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FRANCHISES: STATUTORY AND COMMON LAW CAUSES OF ACTION IN MISSOURI*

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I. INTRODUCTION

Franchising is a method of distributing goods and services; it is not itself a product, service, or industry. The core of all franchising is the licensing of a brand name, trademark, product, or method of service. Three distinct types of franchises are generally recognized: (1) distribution of the franchisor's product, such as automobiles, gasoline, and electrical applicances; (2) retail outlets that follow a common format, such as those found in the fast food industry, restaurant field, and in motel operations; and (3) manufacturing or processing plants involving a formula or method with specifications provided by the franchisor, such as the bottling of soft drinks, and mattress and bedding manufacturing.[1] The type of franchise may be important in determining if a particular business practice is unlawful under federal and state laws.[2]

Franchisors and franchisees are independent businessmen operating under contractual agreements. The franchise agreement establishes a set of restraints under which the franchisee operates the franchised business. One purpose of these restraints is to ensure the success of the enterprise by requiring that a proven pattern of doing business is followed. Another purpose is to satisfy the requirements of the Lanham Act[3] which protects trademarks and trade names of the franchisor only if there is adequate control over the use of the trademark to ensure minimum standards of quality or uniformity.[4]

For the most part, disputes between franchisors and franchisees arise out of the restraints, practices, and controls imposed by the franchisor on the franchised operation. This article will identify and examine the

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1. J. MCCARTHY, TRADEMARKS AND UNFAIR COMPETITION 646-47 (1973).

2. The type of franchise may affect such factors as the permissible scope of a covenant not to compete, Zeidman, *The Rule of Reason in Franchisor-Franchisee Relationships*, 47 ANTITRUST L.J. 873, 885-86 (1978); the applicability of particular statutes such as the Automobile Dealer's Day in Court Act, 15 U.S.C. §§ 1221-1225 (1976); or to what extent the franchisor may require the franchisee to stock or carry the franchisor's products, Miller Motor, Inc. v. Ford Motor Co., 149 F. Supp. 790, 808 (M.D.N.C. 1957), *aff'd*, 252 F.2d 441 (4th Cir. 1958).

3. 15 U.S.C. §§ 1051-1127 (1976).

4. *Id.* § 1052.

various causes of action which are available to the franchisee to challenge the controls embodied in the franchise agreement.

II. Actions Under the Federal and Missouri Antitrust Laws

A. *Antitrust Principles*

The discussion in this section of the causes of action applicable to franchising assumes that the reader has a basic knowledge of antitrust laws and theories.[5] This includes an understanding of such concepts as the so-called "right not to do business," "combination," "per se violations," "rule of reason," "intrabrand and interbrand competition," and "vertical and horizontal restraints." The interplay of these concepts is involved in most antitrust violations and is particularly relevant to franchising disputes.

The Missouri as well as federal antitrust laws may be applicable to franchising practices occurring in the state. Missouri's antitrust statutes follow closely the wording of sections 1 and 2 of the Sherman Act[6] and section 3 of the Clayton Act.[7] Because Missouri provides by statute that judicial interpretation of the federal acts will be precedent for the comparable state laws,[8] the state and federal statutes need not be treated separately.

The franchisor-imposed restraints that are most commonly litigated under the antitrust laws include restrictions on: (1) customers to whom franchisees may sell; (2) territories in which a franchisee may do business; (3) resale prices to be charged by franchisees; (4) types of goods a franchisee may sell; and (5) sources from which raw materials may be purchased. Also challengeable under the antitrust laws are a franchisor's refusal to deal or refusal to continue to deal when the refusal is an attempt to force a prospective or existing franchisee to join in an illegal course of action.

B. *Pricing Restrictions*

Any attempt by a franchisor to control the price at which a franchisee resells goods or services is prohibited.[9] This includes the full range of proscribed price-setting devices: compulsory bargains, discounts, and maximum or minimum prices.[10] The courts have vigorously condemned price-setting,

5. For a general discussion of antitrust law, see L. Sullivan, Antitrust (1977).
6. *Compare* 15 U.S.C. §§ 1, 2 (1976) *with* RSMo § 416.031-1 to -2 (1978).
7. *Compare* 15 U.S.C. § 14 (1976) *with* RSMo § 416.031-3 (1978).
8. RSMo § 416.141 (1978).
9. *See* Capital Temporaries of Hartford, Inc. v. Olsten Corp., 383 F. Supp. 902 (D. Conn. 1974); Mid-America ICEE, Inc. v. John E. Mitchell Co., 1973-2 Trade Cas. ¶ 74,681 (D. Or. 1973).
10. Albrecht v. Harold Co., 390 U.S. 145 (1968); United States v. Parke, Davis & Co., 362 U.S. 29 (1960); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951); Adolph Coors Co. v. FTC, 497 F.2d 1178 (10th Cir. 1974), *cert. denied,* 419 U.S. 1105 (1975).

no matter how ingeniously disguised, as per se violations of section 1 of the Sherman Act. On the other hand, unilateral action by franchisors in setting prices is not unlawful.[11] Practices of a franchisor such as "suggesting" or "recommending" a resale price, preticketing the resale item, and price advertising may be acceptable if other coercive circumstances are not present.[12]

Franchisors are prohibited only from coercing franchisees to set a price. Coercion may be shown from such factors as the entire relationship between the parties, the irrelative economic power, the use of short term agreements, and other restrictions in the franchising arrangement.[13] Coercion exists where the franchisor's conduct injures interstate commerce[14] by depriving franchisees of free judgment to establish prices.[15] A franchisor may not threaten to terminate or to withdraw benefits from a franchisee in order to force compliance with its pricing policy.[16] If franchisors operate businesses at the level of their franchisees and are in competition with them, use of company owned stores to set prices may be viewed as a directive from the franchisor to the franchisee to sell at the company store price and would constitute illegal price-fixing.[17]

Advertising also can be construed as a pricing violation. For example, advertising practices are illegal if they have the effect of encouraging franchisees to police discounting by other franchisees or if they discourage price competition among franchisees.[18] If the practice only indirectly affects prices, courts are likely to apply a rule of reason test to determine its validity.[19] Once price-fixing has been found, however, there is a per se violation of the antitrust statute and defenses are limited. The reason-

11. *See* United States v. Sealy, Inc., 388 U.S. 350 (1967); United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944); United States v. Colgate & Co., 250 U.S. 300 (1919).

12. Evans v. S.S. Kresge Co., 544 F.2d 1184 (3d Cir. 1976), *cert. denied,* 433 U.S. 908 (1977); Chisholm Bros. Farm Equip. Co. v. International Harv. Co., 498 F.2d 1137 (9th Cir.), *cert. denied,* 419 U.S. 1023 (1974); United States v. O.M. Scott & Sons Co., 303 F. Supp. 141 (D.D.C. 1969).

13. Zeidman, *supra* note 2, at 883.

14. An effect on interstate commerce is a jurisdictional prerequisite to the federal cause of action. 15 U.S.C. § 1 (1976).

15. Simpson v. Union Oil Co., 377 U.S. 13 (1964); Cooper Liquor, Inc. v. Adolph Coors Co., 506 F.2d 934 (5th Cir. 1975).

16. Greene v. General Foods Corp., 517 F.2d 635 (5th Cir. 1975), *cert. denied,* 424 U.S. 942 (1976); Phillips v. Crown Cent. Petroleum Corp., 395 F. Supp. 735 (D. Md. 1975), *vacated on other grounds,* 556 F.2d 702 (4th Cir. 1977).

17. *See* Rea v. Ford Motor Co., 497 F.2d 577 (3d Cir.), cert. *denied,* 419 U.S. 868 (1974); Mount Lebanon Motors, Inc. v. Chrysler Corp., 283 F. Supp. 453 (W.D. Pa. 1968), *aff'd,* 417 F.2d 622 (3d Cir. 1969).

18. Mt. Vernon Sundat, Inc. v. Nissan Motor Corp., 1976-1 Trade Cas. ¶ 60,842 (E.D. Va. 1975).

19. *See* Denison Mattress Factory v. Spring-Air Co., 308 F.2d 403 (5th Cir. 1962); Weight Watchers of the Rocky Mountain Region, Inc. v. Weight Watchers Int'l, Inc., 1976-2 Trade Cas. ¶ 61,157 (E.D.N.Y. 1976).

ableness of the price fixed is no defense;[20] the fair trade exemption which formerly acted as a shield against some vertical price-fixing has now been repealed,[21] and the so-called "passing-on" defense which might bar the franchisee from suit if he "passes-on" overcharges to his customers is limited.[22]

C. *Tying and Exclusive Supply Arrangements*

Restrictions requiring a franchisee to purchase certain goods from its franchisor may involve a possible illegal tying arrangement under section 3 of the Clayton Act and section 1 of the Sherman Act.[23] Simply defined, a tying arrangement exists where there are two products and the acquisition of the economically desirable product (tying item) is made conditional upon the purchase of the second product (tied item).[24] A per se violation of section 1 of the Sherman Act results if there are separate tying and tied products and the franchisor has sufficient economic power in the "tying product" to restrain a not insubstantial amount of competition in the "tied product."[25]

Often the central issue of a tying claim in franchising cases is whether franchises or trademarks are separate products from the products sold under the trademarks. Most courts hold that a distributor franchise such as an automobile dealership is not a separate product from the actual line of automobiles sold by the dealer.[26] Store franchises such as fast food restaurants, on the other hand, have been held in some cases to be separate products in their own right and to serve as tying items in tying arrangements.[27] Other cases have not followed this rule and have held that the trademarks of the stores identified the origin of the products sold and were not themselves separate items.[28] Factors to consider in determining whether a trademark is a separate product are whether the purchase price

20. United States v. Trenton Potteries Co., 273 U.S. 392 (1927).

21. Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801, *amending* 15 U.S.C. § 1 (1975).

22. Hanover Shoe, Inc. v. United Shoe Mach. Corp., 392 U.S. 481 (1968); Phillips v. Crown Cent. Petroleum Corp., 426 F. Supp. 1156 (D. Md. 1977).

23. *See, e.g.,* Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971), *cert. denied,* 405 U.S. 955 (1972). The Federal Trade Commission Act may also be applicable. FTC v. Texaco, Inc., 393 U.S. 223 (1968); Atlantic Ref. Co. v. FTC, 382 U.S. 357 (1965).

24. Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971), *cert. denied,* 405 U.S. 955 (1972).

25. United States Steel Corp. v. Fortner Enterprises, Inc., 429 U.S. 610 (1977).

26. *See, e.g.,* Hammond Ford, Inc. v. Ford Motor Co., 39 F.R.D. 604 (S.D.N.Y. 1966). *See generally* 1 J. GILSON, TRADEMARK PROTECTION AND PRACTICES § 6.02 (1974).

27. Carpa, Inc. v. Ward Foods, Inc., 536 F.2d 39 (5th Cir. 1976) (trademark "Zuider Zee" held a tying product where franchisor had a total of six franchises, two of which belonged to the complaining franchisees).

28. Capital Temporaries, Inc. v. Olsten Corp., 506 F.2d 658 (2d Cir. 1974); Krehl v. Baskin-Robbins Ice Cream Co., 1979-2 Trade Cas. ¶ 62,806 (C.D. Cal. 1979); Esposito v. Mr. Softee, Inc., 1976-1 Trade Cas. ¶ 60,786 (E.D.N.Y. 1976); Q-T. Markets, Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975).

for the franchise includes a separate charge for the trademark and whether the trademark identifies the product sold under the mark or is simply the form used to market the product.

To prove sufficient economic power, the second element of a tying arrangement proscribed under section 1 of the Sherman Act, the courts require proof that the tying product was used "coercively." Coercion is often presumed when the franchise agreement requires the purchase of the tied product.[29] Where the contract does not provide for tying, coercion may be proven from a course of conduct showing that the franchisee was "coerced" into purchasing the tied item.[30] The uniqueness of a product is not enough to establish coercion.[31] There also must be a showing that the tying product gives the franchisor some advantage not shared by his competitors in the market for the tying product.[32]

In considering the sufficiency of economic power in the context of franchising, a few courts have presumed that economic power is inherent in the trademark.[33] Most court decisions, however, do not recognize any presumption of power from the trademark itself.[34]

The final requirement for a per se violation of the Sherman Act through an illegal tying agreement is the foreclosure of a not insubstantial amount of commerce to competitors. This requirement is shown if the totality of tied sales, not merely sales to the particular plaintiff, amount to a not insubstantial amount of money. Approximately $60,000 has been held to be an amount sufficient to meet this commerce requirement.[35] Although the test is normally satisfied when tying arrangements are adopted by a sizeable company, franchisees have not always been able to meet the test's requirements.[36]

To avoid liability through the use of express tying agreements, many franchisors exercise quality control by confining their franchisees to the use of products or services obtained from "approved sources of supply," which sometimes includes the franchisor. Courts generally have considered these restrictions under the rule of reason standard.[37] Approval of alternate sources probably will be valid if the franchisor specifies that its approval of alternate sources will not unreasonably be withheld and it in fact

29. Smith v. Denny's Restaurants, Inc., 62 F.R.D. 459 (N.D. Cal. 1974); Abercrombie v. Lum's, Inc., 345 F. Supp. 387 (S.D. Fla. 1972).
30. Krehl v. Baskin-Robbins Ice Cream Co., 78 F.R.D. 108 (C.D. Cal. 1978).
31. Plastic Contact Lens Co. v. Frontier of Northeast, Inc., 441 F.2d 67 (2d Cir.), *cert. denied*, 404 U.S. 881 (1971).
32. United States Steel Corp. v. Fortner Enterprises, Inc., 429 U.S. 610 (1977).
33. Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972).
34. Capital Temporaries, Inc. v. Olsten Corp., 506 F.2d 658 (2d Cir. 1974).
35. United States v. Loew's, Inc., 371 U.S. 38 (1962).
36. Evans v. S.S. Kresge Co., 544 F.2d 1184 (3d Cir. 1976), *cert. denied*, 433 U.S. 908 (1977).
37. Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368 (5th Cir. 1977).

applies that standard. However, the franchisor may not require the use of supplies bearing its trademark.[38]

Two defenses are recognized to a claim that a tying arrangement is per se illegal: the quality control defense and the new business defense. Both are based on the franchisor's right to protect the good will of his business. The quality control defense is available only if there are no substitutes equal in quality to the tied product or if it is impractical or impossible to submit detailed instructions for the manufacture of the tied product to other suppliers.[39] This defense is consistent with the franchisor's obligations under the Lanham Act to ensure that inferior products do not reach the public under its trademark.[40] The new business defense requires proof that tying arrangements are necessary to the development of the goodwill of the franchise during the initial stages of the franchise business.[41] Although there are few guidelines as to when a business is no longer new, it is settled that once a franchise business is established, the defense is no longer available.[42]

D. *Territorial and Customer Restrictions*

In 1977 the Supreme Court in *Continental T.V., Inc. v. G.T.E. Sylvania, Inc.*,[43] overruled the per se rule of the illegality of vertical territorial customer restrictions and held that such restrictions are to be judged by the rule of reason test. The impact of the *Sylvania* decision on franchising is not yet clear. Under the guidelines set out in the *Sylvania* decision, it is likely that courts will uphold vertically imposed territorial and customer restrictions if they do not unreasonably restrain interbrand competition.

Territorial limitations specify the geographical area in which a franchisee may do business. Customer limitations usually define the classes of customers to whom a franchisee cannot sell. There is no limit to the variety of these types of restrictions in the franchise setting.

Some franchise agreements provide for location clauses which establish the physical site of the franchisee's place of business or require the franchisor's consent for any change of location or creation of any branch office. Related restrictions are variously referred to as exclusive distributorships, exclusive franchisees, exclusive representation, or exclusive agency. These restrictions limit the franchisor's freedom to enter into competitive

38. H. Brown, Franchising Realities and Remedies 168-74 (1973).

39. Standard Oil Co. v. United States, 337 U.S. 293 (1948); IBM Corp. v. United States, 298 U.S. 131 (1936); Susser v. Carvel Corp., 332 F.2d 505 (2d Cir.), *cert. granted,* 379 U.S. 885 (1964), *cert. dismissed,* 381 U.S. 125 (1965).

40. 15 U.S.C. §§ 1055, 1064 (e) (1) (1976).

41. United States v. Jerrold Elec. Corp., 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd,* 365 U.S. 567 (1961).

42. Siegel v. Chicken Delight, Inc., 311 F. Supp. 847 (N.D. Cal. 1970), *aff'd in part, rev'd in part,* 448 F.2d 43 (9th Cir. 1971), *cert. denied,* 405 U.S. 955 (1972).

43. 433 U.S. 36 (1977).

franchise agreements with other franchisees in a particular territory. Even though competition between franchisees is reduced by these restrictions, they may pass muster because competition between different brands of the same product or service is increased.[44]

Franchisors also have used "primary area of responsibility" and "quota" clauses to ensure that each territory for which an exclusive franchise is granted receives maximum distribution coverage. Under an area of responsibility clause, a franchisee is required to use its best efforts to develop sales in its assigned territory. The quota clause requires the franchisee to sell a specified amount of the franchisor's product. Normally, such clauses do not prohibit franchisees from making sales outside of their primary area and other franchisees may sell within that area. These clauses are probably lawful so long as they are reasonable in scope and are not designed as a subterfuge to preclude competition.[45]

Franchisees who fail to meet obligations under these clauses often suffer penalties ranging from forfeiture of profits made on unauthorized transactions to loss of their franchises. The area of responsibility clause typically includes a profit-passover requirement. That requirement usually provides that a franchisee who makes sales to customers outside of its assigned territory must forfeit part of its profit to the franchisee in whose territory the customer is situated. Although courts have approved these arrangements in cases where a distributor must, under a compulsory warranty program, service a product sold by another distributor,[46] the lawfulness of these penalties in the framework of a franchising system will depend on their effect on competition in each particular circumstance.[47]

E. *Unilateral versus Concerted Refusals to Deal*

A franchisor may decide not to deal either at the beginning or during the course of the franchise relationship. The franchisor's unilateral decision not to deal, to terminate, or not to renew a franchise is permitted by the antitrust laws if that decision has no unreasonable and adverse effect on competition.[48] Franchisors may decide independently to refuse to grant franchisees new applications even if the underlying reason for the refusal is to protect existing outlets from new competition or to create an exclusive distributorship.[49] In any event, refusals to deal that are part of a program to fix prices at which franchisees may resell goods or services are

44. *See, e.g.*, Salco Corp. v. General Motors Corp., 517 F.2d 567 (10th Cir. 1975).
45. Fontana Aviation, Inc. v. Beech Aircraft Corp., 432 F.2d 1080 (7th Cir. 1970), *cert. denied*, 401 U.S. 923 (1971).
46. Eiberger v. Sony Corp. of America, 459 F. Supp. 1276 (S.D.N.Y. 1978).
47. *See generally* Zeidman, *supra* note 2, at 888-90.
48. United States v. Otter Tail Power Co., 331 F. Supp. 54 (D. Minn. 1971).
49. Burdett Sound, Inc. v. Altec Corp., 515 F.2d 1245 (5th Cir. 1975); Foremost-McKesson, Inc. v. American Hosp. Supply Corp., 1974-2 Trade Cas. ¶ 75,447 (S.D. Tex. 1974), *aff'd*, 527 F.2d 417 (5th Cir. 1976).

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prohibited.[50] Further, concerted refusals to deal by two or more persons are classified as boycotts which courts have held to have no legitimate or reasonable business justification.[51] A refusal to deal based on an agreement between the franchisor and one or more of its franchisees not to grant new franchises is a per se violation of section 1 of the Sherman Act.[52] Concerted actions to drive a franchisee out of business are likewise unlawful.[53]

F. *Laws Prohibiting Monopoly*

Antitrust laws prohibit "monopolization," "attempts to monopolize," and "combination and conspiracy to monopolize."[54] Because of prevalent misconceptions regarding monopolies, little attention has been paid to this antitrust prohibition. Monopoly is not confined to the multi-million dollar industries, and "attempted monopoly" may be found in almost every product or geographic market. The prohibitions against monopoly have been applied to a number of cases involving franchises.[55]

In many franchising systems, the incidence of the franchisor competing with franchisees and terminating or not renewing franchises is spreading.[56] The increasing presence of the franchisor at its franchisees' market level undoubtedly will result in more monopolization suits. Franchisors who compete with their franchisees and engage in predatory conduct run the risk of violating section 2 of the Sherman Act.

G. *Injury or Fact of Damage, Calculation of the Amount of Damages, and Injunctive Relief*

Recovery of damages in an antitrust case requires proof that damages resulted from, or were caused by, the antitrust violation.[57] This requirement is referred to as "the fact of damage," and must be shown if the litigant is to have standing to sue.[58] To show the fact of damage, as distinguished from showing the amount of damage, the claimant must sustain the usual burden of proof by a preponderance of the evidence.[59] If the defendant claims the damages were attributable all or in part to other

50. United States v. Trenton Potteries Co., 273 U.S. 392 (1927).
51. Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959).
52. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967); Times-Picayune Publ. Co. v. United States, 345 U.S. 594 (1953); United States v. Klearflax Linen Looms, Inc., 63 F. Supp. 32 (D. Minn. 1945).
53. United States v. General Motors Corp., 384 U.S. 127 (1966); Helix Miling Co. v. Terminal Flour Mills Co., 523 F.2d 1317 (9th Cir. 1975), *cert. denied*, 423 U.S. 1053 (1976).
54. 15 U.S.C. §§ 1, 2 (1976).
55. Coleman Motor Co. v. Chrysler Corp., 1975-2 Trade Cas. ¶ 60,592 (3d Cir. 1975); E. J. Delaney Corp. v. Bonne Belle, Inc., 525 F.2d 296 (10th Cir. 1975), *cert. denied*, 425 U.S. 907 (1976); Photovest Corp. v. Fotomat Corp., 1977-1 Trade Cas. ¶ 61,529 (S.D. Ind. 1977).
56. H. BROWN, FRANCHISING REALITIES AND REMEDIES 339-49 (1973).
57. Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555 (1931).
58. Kaplan v. Burroughs Corp., 426 F. Supp. 1328 (N.D. Cal. 1977).
59. Bigelow v. RKO Radio Pictures, Inc., 327 U.S. 251 (1946).

causes, such as lack of capital, poor business judgment, or other reasons, the defense has the burden of proof on those causes.[60]

Once the burden of proving the fact of injury and its causation has been met, the amount of damages for antitrust violations can be shown by meeting a less stringent burden of proof. The damage award need only be supported by a reasonable estimate of monetary loss based on relevant data.[61] The most common standard used in calculating damages is the net operating profit which would have been realized "but for" the antitrust violation. The same theory also may be used to determine the capital loss, such as that arising from the destruction of an entire business or of one product line.[62] In an appropriate case, there might be adequate proof to support recovery for lost future profits.[63] Proof of the fact of damage and calculation of damage in antitrust cases usually requires testimony of expert witnesses.[64] The defendant has the burden of establishing any credits against the proven damages. For example, where a franchisor made no charge for the license to use the franchise, he may be entitled to a credit for the reasonable value of the franchise.[65] After finding damages for antitrust violations, the amount must be trebled by the court, together with an award of reasonable attorneys' fees and other costs.[66]

When representing a franchisee, injunctive relief to allow the franchisee to continue operating pending the determination of the merits of the dispute should be considered. Injunctive relief is difficult to obtain; the franchisee must demonstrate a probability of success on the merits of the dispute and irreparable harm if the injunction is not granted.[67] Where termination of the franchise threatens the franchisee's livelihood, the injunction may be the only way to preserve the business entity until a trial on the merits occurs.

III. Actions Under Other Federal and State Statutes

A. *Federal Trade Commission Act*

The Federal Trade Commission Act empowers the Federal Trade Commission (FTC) to prevent "unfair methods of competition and un-

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60. *Id.*

61. Greene v. General Foods Corp., 517 F.2d 635 (5th Cir. 1975), *cert. denied,* 96 U.S. 1409 (1976); Flintkote Co. v. Lysfjord, 246 F.2d 368 (9th Cir.), *cert. denied,* 355 U.S. 835 (1957).

62. Greene v. General Foods Corp., 517 F.2d 635 (5th Cir. 1975), *cert. denied,* 424 U.S. 942 (1976).

63. Deaktor v. Fox Grocery Co., 475 F.2d 1112 (3d Cir.), *cert. denied,* 414 U.S. 867 (1973).

64. Twentieth Century Fox Film Corp. v. Goldwyn, 328 F.2d 190, 213 (9th Cir.), *cert. denied,* 379 U.S. 880 (1964). *But see* Rangen, Inc. v. Sterling Nelson & Sons, 351 F.2d 851, 856 (9th Cir. 1965), *cert. denied,* 383 U.S. 936 (1966).

65. Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971), *cert denied,* 405 U.S. 955 (1972). *But see* Carpa, Inc. v. Ward Foods, Inc., 536 F.2d 39 (5th Cir. 1976) (credit for overdue royalties to franchisor guilty of tying violation not allowed).

66. 15 U.S.C. § 26 (1976).

67. Response of Carolina v. Leasco Response, Inc., 498 F.2d 314 (5th Cir.), *cert. denied,* 419 U.S. 1050 (1974).

fair or deceptive acts and practices."[68] The purpose of the Act is to protect the public and not to punish the wrongdoer or to provide compensatory damages for illegal practices.[69] Although the FTC is an independent regulatory agency and may conduct administrative hearings, it does not hold adversary proceedings between private litigants. A litigant may petition the Commission to take action against an alleged violator, but there are no assurances that it will do so. The FTC has broad powers to order restitution, seek temporary injunctions, issue regulations, and obtain accelerated, industry-wide compliance with its orders.[70]

The Federal Trade Commission Act plays an important role in protecting franchisees from franchisor abuses and anticompetitive practices. The definitions of "unfair methods of competition" and "unfair or deceptive acts or practices" under that Act are flexible and may be adapted to numerous business practices. The Commission can declare practices unfair in light of the antitrust policies even though the practices may not actually violate the antitrust laws or may be only incipient violations.[71] A wide scope of activities affecting franchisees have been declared unlawful by the FTC.[72] Under the 1975 expansion of the FTC's enforcement powers, all cases decided by the Commission are binding precedent against other companies.[73] When handling disputes over franchise matters, the decisions, consent orders, and advisory opinions of the FTC should be reviewed. Applicable rulings may resolve those disputes without resort to private litigation.

The Commission promulgated a franchising disclosure and representation rule which became effective October 21, 1979.[74] In enacting this rule, the Commission joins a number of states in regulating representations of franchisors to prospective franchisees.[75] Under the rule, franchisors are required to deliver disclosure statements to prospective franchisees covering specified topics of the franchise business. If representations are made concerning sales, income, or profit, the franchisor is required to provide a reasonable basis for making them.

Unlike many state franchise laws which require documents to be filed with state administrators,[76] the Commission's disclosure rule has no filing requirements. It does not expressly provide for a private cause of action for its violation. It remains to be seen if the courts will imply one.[77]

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68. 15 U.S.C. § 45(a)(6) (1976).
69. Regina Corp. v. FTC, 322 F.2d 765 (3d Cir. 1963).
70. *See* Rosch, *Federal Developments Affecting Franchising—The FTC's Franchising Rule,* 47 ANTITRUST L.J. 921 (1978).
71. FTC v. Brown Shoe Co., 384 U.S. 316 (1966).
72. H. BROWN, FRANCHISING REALITIES AND REMEDIES 151-55 (1973).
73. Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, 15 U.S.C. §§ 19-21 (1976).
74. 16 C.F.R. § 436 (1979).
75. *See* Zeidman, *supra* note 2, at 874 n.8.
76. *Id.*
77. *See* Cort v. Ash, 422 U.S. 66 (1975).

B. *Automobile Dealers' Franchise Act*

In 1956 Congress amended the antitrust laws by adding the Automobile Dealers' Franchise Act.[78] This law permits a dealer who contends that the franchisor did not act "in good faith and without coercion" in terminating his franchise to bring a cause of action for damages in federal court. Under that statute, courts have held that a franchisor may terminate the franchise relationship for material breaches of valid contract provisions,[79] or for failure to meet sales quotas,[80] observe quality standards,[81] maintain an appropriate level of investment in his business,[82] obtain a suitable location,[83] or to protect its business from potential liability arising from franchisee operations.[84]

On the other hand, coercive conduct which may justify damages or injunctive relief for wrongful termination has been found where the franchise agreement was terminated for failure to comply with a franchisor's price-fixing policies,[85] for making objections to a franchisor's ownership of a competitive dealership,[86] and for refusal to abide by the franchisor's requirement that franchisees stock unwanted products.[87]

C. *Securities Act of 1933 and Securities and Exchange Act of 1934*

Securities include "investment contracts," an often litigated term which appears in the federal and most states' securities laws.[88] Since 1946 the term "investment contracts" has been construed in light of the definition stated in *SEC v. W. J. Howey Co.*:[89] a contract, transaction, or scheme whereby money is invested in a common enterprise in which profits are realized solely from the efforts of others.[90] Franchise agreements usually do not qualify as investment contracts because the franchisee's participation in the business venture is active and not "solely" in reliance on the

78. 15 U.S.C. §§ 1221-1225 (1976).
79. Woodard v. General Motors Corp., 298 F.2d 121 (5th Cir), *cert. denied,* 369 U.S. 887 (1962).
80. Frank Chevrolet Co. v. General Motors Corp., 419 F.2d 1054 (6th Cir. 1969).
81. R.A.C. Motors, Inc. v. World-Wide Volkswagen Corp., 314 F. Supp. 681 (D.N.J. 1970).
82. Pierce Ford Sales, Inc. v. Ford Motor Co., 299 F.2d 425 (2d Cir.), *cert. denied,* 371 U.S. 829 (1962).
83. Woodard v. General Motors Corp., 298 F.2d 121 (5th Cir.), *cert. denied,* 369 U.S. 887 (1962).
84. David R. McGeorge Car Co. v. Leyland Motor Sales, Inc., 504 F.2d 52 (4th Cir. 1974), *cert. denied,* 420 U.S. 992 (1975).
85. Randy's Studebaker Sales, Inc. v. Nissan Motor Corp., 533 F.2d 510 (10th Cir. 1976).
86. Rea v. Ford Motor Co., 497 F.2d 577 (3d Cir.), *cert. denied,* 419 U.S. 868 (1974).
87. American Motors Sales Corp. v. Semke, 384 F.2d 192 (10th Cir. 1967). *See generally* Autohaus Brugger, Inc. v. Saab Motors, Inc., 567 F.2d 901 (9th Cir.), *cert. denied,* 436 U.S. 946 (1978) (elements of violation of the A.D.F.A.).
88. 15 U.S.C. §§ 77(b), 78(c) (1976).
89. 328 U.S. 293 (1946).
90. *Id.* at 298.

efforts of others.[91] In some cases, however, a franchise agreement may be an investment contract and federal securities laws may be applicable. If the investor is required to perform nominal or limited duties which have little effect upon the profits of the enterprise, and if the franchisee has supplied substantial amounts of capital to enable the franchisor to operate, the agreement may constitute a security.[92]

To the extent that the franchise agreement is a security, several remedies are available to franchisees under the securities laws. For example, where deceptive acts and practices are committed in connection with the offer or sale of a franchise agreement, a franchisor may be liable under the antifraud provisions of section 17 (a) of the Securities Act of 1933,[93] sections 10 (b) and 15 (c) (1) of the Securities and Exchange Act of 1934,[94] and rule 10b-5 under the 1934 Act.[95]

D. *Petroleum Marketing Practices Act*

The Petroleum Marketing Practices Act was enacted to protect service station dealers from unwarranted terminations or non-renewals by franchisors.[96] The Act provides for notification procedures prior to termination or non-renewal[97] and sets out the grounds for termination and non-renewal.[98] The courts have broad equitable powers to deal with violations of the Act, including the power to grant injunctive relief to compel continuation or renewal of the franchise.[99] In addition to these remedies, actual and exemplary damages and attorney and expert witness fees may be awarded.[100] State laws which conflict with or contravene the provisions of the Act are preempted.[101]

E. *Missouri Statutes Applicable to Franchising*

1. Notice of Termination Statute

The term franchise is defined and regulated to some degree by statute in Missouri.[102] Franchisors are required to give franchisees ninety days notice before they cancel, terminate, or fail to renew franchise agreements.[103] Failure to give the required notice gives rise to a right to recover damages sustained, including loss of goodwill, costs of the suit, and any equitable relief the court deems appropriate.[104]

91. Chapman v. Rudd Paint & Varnish Co., 409 F.2d 635 (9th Cir. 1969); Mr. Steak, Inc. v. River City Steak, Inc., 324 F. Supp. 640 (D. Colo. 1970), *modified,* 460 F.2d 666 (10th Cir. 1972).
92. Lennerth v. Mendenhall, 234 F. Supp. 59 (D. Ohio 1964).
93. 15 U.S.C. § 77 (g) (1976).
94. 15 U.S.C. §§ 78 (j), 78 (o) (a) (1) (1976).
95. 17 C.F.R. 240.10b-5 (1979).
96. 15 U.S.C. §§ 2801-2806 (1976).
97. *Id.* § 2804.
98. *Id.* § 2802.
99. *Id.* § 2805.
100. *Id.* § 2805 (b) (1).
101. *Id.* § 2806.
102. RSMo § 407.400 (1978).
103. *Id.* § 407.405.
104. *Id.* § 407.410 (2).

2. Termination of Wholesale Liquor Franchise Without Cause

A special Missouri statute provides that wholesale liquor franchises may be terminated only for good cause.[105] Good cause includes requiring the franchisor to comply with reasonable terms of the agreement and not to act in bad faith or without observing reasonable commercial standards of fair dealing in the trade.[106] The franchisee is granted a cause of action for violations of that statute and may recover monetary damages and reasonable attorneys' fees.[107]

3. False Advertising Statute

The Missouri false advertising statute may provide a claim for relief to franchisees who are misled by franchisor advertising.[108] The statute creates a right of action on behalf of private citizens who suffer injury by reason of the false advertising,[109] and also specifically provides for the maintenance of a class action. The elements of this cause of action are similar to the elements for proof of the common law tort of fraud.[110] The franchisee should consider the possibility of using this action in conjunction with a fraud action or with a Missouri antitrust claim.

The statute also authorizes the Missouri Attorney General to institute civil action against persons engaging in fraudulent or deceptive advertising.[111] Private litigants may use a judgment obtained by the attorney general as prima facie evidence of liability in a private action.[112]

IV. Common Law Liability

A. *Fiduciary Relationship*

Under the basic franchise agreement an independent business person (franchisee) agrees to invest money and time in a business to be operated under the guidance of the franchisor. Many franchisees are eager but know little about the franchised business. The franchisor usually purports to have many years of experience and in-depth knowledge about each facet of the business which it agrees to place at the complete disposal of the franchisee. The franchisee under these circumstances often finds himself totally dependent upon the good counsel of the franchisor. Various provisions contained in standard franchise agreements which require the franchisee to lease his store premises from the franchisor, purchase certain goods from the franchisor, and adhere to the franchisor's policies and procedures, place the franchisor in the overwhelming position of being

105. *Id.* § 407.413.
106. *Id.* § 407.413 (5).
107. *Id.* § 407.413 (3).
108. *Id.* §§ 407.010-.130.
109. *Id.* § 407.025.
110. State *ex rel.* Danforth v. Independence Dodge, Inc., 494 S.W.2d 362 (Mo. App., D.K.C. 1973).
111. RSMo §§ 407.040, .100 (1978).
112. *Id.* § 407.025 (8).

the franchisee's lessor, creditor, chief business advisor, and trusted business counselor. Under these circumstances a special relationship described as "fiduciary" in nature which is akin to that of principal and agent may arise between franchisor and franchisee.[113]

The existence of a fiduciary relationship is relevant to many common law theories of responsibility, discussed below, running from the franchisor to the franchisee. The mere fact that such a relationship exists creates a special obligation on the part of the franchisor to deal with its franchisee in a forthright and helpful manner. Whether a fiduciary relationship normally exists between franchisees and franchisors is a question of contemporary significance and has not been fully explored by the courts. Recent state and federal cases indicate that a fiduciary relationship may exist.[114] Many courts, rather than ruling that a fiduciary relationship can never exist in a franchising arrangement, have held that the franchisee failed to proffer sufficient evidence to support its claim that a fiduciary relationship actually existed in the particular case.[115]

Although the United States Court of Appeals for the Eighth Circuit has recently held that a fiduciary relationship exists between franchisor and franchisee, no Missouri court has specifically held that a fiduciary duty exists upon the mere presence of a franchisor-franchisee relationship. Rather than litigate this issue head on, however, the franchisee should argue that, regardless of whether the court believes a fiduciary duty should always be implied in a franchisor-franchisee situation, sufficient "special circumstances" exist in the case before it to justify finding a fiduciary relationship.[116]

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113. H. BROWN, FRANCHISING REALITIES AND REMEDIES 134 (1973).

114. *See, e.g.*, Arnott v. American Oil Co., No. 79-1150 (8th Cir., Oct. 24, 1979). As stated in Ellis v. Zuck, 409 F. Supp. 1151, 1158 (N.D. Ala. 1976), *aff'd*, 546 F.2d 643 (5th Cir. 1977):

> While this state [Alabama] has not had occasion to consider the relationship between franchisor and franchisee, a few courts and several commentators have suggested that a confidential and fiduciary relationship exists between parties to a franchise arrangement. *Broomfield v. Kosow*, 349 Mass. 749, 755, 212 N.E.2d 556, 560 (1963); *Meinhard v. Salmon*, 249 N.Y. 458, 467, 164 N.E. 545, 548 (1928); *see also, Rosenfeld, Big Brother as a Fiduciary: Suing the Franchisor*, Case & Comment, July-Aug. 1971, at 28. Brown, *Franchising: Fraud, Concealment and Full Disclosure*, 33 Ohio State L.J. 517, 548 (1972); Goodwin, *Franchising and the Economy: The Franchise Agreement as a Security under Securities Acts*, 24 Bus. Law 1311, 1319 (1969). Other courts have recognized the disparity between the parties to a franchise arrangement as requiring a duty to disclose. *See, e.g., Weaver v. American Oil. Co.*, 357 Ind. 458, 276 N.E.2d 144 (1971).

115. Arnott v. American Oil Co., No. 79-1150 (8th Cir., Oct. 24, 1979) (holding that a fiduciary relationship exists between franchisor and franchisee); Eaton, Yale & Towne, Inc. v. Sherman Indus. Equip. Co., 316 F. Supp. 435 (E.D. Mo. 1970); Scott-Douglas Corp. v. Greyhound Corp., 304 A.2d 309 (Del. Super. 1973); (holding that "special circumstances" exist in the particular fact situation which justify the finding of a fiduciary relationship).

116. Eaton, Yale & Towne, Inc. v. Sherman Indus. Equip. Co., 316 F. Supp. 435 (E.D. Mo. 1970).

A fiduciary relationship exists when one person is under a duty to give advice and assistance to another on matters within the scope of the relationship.[117] Such a relationship "exists in all cases where there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith, and with due regard to the interest of the one reposing the confidence."[118]

In determining the existence of a fiduciary relationship a court need not rely solely upon written agreements existing between the parties, although such documents as brochures, franchise agreements, and lease agreements can be very helpful in establishing such a relationship. Courts regularly examine all proffered evidence of special circumstances that tend to show a relationship between the parties that is fiduciary in nature. Many of the special circumstances do not appear on the face of the contract between the parties, such as the relative bargaining positions of the parties,[119] whether one party reposed special trust or confidence in the other party,[120] or whether one party to the relationship was aware that the other party was relying upon him.[121] Therefore, the review is not limited to written documents. The entire relationship between the parties must be scrutinized fully to determine whether a fiduciary relationship exists. This, of course, is a factual question for the jury.

B. *Conspiracy Actions*

Conspiracies to restrain trade and monopolize under sections 1 and 2 of the Sherman Act and under comparable Missouri antitrust laws have been discussed above. In addition, the general concept of a civil conspiracy to commit a wrong should always be considered in franchise litigation. A cause of action sounding in tort exists for damages resulting from overt acts done pursuant to a conspiratorial agreement.[122] In Missouri, a civil conspiracy is defined as:

> A combination of two or more persons acting in concert to commit an unlawful act, or to commit a lawful act by unlawful means, the principal element of which is an agreement between the parties to inflict a wrong against or injury upon another and an overt act that results in damage.[123]

Successful proof of a conspiracy affords the plaintiff several benefits,

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117. RESTATEMENT (SECOND) OF TORTS § 874, Comment a (1977).
118. Klika v. Albert Wenzlick Real Estate Co., 150 S.W.2d 18, 24 (St. L. Mo. App. 1941).
119. Hall Motor Co. v. Furman, 285 Ala. 499, 234 So. 2d 37 (1970).
120. Klika v. Albert Wenzlick Real Estate Co., 150 S.W.2d 18, 24 (St. L. Mo. App. 1941).
121. Broomfield v. Kosow, 349 Mass. 49, 212 N.E.2d 556 (1965).
122. Royster v. Baker, 365 S.W.2d 496, 499 (Mo. 1963); Haynes v. Hawkeye Sec. Ins. Co., 579 S.W.2d 693, 703 (Mo. App., W.D. 1979).
123. Bukovac v. Lloyd Ketcham Oldsmobile, Inc., 579 S.W.2d 790, 794 (Mo. App., W.D. 1979).

including: joint and several liability of the defendants;[124] conversion of a contract action into an action sounding in tort under which punitive damages are collectible;[125] extension of the statute of limitations to the last overt act done pursuant to the conspiracy;[126] permitting evidence directed at one defendant to be used against the other defendants, subject to subsequent proof of the conspiracy;[127] and, injection of a sinister motive on the part of the defendants which could have a significant impact on the jury's determination of both actual and punitive damages.

The basis of a conspiracy action is not the conspiracy itself but rather the wrong done to the plaintiff by acts in furtherance of the conspiracy.[128] A conspiracy cannot be the subject of a civil action unless something is done which, without the conspiracy, would give rise to a cause of action. Thus, allegations of conspiratorial conduct should always be made in conjunction with allegations of conduct which, if done by itself, would constitute an actionable wrong.[129]

A combination for the purpose of causing a breach of contract has been held to constitute an unlawful conspiracy. A person who by conspiring with another violates his contract with a third person commits an actionable wrong.[130] A conspiracy to breach a contract can be based upon a third party beneficiary theory in which the plaintiff is not a formal party to the contract.[131] For example, if the franchisor leases store premises from a landlord and then subleases the premises to its franchisee, the franchisee may have an action against its franchisor and the underlying landlord for conspiracy to violate the lease if the franchisor and landlord fail to adhere to provisions of the lease. Such a situation might arise if the lease required that certain stores be located in the shopping center and the stores never opened. It could also occur if the lease provided that certain types of stores would not be located in the shopping center and these types of stores in fact opened.

Damages for breach of contract are generally limited to the pecuniary loss sustained. However, where the breach is occasioned by a conspiracy to

124. Brennaman v. Andes & Roberts Bros. Constr. Co., 506 S.W.2d 462, 466 (Mo. App., D.K.C. 1973); Mills v. Murray, 472 S.W.2d 6, 12 (K.C. Mo. App. 1971); Wooldridge v. Scott County Milling Co., 102 S.W.2d 958, 964 (Spr. Mo. App. 1937).

125. Dickey v. Johnson, 532 S.W.2d 487 (Mo. App., D.K.C. 1975); Mills v. Murray, 472 S.W.2d 6, 17 (K.C. Mo. App. 1971).

126. Kansas City v. Rathford, 353 Mo. 1130, 186 S.W.2d 570 (1945).

127. State v. Davies, 80 Mo. App. 239, 244 (St. L. 1899); FED. R. EVID. 801.

128. Mills v. Murray, 472 S.W.2d 6 (K.C. Mo. App. 1971).

129. For example, in a petition for damages one should not merely allege that a civil conspiracy injured the plaintiff. Instead, the allegation should be that the defendants conspired to breach a contract, to make fraudulent statements, etc.

130. Rosen v. Alside, Inc., 248 S.W.2d 638 (Mo. 1952).

131. Bukovac v. Lloyd Ketcham Oldsmobile, Inc., 479 S.W.2d 790, 795 (Mo. App., W.D. 1979) (breach of agreement for benefit of plaintiff constitutes a conspiracy; punitive damages appropriate).

defraud and the action sued on is for the tort—the fraud committed—exemplary damages may ensue.[132]

One must be imaginative when looking for a conspiracy or concerted action. The obvious situation giving rise to a conspiracy is that where two or more persons are involved in a transaction. This may occur where the franchisee feels he has suffered because of actions taken by his franchisor in concert with other persons such as the landlord, suppliers, creditors, or other franchisees. One might even be able to find a conspiracy between the franchisor and the plaintiff-franchisee himself if the franchisee, due to his subservient position, is forced into a situation where he must acquiesce to the franchisor's wrongful conduct.[133]

It should not be assumed that one can always use the vehicle of a conspiracy merely because there are two or more defendants. A plaintiff alleging a conspiracy must prove its existence by clear and convincing evidence,[134] but because of its covert nature, a conspiracy may be shown by circumstantial evidence.[135] If a plaintiff fails to prove a conspiracy he may still recover against one or more of the defendants shown to have been guilty of the alleged wrong.[136]

C. *Fraud and Misrepresentation*

Successful proof of a claim based on fraud or misrepresentation has definite advantages. Punitive damages can be collected[137] and actual damages may be enhanced due to the nature of the evidence offered to support punitive damages. The elements of a fraud action in Missouri are:

> [A] representation; its falsity; its materiality; knowledge on the part of the one who makes the representation that it is false or his ignorance of its truth; intent that the representation should be acted upon; the actor's ignorance of the falsity; reliance on the representation; [and the] right to rely.[138]

Applying the above factors to the franchisor-franchisee relationship should not be difficult. To sell its product to the franchise the franchisor must make certain statements to the franchisee regarding the nature of the franchisor's business, the franchisor's expertise, and the franchisee's chance of success. If in selling the franchise program the franchisor makes statements which are fraudulent or misleading, and the franchisee relies upon these statements to his detriment, the franchisee may have a tort cause of

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132. Byers Bros. Real Estate & Ins. Agency v. Campbell, 353 S.W.2d 102 (K.C. Mo. App. 1961).

133. Albrecht v. The Herald Co., 390 U.S. 145 (1968).

134. National Rejectors, Inc. v. Trieman, 409 S.W.2d 1, 50 (Mo. En Banc 1966); Mills v. Murray, 472 S.W.2d 6, 12 (K.C. Mo. App. 1971).

135. Steffan v. World Wide Sports, Inc., 502 S.W.2d 264 (Mo. 1973).

136. Rosen v. Alside, Inc., 248 S.W.2d 638 (Mo. 1952); Medich v. Stippec, 335 Mo. 796, 73 S.W.2d 998 (1934).

137. Dickey v. Johnson, 532 S.W.2d 487 (Mo. App., D.K.C. 1975).

138. American Fire & Indem. Co. v. Lancaster, 286 F. Supp. 1011, 1015 (E.D. Mo. 1968), *aff'd*, 415 F.2d 1145 (8th Cir. 1969).

action against the franchisor sounding in fraud, an alternative to a breach of contract action.[139]

1. Intentional Misrepresentations

One who fraudulently misrepresents a fact, opinion, intention, or law for the purpose of inducing another to act or to refrain from acting in reliance upon the statement is subject to liability to the other for fraud. A misrepresentation may be fraudulent under one of the following three circumstances:

(1) The maker knows or believes the situation is not as he represents;
(2) The maker does not have the confidence in the accuracy of his representation that he states or implies; or
(3) The maker knows that he does not have the basis for the representation that he states or implies.[140]

If the franchisor makes an ambiguous representation either with the intention that it be understood in a false sense, without any belief or expectation as to how it will be understood, or with reckless indifference as to how the franchisee might understand it, the franchisee may have a cause of action for deceit.[141]

If the franchisor gives the franchisee documents which contain false statements such as a franchise or lease agreement, the franchisor can be held liable in deceit. Actionable fraudulent statements may be communicated either in writing or verbally.[142] In Missouri, the fact that the fraudulent representation is contained in a contract is not dispositive. The key inquiry in a fraud or deceit action is the promisor's intention at the time of contracting. If the promisor intends to perform the promise at the time the contract is executed but fails to do so, the promisee's only remedy is to file an action for breach of contract.[143] However, if at the time of contracting the promisor did not have the current intention to perform the promises contained in the contract, he has misrepresented his intentions and an action in fraud may be maintained.[144] For example, if the franchisor makes certain representations in a lease agreement as to what other tenants will be in the shopping center with the franchisee, when the franchisor either knows that the tenants will not be available or has

139. Northern v. McGraw-Edison Co., 542 F.2d 1336 (8th Cir. 1976), *cert. denied,* 429 U.S. 1097 (1977) (Missouri franchisee successfully used fraud theory against franchisor as an alternative to federal antitrust law).

140. RESTATEMENT (SECOND) OF TORTS § 526 (1977).

141. *Id.* § 527.

142. *Id.* § 532.

143. 37 C.J.S. *Fraud* § 11, at 234 (1943).

144. *See* Clayton Brokerage Co. v. Teleswitcher Corp., 418 F. Supp. 83 (E.D. Mo. 1976), *aff'd,* 555 F.2d 1349 (8th Cir. 1977) (fraud established when defendant promised to perform various contracted-for services, but did not have the present intention to perform); Brennaman v. Andes & Roberts Bros. Constr. Co., 506 S.W.2d 462 (Mo. App., D. St. L. 1973) (misrepresentation of intention to perform agreement held to state claim for relief in fraud). *See also* RESTATEMENT (SECOND) OF TORTS § 530, Comment c (1977).

no expectation of obtaining them, the franchisor may be subject to suit by the franchisee based upon deceit. This is true even though the particular misrepresentation may have been communicated to the franchisee only indirectly through statements addressed to a third person and overheard by the franchisee with the knowledge of the franchisor, or through receipt of a document provided by the franchisor to a third person with the reasonable expectation that it would be seen and relied upon by the franchisee.[145]

a. Presumption of Fraud

If a fiduciary or confidential relationship exists between the franchisor and franchisee, the franchisor will owe a high degree of honesty and fair play to the franchisee. Contrary to the general rule that fraud is not presumed,[146] certain improper dealings by one party standing in a fiduciary or confidential relationship, which adversely affect another party to the relationship, may be presumed to be fraudulent.[147] It has been stated that:

> Although as a general rule fraud is not presumed, and the burden of establishing it rests on the party who alleges it, that rule is somewhat relaxed in cases where a fiduciary relation exists between the parties to a transaction or contract, and where one has a dominant and controlling force or influence over the other. In such cases, if the superior party obtains a possible benefit, equity raises a presumption against the validity of the transaction or contract, and casts upon such party the burden of proving fairness, honesty, and integrity in the transaction or contract. He must show that there was no abuse of the confidence, that he has acted in good faith, and that the act by which he is benefited was the free, voluntary, and independent act of the other party, done with full knowledge of its purpose and effect.[148]

If the dominant party does not fulfill its duty of good faith, fraud may be presumptively established.[149]

The existence of a fiduciary or confidential relationship between the franchisor and franchisee is significant for yet another reason. Because the law requires the utmost honesty and fair play in such a relationship, courts have recognized that a breach of a fiduciary or confidential duty constitutes constructive fraud.[150] The burden of proof for one victimized by constructive fraud is relaxed because he need not prove actual dishonesty or intent to deceive.[151]

145. RESTATEMENT (SECOND) OF TORTS § 533 (1977).
146. Bolten v. Colburn, 389 S.W.2d 384 (K.C. Mo. App. 1965).
147. *See* Andres v. Brown, 300 S.W.2d 800 (Mo. 1957); Breckle v. Van Dyke Brewing Co., 483 S.W.2d 672 (Mo. App., D. St. L. 1972).
148. 37 AM. JUR. 2d *Fraud and Deceit* § 441 (1968).
149. Acy v. Inland Sec. Co., 287 S.W.2d 347 (K.C. Mo. App. 1956).
150. Mahler v. Tieman, 550 S.W.2d 623 (Mo. App., D. St. L. 1977); 37 C.J.S. *Fraud* § 2 (c) (1943).
151. Vogt v. Town & Country Realty, 194 Neb. 308, 231 N.W.2d 496 (1975).

b. Puffing and the Duty to Disclose

It is a traditional principle of fraud law that mere expressions of opinion or "puffing" are not actionable.[152] This rule is premised on the belief that reasonable people generally have no right to rely on another person's commendatory and self-serving statements.[153] Fraudulent misrepresentation of an opinion, however, can be actionable if the maker purports to have special knowledge of the matter,[154] stands in a fiduciary or similar relationship,[155] or has some other special reason to expect that the recipient will rely on the opinion.[156]

Some cases have questioned whether there is an affirmative duty to disclose a fact which one knows may induce another to act or refrain from acting. It is generally held that liability for deceit may follow from nondisclosure if the defendant is under a duty to the other person to exercise reasonable care to disclose the matter in question.[157] This duty may exist in the special circumstances surrounding the franchisor-franchisee relationship. It is normally held that one party to a business transaction is under a duty to exercise reasonable care to disclose pertinent information to the other party when one of the following circumstances exists: a fiduciary or other similar relationship of trust and confidence exists between the parties;[158] the party making the representations realizes that information he has is necessary to prevent his partial or ambiguous statement of the facts from being misleading;[159] or the person having the duty of disclosure knows that subsequently acquired information he possesses will make untrue or misleading prior statements that were true or believed to be true when originally made.[160]

152. Whittlesey v. Spence, 439 S.W.2d 195 (Spr. Mo. App. 1969); McAlpine Co. v. Graham, 320 S.W.2d 951 (St. L. Mo. App. 1959).

153. *See* W. PROSSER, LAW OF TORTS § 109 (4th ed. 1971).

154. Dawes v. Elliston, 369 S.W.2d 285 (K.C. Mo. App. 1963).

155. Motor Transp. Springfield v. Orval Davis Tire Co., 585 S.W.2d 195 (Mo. App., S.D. 1979).

156. Doll v. Purple Shoppe, 230 Mo. App. 256, 90 S.W.2d 181 (K.C. 1936).

157. RESTATEMENT (SECOND) OF TORTS § 551 (1977).

158. Motor Transp. Springfield v. Oval Davis Tire Co., 585 S.W.2d 195 (Mo. App., S.D. 1979).

159. Doll v. Purple Shoppe, 230 Mo. App. 256, 90 S.W.2d 181 (K.C. 1936).

160. "The common law has long required that a person who has made a representation must correct that representation if it becomes false and if he knows people are relying on it. This duty to disclose is imposed regardless of the interest of defendant in the representation and subsequent nondisclosure." Fischer v. Kletz, 266 F. Supp. 180, 188 (S.D.N.Y. 1967). *See also* St. Joseph Hosp. v. Corbetta Constr. Co., 21 Ill. App. 3d 925, 316 N.E.2d 51 (1974); RESTATEMENT (SECOND) OF TORTS § 551 (c) (1977). There is no essential distinction between affirmative misrepresentation and a failure to correct a representation subsequently known to be false.

> One who, having made a representation which when made was true or believed to be so, remains silent after he has learned that it is untrue and that the person to whom it is made is relying upon it in a transaction with him, is morally and legally in the same position as if he knew that his statement was false when made.

Although there is an affirmative duty to disclose past misstatements of fact irrespective of the relationship between the parties, the duty of full and complete disclosure may be heightened when the franchisor-franchisee relationship exists between the parties. Where there is a relationship of trust and confidence, inequality of condition, or superior knowledge of one party, there is an affirmative duty to disclose all material facts. Failure to do so constitutes fraud.[161] Thus, the franchisor as a fiduciary or as a person in a position of trust and confidence may have an affirmative duty to disclose various information to his franchisee. For example, when such things as brochures and manuals which specify the products and/or services the franchisee is to receive from the franchisor become obsolete, the franchisor has a duty to inform the franchisee that the prior representations, although perhaps true when made, have become untrue and/or misleading.[162]

2. Negligent Misrepresentations

One who in the course of business supplies false information to others for their guidance is liable to those persons for any pecuniary loss caused by reliance on the information if the supplier of the information has failed to exercise reasonable care in *obtaining* or *communicating* the information.[163] A franchisor who supplies misleading information to a franchisee due to the franchisor's negligence in either gathering or disseminating the information may be liable to the franchisee in an action based upon negligent misrepresentation. The franchisor must use reasonable care to assure that statements made to its franchisees on various business matters are correct.

In *J. Louis Crum Corp. v. Alfred Lindgren, Inc.*,[164] the court recognized that a tort cause of action exists in Missouri for negligent misrepresentation. The *Crum* court noted that liability for negligent misrepresentation has been found where the plaintiff is a member of a group that the negligent actor seeks to influence, and where the negligent actor has special reason to know that some member of the limited group will rely on the information misrepresented.[165] The court in *Crum*, however, refused to extend the above line of cases to hold a defendant liable for a negligent act which merely interferes with a contract right. The negligence must rise to the level of a misrepresentation.[166]

Id. § 551 (c), Comment h (1977). Courts applying this principle of law have not required the existence of a fiduciary or confidential relationship between the parties.

161. Jones v. Arnold, 359 Mo. 161, 221 S.W.2d 187 (1949); Parker v. Green, 340 S.W.2d 435 (K.C. Mo. App. 1960).

162. Vinyard v. Herman, 578 S.W.2d 938 (Mo. App., S.D. 1979) (discussing how existence of fiduciary relationship can ease burden of proving fraud).

163. RESTATEMENT (SECOND) OF TORTS § 552 (1977). *See also* Gerich v. General Motors Corp., 588 S.W.2d 107 (Mo. App., W.D. 1979).

164. 564 S.W.2d 544 (Mo. App., D.K.C. 1978).

165. *Id.* at 551.

166. *See* Gerich v. General Motors Corp., 588 S.W.2d 107 (Mo. App., W.D.

D. *Breach of Contract*

In any action against its franchisor, the franchisee will want to consider a breach of contract claim. The basic franchise agreement often provides many opportunities for such a claim. When considering a breach of contract claim, all documents embodying agreements between the parties should be examined. It is a well recognized principle of law that even though writings may be separate, if executed contemporaneously, they will be construed together and considered to constitute one transaction when the parties and the subject matter are the same and the relationship between the documents is clearly apparent. Any ambiguity in the documents will be construed against the party (usually the franchisor) preparing them.[167]

With regard to covenants, conditions, and warranties not specifically embodied in a written document, Professor Williston points out that, "[I]n every contract there exists an implied covenant of good faith and fair dealing."[168] Some courts have referred to this as a necessary implication from the express intent of the parties.[169] It has also been declared that, "[I]n every contract there is an implied covenant that neither party will do anything having the effect of destroying or injuring the right of the other party to receive the fruits of the contract."[170] This concept can be very useful to the franchisee when interpreting the franchisor's actions in light of written or oral contracts, and can be important if the franchisee seeks recoupment.

The doctrine of recoupment may apply when a franchisor, after having required a franchisee to make a sizable investment in the franchise, terminates the franchise without just cause, thereby leaving the franchisee with substantial unrecovered expenditures. In Missouri a franchise agreement silent as to duration and which does not deal specifically with termination is construed to be terminable at the will of either party.[171] Recoupment is an important exception or limitation to this general rule.[172] Where

1979) (broad imposition of liability for negligent misrepresentation if actor cloaked with authority to make representation and did so without knowledge of truth of statement).

167. Structure Sys., Inc. v. Hereford, 564 S.W.2d 62 (Mo. App., D. St. L. 1978); Bradley v. Buffington, 500 S.W.2d 314 (Mo. App., D.K.C. 1973).

168. S. WILLISTON, CONTRACTS § 1926 (1936).

169. *See, e.g.,* Motel Managers Training School, Inc. v. Merryfield, 347 F.2d 27 (9th Cir. 1965) (implied covenant of feasibility in sale of franchise).

170. Lutz v. Bayberry Huntington, Inc., 148 N.Y.S.2d 762, 767 (Sup. Ct. 1956).

171. Superior Concrete Acc. v. Kemper, 284 S.W.2d 482 (Mo. 1955); Want v. Century Supply Co., 508 S.W.2d 515 (Mo. App., D. St. L. 1974).

172. Beebe v. Columbia Axle Co., 233 Mo. App. 212, 218, 117 S.W.2d 624, 629 (K.C. 1938), states:

> The limitation is that, in any case of an indefinite agency where it is revoked by the principal, if it appears that the agent, induced by his appointment, has in good faith incurred expense and devoted time and labor in the matter of the agency without having had a sufficient opportunity to recoup such from the undertaking, the principal will be required to compensate him in that behalf; for the law will not permit one

the franchise has been terminated by the franchisor without just cause before the franchisee has had a reasonable opportunity to recoup his capital investment, the franchisee is entitled to recoupment on a quantum meruit theory.[173]

In some situations a franchisee may wish to avoid the obligations of the franchise agreement, in effect setting the franchise contract aside. A contract or conveyance in Missouri may be set aside because of fraud or deception surrounding its making.[174] Missouri courts are particularly inclined to cancel a contract on the ground of fraud in its procurement if a confidential relationship was instrumental in the execution of the contract.[175] Thus, one of the remedies the franchisee may have is rescission and/or avoidance of the franchise contract itself.

The Uniform Commercial Code also may be helpful to a franchisee who desires to avoid the obligations of a particularly harsh franchise agreement. Section 2-302 provides that a court may refuse to enforce a contract if it finds as a matter of law that the contract or any clause thereof is unconscionable. In *Ashland Oil Inc. v. Donahuse,*[176] the court found section 2-302 to prohibit as unconscionable the enforcement of a contract provision granting a franchisor the unilateral right to terminate a franchise agreement upon ten days notice following a determination that the franchisee had impaired the reputation of the franchised product.[177] *Ashland Oil* is significant because it is one of the first cases to apply the Code's unconscionability provision to a franchise agreement, and further because the court indicated that a franchisee need not show a lack of awareness of the terms of the contract or a lack of choice in the formation of a contract in order to prevail under section 2-302. In addition, the burden of rebutting the presumption that termination without good cause is substantively unconscionable is shifted to the franchisor, and parol evidence

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> thus to deprive another of value without awarding just compensation. The just principle acted upon by the courts in the circumstances suggested requires no more than that, in every instance, the agent shall be afforded a reasonable opportunity to avail himself of the primary expenditures and efforts put forth to the end of executing the authority conferred upon him and that, if such opportunity is denied him, the principal shall compensate him accordingly.

173. Gibbs v. Bardahl Oil Co., 331 S.W.2d 614 (Mo. 1960); Glover v. Henderson, 120 Mo. 367, 25 S.W. 175 (1894); Want v. Century Supply Co., 508 S.W.2d 515 (Mo. App., D. St. L. 1974). *See also* Berra v. Bieg Plumbing Co., 584 S.W.2d 116 (Mo. App., E.D. 1979) (discussing proof required in quantum meruit case). *See generally* Lockewill, Inc. v. United States Shoe Corp., 547 F.2d 1024 (8th Cir. 1976), *cert. denied,* 431 U.S. 956 (1977); Annot., 19 A.L.R.3d 196 (1968).

174. Hart v. Midkiff, 321 S.W.2d 500 (Mo. 1959).

175. Drake v. Greener, 523 S.W.2d 601 (Mo. App., D.K.C. 1975).

176. 223 S.E.2d 433 (W. Va. 1976).

177. Other cases applying the UCC to termination of a franchise agreement are Goldinger v. Boron Oil Co., 375 F. Supp. 400 (W.D. Pa. 1974), *aff'd,* 511 F.2d 1393 (3d Cir. 1975); Division of Triple T Serv., Inc. v. Mobil Oil Corp., 60 Misc. 2d 720, 304 N.Y.S.2d 191 (Sup. Ct. 1969), *aff'd,* 34 App. Div. 2d 618, 311 N.Y.S.2d 961 (1970); W.L. May Co. v. Philco-Ford Corp., 273 Or. 701, 543 P.2d 283 (1975).

is admissible for the purpose of disclosing the underlying agreement of the parties concerning the unconscionable termination provision.[178]

E. *Covenants Not to Compete*

When the franchise agreement terminates either by its own terms or upon the action of either the franchisee or the franchisor, the parties frequently find themselves in potential competition. The franchisee may desire to continue in business either under the same or a different name. The franchisor may continue in the market either through use of its own facility, commonly referred to as a company-owned store, or by franchising someone else. Franchise agreements may contain a covenant running from the franchisee to the franchisor in which the franchisee agrees that, upon termination of the franchise agreement, he will not engage in a business similar to that encompassed by the franchise. In interpreting the validity or "reasonableness" of such covenants not to compete, courts consider all circumstances surrounding the covenant including the subject matter of the contract, the purpose to be served by the covenant, the situation of the parties, the extent of the restraint, and the specialization of the business.[179]

Once the franchise has been terminated both the franchisor and franchisee must consider the manner in which they may thereafter compete. For example, if the franchisor comes into the marketplace and attempts to solicit customers of its former franchisee, thereby causing those customers to breach their contract with the franchisee, the franchisor may be guilty of tortious interference with contract. Alternatively, if the franchisee solicits the franchisor's customers in an improper manner he may be subject to liability. This is not to say, however, that a former franchisor and franchisee cannot actively compete if they do so in a legitimate manner. The Missouri Court of Appeals, St. Louis District, recently set out five necesssary elements to establish a tortious interference with contract: (1) existence of a contract; (2) knowledge of the contract by the defendant; (3) breach of the contract induced or caused by the defendant; (4) defendant's acts not justified; and (5) plaintiff suffered damages.[180]

F. *Class Actions*

Perhaps no other type of litigation has called upon the class action device so frequently as has franchise litigation. This is true because the franchisor typically uses standard practices, procedures, and forms when

178. For an in depth discussion of *Ashland Oil,* see Note, *Uniform Commercial Code—§ 2-302—Unilateral Right of Termination for Cause Determined Solely by Franchisor Unconscionable,* 55 TEX. L. REV. 541 (1977).

179. Chemical Fireproofing Corp. v. Bronska, 542 S.W.2d 74 (Mo. App., D. St. L. 1976) (discussing reasonableness of time and area restrictions); R.E. Harrington, Inc. v. Frick, 428 S.W.2d 945, 950 (St. L. Mo. App. 1968).

180. Smith v. Standard Oil, 567 S.W.2d 412, 417 (Mo. App., D. St. L. 1978). *See also* Tri-Continental Leasing Co. v. Neidhardt, 540 S.W.2d 210, 212 (Mo. App., D. St. L. 1976).

dealing with its franchisees. Thus, the grievance of one franchisee is often common to all franchisees. Rule 52.08 of the *Missouri Rules of Civil Procedure* is the pertinent class action rule in Missouri and is identical to rule 23 of the *Federal Rules of Civil Procedure.* Federal cases interpreting rule 23 are important when considering the Missouri rule. An extensive treatment of class actions is beyond the scope of this paper, but the class action device should be considered by any franchisee contemplating litigation against his franchisor.

Before filing a class action the franchisee should carefully review the decisions concerning the necessity under rule 52.08 (b) (3) of having common questions of law or fact "predominate" over individual questions. Thus, one of the determining factors in deciding whether to permit a class action is whether the claims of all the franchisees can be handled efficiently as well as simultaneously. This necessitates a detailed analysis of the cause of action asserted on behalf of class members. If the cause of action is such that its proof by one franchisee against the franchisor will prove the same cause of action on behalf of all franchisees, a class action may be proper. If, however, the cause of action is such that establishing liability on behalf of one franchisee will not help prove the claims of other franchisees, a class action is inappropriate.[181]

Missouri and federal courts may create subclasses in order to segregate certain issues for class action treatment.[182] Liability may be tried on a class-wide basis even though individual trials are necessary to determine the amount of damages to which each class member is entitled.[183]

Perhaps the case most often cited by franchisees in support of a request for a class action is *Siegel v. Chicken Delight, Inc.*[184] This case involved various antitrust claims including illegal tying of merchandise to the trademark. It is a good case with which to *begin* researching class actions, but it is only a starting point. Hundreds of cases have been handed down since *Siegel* which change and modify the concepts established therein. Due to the rash of class actions experienced by federal courts in recent years, judges at the federal level are becoming more conservative in granting class actions. What once was a flood tide of class actions has now been throttled to a mere trickle by the federal judiciary. Most state courts, however, have not yet adopted the same approach.

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181. For example, if a franchisee desires to assert a fraud claim against his franchisor he may do so based upon either written or verbal representations made to him by the franchisor. If the fraudulent statements are contained in a written publication given to all franchisees, a class action may be appropriate since the claims of all franchisees will be based upon the same fraudulent statement. However, if each franchisee must prove separate verbal representations made to him by various employees of the franchisor, a class action is most likely inappropriate.

182. Mo. R. Civ. P. 52.08 (b) (4); Fed. R. Civ. P. 23 (c) (4).

183. *See, e.g.,* Eisen v. Carlisle & Jacquelin, 391 F.2d 555 (2d Cir. 1968), *rev'd on other grounds,* 417 U.S. 156 (1974).

184. 271 F. Supp. 722 (N.D. Cal. 1967), *scope restricted,* 412 F.2d 830 (9th Cir. 1969).

V. Conclusion

The tremendous expansion of franchising as a method of doing business has inevitably led to an expansion of litigation involving disputes between parties to franchises. Statutory antitrust causes of action, as well as novel applications of older common law theories, have been applied to determine the rights and liabilities of the parties. Franchisees have banded together in associations to advance their causes, both through litigation and lobbying; the franchise industry, with 492,000 franchise businesses and $298.5 billion in annual sales, certainly has a nation-wide impact.[185] Imaginative applications of accepted legal theory, and novel arguments for innovation in law, can make franchise litigation important to our economic as well as our legal communities.

185. Wall St. J., Oct. 30, 1979, at 4, col. 1.