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Harold Brown, Franchising: Trap for the Trusting

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BOOK REVIEWS

FRANCHISING: TRAP FOR THE TRUSTING. By Harold Brown. Boston: Little, Brown and Company. 1969. Pp. 180.

Introduction

Elmira, New York is a community of 40,000 people. Valparaiso, Indiana is a community of 20,000 people. Driving into Elmira from the surrounding countryside one passes an array of specialized "fast" food stores, motels, gasoline service stations, automobile dealers, soft icecream dispensers, chain restaurants, car and truck-rental agencies, one-hour drycleaners, automotive assessory stores, automatic car washes, miniature golf courses and even thirty foot high "giants" munching on simulated burgers at entrances to various drive-in stomach pits. Driving into Valparaiso, Indiana affords one similar visual and odoriferous stimuli. The business names, the shape and color of the buildings, even the munching giants, will often be identical with their cousins in Elmira, 735 miles to the east.

These multifarious roadside inns and accompanying flags,[1] giants,[2] neon lights,[3] stilted signs[4] and other cheap imitations of 42nd Street sense stimuli[5] line the approaches to most of America's cities, towns and

1. Automobile dealers traditionally have used flags and pennants as an attention-drawing device.

2. To many people, the munching giants represent the ugliest feature of fast-food service establishments. Their purpose is to serve as an eyecatcher. They succeed.

3. Neon lights have gone through a technological revolution of sorts in recent years. No longer does a neon sign simply portray the name of the establishment in bright fluorescent colors. Today, the neon sign has become an exploding flash with moving wheels and bouncing balls, combining shifting lights with dramatic motions which, like the giants, make them virtually impossible to ignore.

4. The conservationists and those concerned with environmental aesthetics thought they had won a significant victory in those instances when the interstate highway program limited billboard construction and did not permit gasoline dealers to build along limited access highways. Drivers were periodically reminded by small roadway signs that gasoline would be available only along approach roads at various interchanges. But, the petroleum industry developed the stilted sign—in some instances the sign stretching as high as sixty-five feet. Thus, the signs become visible along limited access highways at distances approaching one mile. The real tragedy of the "stilted sign" has been its encroachment within towns and villages. Immediately to the east of the Valparaiso University campus is a Sunoco Service Station. The Sunoco station has a blue and yellow stilted monster visible for at least a quarter mile and visible from much of the campus. The game is not only how large your sign is but also how high it is. One can imagine the scene a few years hence when this development has run its inevitable course.

5. It is becoming more likely that one will be subjected to distorted, high decible noise as he drives by a particular franchise. Although our senses are battered, the transformation is complete. The approaches to our cities and towns have become midways and amusement parks.

villages. Typically, they first appear a few miles out in the country beyond the city limits. The frequency of these Americanized[6] roadside inns generally increases and reaches its greatest density with a mile of the city limits. Often the city limits have been extended or will be extended to include these high-density developments. The result has been and will continue to be the growth of what urbanologists and land planners call "strip cities." Strip cities are largely the result, we are told, of a lack of coordinated long-range planning coupled with a national phenomenon of sorts, franchising, which has taken little or no account of environmental aesthetics.

Elmira, New York has approximately forty-five franchised businesses along its approach roads and main boulevards. Valparaiso, Indiana has about thirty-five. The names usually are familiar. Burger Chef, Dairy Queen, Azar's, McDonald's, Firestone, Big Wheel, Western Auto, United Rent-All, One Hour Martinizing, Laundromat, Dunkin Donut, Alfie's Fish & Chips, Tastee Freeze, Wagon Ho, Howard Johnson and on and on.

This national franchising phenomenon, which may be described as a method of retail distribution whereby "independent" businessmen are granted a license to use recognizable trademarks to sell and/or service various trademarked products and/or services, has been well documented in recent years.[7] Reportedly, there are approximately 500,000 franchisees currently operating within the United States. On a national average this means that one of every 400 people is a franchisee. A small town of 5,000 people, therefore, based upon this ratio, could be expected to have at least twelve franchises; a city of 20,000 would have fifty. The annual sales of the nation's franchisees amounts to $80 billion, a figure representing over twenty percent of retail sales.[8] And, the substantial character of the franchise method of distribution keeps growing, both quantitatively and qualitatively.[9] Franchising has been called "the fastest growing

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6. Franchising is an institution today, for the most part an American institution. There are indications, however, that the principle of mass distribution of standardized products or services through the use of independent, licensee distributors is gaining popularity in Western Europe, in spite of groups that have been formed to prevent the inevitable environmental loss occasioned by franchise development. One of these groups is known as the American Friends of France. Operating from New York City they have attempted to persuade the French citizenry not to make the same environmental planning mistakes in their commercial development that have been made in the United States.

7. R. Levy, *So You Want To Run a Franchise*, DUN'S REVIEW 149 (Jan. 1969).

8. H. BROWN, FRANCHISING: TRAP FOR THE TRUSTING 2-4 (1969).

9. Quantitative substantiality refers to dollar amounts alone, whereas qualitative substantiality refers to relative market position, usually denoted in percentage shares.

industry in the United States,"[10] a statement that is accurate provided one substitutes the phrase "merchandising method" for the word "industry."

It is an old cliché that progress is not free—that it exacts a price. This has come to be widely accepted and understood in recent years, at least as applied to industrial technology. Technological progress has extracted its price from society in the form of the pollution of our environmental resources, notably our water and air. Franchising, too, has exacted a "social" price by contributing to the hodge-podge, strip-city development. Thus, today it is impossible to find a single town of any significant size, approachable by other than an electric, neon, sign-filled, black-topped, gasoline-pumped, bill-boarded highway. That beautiful New England town, sitting in the valley, surrounded by wooded hills, approachable by a two-lane road having *no* billboards, having *no* dairy queens, having *no* sixty-five foot stilted Shell sign (to let people know in the village across the hill that "platformate" is nearby), that lovely, tranquil village where the most visible structure is a church steeple, where telephone lines are buried, where neon and sidewalk overhang signs are prohibited—that village appears only on calendars today.

Why? Where is the planning? Where are the planners? "Aesthetics" has been a rather foreign word in American planning, particularly in the industrial, commercial worlds. Franchisors know that aesthetics have not made America what it is today. Thus, one of these franchisors can and does advertise its franchise as follows:

> WAGON HO! is a successful and exciting concept in the fast food franchise field. Each WAGON HO! is the most attention-getting and distinctive physical plant in the restaurant business. Its a replica of a huge covered wagon, 60 feet long and 38 feet high. *On the driver's seat is a LIFE-LIKE 16 foot tall Wagon Master. A Real family eye-catcher*![11]

In short, the cost to our landscape, to the community development of a collective sense and appreciation of beauty and orderly urban structural integration, has been great, so great, I submit, that it should be the subject of a book in itself. Such a book might be called, "Franchising: Deterioration of Our National Landscape."

There has been another cost, the cost born by countless individual investors, often from traditional middle-class or working-class back-

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Franchising is not only increasing quantitatively—annual sales continue to climb—but also qualitatively—each year franchising is capturing a greater percentage of the retail distribution market in the United States.

10. H. BROWN, *supra* note 8, at 2.

11. MODERN FRANCHISING MAGAZINE, June-July 1969.

grounds, who have been induced by fly-by-night franchisors and even by legitimate, well-meaning franchisors, to "handover" huge sume of money, not infrequently their life savings, only to end up helplessly in debt. A book should be written on this subject too. It has been: *Franchising: Trap for the Trusting* by Harold Brown, a Boston attorney. This small (180 pages) but useful book presents some rather dramatic messages for would-be franchisees and for their lawyers as well. In short, the overall lesson is "look before you leap."

Inducements

Author Harold Brown cautions prospective franchisees not to be unduly impressed by the franchisor's statements which typically appear in the form of magazine or newspaper advertising, pointing out that one reason why franchisees enter into ill-advised franchise arrangements is because they often *react* to a particularly attractive (to them) advertisement. They then enter into negotiations with the franchisor and subsequently sign a franchise agreement and pay the franchisee fee, *all without consulting a lawyer*. The franchisor's advertisements often encourage the prospective franchisee to act quickly. Implicit is the suggestion that should you wait to make your decision someone else from *your* community will "jump in" ahead of you.

The advertising inducements are found in franchising periodicals such as "Modern Franchising Magazine." The advertisements appeal to the various emotive responses of readers. An actual sampling of advertisements from one such magazine[12] follows:

APPEAL TO:	ADVERTISEMENT	FRANCHISOR
Fear of unemployment	"A million jobs have disappeared since 1960 . . . shouldn't you start your own business now, while still employed?"	Duraclean, Inc.
Implicit sexual virility	"My biggest day was a sorority house . . ."	Duraclean, Inc.
Regional acceptance	"Get into the highly lucrative fast food service field . . . . You benefit from the association with James Brown— 'Number One Soul	

12. *Id.*

	Singer' — offering strong appeal to the multitudes who live in the thickly populated central city areas."	James Brown Gold Platter
Dissatisfaction with existing employment	"You're 41 years old and dread going to work every morning . . ."	United Rent-All
Retirement	"For 20 years a self-service laundry has been the best retirement program in America. It is more true today."	Laundromat, Inc.
Popularity of well-known personality	"For $15,000 you can open an *Arnold Palmer* Drycleaning Center."	Arnold Palmer Drycleaning Centers
Self-worth	"If you invest $20,000 in yourself, we'll invest $100,000 in you."	Wagon Ho, Inc.
Financial success	"Ready for the Big Money? $___ ___,000. The first two figures are up to you.	Aamco Transmissions
Profit potential	"$20,000 or more can be earned."	Bresler's 33 Flavors, Inc.
Part-time money making	"Jim Merrill finds great success in FOOSBALL Competitive Sportsystem Franchise . . . . After fifteen great years as a teacher and psychologist, he has found even greater income and satisfaction from his FOOSBALL program. Jim Merrill is averaging over $500 per week from FOOSBALL."	FOOSBALL Competitive Sportsystem
Acting quickly	"We can appoint only one franchisee in your area, and others will be writing in too. Inquiries will be processed by date of postmark so do	FOOSBALL

not delay. Send in your coupon now!"	Competitive Sportsystem
"Better move fast. Top locations are few."	Mr. Angus Restaurants

Answering an advertisement, the prospective franchisee typically receives a "franchisee kit" in the mail, "and then is subjected to high pressure sales talk by long distance phone calls, telegrams, and personal visits . . ."[13] Author Brown goes on to point out that the prospective franchisee is usually "all too anxious to become associated with a national product" and, having little or no business background, he will sign "whatever is placed before him."[14]

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13. H. BROWN, *supra* note 8, at 5.
14. A typical termination provision follows:

Dealer's Option to Terminate: Dealer shall have the option to terminate this agreement and the sublease from Company of Dealer's Premises, if any, and to be released from responsibility from making any further payments to Company for National Donut equipment at any time when no franchise fees, advertising contributions, rent, installment payments for National Donut equipment, or other sums owed Company are past due. Dealer shall give company at least 60 days written notice of his election to exercise this option and of his chosen date of termination and until such date of termination Dealer shall continue to operate his National Donut shop in conformance with this agreement and to make all payments required under all agreements between Dealer and Company as they become due. If Dealer exercises this option, the parties hereto shall enter into written instruments evidencing such termination and Dealer shall release or convey Dealer's interest in all his National Donut shop equipment to Company and shall release Company from all claims and damages arising out of events prior to the date of termination and Company shall release Dealer of and from all claims and damages for the early termination of the above mentioned agreements. If any financing agreement between Dealer and Company relating to Dealer's National Donut equipment shall have been assigned by Company to any lender and therefore is not subject to cancellation by Company, Company shall agree in writing to hold Dealer harmless from any liability thereunder. The word "Company" in this Article only, shall mean Company and/or any of its affiliates. Each party will sign such documents as may be reasonably requested by the other party in order to provide suitable evidence of the foregoing. *Notwithstanding such termination Dealer shall observe the provisions of Article 13 hereof.* If Dealer, as a part of any legal proceedings (whether as plaintiff or defendant) seeks to terminate or be released from his obligations under any of the above mentioned agreements on terms other than those contemplated herein, such action shall be deemed to be an election by Dealer not to exercise this option and it shall thereupon, ipso facto, lapse and be no longer exercisable.

Termination by Company: If Dealer fails to pay when due any monies owed Company or its affiliates hereunder or under any other agreement or if Dealer fails to observe or perform any of the terms, conditions or covenants of this agreement on its part to be observed or performed *for more than 10 days after notice of such failure,* or commits repeated violations of such provisions; or *if Dealer falsifies any report* required to be furnished Company hereunder; or if Dealer ceases to do business on Dealer's premises; or if Dealer makes any general assignment or trust mortgage for the benefit of creditors or is adjudicated a bankrupt; *or if* a receiver, *guardian,* conservator or other similar officer *is appointed* to take charge of all or any part of Dealer's property; or *if*

Economic and Business Justifications

Emotive appeals alone have not made franchising the successful retailing system that it is. There are legitimate economic and business principles favoring retailing through independent trademark licensing. On an economic basis there can be a realization of considerable savings by the widespread utilization of a trademarked product or service. To take the maximum advantage of a trademarked product or service, numerous merchandisers are needed.

Lack of requisite capital precludes most trademark holders from *owning* all or even a significant portion of the optimal number of retailing establishments which are needed to maximize the trademark's potential. Consequently, they need distributor agents. In order to maximize the marketing potential of the trademarked product or service, they typically will grant a territorial non-exclusive license in the form of a franchise appointment. The so-called "independent" businessman assists in the necessary capitalization by extending an initial franchise fee, which constitutes legal consideration for the license grant.

Another theoretical economic benefit of franchising is that it makes centralized volume purchasing feasible. The economic result of such purchasing may be significant volume discounts, which savings supposedly will be passed on to the various franchisees in the form of lower costs for the goods obtained from the franchisor vis-á-vis competitive sources of

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Dealer fails to perform or observe any of the provisions required to be performed or observed by Dealer *under lease or sublease* of Dealer's Premises *or under any promissory note, security agreement or other instrument* executed by Dealer in connection with obtaining equipment for use on Dealer's Premises, then, and in any of said cases, (notwithstanding any waiver of the provisions hereof or consent in a former instance) *Company may forthwith terminate dealer's franchise by notice to Dealer and all rights of Dealer hereunder shall cease and Dealer shall pay Company* all sums then due plus liquidated *damages equal to the present value,* discounted at 6% per year, of the *right to receive $1,000 for each year* or portion *thereof remaining* in the original term of this agreement. *If suit is brought by Company* on account of any default by Dealer *and if such a default is established* Dealer shall pay to Company all expenses of such suit *including reasonable attorneys' fees.*

Events on Termination: Upon the expiration or termination of Dealer's franchise for any cause Dealer shall immediately discontinue the use of the name "National Donut" and of all signs, emblems, marks, color scheme and forms of advertising indicative of the National Donut system or resembling any of its distinguishing characteristics, and, so far as Dealer may lawfully do, shall make or cause to be made such removals of or changes in signs, buildings and structures as Company shall reasonably request so as to eliminate the name "National Donut" from Dealer's Premises and to effectively distinguish said premises from their former appearance and from any other National Donut shop, and if the Dealer shall fail or refuse to make or cause such changes to be made Company, without prejudice to its other rights and remedies, may enter upon Dealer's Premises, forcibly if necessary, without being guilty of trespass or any other tort, and make such changes at Dealer's expense.

supply sought unilaterally by the franchisee. In short, the franchisee should pay less for his raw materials or supplies, this savings, in theory, to be passed on to the consumer. The facts, however, are often otherwise. Yet, there is little doubt that economists can construct arguments which will conclude that franchising is an efficient distribution system on the basis of scale economies, involving a minimal misallocation of resources.

Author Brown tends to minimize these economic considerations. Rather, he focuses on the claimed business benefits flowing from the franchisor to the franchisee. His list of possible benefits includes:

(1) The franchisor's expertise in locating real estate sites which will, according to the franchisor's marketing experts, afford maximum profit potential;
(2) Franchisor's pledge of credit for a long-term lease;
(3) Franchisor's design, financing, and arranging for the standardized construction of the facility and for the installation of standardized fixtures and equipment;
(4) Franchisor's intensive national advertising of its trademarked product or service;
(5) Franchisor's preparation of training manuals and conduction of training seminars and programs; and
(6) Franchisor's continuous advice regarding: i) advertising and promotional methods; ii) accounting and bookkeeping systems including inventory controls; iii) employment and labor practices; and iv) daily operational methods, including public relations.

These claimed benefits, to wit, the franchisor's "know how," often become the determinate inducement factors.

The Franchise Agreement

Brown notes that the bargaining power of the franchisee is no match for the bargaining power and economic position of the franchisor. The franchisee has little to offer but his cash and willingness to learn, that is, to be told how to be a success. The prospective franchisee is not a graduate of the Harvard Business School. He often will not have gone to college at all. The bargaining strength of the franchisor is, consequently, enhanced not by the depth of his pocket, but by his comparative know how. "Know how" is a recognized business asset, the recognition coming from the courts, administrative agencies—the Internal Revenue Service—and from franchisees. Franchisees are not in a strong position to dispute the "facts." The franchisee has neither the conceptual knowledge nor the practical experience to challenge or test the asserted know how and claimed expertise of the franchisor. The net result is that the terms of the typical franchise agreement are not altered by negotiation of the parties; the principal terms including the all-important termination provisions are generally reduced to boiler plate form in the legal department of the franchisor long before the prospective franchisee sees them. He might complain about a provision or two but he is reminded of his relatively ignorant (businesswise) status, that there are other prospective franchisees in the sea and thus he can take it or leave it. If the prospective franchisee has reached this point in negotiations, the chances are overwhelming that he will *bite* and sign the agreement as it was originally presented.

Brown goes on to discuss various provisions in typical franchise agreements, particularly the termination provisions.[14] Lawyers representing franchisees should carefully study these provisions and explain, in detail, the significance of them to their clients. Misunderstandings in the areas of termination options, transfers and rights of cancellation occur frequently, Brown cautions.

Remedies

Brown's book is commendable for pointing out the inequities, the abuses and the overall oppressive nature of franchising relationships. He holds no punches. He admits in the conclusion that he "excoriates" the franchise system as it is presently constituted.[15] In this sense, his book is descriptive, informative, even muck-raking in the Upton Sinclair tradition.

The book, however, has a serious weakness, at least from the perspective of the practicing lawyer who is looking for suggestions in assisting a franchisee-client. It does not offer any particularly imaginative suggestions for new legal remedies. To be sure, Brown lists the traditional remedial theories; unfair trade practices (common law); unlawful extension of trademark privileges under the Lanham Act; restraint of trade section 1 of the Sherman Antitrust Act; an unlawful contract, the effect of which may be to substantially lessen competition or tend to create a monopoly under section 3 of the Clayton Antitrust Act; fraud in the sale of securities under the 1935 Securities and Exchange Act; or just plain fraud—misrepresentation under common law. Surprisingly, he fails to mention one of the more promising remedial theories available, one that is being recognized increasingly by the courts today, unconscion-

15. H. BROWN, *supra* note 8, at 103.

ability.[16]

Brown discusses the antitrust per se illegal offenses, including partial or full-line tying arrangements, price fixing, resale price maintenance (where fair trade laws do not apply), market divisions, boycotts, exclusive dealing, etc.[17] Brown's antitrust discussion is admittedly introductory.

He correctly notes that franchisees are rarely, if ever, in a position to bring a treble damage private antitrust action, at least alone. Of course, new rule 23 of the Federal Rules of Civil Procedure[18] does present an "awesome threat" to the franchisor since the rule permits a *class action* to be brought by any member of a class in behalf of all other members of the class similarly situated or where there are substantially uniform questions of law and fact. Brown concludes that "there is every reason to believe that courts will allow a franchisee to bring action against his franchisor on his own behalf and on behalf of all other franchisees of that franchisor."[19]

The Human Setting

In the midst of the antitrust remedial discussion, Brown mentions a point that is often overlooked. Franchising, in addition to being an economic and business phenomenon, is responsive, at least in part, to a human drive for independence. Brown writes:

> In the broadest economic sense, the franchise system has been responsive to the basic conflict between big business and the small, independent businessman . . . . Franchising is sound when it combines the genuine expertise of the franchisor in obtaining maximum efficiencies of scale and centralization with the *true fulfillment of the small investor's dream of becoming his own boss.*[20]

In 1956 William H. Whyte, Jr. wrote that because of our social ethics society views the well-rounded man as the loyal company man, the man that not only belonged to a group but that *wanted to belong* to a group.[21] In short, he did not fear conformity. Thus, Whyte's "The Organization Man" was received as an insightful commentary on the corporate state. But throughout American history the entrepreneur strain has been a powerful force. Even the corporate giants of the 1960's have been unable,

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16. UNIFORM COMMERCIAL CODE § 2-302; Leff, *Unconscionability and The Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967).
17. H. BROWN, *supra* note 8, at 45-69.
18. FED. R. CIV. P. 23.
19. H. BROWN, *supra* note 8, at 67.
20. *Id.* at 48, 103.
21. E. WHYTE, THE ORGANIZATION MAN 129-33 (1956).

and in all fairness unwilling, to do away with the small independent businessman. He supposedly survives, indeed, flourishes today. But does he? In reality, the small businessman today is often a franchisee—a licensee, in essence an agent of a national franchisor.

To be sure, one can describe the 500,000 franchisees operating in America today as small businessmen. Brown's thesis, in part, however, is that the *franchisee is not independent.*[22] The implications of this fact—the non-independence of the small merchant who enters into a dependent, subservient franchise relationship—are beyond the scope of this review. They also are beyond the scope of Brown's book. The reviewer submits that these broader social and psychological implications may prove in time to have greater significance than the legal and economic ramifications of franchising.

In any event, we will all agree with author Brown that franchising is indeed a social-economic phenomenon. A few of us reveal a bias when we go a bit further to opine that franchising is a social blight—that it corrupts our landscapes, cityscapes and countryside, that it claims to be serving the interests of "independent" merchants when in reality it has created a class of subservient commission employees.

Driving into Gary, Indiana along U.S. 20, one comes upon what appears to be a thirty foot Frankenstein monster munching a six foot hamburger. The temptation is to laugh at what might appear to be a Yippie-type put-on. But, it is not a put-on. What can the law do about it? The question is properly before us.

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