definition of "sale" and "contract for sale" are collected in Annot., 17 A.L.R.3d 1010, 1048-52 (1968). See also note 74 supra; Lovett v. Emory Univ., Inc., 116 Ga. App. 277, 156 S.E.2d 923 (1967) (blood transfusion not a sale); O'Brien v. Isaacs, 32 III. 2d 105, 203 N.E.2d 890 (1965) (florist who fills telegraphic order from out-ofstate effects present sale); General Equip. Mfrs. v. Bible Press, Inc., 10 Mich. App. 665 (1968) (sale of classroom scientific equipment is sale of goods); Burnside & Co. v. Havener Sec. Corp., 25 App. Div. 2d 373, 374-75, 269 N.Y.S.2d 724, 726 (1966) (per curiam) (agreement for transfer of stock warrants is not a sale); Recchio v. Manufacturers & Traders Trust Co., 55 Misc. 2d 788, 286 N.Y.S.2d 390 (Sup. Ct. 1968) (agreement under which person took possession of mobile home was a contract for sale); Cutler v. General Elec. Co., 4 UCC Rep. Serv. 300 (N.Y. Sup. Ct. 1967) (surgical insertion of "Pacemaker" is not a sale); Dorfman v. Austenal, Inc., 3 UCC Rep. Serv. 856 (N.Y. Sup. Ct. 1966) (insertion of surgical pin is not a sale); Wickham v. Levine, 47 Misc. 2d 1, 261 N.Y.S.2d 702 (Sup. Ct. 1965) (code definition employed when state agriculture commissioner sought to enjoin Chicken Delight operators from preparing meat for off-premises consumption); Commonwealth v. Kayfield, 40 Pa. D. & C. 2d 689 (Ct. Quarter Sess. 1965) (code definition employed in criminal action for sale of vehicle with defaced serial number). None of the preceding cases construing 2-106(1) involved anything resembling a franchise distribution agreement.

[&]quot;The central element of most franchises of entire enterprises is a license granted the franchisee to use the franchisor's trademark or trade name. This right to do business under a well known brand name is usually the single most valuable asset acquired by a franchisee with his franchise." Handler, supra note 11, at 433. See Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962), aff'd, 332 F.2d 505 (2d Cir.), cert. granted, 379 U.S. 885 (1964), cert. dismissed, 381 U.S. 125 (1965); Rothschild, Control of Sales by Retail Outlets, 11 Antitrust Bull. 527, 530 (1966); Wilson, supra note 7, at 6.

^{NI} Rudnick & Rudnick, supra note 5, at 512. "[T]he cornerstone of a franchise system must be the trademark or trade name of a product." Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962), aff'd, 332 F.2d 505 (2d Cir.), cert. granted, 379 U.S. 885 (1964), cert. dismissed, 381 U.S. 125 (1965). See Pollock, supra note 8, at 107; 41 S. Cal. L. Rev., supra note 34, at 147.

franchisees have sometimes been denominated as "purchasers,"82 the language most frequently used in franchise distribution agreements is that of "license" and "licensee."83

The question of license versus sale as the true nature of a franchise agreement has been litigated in the Dairy Queen cases,84 with divergent results. These income tax decisions are relevant to this examination of the Code's scope because the definition of sale employed in the opinions can be roughly equated to the Code definition.85 In the discussion of these service sponsor-retailer franchise relationships, 86 the sale versus license issue is cast in terms of the control that a territorial franchisor may retain over his subfranchisees. In United States v. Wernenting the Eighth Circuit concluded from the distribution agreement and the subsequent dealings of the parties that sales were not effected.88 In Moberg v. Commissioner89 the Ninth Circuit held that most of the agreements that it considered were not sales because of the control exercised by the franchisor.90 However, the Fourth,91 Fifth,92 and Tenth Circuits93 found that similar transactions effected sales whose proceeds could be accorded capital gains treatment.94 The

⁸² See. e.g., E. Lewis & R. Hancock, supra note 5, at 8; Coleman, supra note 18, at 493. For a reference to franchisors as "sellers," see Jones, supra note 8, at 737 n.36.

⁸³ See, e.g., E. Lewis & R. Hancock, supra note 5, at 36 (Dari-Delite); id. at 38 (Nationwide Safti-Brake); id. at 41 (A & W Root Beer); id. (Burger Chef); id. at 45 (Hertz System Inc.).

⁸⁴ See note 33 supra.

ss The Supreme Court has reaffirmed the proposition that "sale," as used in tax litigation such as the *Dairy Queen* cases, is to be given its ordinary meaning. See Commissioner v. Brown, 380 U.S. 563, 571 (1965); 80 Harv. L. Rev. 455, 457 (1966). "A sale, in the ordinary sense of the word, is a transfer of property for a fixed price in money or its equivalent." lowa v. McFarland, 110 U.S. 471, 478 (1884). The similarlity of this statement to § 2-106(1) of the Code has been noted by the Court. See Commissioner v. Brown, supra at 571.

⁸⁶ See 34 U. CHI. L. REV., supra note 33, at 884 n.4.

^{87 354} F.2d 757 (8th Cir. 1965).

⁸⁸ Id. at 766.

^{89 310} F.2d 782 (9th Cir. 1962).

⁹⁰ Id. at 784.

⁹¹ Gowdey v. Commissioner, 307 F.2d 816 (4th Cir. 1962).

⁹² Moberg v. Commissioner, 305 F.2d 800 (5th Cir. 1962).

^{ss} Dairy Queen v. Commissioner, 250 F.2d 503 (10th Cir. 1957).

⁹⁴ See 307 F.2d at 820; 305 F.2d at 806; 250 F.2d at 506. See also note 33 supra.

The Fifth Circuit based its finding of sale on the fact that the franchisee had the power to exclude others. See 305 F.2d at 806. The Tenth and Fourth Circuits reasoned that since the franchise distribution agreement conveyed the exclusive right to make and sell a trademarked product within a designated area, this right was property which could be sold. See 307 F.2d

importance of trademark licensing in franchise distribution would seem to indicate that Wernentin and Moberg have most accurately described this type of transaction. Indeed, it is submitted that the essence of a franchise agreement is the licensing of a trademark, and for reasons emanating from this premise, the granting of rights to the franchisee cannot be considered a sale within the Code since the requisite "passing of title" to these rights does not occur. However, even if the view of the latter three Dairy Queen cases is adopted, direct applicability of the Code would not be affected, because of the inability to equate the broad concept of "property" used by them with the restricted concept of Code goods.

Beyond the definitional limitations of the Code, several other factors would seem to present significant problems when the direct application of the Code is considered. One collateral problem arises when the proposition that the Code applies to the sale of goods within the franchise relationship is combined with the fact that arrangements for the sale of goods and the granting of franchise rights often occur in the same instrument.95 The Seventh Circuit dealt with this question in Tele-Controls, Inc. v. Ford Industries, Inc., 96 where the manufacturer-franchisor terminated a dealer pursuant to a contract providing for termination with or without cause on thirty days notice. In seeking a preliminary injunction, the franchisee relied, in part, on the theory that 1-203 imposed an obligation of good faith on the termination provisions of 2-309.97 In avoiding this issue, the court stated that "filt is unnecessary to decide whether the Uniform Commercial Code governs this entire dealership contract," because the applicable state case law required that the termination be in good faith.98 In Warner Motors, Inc. v. Chrysler Motor Corp.99 the court, granting a motion for summary

at 818-19; 250 F.2d at 506. The Fourth Circuit held further that reasonable restrictions by the franchisor did not destroy the absolute nature of the sales transactions. *See* 307 F.2d at 818-19.

⁹⁵ See notes 48-53 supra and accompanying text.

^{96 4} UCC Rep. Serv. 1042 (7th Cir. 1967).

⁹⁷ Id. at 1044.

⁸⁸ Id.

^{99 5} UCC Rep. Serv. 365 (E.D. Pa. 1968).

Here the franchisor-manufacturer's motion for summary judgment was sustained as to certain of the franchisee-retailer's claims arising out of the breach by the franchisor of the distribution agreement. The breach was the discontinuance of the DeSoto automobile, which had occurred six years before the litigation. The franchisor utilized the Code's four year

judgment, found that the distribution agreement involved a "contract for sale" so that the Code statute of limitations was applicable. The overall character of the agreement was said to be a sale of goods, and "terms providing for . . . franchising . . . in no way" affected this character. 100 A possible implication of this dictum is that the Code would not apply to contracts dealing only with franchising terms. A further possible implication is that if the overall purpose of the agreement were the granting of intangible franchise rights, the Code would not apply to the sale of goods incidentally involved. This "unitary" view of the transaction is similar to that of opinions construing a transaction as either entirely a service or entirely a sale. 101 This would lead to the seemingly incongruous result that a sale of goods incidentally involved in a franchise agreement would be governed by non-Code law, 102

statute of limitations. In summarily dismissing the franchisee's contention that the distribution agreement was not a contract of sale, the court cited Weilersbacher as holding that Article Two of the Code was applicable to this type of agreement. The judge stated that "[i]t seems . . . that there can hardly be any question that the dealer agreement is a contract for sale' within the meaning of § 2-725 of the Uniform Commercial Code. The business of the Chrysler corporations was selling the automobiles, which Chrysler manufactured and the declared 'purpose of the relationship established' by the agreement was 'to provide a means for the sale and service of DeSoto and Plymouth passenger cars, parts and accessories.' Certainly, the fact that the agreement contained terms providing for services, franchising and the like in no way affects its character as determined by its overall object, namely selling automobiles." Id. at 367 (emphasis added).

The statute of limitations for Article Two provides that "[a]n aetion for breach of any contract for sale must be commenced within four years after the cause of aetion has accrued." UCC § 2-725(1).

100 5 UCC Rep. Serv. at 367.

¹⁰¹ "In the . . . situation of a service contract wherein a physical item is transferred in connection with performance of the contract . . . courts both before and since the Code have characterized the transaction either as all service or all sales." R. Duesenberg & L. King, supra note 72, § 1.03[1], at 4 n.5 (Supp. 1969).

loss Enticing, although inapposite, analogues to the franchise agreement exist in traditional agency and sale of goods contracts. E.g., "A distributorship contract is more than a mere contract of agency. It is also a sales contract, but it is also more than a mere sales contract. It partakes of the substantial aspects of both." Des Moines Blue Ribbon Distributors, Ine. v. Drewrys Limited, U.S.A., Inc., 256 Iowa 899, 906-07, 129 N.W.2d 731, 736 (1964). See also Banker Bros. Co. v. Pennsylvania, 222 U.S. 210, 213 (1911); Hunt Foods, Inc. v. Phillips, 248 F.2d 23, 28 (9th Cir. 1957); Bendix Home Appliances, Inc. v. Radio Accessories Co., 129 F.2d 177, 181 (8th Cir. 1942); J.C. Millett Co. v. Park & Tilford Distillers Corp., 123 F. Supp. 484, 492 (N.D. Cal. 1954); Reiter v. Anderson, 87 Cal. App. 642, 648-49, 262 P. 415, 417 (1927); Piper v. Oakland Motor Co., 94 Vt. 211, 214, 109 A. 911, 912 (1920); Gellhorn, supra note 23, at 469; Kessler, Autonobile Dealer Franchises: Vertical Integration by Contract, 66 YALE L.J. 1135, 1135 & n.1 (1957).

The "sales agency" is also similar to a franchise but differs in that the sales agent "derives his income or compensation primarily from commissions on sales promoted and

whereas the same transaction, standing alone, would be governed by the Code. The converse view is presented by Foster v. Colorado Radio Corp. 103 where the elements of an agreement were severed so that the Code applied to the statutory goods which were involved in the sale but not to the broadcasting license, real estate, and good will conveyed. The Tenth Circuit refused to characterize the going concern as a service but instead chose to categorize the individual assets as statutory goods or non-goods, on the assertion that this procedure was that intended by the drafters of the Code.¹⁰⁴ If applied to a franchise distribution agreement, Foster would be susceptible to the criticism that two different sets of rules would govern one commercial transaction. 105 Such criticism would be obviated if some analysis can be formulated which would apply the Code to the non-goods involved in a franchise distribution agreement. The entire transaction would then come within the purview of the Code.

There would seem to be one other possible avenue of analysis which would construe Article Two as directly governing franchise distribution agreements. This approach places more reliance on language in 2-106(1) than on the definition of "sale," the definition of "goods" in 2-105(1), or the language of 2-102 limiting the scope of the Article. Section 2-106 states that the term "contract for sale" includes "a contract to sell goods at a future time." It also

does not purchase the manufacturer's products" Annot., 19 A.L.R.3d 196, 208 (1968). The sales agent solicits orders for the manufacturer rather than buying for resale. Rubinger v. International Tel. & Tel. Corp., 310 F.2d 552 (2d Cir. 1962), cert. denied, 375 U.S. 820 (1963). It has been noted, however, that "[a]lthough there is a marked distinction between a true sales agency contract and a sales and distribution contract for many purposes, yet for the purpose of determining the duration of the relation between the parties and the power to terminate it, they are so substantially similar that cases of either type are authoritative on this point for the other." S. WILLISTON. supra note 23, § 1017A. at 138.

^{103 381} F.2d 222 (10th Cir. 1967). In this action for breach, the breaching party, the buyer, contended that the seller did not give notice of a private resale as required by §§ 2-706(1) and (3) and, therefore, could not recover the contract price less the resale price. *Id.* at 225. 104 *Id.* at 225-27.

¹⁰⁵ See, id. at 226-27. The result in Foster was that two different damage rules were employed in the same transaction. The parties had stipulated that the measure of damages should be the contract price less the resale price, which is the measure of 2-706. Since the notice of private resale was not given, the seller could not recover for the breach as to the Code goods. However, he could recover as to the non-goods since the notice was not required. See id, at 226.

¹⁰⁵ UCC § 2-106(1).

provides that "contracts" that are within the Code's purview are "limited to those relating to the . . . sale of goods." It, therefore, does not limit the Code's applicability to either contracts or contractual terms that exclusively involve the sale of goods. A franchise agreement often does provide for the future sale of goods, and "goods" are at least incidentally involved in many agreements. Several other factors buttress this approach. First, inasmuch as it involves the "title" concept, which is minimized by 2-401,108 the definition of "sale" does, indeed, seem to be auxiliary. Also, the "scope" language of 2-102, "transactions in goods," could be construed as "transactions involving goods." This language was not present in the early drafts of the Code, where 2-102 apparently only served to exclude Article Nine transactions from Article Two, 100 rather than additionally to establish the affirmative limitations of Article Two. Finally, it seems that the drafters sought to deal with one franchise problem in 2-306(2), governing exclusive dealing arrangements, when they spoke of exclusive agents and territories.¹¹⁰

Mitigating against this mode of analysis, however, are at least two factors. First, the addition of "transactions in goods" to 2-102 was designed "to eliminate any ambiguity as to the application of Article 2 to contracts not related to the sale of goods." Also, 2-105(1)'s definition of goods, with its concept of movability, seems crucial to the issue of direct applicability, since this is the subject matter against which the drafters tested their statute. Nevertheless, the statutory language provides room for the argument that the Code directly governs all aspects of a contract that involves both statutory goods and non-goods.

Should Article Two Be Applicable by Analogy to Franchise Distribution Agreements?

While Article Two contains its technical boundaries, a restrictive interpretation of the Article's scope would deny vitality

¹⁰⁷ Id.

 $^{^{108}}$ "Each provision of this Article . . . applies irrespective of title to the goods except where the provision refers to such title." UCC \S 2-401.

¹⁰⁹ See UCC § 2-102 (1952 version); UCC § 2-102 (1950 version).

¹¹⁰ See UCC § 2-306, Comment 5.

[&]quot;UCC § 2-102 (1956 recommendations of the Editorial Board).

¹¹² See 1 REPORT OF THE LAW REVISION COMMISSION FOR 1954 AND RECORD OF HEARINGS ON THE UNIFORM COMMERCIAL CODE 173-74 (New York 1954) (dialogue between Mr. MacDonald and Professor Llewellyn).

to the preference for expansibility that is built into the Code. As indicated in the official comments:

This Act is drawn to provide flexibility so that . . . it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices

Courts have been careful to keep broad acts from being hampered in their effects by later Acts of limited scope. . . . They have recognized the policies embodied in an act as applicable in reason to subject-matter which was not expressly included in the language of the act . . . They have done the same where reason and policy so required, even where the subject-matter had been intentionally excluded from the act in general. . . Nothing in this Act stands in the way of the continuance of such action by the courts. 113

It is said to be traditional of the uniform acts that they have been applied beyond their stated subject-matter.¹¹⁴ In continuing this tradition the Code has aligned itself with the view of Mr. Chief Justice Stone, who could "find in the history and principles of the common law no adequate reason for our failing to treat a statute much more as we treat a judicial precedent, as both a declaration and a source of law, and as a premise for legal reasoning." Dean Pound has described the traditional common law attitude toward legislation as standing in the way of making statutes the basis for "creative development." This restrictive attitude is clearly rebutted by the explicit predisposition of the Code for the rational extension of its principles.

It has long been recognized that a legitimate function of the judiciary is the application of statutory principles to situations

¹¹³ UCC § 1-102, Comment 1 (emphasis added).

¹¹⁴ See Agar v. Orda, 264 N.Y. 248, 190 N.E. 479 (1939); Hertz Commercial Leasing Corp. v. Transportation Credit Clearing House, 6 UCC Rep. Serv. 132, 135 (N.Y. Civ. Ct. Feb. 20, 1969); Gellhorn, supra note 23, at 510 n.169; Landis, Statutes and the Sources of Law, in Harvard Ligal I:ssays 213, 229 (R. Pound ed. 1934).

¹¹⁵ Stone, The Common Law in the United States, 50 HARV. L. REV. 4, 13 (1936). "Apart from its command, the social policy and judgment, expressed in legislation by the lawmaking agency which is supreme, would seem to merit that judicial recognition which is freely accorded to the like expression in judicial precedent." Id. at 14. See generally Loyd, The Equity of a Statute, 58 U. PA. L. REV. 76 (1909).

¹¹⁶ R. POUND, THE FORMATIVE ERA OF AMERICAN LAW 47 (1938). "The common law thinks of a statute as giving a rule, prescribing a detailed situation of fact, but not as a starting point for legal reasoning." *Id. See also* Pound, *Common Law and Legislation*, 21 HARV. L. REV. 383 (1908).

For an explication of the common law's history of hostility toward statutes as premises for judicial reasoning, see Note, *The Uniform Commercial Code as a Premise for Judicial Reasoning*, 65 Colum. L. Rev. 880, 882-84 (1965).

analogous to those expressly envisaged by the legislators.¹¹⁷ This jural theory is reflected in the statement of Professor Llewellyn that the drafters of Article Two intended that the possibility of extension would exist for all provisions of the Article, but that because of a desire to adhere to situations which had been tested, the scope of the Article was limited to the sale of goods.¹¹⁸ The analogical force of the Code has been said to be such that "it decides by analogy what it does not control by genuine interpretation . . ."¹¹⁹ It seems apparent that the general rules and policies of the Code, which are supposedly responsive to the needs of modern commercial life, readily lend themselves to treatment as premises for judicial reasoning.¹²⁰ Indeed, the Third Circuit once suggested, even before the Code had the force of positive law, that the Code was entitled to the same respect as the Restatements.¹²¹

Moreover, Article Two further acknowledges the possibility of application by analogy in two specific areas, investment securities¹²² and warranties.¹²³ This invitation for extension of the Code has

¹¹⁷ See Freund, Interpretation of Statutes, 65 U. PA. L. REV. 207, 229-31 (1917); Landis, supra note 114, at 229. Professor Freund cites as an example of statutory development the extension of the French Commercial Code to analogous situations. Freund, supra at 229.

¹¹⁸ See 1 REPORT OF THE LAW REVISION COMMISSION FOR 1954 AND RECORD OF HEARINGS ON THE UNIFORM COMMERCIAL CODE 173-74 (New York 1954) (dialogue between Mr. MacDonald and Professor Llewellyn). Mr. MacDonald raised the question of whether certain sections were intended to be extended and others were not. Professor Llewellyn answered that "[w]e intended that some of these provisions should be open to extension to other types of contracts, but we didn't intend to make any distinction among the sections in that regard." Id. at 173.

¹¹⁹ Franklin, On the Legal Method of the Uniform Commercial Code, 16 LAW & CONTEMP. PROB. 330, 333 (1951).

¹²⁰ See 65 COLUM. L. REV., supra note 116, at 892. The recognition by courts of statutory solutions as sources of law is said to be "particularly appropriate and necessary in the case of the Uniform Commercial Code, a statute designed both to take account of rapidly changing customs and to achieve a satisfactory accommodation between diverse competing interests." Id. at 881. See also King, The New Conceptualism of the Uniform Commercial Code, 10 St. Louis U.L.J. 30, 40 (1966).

¹²¹ See Fairbanks, Morse & Co. v. Consolidated Fisheries Co., 190 F.2d 817, 822 n.9 (3d Cir. 1951). "It, like the Restatements, has the stamp of approval of a large body of American scholarship." *Id.*; see 65 COLUM. L. REV. supra note 116, at 885; cf. Vitex Mfg. Corp. v. Caribtex Corp., 377 F.2d 795, 799 (3d Cir. 1967); United States v. Wegematic Corp., 360 F.2d 674, 676 (2d Cir. 1966) (UCC source of "federal" sales law).

¹²² See UCC § 2-105, Comment 1; 65 COLUM. L. REV., supra note 116, at 887. See note 124 infra.

^{123 &}quot;Although this section is limited in its scope . . . to warranties made by the seller to the buyer as part of a contract for sale, the warranty sections of this Article are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined . . . to sales contracts . . . " UCC § 2-313, Comment 2. See 65 COLUM. L. REV., supra note 116, at 887.

been readily accepted by the courts in the area of investment securities,124 and although the analogical development of the warranty provisions of Article Two has not been as dramatic as that of investment securities, it has been significant. In Cintrone v. Hertz Truck Leasing & Rental Service¹²⁵ the court found that the considerations of reason and policy which demand the implication of warranties of fitness in sales transactions apply with equal force to bailments for hire.126 In Sawyer v. Pioneer Leasing Corp.,127 2-316(2), requiring that disclaimers of implied warranties of merchantability and fitness be conspicuous on a written contract, was applied to the lease of an ice machine, which established a financial relationship substantially similar to a sale of goods.¹²⁸ Similarly, in Newmark v. Gimbel's, Inc. 129 the imposition of liability for injuries resulting from a hairdresser's treatment proceeded from a recognition of the relevance of implied warranties outside the stated boundaries of the Code. 130 Finally, it has

¹²¹ See, e.g., Stern & Co. v. State Loan and Fin. Corp., 238 F. Supp. 901, 911-12 n.2 (D. Del. 1965) (dictum that Pennsylvania case law parol evidence rule is consistent with 2-202 and that Article 2 can be used by analogy in investment securities area); Wilmington Trust Co. v. Coulter, 41 Del. Ch. 548, 570-71, 200 A.2d 441, 454 (Sup. Ct. 1964) (2-205, dealing with firm offers, and 2-204, dealing with indefiniteness, employed in action to surcharge trustee for failing to pursue an offer to sell stock); Pennsylvania Co. v. Wilmington Trust Co., 39 Del. Cb. 453, 463, 166 A.2d 726, 731 (Ch. 1960), aff'd, 40 Del. Ch. 1, 7, 172 A.2d 63, 66 (Sup. Ct. 1961) (2-204 employed in determining whether the parties intended to make a contract); Mortimer B. Burnside & Co. v. Havener Sec. Corp., 25 App. Div. 2d 373, 375, 269 N.Y.S.2d 724, 728 (1966) (dissent) (promise to assign stock warrants does constitute "price" under 2-304); Hunt Foods & Indus., Inc. v. Doliner, 49 Misc. 2d 246, 248-49, 267 N.Y.S.2d 364, 368-69 (Sup. Ct. 1966), rev'd, 26 App. Div. 2d 41, 42-43, 270 N.Y.S.2d 937, 939-40 (1966) (evidence of alleged condition precedent held admissible as additional term under 2-202); R. Duesenberg & L. King. supra note 72, § 1.03[1], n.8 (Supp. 1969). But see Saphier v. Devonshire St. Fund, Inc., 352 Mass. 683, 691-92, 227 N.E.2d 714, 720 (1967) (2-305 held to be inapplicable on facts of case); Edwin J. Schoettle Co. Appeal, 390 Pa. 365, 374, 134 A.2d 908, 913 (1957) (situation before the court held not to call for application of 2-714, 2-717, or 2-720).

^{123 45} N.J. 434, 212 A.2d 769 (1965).

¹²⁶ Id. at 446-47, 212 A.2d at 775-76.

^{127 244} Ark. 943, 428 S.W.2d 46 (1968); noted in 1969 WASH. U.L.Q. 90; 15 WAYNE L. REV. 929 (1969).

¹²⁵ Id. at 957, 428 S.W.2d at 54. For a similar result see Hertz Commercial Leasing Corp. v. Transportation Credit Clearing House, 6 UCC REP. SERV. 132 (N.Y. Civ. Ct. I'eb. 20, 1969). Cj. E.F. Lyncb, Inc. v. Piccirilli, 28 Mass. App. Dec. 49 (1964); Electronics Corp. of America v. Lear Jet Corp., 55 Misc. 2d 1066, 286 N.Y.S.2d 711 (1967); Fairfield Lease Corp. v. Colonial Aluminum Sales, Inc., 3 UCC Rep. Serv. 858 (N.Y. Sup. Ct. 1966), But see 244 Ark, at 958-962, 428 S.W.2d at 54-56 (dissent).

^{120 5} UCC Rep. Serv. 686 (N.J. Super. Ct., App. Div. 1968).

¹²⁰ Id. at 690. Epstein v. Giannattasio, 25 Conn. Supp. 109, 197 A.2d 342 (C.P. 1963) is criticized and *Cintrone* is cited with approval. 5 UCC Rep. Serv. at 690, 692.

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frequently been suggested that the policies underlying 2-302, which provides relief from unconscionable bargains, should be utilized in areas other than transactions in goods.¹³¹

While the application by analogy of Article Two will necessarily be the product of an ad hoc examination of individual Code sections together with the terms of an individual agreement, 132 several broad policies supporting such application can be enunciated. A franchise distribution agreement is a contractual arrangement, and the rules concerning the process of contracting should be utilized despite the intangibility of the subject matter. The fact that franchise rights may be an analogue of Code goods should not be the primary focus of an analogical use. Rather, the court should look to the reasons which brought about the Code's statement of a particular rule to determine if these reasons are equally valid in the context of the franchise agreement.¹³³ A corollary of this common nature as contractual arrangements is the fact that courts looking at a franchise agreement should be attuned to the same basic policies as those enunciated by the Code: (1) "to simplify, clarify and modernize the law governing commercial transactions;" (2) "to permit the continued expansion of commercial practices through custom, usage and agreement of the

should fail to make it applicable to all other contracts for the sale of goods, no court should fail to make it applicable to all other contracts; for the policy that it adopts is applicable to all alike, it puts upon the court the responsibility of determining the degree of unconscionability and the requirements of 'justice.' "5A A. CORBIN, CONTRACTS § 1164, at 223 (1964). One commentator has gone so far as to suggest that "[t]he extension of the equity of . . . [2-302] to all contracts seems inevitable." Newman, The Renaissance of Good Faith in Contracting in Anglo-American Law, 54 CORNELL L. Rev. 553, 561 (1969). See, e.g.. Leff, Unconscionability and the Code—The Emperor's New Clause, 115 U. Pa. L. Rev. 485, 486 n.4 (1967); 65 COLUM. L. Rev., supra note 116, at 891-92; Note, Unconscionable Sales Contracts and the Uniform Commercial Code, Section 2-203, 45 Va. L. Rev. 583, 590-91 (1959); 78 HARV. L. Rev. 895, 898 (1965). But see In re Elkins-Dell Mfg. Co., 253 F. Supp. 864, 873 n.4 (E.D. Pa. 1966). Professor Ellinghaus seemingly views Elkins-Dell, however, as at least a "half-application" of 2-302. See Ellinghaus, supra note 2, at 757, 767-68, 808-09 & n.240. The uses of 2-302 in the contexts of financing transactions, leases, and guarantee agreements are reviewed in Ellinghaus, supra, at 808-09 & nn.240-42.

¹³² It should be obvious that when a section is applied analogically, only that section is applied and not other Code provisions. *See* Sawyer v. Pioneer Leasing Corp., 244 Ark, 943, 957-58, 428 S.W.2d 46, 54 (1968); note 59 *supra*.

In the context of § 2-302 it has been stated that "[s]ince the problem of distortion and the undesirability of enforcing unconscionable agreements are not at all confined to the sale of goods, the fundamental approach advanced by the Code should be considered applicable in a variety of contracting situations beyond its terms." 65 COLUM. L. REV., supra note 116, at 892.

parties;" (3) "to make uniform the law among the various jurisdictions." While the analogical use of the Code may benefit only one of the parties to a distribution agreement during litigation, it is reasonable to assume that the application of a uniform act would ultimately benefit the entire industry by correcting some of the legal uncertainty that surrounds franchising. 135

The positive advantages of the analogical use of a uniform sales law have been presented by Professor Farnsworth, who suggests, for several reasons, that in ambivalent situations reasoning by analogy is preferable to construing the agreement as one of sale and applying directly the sales statute. First, the adjustment of old rules to new social conditions is facilitated by avoiding the classification as a sale of a transaction that only recently was not. Also, reasoning by analogy allows the court to use appropriate provisions of the sales statute without applying inappropriate ones, and it necessitates a forthright presentation of the underlying policy reasons of the decision, which would be obfuscated if the decision turned only on legalistic categorization.

A Hypothetical Approach to Uses of the Code

This analysis of Code sections and the franchising problems they can meet will necessarily be incomplete. Many sections of Article Two are obviously inappropriate to the conveyance of intangible commercial rights.¹⁴¹ These provisions, such as those controlling the risk of loss,¹⁴² so clearly contemplate tangible chattels as their subject matter that their analogical utility is

¹³⁴ UCC § 1-102(2).

¹³⁵ Professor Gellhorn has described the rules dealing with franchise terminations as "haphazard." Gellhorn, *supra* note 23, at 469. Seemingly, the Code is an excellent premise from which to develop rules of some uniformity, which relate to industries with similar franchise operations in many jurisdictions.

¹³⁶ Farnsworth, *Implied Warranties of Quality in Non-Sales Cases*, 57 COLUM. L. REV. 653 (1957). Although Professor Farnsworth was dealing directly with warranties under the Uniform Sales Act, his comments are equally germane to the present discussion.

¹³⁷ Id. at 667.

¹³⁸ See id.

¹³³ See id.

¹⁴⁰ See id. at 669.

¹¹¹ See, e.g., UCC §§ 2-504 (shipment by the seller); 2-505 (seller's shipment under reservation); 2-513 (buyer's right to inspection of goods); 2-613 (casualty to identified goods).

¹⁴² See UCC §§ 2-509, 2-510.

severely limited. But several applications of other sections have been suggested and still others seem apparent. For analytical purposes the following set of exaggerated, hypothetical facts is presented.

Mr. John Fee, a postal clerk, was taken by the entrepreneurial urge after reading the following advertisement in the business section of his local paper:

Be your own boss! ZESTburgers is looking for reputable, competent individuals in this area, who wish to share in the meteoric success of this franchise company. No previous business experience is necessary because of our excellent training programs. For further information, write James Ore, Box 1, New York, New York.

After sending a resume to Ore, Fee was contacted by Ore himself, the president of ZESTburgers. While looking over prospective construction sites for a restaurant in Fee's town, Ore talked of the aspects of the franchise relationship that ensued after a ZESTburger distribution agreement was executed. "Of course," he said, "we require you to make certain minimum purchases of soft drink cups and hamburger wrappers from us, unless you can prove that items of similar quality can be found elsewhere. However, if this minimum should be unduly burdensome at first, we will cut it in half. Also, our company has a long-standing policy of repurchasing such items as the big neon ZESTburger sign and the charcoal grill at their fair market value, should our relationship come to an end. Furthermore, we will either find you a buyer for your fixed assets, the land and building, or lease them from you for one year." After finding a suitable site and making a thorough investigation of the competition, Ore turned to Fee and said: "If a man of your character and business sense should decide to go with us, I can assure you that he would net at least \$25,000 a year in this town. In fact, John, I think so much of you that I'm going to make you a firm offer that you can accept if you like after thinking about this." After thoughtful consideration, Fee wrote Ore and stated: "I've decided to accept. Please send your contract for examination." Within two days Fee received a seventeen page printedform contract. A cover letter stated: "It is imperative that you sign this contract immediately and return it by return mail." Fee followed these instructions.

Fee quit his job at the Post Office and embarked on his business career, which was something less than "meteoric." For the first six months, his profits were very low—around \$100 a month. Ore told him that he would, indeed, only require Fee to purchase one-half of the cups and wrappers specified in the contract. At the end of his first year, Fee's position had improved very little. He figured his taxable business income at \$8,000 before payment of the annual "franchise fee" which Ore had mentioned and which Fee knew was provided for in the contract. This bill for the licensing of the ZESTburger trademark and the "system of business" amounted to \$3,200 or 40 percent

of the taxable income. Fee had no idea that the contract provided for such a high percentage. The day after receiving this bill Fee was served with process by FranSys, Inc., for infringement of their licensed trademark, "ZESTburgers." The next day Fee was served with process by a customer who had almost choked to death on the wax that fell off the edge of a cup supplied by Ore. Fee refused to pay the \$3,200. He then received notice that his franchise had been cancelled immediately pursuant to section 252 of the Standard Contract, which provided for termination without prior notice "at any time for any reason." Ore then brought an action for breach of contract against Fee for the \$3,200 plus the amounts of cups and wrappers that Fee failed to purchase. Fee then counterclaimed for damages resulting from Ore's failure to carry out the promises made before the contract was executed.

An examination of the Standard Contract revealed that the amount that Ore represented to be half the contract amount was actually the minimum specified in a term that required Fee to purchase his "ordinary business requirements." No modification was allowed.

By means of pre-trial discovery and other investigation, Fee learned that ZESTburgers' financial situation was precarious; that Fee was only the sixth franchisee; that none of the other five had netted over \$7,500 before payment of the franchise fee and taxes; that the contract contained no buyback or lease-back provisions; that the 40 percent fee was double that charged by other members of the industry; and that the prices he paid for cups and wrappers were 200 percent above the ordinary market price.

Despite these troubles, Fee decided that he liked the roadside restaurant business. Before counterclaiming, Fee looked around for another franchise but found that his market area had all other systems represented. During the litigation, Fee received an offer from T. Party to buy his "business." Counsel for Ore pointed out, however, that the Standard Contract had an express prohibition against "assignment of this contract."

Sometime prior to judgment ConGlobs, Inc. acquired ZESTburgers, Inc. and decided not to pursue the breach of contract action against Fee; they did not, however, wish to continue his franchise. Fee decided things looked much better with ConGlobs in the picture and brought an action for specific performance.

The following discussions, although certainly not exhaustive, present some of the issues raised by these facts within the context of Article Two.

Good Faith

One critical element in the Fee-Ore litigation, if the Code were analogically employed, would be the good faith of Ore in the transaction. Under 1-203 "[e]very contract or duty within" the purview of the Code "imposes an obligation of good faith in its

performance or enforcement.''143 Furthermore, Article Two contains its own definition of good faith. "Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.''144 It has been suggested that these provisions be employed outside the sale of goods' and predicted that "if real court supervision of the franchise relationship under the Code comes, it will arise out of the good faith requirement.''146

In this as in other areas, the primary focus of any analogical use of the Code should be upon the policies underlying the Code provision and their validity in the context of franchising. The rationale of 1-203 is said to be the basic principle that good faith is required in commercial transactions.¹⁴⁷ Certainly no aspects of franchising indicate that the analogical establishment of basic commercial morality would be inappropriate.

114 UCC § 2-103(1)(b). The special Article Two standard of good faith would apply to franchisors only if they were considered "merchants." It would seem they would fall within the Code definition, by analogy. "'Merchant' means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill." UCC § 2-104(1).

As in the case of 1-201(19), Professor Summers finds 2-103(1)(b) to be so restricted as to threaten its utility. The limitations he ascribes to it include: (1) its possible applicability only when "good faith" is specifically mentioned; (2) its applicability only to merchants; (3) its applicability only when reasonable commercial standards exist within a trade. Summers, supra note 143, at 212-13.

It has been observed that "good faith," as used in about 50 of the 400 sections of the Code is used in two divergent contexts. In some instances it deals with "good faith purchase." When used in the franchise context, however, it deals with "good faith performance." Farnsworth, Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code, 30 U. Chi. L. Rev. 666 (1963); Gellhorn, supra note 23, at 470 n.17.

¹²⁵ UCC § 1-203. The general Code definition of "good faith" is found in § 1-201(19): ""Good faith' means honesty in fact in the conduct or transaction concerned." It has been argued that this definition is unduly restrictive in light of the pre-Code law. It is said not to reach acts of bad faith which are negligent or do not involve dishonesty. Summers, "Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 VA. L. Rev. 195, 210-12 (1968). Summers suggests that "good faith" was a vital concept in pre-Code law, even though it was not precisely defined. It was rather an "excluder," which acquires meaning in terms of the type of bad faith that a judge intends to exclude by his use of the term "good faith." Id. at 199-207. For a suggested revision of 1-203 to express good faith as an excluder concept, see id. at 215 n.73.

¹⁴⁵ The analogical employment of the Code's good faith test has been suggested by Professor Farnsworth. See Farnsworth, supra note 144, at 679.

¹⁴⁶ Hewitt, supra note 2, at 1086.

¹⁴⁷ See UCC § 1-203, Comment. See generally Newman, supra note 131.

The commercial doctrine of good faith performance has been significant in the legal history of franchising. The Dealers' Day Act imposed a duty of good faith upon the termination of dealerships by automobile manufacturers.¹⁴⁸ However, litigation under the Act has generally restricted "good faith" to the lack of coercion or intimidation.¹⁴⁹ Very limited attempts were made in some decisions to correct the abuse of termination rights by imposing a duty of subjective good faith upon the motives of the franchisor.¹⁵⁰ The imposition of this constructive condition has been repeatedly rejected by other courts¹⁵¹ and criticized by commentators, ¹⁵² the general view being that the "right to terminate . . . [is] not subject to question on the ground of . . . lack of good faith, bad faith or because of motive, intent or resultant detriment '153 Bushwick-Decatur Motors, Inc. v. Ford Motor Co., 154 one of the leading cases rejecting the good faith test, asserted as the principal objections to the imposition of the condition that the contract provided for termination at will and that courts are not equipped to weigh the economic factors which might require the imposition of

^{*}An automobile dealer may bring suit against any automobile manufacturer . . . and . . . recover the damages by him sustained and the cost of suit by reason of the failure of said automobile manufacturer . . . to act in good faith in performing . . . canceling or not renewing the franchise with said dealer *15 U.S.C. § 1222 (1964).

¹¹⁹ See, e.g., Kotula v. Ford Motor Co., 338 F.2d 732 (8th Cir. 1964), cert. denied, 380 U.S. 979 (1965); Globe Motors, Inc. v. Studebaker-Packard Corp., 328 F.2d 645 (3d Cir. 1964); Milos v. Ford Motor Co., 317 F.2d 712 (3d Cir.), cert. denied, 375 U.S. 896 (1963); Pierce Ford Sales, Inc. v. Ford Motor Co., 299 F.2d 425 (2d Cir.), cert. denied, 371 U.S. 829 (1962); Augusta Rambler Sales, Inc. v. American Motors Sales Corp., 213 F. Supp. 889 (N.D. Ga. 1963); S. MACAULAY, supra note 23, at 106.

¹²⁰ See Philadelphia Storage Battery Co. v. Kelley-How-Thomson Co., 64 F.2d 834 (8th Cir. 1933); Gaines W. Harrison & Sons v. J.1. Case Co., 180 F. Supp. 243 (E.D.S.C. 1960); J.R. Watkins Co. v. Rich, 254 Mich. 82, 235 N.W. 845 (1931). The "good faith" cases are collected and analyzed in Gellhorn, *supra* note 23, at 499-505.

 ¹⁵¹ See, e.g., Zaiden v. Borg-Warner Corp., 228 F. Supp. 669 (E.D. Pa. 1964), aff d, 341
 F.2d 391 (3d Cir. 1965); Smoky Mountains Beverage Co. v. Anheuser-Busch, Inc., 182 F.
 Supp. 326 (E.D. Tenn. 1960); Sharpe v. Great Lakes Steel Corp., 9 F.R.D. 691 (S.D.N.Y.
 1950); Chrysler Corp. v. Quimby, 51 Del. 295, 297, 144 A.2d 885, 886-87 (1958).

¹⁵² See Gellhorn, supra note 23, at 504-05. Professor Gellhorn suggests that an examination of the franchisor's motives is futile, since there is no assurance that protection of franchisees would result from a requirement of good motives. Id. But see Summers, supra note 143, at 251 n.222. Professor Summers attacks Gellhorn's position by arguing that "good faith" is not invariably a matter of "motives." Id.

¹²³ Busan Motors Sales, Inc. v. Ford Motor Co., 104 F. Supp. 639, 643 (S.D. Ohio 1952), rev'd on other grounds, 203 F.2d 469 (6th Cir. 1953).

^{154 116} F.2d 675 (2d Cir. 1940).

this condition as a matter of public policy. Professor Gellhorn has criticized the latter basis because "[c]ourts... are constantly called upon to weigh economic factors and to determine economic needs—tasks imposed by statute and assumed under common law practice." Also, if the first basis of Bushwick-Decatur can be viewed in the context of the Code, the right to terminate at will is impressed with the good faith obligation. This argument was presented by a franchisee to the Seventh Circuit in Tele-Controls, Inc. v. Ford Industries, Inc., 158 but the court avoided a determination of this point by holding that the applicable state case law, apart from the Code, imposed an obligation of good faith on franchise termination. Finally, Article Two's definition of good faith seems to avoid the labyrinthine search of the prior cases for good and bad motives, by looking objectively at "honesty in fact" and "reasonable commercial standards."

Ore's actions in deceptively representing the success of ZESTburgers and in dishonestly stating the terms of the contract

¹⁵³ Id. at 677.

¹⁵⁶ Gellhorn, supra note 23, at 503.

¹⁵⁷ The Second Circuit in *Bushwick-Decatur* was specifically concerned that the reading into the agreement of a good faith limitation would be a "doubtful policy" in the absence of "legislative authority." 116 F.2d at 677. It has been cogently argued that 2-302 is the "requisite legislative utterance." Ellinghaus, *supra* note 2, at 810. Moreover, 1-203, 1-201(19), and 2-103(1)(b) would seem to be precise legislative utterances.

^{158 4} UCC Rep. Serv. 1042 (7th Cir. 1967).

¹⁵⁹ Id. at 1044.

¹⁶⁰ See UCC § 2-103(1)(b). While the Code's test of "reasonable commercial standards" does, indeed, seem to be objective, the determination of "honesty in fact" may involve inquiry into a subjective state of mind. If this is true, then the general Code definition, from Article 1, may be subjective, while the Article 2 definition is, at least partially, objective. In his discussion of this problem, Professor Farnsworth notes that many sections do not explicitly indicate which test is to be used. He concludes, however, that "courts can, by sound construction of the Code, arrive at an objective standard of good faith performance as to sales contracts by a merchant." Farnsworth, supra note 144, at 678. Professor Summers, however, clearly regards the "honesty in fact" test to be subjective. Summers, supra note 143, at 208-11.

It has been assumed, perhaps without warrant, in this discussion that the Code good faith provisions possess sufficient vitality to affect franchisor-franchisee relations. If, however, Professor Summers' view of them as critically restrictive is correct, then extra-Code good faith law may have more significance. See Summers, supra at 220-52. In specific reference to the termination issue, Summers notes that an arbitrary termination may be honest, so not within 1-201(19), but his view that 1-203 is "obviously inapplicable" because a termination is neither "performance" or "enforcement," is unfairly narrow. See Summers, supra at 252. Surely termination is the conclusion of "performance," and it may be a method of "enforcement." Summers also makes an interesting argument for noncontractual relicf, involving a quasi-tort of bad faith. Id. at 256-62.

as to franchisee purchase requirements and inventory buy-back procedures do not meet the Code standards. The statement concerning the income that the franchise would provide also would not meet the Code standard. The cover letter sent with the Standard Contract takes advantage of Fee's reliance on Ore and his lack of business experience. None of these actions were honest, and none should be permitted to come within "reasonable commercial standards of fair dealing in the trade," even if it could be shown that the trade practices were uniformly dishonest. Notwithstanding other Code provisions or legal theories, this failure of Ore to act in good faith should deprive him of his right to terminate without notice and without any provision being made to ease the economic burden that Fee has assumed. 162

Arguably, the use of the Code by analogy would have made significant differences in several non-Code termination cases. Bushwick-Decatur was followed in Prince v. Miller Brewing Co., 163 where a franchisee was refused restitution of expenditures he made in developing an additional area acquired at the request of the franchisor, with the understanding that it would take two or three years to make the new area profitable. During the three years prior to termination, he had incurred losses of \$20,000 and in the month prior to termination had finally shown a profit. The basis of the termination was that there had been a "breakdown in honesty and integrity," evidenced by litigation arising from the original franchise. Two agents of the franchisor had been paid \$1,000 each for "good will," which the franchisee claimed was extortion. Also, at the insistence of a franchisor's agent, an employee of the franchisee had falsely stated sales volume, so that the agent would receive

Ore's representations were made without a reasonable basis in fact, in light of the low profitability of the other ZESTburger franchises. Extravagent claims of profitability apparently pervade the franchise industry. See Witson, supra note 7, at 2, 13.

¹⁶² The merchandise, equipment, special tools, and spare parts in which franchisees often have to invest "may have little value on the open market yet be of almost cost value to . . .[a] manufacturer. A Holiday Inn sign, for example, probably would be of value only to other franchisees—or to the franchisor for sale or lease to them. Allowing a franchisor to terminate a franchise under such conditions without an inventory or advertising buy-back provision would seem unfair." Gellhorn, supra note 23, at 519.

Franchisors should not fear that a standard of "good faith termination" will effectively prevent all terminations. For an example of a permissible termination under a state case law good faith standard, see Seegmiller v. Western Men, Inc., 20 Utah 2d 352, 437 P.2d 892 (1968).

^{163 434} S.W.2d 232 (Tex. Civ. App. 1968).

a bonus of trading stamps; the franchisee claimed ignorance of this affair.164 These actions by the franchisor's agents were certainly dishonest and should not be considered as within the reasonable standards of any business. Even if in assessing the relative equities of the parties, the franchisee is determined not to have been without fault in the conduct of his original business, arbitrary termination of the new business and the accompanying confiscation of his good will seems to be a Draconian penalty. In Kotula v. Ford Motor Co. 165 the franchisee established in an unsuccessful action under the Dealers' Day Act that the manufacturer's representative had responded in the following manner to his refusal to purchase a truck. "Look, Kotula, if its the last thing I ever do, it will be to make you wish you were never a Ford dealer in your life. . . . Don't ever forget it, Mr. Kotula, that I will get you yet." The franchisee in Walker v. Ford Motor Co. 167 had employed unneeded salesmen and mechanics and unnecessarily kept its doors open, at the insistence of the franchisor. Despite compliance with such demands and forty years service as a Ford dealer, the franchise was cancelled. 168 Such actions cannot easily be described as either "honest" or measuring up to reasonable standards of fair dealing.

Unconscionability

Other important issues in the Fee-Ore litigation could arise from the use by analogy of 2-302, which empowers courts to provide relief from unconscionable bargains. The possibility that some franchise terms would be unconscionable has been raised, and the extension of the provision beyond sales law has often been

¹⁶⁴ Id. at 232-36.

^{165 338} F.2d 732 (8th Cir. 1964), cert. denied, 380 U.S. 979 (1965).

¹⁶⁶ Id. at 736.

^{167 241} F. Supp. 526 (E.D. Tenn. 1965).

¹⁶⁸ See id. at 529-30. See also Gellhorn, supra note 23, at 467-68 & n.7.

^{169 &}quot;(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

⁽²⁾ When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination." UCC § 2-302.

¹⁷⁰ See Sinkoff Beverage Co. v. Joseph Schiltz Brewing Co., 51 Misc. 2d 446, 273 N.Y.S.2d 364 (Sup. Ct. 1966); Hewitt, supra note 2, at 1082-83.

urged.¹⁷¹ The section's underlying policy seems equally valid when transposed to the franchise context.¹⁷² Nevertheless, the vitality of 2-302 in the franchise area is limited since the Comments indicate that this provision does not seek to disturb the allocation of risks because of superior bargaining power.¹⁷³ lt is designed rather to prevent "oppression and unfair surprise." Since many of the inequities involved in franchise agreements result from the superior bargaining power of the franchisor,175 the section, as construed by the Comment, is of little help to franchisees. Nevertheless, ZESTburgers' Standard Contract terms on requirements and cost should be unenforcable under 2-302 because of the surprise resulting from Ore's assurances to the contrary.¹⁷⁶ Likewise, the franchise fee should be unenforcable because it is imbedded in lengthy boilerplate. Also, under the pre-Code case of Campbell Soup Co. v. Wentz, 177 this may be too hard a bargain for a court to enforce in good conscience.178

¹⁷¹ See note 131 supra and accompanying text.

¹⁷² See 65 COLUM. L. REV., supra note 116, at 892.

liss. See UCC § 2-302, Comment 1. But see Jefferson Credit Corp. v. Marcano, _____ Mise. 2d _____, 302 N.Y.S. 2d 390, 394-95 (Civ. Ct. 1969). Jones v. Star Credit Corp., 59 Misc. 2d 189, 298 N.Y.S. 2d 264 (Sup. Ct. 1969). Both of these decisions looked specifically at inequality of bargaining power in finding unconscionability.

¹⁷⁴ UCC § 2-302, Comment 1.

¹⁷⁵ See Atlantic Refining Co. v. FTC, 381 U.S. 357, 368 (1965); Simpson v. Union Oil Co. of California, 377 U.S. 13, 21 (1964); S. MACAULAY, supra note 23, at 24; 1967 Hearings, supra note 3, at 1; Gellhorn supra note 23, at 468. Franchisors are said to seek "small businessmen, retired persons, blue-collar workers, and others lacking in entrepreneurial experience" as franchisees. Wilson, supra note 7, at 13.

There are other difficulties with the utilization of 2-302. It would be difficult for a franchisee who entered the agreement with the advice of counsel to claim that he had been surprised. Also, any unconscionability must be present "at the time it was made." UCC § 2-302(1). Therefore, unfairness which arises after the execution of the agreement from changed business circumstances would not be corrected by the section. *But see* Campbell Soup Co. v. Wentz. 172 F.2d 80 (3d Cir. 1948); UCC § 2-302, Comment 1.

¹⁷⁸ Cf. text accompanying note 189 infra.

^{171 172} F.2d 80 (3d Cir. 1948).

[&]quot;We...think...that a party who has offered and succeeded in getting an agreement as tough as this one is, should not come to a chancellor and ask court help in enforcement of its terms." *Id.* at 83. In limiting 2-302 to "oppression and unfair surprise," *Campbell Soup* is cited with approval by the drafters of Article Two. *See* UCC § 2-302, Comment 1.

In Campbell Soup the contract price for carrots was \$30 a ton for all the carrots that the sellers would grow on 15 acres. The market price rose within seven months to \$90 a ton. The buyer sought specific performance. 172 F.2d at 81. Although the court was dealing with the equity doctrine of unconscionability, the principle of the case, under 2-302, would seem to apply to all contract actions.

A primary difficulty with the utilization of 2-302 analogically is that the content of the term "unconscionable" is nowhere prescribed¹⁷⁹ and must be judicially developed. The test of unconscionability adopted by the District of Columbia Circuit in Williams v. Walker-Thomas Furniture Co., 180 the absence of meaningful choice where the terms of the contract were unreasonably favorable to the other party, 181 has been said to be of limited usefulness to franchisees.¹⁸² This test would be ineffective if the franchisee were offered a variety of terms. 183 Hewitt acknowledges the probable impotence of 2-302 but observes that some other writers have suggested that use of standard form contracts throughout an industry, perhaps such as ZESTburgers' Standard Contract, is one indication of unconscionability.¹⁸⁴ Since the franchises offered by different members of the same industry tend to become uniform, 185 this could be a useful theory through which to apply 2-302 analogically.

The formulation of 2-302 that Fee could use most effectively would be that the 40 percent franchise fee and the price of the cups and wrappers are too expensive to be enforced. There is substantial authority for the proposition advanced in *Toker v. Perl*¹⁸⁶ that an "exorbitant price . . . makes [the] contract unconscionable and

declared, in part, that the present version of the section only defines unconscionability "in terms of itself." Id. at 499. The section was said to have no "reality referent." Id. at 558. However, this position has recently been the subject of an extended analysis. See Ellinghaus, supra note 2. This "standard" of unconscionability can now be empirically discerned, it is said, in cases involving: "misleading bargaining conduct," "inequality of bargaining position," "exploitation of the underprivileged," "overall imbalance" in the allocation of contractual benefits, "excessive price," "warranty disclaimers and remedy limitations," among others. Id. at 763-808. Ellinghaus's mode of analysis would seem similar to Summer's view that "good faith" can be usefully defined only in terms of the conduct that it proscribes: Cf. Summers, supra note 143.

^{· 180 350} F.2d 445 (D.C. Cir. 1965).

¹⁸¹ Id. at 449.

¹⁸² See Gellhorn, supra note 23, at 511.

¹⁸³ See id. However, another commentator has suggested that franchisees should be wary of companies who will agree to changes in their standard contract, since this is said to be a sign of weakness. See Rosenfield, supra note 12, at 22.

¹⁸⁴ See Hewitt, supra note 2, at 1083.

¹⁸⁵ Professor Macaulay has described the distribution agreements employed by the automobile manufacturers in the following terms: "a printed-form, take-it-or-leave-it contract," a "standardized contract of adhesion," and "a contract of adhesion drafted by the manufacturer." S. MACAULAY, supra note 23, at 9, 117, 127.

¹⁸⁶ 103 N.J. Super. 500, 247 A.2d 701 (Super. Ct. 1968).

therefore unenforceable." This assertion was made in reference to a total contract price more than triple the true value of the goods involved. 188

The cover letter, in which Ore asked Fee to sign the Standard Contract immediately and return it, was apparently for the sole purpose of preventing thorough examination by Fee, and this bargaining technique should render the contract unconscionable. In *Toker*, where unconscionability was found, the seller laid the contract for the purchase of a freezer beneath the contract for the purchase of food, which was the agreement that the buyers thought that they were entering. Obviously, Fee could have read the contract, but Ore should not be allowed to benefit from his oppressive use of Fee's inexperience.

Another test of unconscionability applicable to franchise terminations has been submitted by Professor Gellhorn, who would look to see if "the condition which 'creates' the right to terminate the agreement in one party . . . [bears] a reasonable relationship to the risks sought to be allocated and the benefits granted by the agreement." Fee receives no benefits under the written contract of sufficient magnitude to make it reasonable that the franchisor be given the unconditional right to terminate. Further, Ore's risks under the contract are not sufficient for him to be allowed to escape from the contract at any time without reason or prior notice, because of the large risks alloted to Fee—the possibility that he will be left with useless equipment and inventory upon

Ist Id. at 503, 247 A.2d at 703. See American Home Improvement Co. v. MacIver, 105 N.H. 435, 201 A.2d 886 (1964); Jones v. Star Credit Corp., 59 Misc. 2d 189, 298 N.Y.S.2d 264 (Sup. Ct. 1969); Central Budget Corp. v. Sanchez, 53 Misc. 2d 620, 621, 279 N.Y.S.2d 391, 392 (Sup. Ct. 1967); Frostifresh Corp. v. Reynoso, 52 Misc. 2d 26, 274 N.Y.S.2d 757 (Sup. Ct. 1966), rev'd in part, 54 Misc. 2d 119, 281 N.Y.S.2d 964 (App. T. 1967); Ellinghaus, supra note 2, at 787-93; Hester, Deceptive Sales Practices and Form Contracts—Does the Consumer Have a Private Remedy? 1968 DUKE L.J. 831, 872; Summers, supra note 143, at 232; Note, Inadequacy of Consideration As a Factor in Determining Unconscionability Under Section 2-302 of the Uniform Commercial Code, 67 MICH. L. REV. 1248 (1969). But see Spanogle, Analyzing Unconscionability Problems, 117 U. PA. L. REV. 931, 964-67 (1969) (unconscionability cases resting on price disparity usually involve additional inequitable elements).

¹⁸⁵ The value of a food freezer was \$300, but the total contract price was \$1,092. 103 N.J. Super. at 502, 247 A.2d at 702.

unconscionability." See generally Leff, supra note 131, at 489-508.

¹⁹⁰ Gellhorn, supra note 23, at 512 (emphasis omitted). See also Wilson, supra note 7, at 17.

termination. Such benefits as are granted Fee are minimized by the exorbitant franchise fee, which exaggerates the imbalance in risk allocation under the contract. "Termination clauses which permit such unilateral oppression should . . . be regarded as prima facie unconscionable—subject always of course, to vindication by explanatory and exculpatory evidence as to 'commercial setting, purpose and effect."" ¹⁹¹

This formulation and others could provide additional weapons to franchisees, but without internal expansions of 2-302, extension by analogy may be futile.

The national perspective of many franchise companies could give rise to yet another unconscionability issue, if the franchise agreement contained an unreasonable submission to foreign jurisdiction. A franchisor could easily curtail franchisee litigation if the agreement imposed a grossly inconvenient forum.

Termination

The issue of unconscionability is also raised by 2-309(3). Section 2-309(2) codifies the widely held view that a distributorship agreement which has an indefinite duration is terminable at will,¹⁹³ but subsection (3) requires reasonable notification of termination,¹⁹⁴ and "an agreement dispensing with notification is invalid if its

¹⁹¹ Ellinghaus, supra note 2, at 812.

¹⁹² See Paragon Homes, Inc. v. Carter, 56 Misc. 2d 463, 288 N.Y.S.2d 817 (Sup. Ct. 1968), aff'd mem.. 295 N.Y.S.2d 606 (App. Div. 1968). See generally Paragon Homes of Midwest, Inc. v. Grace, 4 UCC Rep. Serv. 19 (N.Y. Sup. Ct. 1967); Paragon Homes of New England, Inc. v. Langlois, 4 UCC Rep. Serv. 16 (N.Y. Sup. Ct. 1967); Ellinghaus, supra note 2, at 803-05. Furthermore, it is possible that a franchise agreement's choice of law provision might be held unconscionable if the chosen law lacked a "normal connection with the bargain." Nordstrom & Ramerman, The Uniform Commercial Code and the Choice of Law, 1969 Duke L.J. 623, 631.

[&]quot;Where a contract provides for successive performances but is indefinite in duration it is valid for a reasonable time but unless otherwise agreed may be terminated at any time by either party." UCC § 2-309(2). Authorities stating the similar pre-Code rule are collected in Gellhorn, supra note 23, at 479 & n.49; Annot., 19 A.L.R.3d 196, 264-73 (1968).

requires that reasonable notification be received by the other party...." UCC § 2-309(3). The Code represents the view presented by apparently the majority of the cases. See, e.g., Willcox & G. Sewing Mach. Co. v. Ewing, 141 U.S. 627 (1891). Cases are collected in Annot., 19 A.L.R.3d 196, 292-94 (1968). For collected contrary authorities see id. at 294.

The use of the Code would presumably modify a term which provides that "[t]his agreement may be terminated by the Dealer or by the Company at any time." 1965 Hearings, supra note 9, at 458 (Snap-On Tools).

operation would be unconscionable." Section 2-309(2) directs that a contract of indefinite duration which provides for successive performances is "valid for a reasonable time." 195

Whenever the sale of goods is the primary facet of the franchise relationship, 2-309(2) and (3) would seem to apply directly to the agreement, and concurrently may apply to franchise rights, because they will often be coterminous with the right to buy the franchisor's goods. Where the franchisor only licenses a trademark or provides a system of business, these provisions should be employed analogically because they are rational rules especially adaptable to the realities of franchising.

Under the Code, ZESTburgers' right to terminate would be limited in several ways. Since it is apparently of indefinite duration, 2-309(2) would hold it valid for a reasonable time. Perhaps one year is not a reasonable time since Fee has not had an opportunity to recoup his initial expenses.¹⁹⁷ Section 2-309(3) would require reasonable notification of the termination, and the term dispensing with such notification, imbedded in the form contract, should be invalid as unconscionable.

In addition to *Tele-Controls, Inc.* v. Ford Industries, Inc. 198 and Mastrian v. William Freihofer Baking Co., 199 2-309 has been involved in franchisee-franchisor litigation in Sinkoff Beverage Co.

¹⁹⁵ UCC § 2-309(3). It is inferable from the Comments that this unconscionability might arise from the inability of the terminated party to procure a substitute arrangement, at least where this inability arose from the nature of the notice. See UCC § 2-309, Comment 8.

¹⁹⁵ UCC § 2-309(2). This seems to be a codification of the "Missouri doctrine" of agency that there must be a time before termination for recoupment of expenditures. The Missouri doctrine's ramifications for franchise agreements are discussed in Gellhorn, *supra* note 23, at 479-83. Authorities are collected in Annot., 19 A.L.R.3d 196, 319-48 (1968).

The Comments indicate that this provision is a resolution of conflict, but avoids deciding whether the reasonableness of the duration is to be determined at the time of contracting or the time of termination. See UCC § 2-309, Comment 7; Gellhorn, supra at 480-81. See also 3A A. CORBIN, CONTRACTS § 684, at 231 (1960).

The use of this provision would apparently modify the terms of Chrysler franchises which have no expiration date and Ford franchises which are indefinite but provide for cancellation at will upon 120 days notice. See S. MACAULAY, supra note 23, at 82.

¹⁹⁷ One year was suggested by the franchisee as being a reasonable time in Sinkoff Beverage Co. v. Joseph Schlitz Brewing Co., 51 Misc. 2d 446, 447, 273 N.Y.S.2d 364, 366 (Sup. Ct. 1966).

¹⁹⁸ 4 UCC Rep. Serv. 1042 (7th Cir. 1967). See notes 95-98 & 158-59 supra and accompanying text.

¹⁹⁹ 45 Pa. D. & C. 2d 237 (C.P. Luzerne County 1968). See notes 60-66 supra and accompanying text.

v. Joseph Schlitz Brewing Co.200 and Weilersbacher v. Pittsburgh Brewing Co.201 Both actions were by wholesaler-franchisees against manufacturer-franchisors. In Sinkoff the written distribution agreement provided for termination at any time and did not grant any exclusive territory. After termination upon ten days notice, the franchisee sought to enjoin sales by the franchisor to other beer distributors, alleging a parol contract making its franchise exclusive for the county. The court held that the franchisee was bound by the terms of the written contract. However, the franchisee also argued that under 2-309(3) the ten days notice of termination was unreasonable. The court construed the provision as requiring a hearing on unconscionability if a "specter of oppression" could be found in the termination provision as of the time the contract was entered. Since it was unable to find this "specter," the injunction was denied.202 In Weilersbacher the parties entered a parol agreement which did not provide for its duration. Termination by the franchisor prompted the franchisee's action for specific performance. In denying the franchisee relief, the court noted that under 2-309(2) an agreement providing for successive performances but indefinite in duration was valid for a reasonable time but unless otherwise agreed might be terminated at any time.²⁰³

It would seem that neither Sinkoff nor Weilersbacher have utilized the full strength of 2-309. The Weilersbacher court exhibited a fixation with the last clause of 2-309(2), allowing termination at any time.²⁰⁴ Apparently, however, this clause is severely modified by the first half of 2-309(2), directing that a contract of indefinite duration, providing for successive performances, is valid for a reasonable time. Therefore, the termination "at any time" should come only after the "reasonable time" as determined by the specific circumstances has passed, but the Weilersbacher court failed to inquire whether such a reasonable time had passed.²⁰⁵ Even though subsection (2) allows termination at any time, subsection (3) requires notice of termination except where termination occurs

²⁰⁰ 51 Misc. 2d 446, 273 N.Y.S.2d 364 (Sup. Ct. 1966).

²⁰¹ 421 Pa. 118, 218 A.2d 806 (1966).

²⁰² Sinkoff Beverage Co. v. Joseph Schlitz Brewing Co., 51 Misc. 2d 446, 273 N.Y.S.2d 364 (Sup. Ct. 1966).

²⁰³ Weilersbacher v. Pittsburgh Brewing Co., 421 Pa. 118, 218 A.2d 806 (1966).

²⁰⁴ See id. at 121, 218 A.2d at 808.

²⁰⁵ See id. at 121-22, 218 A.2d at 808.

upon the happening of an agreed event or where notice is validly waived by agreement of the parties. Therefore, the "at any time" language is further modified by the requirement of notice. To construe "at any time" as "without notice" would disregard the language of subsection (3) which incorporates notice into the concept of "termination" in subsection (2). In fact, 2-309(3) was not mentioned in Weilersbacher.206 Sinkoff dealt with that portion of subsection (3) which allows notice to be waived if the agreement is not unconscionable. The court looked only, however, for unconscionability at the time the contract was executed.²⁰⁷ Such a view is unduly restrictive because the subsequent dealings of the parties and their reliance on the agreement may make the operation of a contract term unconscionable, even though it was reasonable when the agreement was executed.208 Even though 2-302 clearly restricts the search for unconscionability to the time of agreement,²⁰⁹ it has been pointed out that the drafters seem to have viewed 2-309(3) as looking to subsequent circumstances.²¹⁰

Requirements and Exclusive Dealings Provisions

Section 2-306 also applies directly to the sale of goods involved in a franchise agreement, but, like 2-309, deserves specific attention because the rules and policies it enunciates deal with recurrent legal problems of franchising. Since the terms of many franchise agreements involve requirements and exclusive dealings arrangements,²¹¹ as in the ZESTburger contract, they were susceptible to attack under pre-Code law for indefiniteness or lack of mutuality of obligation.²¹² It has been said of automobile dealer franchises:

²⁰⁵ See id. at 119-22, 218 A.2d at 807-08.

²⁰⁷ See 51 Misc. 2d at 448, 273 N.Y.S.2d at 367.

²⁰⁸ Gellhorn, supra note 23, at 516.

²⁰³ "If the court . . . finds the contract . . . to have been unconscionable at the time it was made the court may refuse to enforce the contract" UCC § 2-302(1) (emphasis added).

²¹⁰ Ellinghaus, supra note 2, at 811 n.254.

²¹¹ See Handler, supra note 11, at 424; Hewitt, supra note 2, at 1084.

²¹² See, e.g., Williams Co. v. Colorado Milling and Elevator Co., 246 F.2d 240 (5th Cir. 1957); Utility Appliance Corp. v. Kuhns, 393 Pa. 414, 143 A.2d 35 (1958); Hirschhorn v. Nelden-Judson Drug Co., 26 Utah 110, 72 P. 386 (1903). The numerous authorities are collected and discussed at Note, "Mutuality" in Exclusive Sales Agency Agreements, 31 COLUM. L. Rev., 830, 832-33 (1931); 63 HARV. L. Rev., supra note 46, at 1012-13; 28 ILL. L. Rev., supra note 44, at 804-05; Annot., 19 A.L.R.3d 196, 249-52 (1968).

[U]ntil fairly recently, when major ehanges were made in the franchises, they were legally unenforceable as contracts because they lacked mutuality of obligation. While the manufacturer demanded that the dealer sell enough ears and invest enough capital in the dealership to satisfy the manufacturer, it reserved the right to cancel the agreement at will and was careful not to promise to do anything.²¹³

Neither indefiniteness nor lack of mutuality, however, would be available to either Fee or Ore under 2-306(2).²¹⁴

Section 2-306(1) also is important to franchisees and franchisors, for it would limit the requirements that the franchisee can demand to those "actual . . . requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior . . . requirements may be . . . demanded." Seemingly, the ZESTburger Standard Contract term requiring Fee to purchase his "ordinary business requirements" but not less than a stated minimum, is limited to "such actual . . . requirements as may occur in good faith." Ore, however, could insist that the minimum amount is enforceable since 2-306(1)²¹⁷ implicitly recognizes that the parties can decide upon an amount that restricts the "actual . . . requirements." The Comments recognize that a stated minimum "shows a clear limit on the intended elasticity." This minimum, however, seems open to

²¹³ S. MACAULAY, supra note 23, at 25.

²¹⁴ "(1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded. (2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to promote their sale." UCC § 2-306. It is arguable that the Comment's discussion of "exclusive agent" and "dealer" explicitly directs subsection (2) to franchising. See UCC § 2-306, Comment 5. Professor Hewitt concludes that "it seems clear that lack of mutuality and indefiniteness are much less likely to be the basis for invalidating franchises than in the past." Hewitt, supra note 2, at 1083-84.

²¹⁵ UCC § 2-306(1).

²¹⁶ Id.

^{217 &}quot;[N]o quantity unreasonably disproportionate to any stated estimate... may be tendered or demanded." UCC § 2-306(1). It could be argued that any new business such as Fee's has no basis for the establishment of a reasonable stated estimate, and, obviously, a new business could not come within the "in the absence of a stated estimate" provision, since there were no prior requirements. In a uniform, national franchise system, however, the requirements of a new site would seem to be predictable on the basis of prior experience.

²¹⁸ UCC § 2-306, Comment 3.

attack on grounds of either bad faith or unconscionability, resulting from the declarations of Ore to the contrary.

In Massachusetts Gas & Electric Light Supply Corp. v. V-M Corp.²¹⁹ the franchisee learned that the franchisor intended to terminate him pursuant to the distribution agreement's term allowing cancellation on thirty days notice. The agreement required the franchisor-manufacturer to "maintain a reasonable inventory for . . . [the franchisee's] current sales."220 The normal monthly inventory had been 100 units. The franchisee ordered 892 units after learning of the impending termination. The franchisor refused to fill all of the order and terminated. Citing 1-203, 2-103(1)(b) and 2-306, the First Circuit sustained the franchisor's actions, holding that the franchisee did not act in good faith and was attempting to nullify the contractual provision for termination.²²¹ The converse of Massachusetts Gas & Electric is presented by the frequent automobile dealer complaint that unwanted units are forced on them by overly zealous factory representatives.222 Subject to the other qualifications of 2-306(1),223 the refusal of a dealer to accept unnecessary inventory should not serve as a ground for termination.

Statute of Frauds

Arguably, Fee and Ore entered a contract when Fee wrote that he accepted. If the Standard Contract had never been executed, Ore could insist that a contract concerning only the franchise rights was consummated by Fee's letter. In requiring only that there be "some writing sufficient to indicate that a contract for sale has been made between the parties," which evidences a quantity and is signed by the party against whom enforcement is sought,²²⁴ the drafters of 2-201 sought to liberalize the technical requirements of the statute of frauds.²²⁵ In the present case there is a writing; it is signed by Fee, and no "quantity" is involved, since Ore is seeking under this theory enforcement only as to the franchise.

^{219 387} F.2d 605 (1st Cir. 1967).

²²⁰ Id. at 606.

²²¹ Id. at 607.

²²² See, e.g., Kotula v. Ford Motor Co., 338 F.2d 732, 735-36 (8th Cir. 1964), cert. denied, 380 U.S. 979 (1965); S. Macaulay, supra note 23, at 13, 15, 16, 23-24, 30, 32, 48, 51-52, 66, 120, 166, 167, 180, 182, 195.

²²³ The term of the contract must measure the quantity by the output of the seller or the requirements of the buyer, and if there is an estimate, it must be stated. UCC § 2-306(1).

²²¹ UCC § 2-201(1).

²²⁵ See 65 COLUM. L. REV., supra note 116, at 889-90.

Section 2-301(1) should not be analogically employed in this instance. The complex terms of franchise contracts require a high degree of specificity in the statement of each party's duties in such areas as the licensing of the trademark, even though quantities and prices may be indefinite.²²⁶ Also, it is possible that the use by analogy of 2-201(1), in instances such as this, would further weaken the bargaining power of an inexperienced party by allowing him to write himself into a burdensome contract.²²⁷

Parol Evidence Rule

It has been suggested that 2-202, the Code's parol evidence rule, might be beneficially used by analogy as a "definitive reformulation" where the case law is conflicting.²²⁸ Assuming the Standard Contract to be enforceable, Fee would desire to introduce parol evidence as to Ore's statements concerning the cups and wrappers requirements and the non-existent inventory and equipment buy-back provision. Ore's statements concerning the minimum requirements of cups and wrappers would be inadmissible under 2-202, since "[t]erms . . . which . . . are . . . set forth in a writing intended . . . as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement "229 However, the agreement may be explained or supplemented by a "course of performance" under 2-208(1),230 but 2-208(2) indicates that a course of performance is controlled by express terms of the contract.²³¹ Another possible defense would be proof that Ore's

²²⁶ See 65 COLUM. L. Rev., supra note 116, at 890. See notes 237-44 infra and accompanying text.

²²⁷ Such a contract would, of course, be subject to the limitations of 2-302.

The suggestion that a weaker party is protected by a strict statute of frauds is founded on the assumption that the flexibility given the parties under the liheral rule could be arbitrarily exercised by the party with the greater economic power. The "strict" contract, which is envisioned as preferable, would be one which sets forth in detail the rights and duties of both parties but also is of such clarity that the allocation of risks is evident.

²²⁸ 65 COLUM. L. REV., supra note 116, at 890-91.

²²⁹ UCC § 2-202.

²³⁰ See UCC §§ 2-202(a), 2-208(1). "Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement." UCC § 2-208(1).

²³¹ "The express terms of the agreement and any . . . course of performance . . . shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance" UCC § 2-208(2).

subsequent dealings constituted a waiver under 2-209.²³² As to the buy-back promise, it could be established as a "consistent additional" term only if the court found that the writing was not intended "as a complete and exclusive statement of the terms of the agreement."²³³

Since only tangibles are involved in this dispute over the quantity and buy-back terms, this can be said to be a direct application of the Code. But the use of 2-202 attempted by the franchisee in *Eskimo Pie, Inc. v. Whitelawn Dairies, Inc.*²³⁴ should be viewed as use by analogy since only intangible rights were involved. The franchisee unsuccessfully sought to show that "non-exclusive" as used in a distribution agreement was to be construed in the light of an alleged "course of dealing." Although the court in *Eskimo Pie* employed a case law formulation of the parol evidence rule because the transaction predated the effective date of the Code in the jurisdiction, on reasons immediately present themselves, however, why 2-202 should not be analogically employed.

Indefiniteness

If a contract were established as existing prior to the signing of the Standard Contract, it would not be invalid merely because certain material terms were indefinite. A characteristic of franchise agreements is that material terms, including those controlling prices, are often indefinite.²³⁷ Section 2-204(3) provides that even though one or more terms are left open a contract for sale does not fail for indefiniteness.²³⁸ In Weilersbacher the Pennsylvania

²²² See UCC §§ 2-209(1) & (4).

²³³ UCC § 2-202(b).

^{234 284} F. Supp. 987 (S.D.N.Y. 1968).

²³⁵ Id. at 994-95.

²³⁶ See text accompanying notes 67-69 supra.

²³⁷ "In the very nature of an exclusive sales and distribution contract, it is not usually practicable to fix prices and the quantum of goods sold; and the rules of certainty and definiteness which govern the ordinary contract of sale have no application. Unlike a pure contract of purchase and sale, agreements of this class embody mutual promises and obligations with sufficiently definite standards by which performance can be tested. . . . The character of the contractual arrangement is such as to preclude explicitness as to quantity and prices." Mantell v. International Plastic Harmonica Corp., 141 N.J. Eq. 379, 388-89, 55 A.2d 250, 256-57 (Ct. Err. & App. 1947). See also E. Lewis & R. Hancock, supra note 5, at 28.

²³⁵ UCC § 2-204(3).

Supreme Court applied 2-204 to the distribution agreement there involved.²³⁹ Similarly, 2-305(1) provides that "[t]he parties if they so intend can conclude a contract for sale even though the price is not settled,"²⁴⁰ and 2-311 sustains contracts which leave particulars of performance to be later specified by one party.²⁴¹ The policy beneath these Code provisions has been described as a recognition of valid commercial practices reflecting a business need for flexibility.²⁴² The analogical extension of these sections has been proposed,²⁴³ and indeed, these provisions merge well with the commercial realities of franchising.²⁴⁴

Firm Offers

If it were ever in issue, the "option" that Ore gave Fee would not be binding under 2-205 because it was not in writing. It would not fail, however, under this section because of lack of consideration. The section's theory is said to be the effectuation of the stated deliberate intention of the offeror to make an offer binding. This broad principle has been described as having great analogical potential. 248

Bromberg v. Holiday Inns of America²⁴⁹ presents a fact situation that would perhaps have resulted in a firm offer under the Code. Holiday Inns gave a writing to an individual seeking a franchise, which stated that it would accept an application to be

²²⁹ Weilersbacher v. Pittsburgh Brewing Co., 421 Pa. 118, 121, 218 A.2d 806, 807 (1966).

²⁴⁰ UCC § 2-305(1).

²¹¹ UCC § 2-311.

²⁴² See 65 COLUM. L. REV., supra note 116, at 891.

^{243 1.4}

²¹¹ See generally Hewitt, supra note 2, at 1079, 1083.

²¹⁵ "An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror." UCC § 2-205.

²¹⁸ Id.

²¹⁷ UCC § 2-205, Comment 2.

²¹⁸ See 65 COLUM. L. REV., supra note 116, at 889. It is also suggested that 2-205 should not be used by analogy, if the effect would decrease the bargaining power of an already inferior party. Id. This, however, could lead to the result that the stronger party's offers would be enforced but not those of the weaker party. Such a result is questionable since the stronger party is penalized only because of his strength, not because of anything inequitable in the contract or offered term itself.

^{219 388} F.2d 639 (7th Cir. 1967).

placed before its Executive Committee for final approval. The holding that no contract resulted followed from the conclusion that the writing placed Holiday Inns under no obligation, despite the fact that the writing did "assure" the prospective franchisee that, subject to his meeting four named conditions, "the approval [would] be forthcoming." Assuming that this was not an illusory promise the further objections of the court that there was no consideration and that it was not signed by the offeree²⁵¹ would be answered by 2-205 in favor of enforceability.

Infringements

The suit by FranSys, Inc. against Fee for ZESTburger's infringement of his trademark raises several Code issues. If 2-312(3) were employed by analogy, then Fee would have an action against Ore on the warranty provided in that section. Further utilization of the Code would require Fee under 2-607(3)(b) to notify Ore of the suit by FranSys within a reasonable time or be barred from his action on the warranty of 2-312(3). Also, under 2-607(5)(b) Ore could demand in writing that Fee surrender control of the FranSys litigation to him, and agreement by Ore to bear the expenses and any adverse judgment would compel Fee to do so after receipt of demand or be barred from his remedy.

These provisions offer a rational pattern of remedies and procedures for use in a critical area of franchising. The ability of the franchisor under the Code to demand control of the infringement litigation seems very appropriate because of the interest of most franchisors in protecting their trademark.

Assignment and Delegation

Very often the conveyance by the franchisee of his business is controlled by the terms of the distribution agreement.²⁵⁵ If cast in

²⁵⁰ Id. at 641-42.

²⁵¹ Id. at 642.

²⁵² "Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications." UCC § 2-312(3).

²⁵³ See UCC § 2-607(3)(b).

²⁵¹ See UCC § 2-607(5)(b).

²⁵⁵ E.g., "This Agreement is personal to Licensee and none of Licensee's interest herein nor rights hereunder may he transferred, conveyed or assigned by licensee whether by operation

the manner of the prohibition in the ZESTburger Standard Contract, the franchise could presumably effect a transfer so long as he remained liable for performance. Under 2-210(3) a prohibition of "assignment of the contract," would be construed as barring only delegation of performance. Therefore, Fee could assign his rights to T. Party under the Standard Contract if he did not delegate his duties. Underlying 2-210 is the recognition that delegation of performance and assignment of rights are normal actions for a party to a contract. It could be used by analogy without any foresæeable offense to franchise agreements.

Warranties

Under 2-314(1) an implied warranty of merchantability would render Fee liable to his customer who was injured by the defective cup.²⁵⁸ This provision expressly states that "[t]he serving for value of food or drink to be consumed either on the premises or elsewhere is a sale." Furthermore, there is substantial authority that Ore would also be liable as franchisor, ²⁶⁰ under the aegis of several recent state court decisions treating the franchisee as agent of the franchisor. Other than these direct applications, 2-313(2) could serve as the basis for an assertion by Fee that an affirmation of the value of the franchise had been made to him by Ore.²⁶¹ Assuming

of law or otherwise; provided that if Licensee shall at any time desire to sell Licensee's Vehicle Renting Business, Licensee may, with the prior written consent of Hertz, assign to the purchaser of such Vehicle Renting Business all of the interest of Licensee in and under this Agreement." E. Lewis & R. Hancock, supra note 6, at 63 (Hertz). "Neither this agreement nor any supplement thereto nor any rights hereunder is transferable or assignable either voluntarily or by operation of law, but all rights created by this agreement and any supplements apply solely to the personal benefit of the parties hereto." 1965 Hearings, supra note 9, at 459 (Snap-On Tools). "Neither this contract nor any right or rights hereunder may be in any way transferred or assigned without the written consent of the Distributor." Id. at 446 (Sun-X). "The interest of the Shop Owner in this Agreement is personal and shall not be assigned, transferred, shared or divided in any manner by the Shop Owner" Id. at 406 (Midas Mufflers).

²⁵⁶ See UCC § 2-210(3). For an example of a provision barring assignment of rights, which under the Code would be construed as prohibiting a delegation, see Prince v. Miller Brewing Co., 434 S.W.2d 232, 234 (Tex. Civ. App. 1968).

²⁵⁷ See UCC § 2-210 & Comment 1.

 $^{^{258}}$ "Unless excluded or modified . . . a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind." UCC § 2-314(1).

²⁵⁹ UCC § 2-314(1).

²⁶⁰ See note 34 supra and accompanying text.

²⁶¹ UCC § 2-313(2). This possibility has apparently been considered by at least one franchisor, as evidenced by the following contract term. "This agreement is not based upon

that such express representations of the profitability of a franchise would be admissible, 262 they could serve to prevent the unjust enrichment of the franchisor.

Remedies

The pattern of remedies outlined in part seven of Article Two does not generally seem to be adaptable to the franchise situation because of the extent to which it is structured around the sale of tangibles. Indications of this limitation include the provisions for reclamation on discovery of insolvency²⁶³ and the right to identify goods to the contract.²⁶⁴ Nevertheless, Ore's action against Fee for the "franchise fee" is analogous to an action for the price under 2-709,265 and in some cases the franchisor's action may be similar to one under 2-708(1) for repudiation of the contract. If a market price at the time the franchise rights were "tendered" could somehow be established, his measure of damages would presumably be "the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages . . . but less expenses saved" because of the breach.²⁶⁶ A franchisor might seek to rely on 2-708(2) where his measure of damages would be the profit which he would have made from full performance by the franchisee.267 If Fee's counterclaim is

any representation as to prospective profits, nor has any other representation not expressly set forth herein been made to induce Licensee to solicit and enter into this agreement." 1965 Hearings, supra note 9, at 426 (Handy Dan's). Franchisees, as persons lacking entrepreneurial experience, have been described as "[t]he segment of the general public which seems to be particularly susceptible to the blandishments of franchise advertising with its dual emphasis on glamorous earnings, and 'no experience is necessary." Wilson, supra note 7, at 13. Cease and desist orders have been issued by the Federal Trade Commission in franchise "earning claims cases." National Outdoor Display, Inc., [1965-1967 Transfer Binder], Trade Reg. Rep. ¶ 17,768 (FTC 1966); Decorwood Corp., [1965-1967 Transfer Binder], Trade Reg. Rep. ¶ 17,598 (FTC 1966). See Wilson, supra at 13 n.46.

²⁶² See notes 228-35 supra and accompanying text.

²⁶³ See UCC §§ 2-702(2) & (3).

²⁶¹ See UCC § 2-704.

 $^{^{265}}$ "When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages . . . the price" UCC § 2-709(1).

²⁶⁵ See UCC § 2-708(1).

²⁶⁷ If the damages provided in 2-708(1) are inadequate to put the seller "in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided . . . due allowance for costs reasonably incurred and due credit for payments or proceeds of resale." UCC § 2-708(2).

viewed as an action for breach of the parol contract, assuming such a contract to exist, then it is analogous to an action by a buyer of goods under 2-711, when the seller has repudiated.²⁶⁸ If Fee had procured another franchise, this could be viewed as "cover" under 2-712 so that he could recover from Ore the difference between the cost of the new franchise and the cost of the ZESTburger franchise.²⁶⁹ He could then also recover his consequential damages under 2-715.270 Since Fee had been operating under the franchise for a year, his action could be considered analogous to one under 2-714 for breach in regard to accepted goods. Fee would then recover "the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable."271 Fee's action against ConGlobs, Inc. is analogous to an action for specific performance under 2-716, where unique goods are involved.²⁷² A franchisee might beneficially employ 2-717 by analogy if he were to deduct any damages resulting from the franchisor's breach from the franchise fee.273

²⁶⁸ See UCC § 2-711.

²²⁹ "(1) After a breach within the preceding section the buyer may 'cover' by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

⁽²⁾ The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages . . . but less expenses saved in consequence of the seller's breach." UCC §§ 2-712(1) & (2).

²⁷⁰ "Consequential damages resulting from the seller's breach include . . . any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise" UCC § 2-715(2)(a).

²⁷¹ UCC § 2-714(1). The "reasonable" manner of calculating the "loss resulting in the ordinary course of events," under 2-714, upon termination by a franchisor could logically include the damage measure of franchisee investment recoupment allowed in Clausen & Sons, Inc. v. Theo. Hamm Brewing Co., 395 F.2d 388 (8th Cir. 1968). See also Gellhorn, supra note 23, at 519-20; Henderson, supra note 39, at 363; Note, Measure of Damages Resulting From Breach of Distributorship Agreements, 2 Ind. Legal F. 316 (1969); 53 Minn. L. Rev. 1146 (1969).

²⁷² "(1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

⁽²⁾ The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just." UCC §§ 2-716(1) & (2).

²⁷³ "The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract." UCC § 2-717.

Miscellany

Several other Code provisions could be suggested whose use by analogy would apparently not offend any policy or valid practice of franchising. Beneath 1-102(3) is the traditional notion of freedom of contract; the Code's effect may be altered by agreement of the parties, subject to specific provisions otherwise and to the duties of good faith, reasonableness, diligence, and care.²⁷⁴ This principle, like that of 1-205(3) is a general theme of the Code. Section 1-205(3) allows courses of dealing and usages of trade to supplement and qualify the terms of agreements.²⁷⁵ Others include 2-511, concerning payment by check,²⁷⁶ and 2-725, the Code's statute of limitations.²⁷⁷

Conclusion

As the specialized problems of franchising receive further treatment by the legislative and judicial authorities, the industry may develop its own specialized body of law. Professor Friedman has observed that many of the significant economic relationships in our society have been taken out of the general body of "contract law." Such relationships include insurance, antitrust, and labor law. Before franchising develops its individual rules, however, there seems to be no adequate reason why this modern commercial form should not be governed by the modern commercial principles of the Code whenever they are appropriate.

²⁷⁴ UCC § 1-102(3). Furthermore, the standard of performance by which these duties are measured can be determined reasonably by the parties. *Id. See* UCC § 1-102, Comment 2; Hewitt, *supra* note 2, at 1082.

²⁷⁵ UCC § 1-205(3). For definitions of "course of dealing" and "usage of trade" and the rules of interpretation by which they are to be employed, see id. §§ 1-205(1)-(2), (4)-(6).

²⁷⁶ UCC § 2-511.

²⁷⁷ UCC § 2-725. See Warner Motors, Inc. v. Chrysler Motors Corp., 5 UCC Rep. Serv. 365 (E.D. Pa. 1968).

²⁷⁸ See L. FRIEDMAN, CONTRACT LAW IN AMERICA 24 (1965).

