St. Mary's Law Journal

Volume 19 | Number 3 Article 4

1-1-1988

Franchise Litigation in Texas: Analyzing Claims and Defenses Symposium - Business Tort Litigation.

John G. Lewis

FRANCHISE LITIGATION IN TEXAS: ANALYZING CLAIMS AND DEFENSES

JOHN G. LEWIS*

* President, Chairman of the Board, Groce, Locke & Hebdon, P.C., Houston Baptist University, B.A., University of Houston, J.D., magna cum laude, 1977.

I. INTRODUCTION

Franchising, as a method of national and international distribution of goods and services, has rapidly expanded over the past twenty years.[1] In the absence of comprehensive state or federal legislation governing the franchise relationship at the points where the potential for abuse is greatest,[2] courts and juries are called upon with greater regularity to evaluate the conduct of the parties upon a variety of factual and legal situations. While some courts have attempted to reach a just result on the facts of specific cases by the application of new legal theories,[3] other courts have strictly applied firmly established contract doctrines resulting in predictable, but sometimes harsh, re-

1. For excellent discussions regarding the economic impact of franchising on the development of national commerce, *see, e.g.,* Briley, *Franchise Termination Litigation: A Comparative Analysis*, 16 TOLEDO L. REV. 891 (1985); Brown & Cohen, *Franchise Equities*, 63 MASS. L. REV. 109 (1978); Caine, *Termination of Franchise Agreements: Some Remedies For Franchises Under the Uniform Commercial Code*, 3 CUMBERLAND-SAMFORD L. REV. 347 (1978); Gellhorn, *Limitations on Contract Termination Rights - Franchise Cancellations*, 1967 DUKE L.J. 465 (1967).

2. To date there is limited federal regulation governing only certain types of franchise relationships. *See* 15 U.S.C. §§ 1221-1225 (1982)(Automobile Dealer Suits Against Manufacturers Act, permitting dealers to sue manufacturers for failure to exercise good faith when executing any terms of franchise, or when cancelling, terminating, or not renewing franchise); 15 U.S.C. §§ 2801-41 (1982)(Petroleum Marketing Practices Act, imposing notice requirements on franchisors before they may terminate or fail to renew franchises). In 1984, proposed federal regulation of franchise terminations and nonrenewals was rejected by the House Committee on Energy and Commerce. *See* H.R. 298, 98th Cong., 1st Sess. (1983)(entitled "Franchise Reform Act"). For a more thorough discussion of the Act, see generally, Briley, *Franchise Termination Litigation: A Comparative Analysis*, 16 TOLEDO L. REV. 891, 893-94 (1985). The state of Texas has passed legislation dealing only with the rights of automobile dealers. *See* TEX. REV. CIV. STAT. ANN. art 4413(36) (Vernon Supp. 1988)(Motor Vechicle Commission Code, defining obligation of automobile dealers, and establishing Texas Motor Vehicle Commission).

3. *See, e.g.*, Carter Equip. Co. v. John Deere Indus. Equip. Co., 681 F.2d 386 (5th Cir. 1982)(Missisippi law recognizes fiduciary relationship in franchising arrangement in certain circumstances); Arnott v. American Oil Company, 609 F.2d 873, 881 (8th Cir. 1979)(franchise relationship gives rise to fiduciary duties separate from contractual provisions).

sults.[4] Thus, it is not surprising that widespread inconsistency exists in the application of legal principles to the growing field of franchise law.

Although the issues related to franchise litigation have been the subject of a number of publications,[5] there has been no undertaking to correlate the emerging theories across the country with existing Texas case law. Therefore, this article will attempt to provide a useful tool for analyzing potential franchise claims from the perspectives of each party to a franchise relationship.[6] Furthermore, this article will

---

4. *See, e.g.*, Domed Stadium Hotel, Inc. v. Holiday Inns, Inc., 732 F.2d 480, 485 (5th Cir. 1984)(franchisee, unprotected by contract, cannot imply fiduciary duty breach when additional franchise opened nearby); Newark Motor Inn Corp. v. Holiday Inns, Inc., 472 F. Supp. 1143, 1151-52 (D.N.J. 1979)(fiduciary obligation restricted to termination cases); Picture Lakes Campground, Inc. v. Holiday Inns, 497 F. Supp. 858 (E.D. Va. 1980)(fiduciary duty in franchising relationship inapplicable to business relationship).

5. *See, e.g.*, Briley, *Franchise Termination Litigation: A Comparative Analysis*, 16 TOLEDO L. REV. 891 (1985); Brown, *Franchising - A Fiduciary Relationship*, 49 TEX. L. REV. 650 (1971)(arguing that franchise relationship imposes fiduciary duty of providing franchisee with reasonable opportunity to succeed); Brown, *Franchising: Fraud, Concealment and Full Disclosure*, 33 OHIO ST. L.J. 517 (1972)(detailed discussion of abuses possible in franchise marketing method); Brown & Cohen, *Franchise Equities*, 63 MASS. L. REV. 109 (1978)(basic analysis of franchise relationship, regulation and termination); Brown & Cohen, *Franchise Misuse*, 48 NOTRE DAME L. REV. 1145 (1973)(defining franchise as "industrial-intellectual property" and discussing policies of misuse, remedies available under misuse doctrine); Caine, *Termination of Franchise Agreements: Some Remedies for Franchisees Under the Uniform Commercial Code*, 3 CUM.-SAM. L. REV. 347 (1972)(discussing methods of terminating franchise contracts, legislation affecting termination, UCC's requirement of good faith when terminating relationship and use of doctrine of unconscionability as valid defense to arbitrary termination); Gellhorn, *Limitations on Contract Termination Rights - Franchise Cancellations*, 1967 DUKE L.J. 465 (1967)(arguing in favor of expanding contract rights in franchise relationships to include subjective good faith standard when terminating relationship); C. Hewitt, *Good Faith or Unconscionability - Franchisee Remedies for Termination*, 29 BUS. LAW. 227 (1973); Comment, *Franchise Termination and Nonrenewal*, 26 S.D.L. REV. 321 (1981)(discussing causes of action available to franchisees, the "good cause" requirement and methods of judicially regulating private franchise contracts).

6. A discussion of substantive legal remedies which may be available under the federal and state antitrust laws or the Lanham Act will not be attempted, nor will the litigation of procedural issues relating to jurisdiction, venue, or arbitration provisions which may be contained in the parties' written agreements be discussed. Also, the Texas Legislature has recently enacted several new measures relating to contractual arbitration and choice of law provisions which are beyond the scope of this article. *See,e.g.*, TEX. REV. CIV. STAT. ANN. art. 224-249 (Vernon Supp. 1988)(recent changes to Texas Arbitration Act); TEX. BUS. & COM. CODE ANN. § 35.53 (Vernon Supp. 1988)(relating to choice of law provisions in contracts); Act of June 18, 1987, Ch. 817, § 1, TEX. SESS. LAW SERV. 5670 (Vernon)(repealing bold face notice provisions applicable to arbitration provisions in contracts). For a discussion of federal law relating to the enforceability of contractual arbitration provisions, see generally, Hollering, *Arbitrability of Disputes*, 41 BUS. LAW. 125 (1985); *see also* 9 U.S.C. §§ 1-208 (1982)(Federal

provide a review of the accepted legal theories in Texas regarding franchise disputes, and enunciate the evolving national theories that may further affect the development of Texas jurisprudence.

Initially, to place the legal theories discussed throughout this article in proper context, the practitioner must determine the full extent of any written agreements that exist between the parties to the franchise relationship. Specifically, it is important to ascertain whether: (1) provisions exist defining the rights and obligations of the parties during the existence of the relationship; (2) the parties contracted expressly to exercise good faith in their course of performance; (3) the right to terminate the relationship exists; and, (4) mutuality of rights and obligations is present in the executed agreement. As in most contractual disputes, the written document will serve as the basis for many claims and defenses, as well as the focal point of parties seeking to avoid the effects of certain contractual terms.

Further, the practitioner must realize that the strength of certain claims or remedies of the franchisor or franchisee may vary depending upon the point in the relationship at which the disagreement arises. Accordingly, the liability theories available to the parties to a franchise agreement will be expressed at three critical junctures: (1) at the formation of the franchise relationship; (2) during the ongoing relationship; and, (3) at the termination or nonrenewal of the franchise relationship. Although different theories may be available to a party during each of the periods, this article will discuss each theory at the point at which it appears to have its greatest application.

II. FRANCHISE DEFINED

For purposes of this article, a "franchise" is defined broadly to include a number of different types of relationships that may exist between parties involved in the distribution of goods and services.

Arbitration Act). The enforceability of contract provisions attempting to fix venue will vary depending on the forum of the suit. *Compare* Fidelity Union Life Insurance Co. v. Evans, 477 S.W.2d 535, 537 (Tex. 1972)(absent statutory authorization, contractual venue provisions violate public policy) *with* Taylor v. Titan Midwest Constr. Corp., 474 F. Supp. 145, 147-49 (N.D. Tex. 1979)(public policy, as stated by Texas courts, insufficient to overcome federal interest in avoiding balkanization; enforcing contractual venue provision). For summaries of the guidelines employed by federal courts in construing contractual venue provisions, see M/S Bremen v. Zapata Off-Shore Company, 407 U.S. 1 (1972); General Engineering Corp. v. Martin Marietta Alumina, Inc., 783 F.2d 352 (3d Cir. 1986); and Stewart Or., Inc. v. Ricoh Corp., 810 F.2d 1066 (11th Cir. 1987).

Generally, a "franchise" can be defined as a continuing commercial relationship created by an agreement, either express or implied, whereby a franchisee sells goods or services identified by the trademark or other commercial symbol of the franchisor.[7] In addition, such an arrangement typically includes the right of the franchisor to exercise some quality control over the merchandise and general business practices of the franchisee.[8]

A 1983 congressional attempt to define "franchise" in the "Franchise Reform Act" was paraphrased by one commentator as:

> any commercial relationship, created by agreement and affecting commerce, whereby one person authorizes another to sell, offer or distribute goods, commodities or service and (1) where the operation of the business is "substantially dependent upon the grantor's trademark, service mark, trade name or symbol or (2) where the grantee makes a substantial change in the nature of operation of his business . . . in reliance upon continuation of the franchise relationship and (3) in excess of $25,000 in anticipated gross annual sales are involved".[9]

Still other sources, however, reflect that a "true franchise," on one end of the franchise spectrum, differs from a distributorship or dealership, perhaps on the other end, in that the former involves licensing the right to market a particular product, as well as the right to control the conduct of the franchisee regarding all aspects of the business under the franchisor's tradename.[10] The courts, however, consistently treat distributorships and dealerships as falling within the broad spectrum of franchises.[11]

Thus, a "franchise" encompasses a broad range of commercial relationships. As a result, when addressing allegations of breach of a franchising agreement, courts have applied a variety of tort and contract principles, sometimes inconsistently and inaccurately, to fashion appropriate relief.

---

7. 16 C.F.R. § 436.2(a) (1987).

8. *Id.* § 436.2 (a)(1)(i)(A), (B); *see also* 10 Z. CAVITCH, BUSINESS ORGANIZATIONS WITH TAX PLANNING, § 240.02 [1].

9. H.R. 298, 98th Cong., 1st Sess. (1983), as paraphrased in Briley, *Franchise Termination Litigation: A Comparative Analysis*, 16 TOLEDO L. REV. 891, 893-94 (1985).

10. *See* Annotation, *Fraud in Connection with Franchise or Distributorship Relationship*, 64 A.L.R.3d 11, 11 (1975).

11. Shell Oil Co. v. Marinello, 307 A.2d 598, 602 (N.J. 1973)(lease agreement between service station owner and oil company recognized as franchise agreement).

III. DISPUTES CONCERNING THE FORMATION OF THE FRANCHISE RELATIONSHIP

Texas case law in the franchise area has centered primarily around disputes involving the formation of the franchise relationship or its termination. Formation disputes typically involve allegations that certain misrepresentations were made during the course of the negotiations leading up to a contractual agreement. Upon discovery of such misrepresentations, a party usually seeks either rescission of the contract and restitution of amounts paid in establishing the business arrangement, or affirms the contract and sues for damages.[12] The most frequently utilized causes of action, however, are fraud or fraudulent inducement[13] and violations of the Texas Deceptive Trade Practices-Consumer Protection Act (DTPA).[14] If no franchise agreement is ever finalized, a claim may also exist for reliance damages under a promissory estoppel theory.[15] Following the formation of the contract, the complaining party may also sue for breach of the contract for nonperformance of a specific term.[16]

A. *Fraud and Fraudulent Inducement To Franchise Agreements*

In a franchise setting, either party may become disillusioned at an

---

12. These lawsuits are most commonly based upon the DTPA, TEXAS BUS. & COM. CODE ANN. §§ 17.01-.826 (Vernon 1987), and common law breach of contract principles. *See, e.g.*, Dowling v. NADW Mktg., Inc., 631 S.W.2d 726, 727 (Tex. 1982)(suit under DTPA allowing recovery of damages for breach of franchise contract); Wheeler v. Box, 671 S.W.2d 75, 76 (Tex. Civ. App.—Dallas 1984, no writ)(suit by franchisees under DTPA and breach of contract to recover business losses sustained while franchise owners); Staley v. Terns Serv. Co., 595 S.W.2d 882, 882-83 (Tex. Civ. App.—Waco 1980, writ dism'd)(suit by franchisee under DTPA, fraud and breach of contract to recover business losses incurred as result of failed business efforts); United Postage Corp. v. Kammeyer, 581 S.W.2d 716, 719-20 (Tex. Civ. App.—Dallas 1979, no writ)(suit by purchaser of five postage stamp vending machines under DTPA for seller's misrepresentation of volume of anticipated business and quality of machines); Woo v. Great Southwestern Acceptance Corp., 565 S.W.2d 290, 293 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.)(suit seeking contractual damages and damages under DTPA for misrepresenting nature of franchise relationship).

13. *See* Staley v. Terns Serv. Co., 595 S.W.2d at 882-83 (plaintiffs alleged defendants fraudulently induced purchase of collection agency franchise by misrepresenting profit potential).

14. *See Dowling*, 631 S.W.2d at 727 (allowing recovery under DTPA for breach of franchise contract); *see also* TEX. BUS. & COM. CODE ANN. § 17.01-.826 (1987)(DTPA).

15. *Cf.* Prince v. Miller Brewing Co., 434 S.W.2d 232, 239 (Tex. Civ. App.—Houston [1st Dist.] 1968, writ ref'd n.r.e.).

16. Since actions for breach of contract depend on the specific facts and terms of each agreement, a detailed discussion of this cause of action is beyond the scope of this article.

early stage in the relationship due to the discovery of material misrepresentations made during the negotiation process. The party complaining of such fraudulent inducement may be a defendant seeking to avoid the effects of the contract,[17] or may be a plaintiff asserting a cause of action for recission based on the actionable fraud.[18] Fraud in the inducement of a contract is fatal to its enforcement because no mutual assent exists to enter an agreement induced by fraud.[19] Thus, fraudulent inducement is a valid defense to the enforcement of a contract.[20]

The plaintiff filing suit alleging actionable fraud by the defendant may rely on the contract and recover damages for the fraud, or, alternatively, rescind the transaction and seek restoration of the situation that existed before the parties entered the agreement.[21] By seeking damages for actionable fraud, as opposed to seeking rescission, a party to a franchise relationship must keep in mind that each party originally contemplated and contracted for an ongoing business relationship of some stated duration. The fact that one party elects to enforce the contract, and sue for damages, ordinarily would not relieve that party from continuing to perform the contractual obligations for the remainder of the contract period. Care should be taken by the party seeking damages, as opposed to rescission, to review the

---

17. *Cf.* Dallas Farm Mach. Co. v. Reaves, 307 S.W.2d 233, 238-39 (Tex. 1957)(defendant, purchaser of machinery in cross-action, sought recission and recovery of machinery given as part of purchase price of new machinery).

18. *See, e.g.*, Texas Industrial Trust v. Lusk, 312 S.W.2d 324, 325, 328 (Tex. Civ. App.—San Antonio 1958, writ ref'd)(plaintiff who gave defendant two deeds in exchange for defendant's corporate stock successful in rescinding deeds since stock worthless and corporation fraudulently induced plaintiff to deed land); L & B Oil Co., Inc. v. Arnold, 620 S.W.2d 191, 193 (Tex. Civ. App.—Waco 1981, writ dism'd)(plaintiff landowners successful in setting aside oil and gas contracts made by defendant corporation because drafts in payment of bonus due under lease terms dishonored); Middleman v. Atlantic Mut. Ins. Co., 597 S.W.2d 565, 568 (Tex. Civ. App.—Waco 1980, writ ref'd n.r.e.)(summary judgment in favor of defendant reversed where plaintiff fraudulently induced into signing compromise settlement agreement with worker's compensation carrier); Panhandle & Santa Fe Ry. Co. v. O'Neal, 119 S.W.2d 1077, 1080-81 (Tex. Civ. App.—Eastland 1938, writ ref'd)(plaintiff not bound by release fraudulently procured by defendant insurance company).

19. Middleman v. Atlantic Mut. Ins. Co., 597 S.W.2d at 568 (plaintiff fraudulently induced to sign settlement agreement with worker's compensation carrier did not assent to agreement, thus agreement set aside).

20. Cecil v. Zivley, 683 S.W.2d 853, 857 (Tex. Civ. App.—Houston [14th Dist.] 1984, no writ)(rule recognized but not applied).

21. Blythe v. Speake, 23 Tex. R.429, 436 (1859)(conflicting cases regarding remedies available for fraudulent inducement reconcilable because well settled in Texas that remedy for fraudulent inducement is recission or restitution).

written agreement and take the appropriate steps under the contract to terminate the relationship.[22] Failure to properly terminate under such circumstances could arguably lead to a later allegation that the originally defrauded party has breached the franchise agreement by failure to continue performance.

The party alleging fraudulent inducement may also be in the position of being the defendant in a suit between the parties. For instance, when the franchisee believes that certain misrepresentations were made by the franchisor that induced the contract, the franchisee often refuses to continue payments of the franchise fees. The franchisor may then file a suit against the franchisee for breach of contract for nonpayment of the franchise fee. Under such circumstances, fraudulent inducement would be an appropriate defensive pleading. Once again, the party alleging fraud must elect whether to adhere to the contractual remedies, or to sue for recission, return the consideration secured, and seek restitution.[23]

Any party alleging fraud or fraudulent inducement regarding any aspect of a franchise agreement should consider a request for punitive damages. Generally, punitive damages may be properly awarded when a defrauded party has suffered actual damages as a result of intentional fraud.[24] Misrepresention of the facts for the purpose of injuring another is considered wanton and malicious conduct, which suffices for the imposition of punitive damages.[25] Conscious indiffer-

---

22. Fredonia Broadcasting Corp., v. RCA Corp., 481 F.2d 781, 790 (5th Cir. 1973)(injured party entitled to damages, recission, or enforcement of bargain represented). Seeking recission and damages under the contract is not allowed since these remedies are incompatible. However, fraud and breach of contract are not inconsistent causes of action, and damages may be recovered for both. *See id.* Dallas Farm Machinery Co. v. Reaves, 307 S.W.2d 233, 238-39 (Tex. 1957)(rule recognized); L & B Oil Co. v. Arnold, 620 S.W.2d 191, 193 (Tex. Civ. App.—Waco 1981, writ dism'd)(rule recognized where defendant's drafts in payment of oil and gas leases dishonored; fraud based upon defendant's claim that title to plaintiff's land "unacceptable"); Middleman v. Atlantic Mut. Ins. Co., 597 S.W.2d 565, 567-68 (Tex. Civ. App.—Waco 1980, writ ref'd n.r.e.)(plaintiff who was fraudulently induced to sign settlement agreement with worker's compensation carrier could rescind agreement or recover damages for fraud).

23. Fredonia Broadcasting Corp., v. RCA Corp., 481 F.2d 781, 790 (5th Cir. 1973)(party seeking redress for injuries for breach of contract may recover damages, rescind, or enforce bargain); L & B Oil Co. v. Arnold, 620 S.W.2d 191, 193 (Tex. Civ. App.—Waco 1981, writ dism'd)(when defendant's drafts in payment of oil and gas leases dishonored, plaintiff could adhere to contract and collect damages or sue to rescind contract).

24. Dennis v. Dial Fin. & Thrift Co., 401 S.W.2d 803, 805 (Tex. 1966)(defendant finance company, which intentionally sought to collect additional money after settling account in full, liable for exemplary damages).

25. *Id.*

ence to the rights of others is also sufficient for an award of punitive damages for fraud.[26]

1. Elements of Fraud

The elements of actionable fraud have been consistently stated by the Texas Supreme Court as requiring proof:

(1) that a material representation was made by the defendant;
(2) that it was false;
(3) that when the defendant made it, he knew it was false but made it recklessly without knowledge of its truth as a positive assertion;
(4) that the defendant made it with the intention that it be acted upon by the plaintiff;
(5) that plaintiff acted in reliance upon it; [and]
(6) that plaintiff thereby suffered injury.[27]

Other decisions from the supreme court indicate that a misrepresentation is "material" if it would be likely to affect the conduct of a reasonable man with reference to the transaction in question.[28] In addition, reliance on the material misrepresentation must also be justifiable.[29] Furthermore, if the representation involves an expression of intent to perform an act in the future, it must be a representation of existing intent on the part of the speaker at the time of the statement, as opposed to a representation that the event will actually occur.[30] To be actionable, the complaining party must establish (1) that at the time the promise to perform in the future was made, the speaker had no present intent to perform, and (2) that the promise was made with

26. *Id.*

27. Stone v. Lawyers Title Ins. Corp., 554 S.W.2d 183, 185 (Tex. 1977)(suit against title insurance company for misrepresenting in title opinion existence of pipeline easement); Custom Leasing, Inc. v. Texas Bank & Trust Co., 516 S.W.2d 138, 143 (Tex. 1974)(suit in fraud by leasing company against bank to recover damages incurred when alleged invalid chattel mortgage on construction equipment improperly released); Oilwell Div., United States Steel Corp. v. Fryer, 493 S.W.2d 487, 491 (Tex. 1973)(fraud alleged as defense to promissory note guaranty agreement).

28. Custom Leasing, Inc. v. Texas Bank & Trust Co., 516 S.W.2d at 142.

29. Barrier v. Brinkman, 109 S.W.2d 462, 466-67 (Tex. Comm'n App. 1937, opinion adopted)(plaintiff's fraud action for foreclosure of property denied since plaintiff could not have relied on alleged promise); Bynum v. Signal Life Ins. Co., 522 S.W.2d 696, 700 (Tex. Civ. App.—Dallas 1975, writ ref'd n.r.e.)(where insurance company knew of falsity of alleged fraudulent statement, reliance not allowed).

30. Spoljaric v. Percival Tours, Inc., 708 S.W.2d 432, 434 (Tex. 1986)(in suit for fraudulent misrepresentation in employment relationship, held intent determined at time of representation and may be inferred from subsequent actions).

the intention, desire and purpose of deceiving.[31] An expression of opinion, however, may constitute actionable fraud if the opinion is rendered with actual knowledge of its falsity, or if a speaker, who purports to have special knowledge of facts that will occur or exist in the future, expresses an opinion as to the happening of a future event.[32]

2. Duty to Disclose Information During Negotiations

a. No Duty To Disclose When Parties At Arm's Length

No actionable fraud exists if a party is not legally bound to volunteer information, such as where the parties are dealing at arm's length, or where no confidential relationship exists between the parties.[33] Under some circumstances, however, actionable fraud may be found where there has been a concealment or failure to disclose material facts within the knowledge of the party sought to be charged, if the law has imposed upon such party a duty to disclose.[34] The circumstances under which a duty to disclose may arise include a confidential or fiduciary relationship between the parties, or a situation in which a party later learns that previous affirmative representations are

---

31. *Id.* at 434; Dowling v. NADW Mkt., Inc., 625 S.W.2d 392, 395 (Tex. App.—Tyler 1981), *rev'd on other grounds*, 631 S.W.2d 726 (Tex. 1982)(recognizing general rule in Texas that actionable fraud arises when false representation is made of past or existing fact, but no liability arises for breaking mere promise to perform future event); Texas Indus. Trust v. Lusk, 312 S.W.2d 324, 326-27 (Tex. Civ. App.—San Antonio 1958, writ ref'd)(in suit by grantor to rescind deeds, defendant's representation of future fact, which at time made defendant knew to be false, held fraudulent).

32. Trenholm v. Ratcliff, 646 S.W.2d 927, 929-31 (Tex. 1983)(held defendant's statements and predictions that land would become shopping center so intertwined as to constitute representations of facts).

33. Moore & Moore Drilling Co. v. White, 345 S.W.2d 550, 555 (Tex. Civ. App.—Dallas 1961, writ ref'd n.r.e.)(no actionable fraud arose where parties dealt at arm's length without confidential relationship). Additionally, a party cannot be charged with fraud for suppressing information he is not legally obligated to volunteer. The only exception to this rule is when he suppresses information of which he knows the other party to be unaware and without equal opportunity to discover. *See id.*; *see also* Phillips Petroleum Co. v. Daniel Motor Co., 149 S.W.2d 979, 988 (Tex. Civ. App.—Eastland 1941, writ dism'd judgm't cor.)(rule and exception recognized).

34. Spoljaric v. Percival Tours, Inc., 708 S.W.2d at 435 (in suit over employee bonus plan, intentional breach of duty was false representation and therefore fraudulent); Smith v. National Resort Communities, Inc., 585 S.W.2d 655, 658 (Tex. 1979)(sellers of property had duty to inform purchasers that lot lay below water contour line; failure to so inform held breach of duty to inform and, thus, actionable fraud).

false.[35] Where a party makes only a partial disclosure of facts, even though originally under no duty to speak, and such partial disclosure conveys a false impression, the speaking party may be liable for actionable fraud for failure to disclose.[36]

b. Duty To Disclose If Fiduciary Relationship Exists

No reported case from any jurisdiction imposes a fiduciary or confidential relationship on the parties during arm's length negotiation of the terms of a franchise relationship, prior to the signing of a written agreement, which would thereby impose upon the parties a duty to disclose superior information. Although a fiduciary duty has been found to be an inherent element of a franchise relationship by at least one court,[37] other courts have refused to apply the fiduciary duty concept so broadly as to include franchise cases.[38]

---

35. Tempo Tamers, Inc. v. Crow-Houston Four, Ltd., 715 S.W.2d 658, 669 (Tex. App.—Dallas 1986, writ ref'd n.r.e.)(defendant which owed plaintiff no affirmative duty to inform of intent to insist on written approval clause in lease not liable for fraud based on failure to disclose such information; court found no confidential or fiduciary relationship, nor subsequent knowledge that previous statements were false); Susanoil Inc. v. Continental Oil Co., 519 S.W.2d 230, 236 (Tex. Civ. App.—San Antonio 1975, writ ref'd n.r.e.)(defendant corporation which promised plaintiffs equal treatment regarding oil and gas Unitization Agreement had legal duty to inform plaintiffs of subsequent agreement made with individual plaintiff affording individual plaintiff special considerations; held failure to inform plaintiffs of subsequent agreement breached duty resulting in actionable fraud); Richman Trusts v. Kutner, 504 S.W.2d 539, 543-44 (Tex. Civ. App.—Dallas 1973, writ ref'd n.r.e.)(insurance agent had no legal duty to inform plaintiff of adequacy of coverage or of expiration, and thus failure to speak not fraudulent misrepresentation).

36. *See, e.g.*, Southeastern Fin. Corp. v. United Merchants & Mfrs., Inc., 701 F.2d 565, 566-67 (5th Cir. 1983); International Security Life Ins. Co. v. Finck, 475 S.W.2d 363, 370 (Tex. Civ. App.—Amarillo 1972) *rev'd on other grounds*,496 S.W.2d 544 (Tex. 1973); American Empire Life Ins. Co. v. Long, 344 S.W.2d 513, 518 (Tex. Civ. App.—Eastland 1961, writ ref'd n.r.e.).

37. Arnott v. American Oil Co., 609 F.2d 873, 881 (8th Cir. 1979)(fiduciary relationship inherent in oil company-station dealer agreement); *see also infra*, text accompanying notes 114-35 for a more detailed discussion of the establishment of confidential, special relationship in Texas.

38. Domed Stadium Hotel, Inc. v. Holiday Inns, Inc., 732 F.2d 480, 485 (5th Cir. 1984)(applying Louisiana law, defendant franchisor owed franchisee no fiduciary duty); Carter Equip. Co. v. John Deere Indus. Equip. Co., 681 F.2d 386, 390-91 (5th Cir. 1982)(applying Mississippi law, court reasoned that fiduciary duty does not arise where parties have mutually shared intentions). The existence of a fiduciary relationship is to be determined by the trier of fact. *See Carter Equip. Co.*, 681 F.2d at 390; *see also* Murphy v. White Hen Pantry Co., 691 F.2d 350, 351, 354 (7th Cir. 1982)(under Wisconsin law, refusing to impose fiduciary duty on franchisor; plaintiff's allegations of superior economic power and superior bargaining power did not create fiduciary duty); Newark Motor Inn Corp. v. Holiday Inns, Inc., 472 F. Supp. 1143, 1151-52 (D.N.J. 1979)(following other federal courts which refused to impose fiduciary

In *Arnott v. American Oil Company*,[39] the United States Court of Appeals for the Eighth Circuit was confronted with a case that involved a claim for damages by the franchisee arising out of the franchisor's failure to deal in good faith during the term of a lease, and the subsequent termination of the lease without good cause. The court found that a fiduciary duty is an innate characteristic of a franchise relationship.[40] Inherent in the court's statement that fiduciary duty is an element of the franchise relationship is the fact that the franchise relationship *existed at the time* the alleged breaches of duty occurred. In other words, the basis for the imposition of such duties is the actual relationship between the parties, evidenced by the signed written agreement. Thus, it would seem illogical that such a fiduciary duty would be imposed on the parties' arm's length negotiations—the negotiations attempting to establish the same franchise relationship which allegedly later gives rise to the imposition of fiduciary duties pursuant to the *Arnott* decision. Even under the *Arnott* analysis, the conclusion that the fiduciary duty attaches *after* the franchise relationship is formed is strengthened by an examination of the rationale used by the *Arnott* court in discussing the fiduciary concept: that the parties enter an agreement to work together for common goals and profits.[41]

At least two courts have argued that the instruction submitted to the jury defining "fiduciary" in the *Arnott* case, rather than a submission of an instruction on the concept of a true fiduciary relationship, was nothing more than the submission of the basic contract principle

---

duty on franchisor); Weight Watchers of Quebec Ltd. v. Weight Watchers Int'l, Inc., 398 F. Supp. 1047, 1053-54 (E.D.N.Y. 1975)(in franchise cases, trademark license, by itself does not create fiduciary duty; underlying contract defines rights and duties of parties); In Re 7-Eleven Franchise Antitrust Litigation [1974] Trade Cases (CCH) ¶ 75,429 at 98,428 (N.D. Cal. 1974)(neither party cited case, and court could not find case imposing fiduciary duty on franchisor). Courts usually refuse to impose a fiduciary duty except when franchises are terminated; in termination cases, most courts hesitate to give literal effect to franchise agreement language and often impose a fiduciary duty upon the franchisors. *See Domed Stadium Hotel, Inc.*, 732 F.2d at 485.

39. 609 F.2d 873 (8th Cir. 1979).

40. *Id.*

41. *Id.* at 881-82. The court stated: "both parties have a common interest and profit from the activities of the other . . . . A franchisee . . . builds the goodwill of his own business and the goodwill of the franchisor." *Id.* The court also relied on the "recent surge" of general franchise legislation in Congress involving the relationship between service station dealers and franchisors. *See* 15 U.S.C. §§ 2801-41 (1978)(Petroleum Marketing Practices Act discussing the activities of some state legislators contracting the surface with franchise legislation).

imposing a duty of good faith and fair dealing on the parties.[42] *Arnott* has also been distinguished on the grounds that it was a franchise termination case, as opposed to a dispute alleging harm resulting from an ongoing franchise relationship.[43] Other courts have refused to adopt the fiduciary duty argument, even when deciding disputes arising during the ongoing franchise relationship.[44] One United States District Court has maintained that a franchise relationship is inherently a business relationship, not a fiduciary relationship.[45] In addition, the United States Court of Appeals for the Fifth Circuit, interpreting Mississippi law, in *Carter Equipment Co. v. John Deere Industrial Equipment Co.*,[46] held that the existence or nonexistence of a fiduciary relationship between the parties is a question of fact for the jury, thereby precluding the imposition of fiduciary duty as a matter of law.[47] Another court has simply refused to hold that, as a matter of law, under the *Arnott* rationale, fiduciary obligations are inherent in the franchise relationship.[48]

---

42. Domed Stadium Hotel, Inc. v. Holiday Inns, Inc., 732 F.2d 480, 485 (5th Cir. 1984)(appellant's reliance upon fiduciary duty misplaced because closer analysis of *Arnott* opinion reveals reliance on basic contract principles of good faith and fair dealing, not upon fiduciary duty); *see also* Murphy v. White Hen Pantry Co., 691 F.2d 350, 355 (7th Cir. 1982).

43. Murphy v. White Hen Pantry Co., 691 F.2d 350, 355 (7th Cir. 1982)(*Arnott* distinguished on grounds that case involved franchise termination whereas instant case involved ongoing franchise relationship, and that *Arnott* based upon basic contract principles, not upon fiduciary relationship); *see also* Domed Stadium Hotel, Inc. v. Holiday Inns, Inc., 732 F.2d 480, 485 (5th Cir. 1984).

44. *See, e.g.*, Newark Motor Inn Corp. v. Holiday Inns, Inc., 472 F. Supp. 1143, 1151-52 (D.N.J. 1979)(excellent discussion of policy arguments; court found no cases imposing fiduciary duty); Weight Watchers of Quebec Ltd. v. Weight Watchers Int'l, Inc., 398 F. Supp. 1047, 1053-54 (E.D.N.Y. 1975)(trademark license, by itself, does not create a fiduciary relationship; relationship governed by underlying franchise contract); Picture Lake Campground, Inc. v. Holiday Inns, Inc., 497 F. Supp. 858, 868-69 (E.D.Va. 1980)(interpreting Virginia Code to preserve plaintiff's legal and equitable remedies, not to create cause of action for breach of fiduciary duty); In Re 7-Eleven Franchise Antitrust Litigation, [1974] Trade Cases (CCH) ¶ 75,429 at 98,428 (N.D. Cal. 1974)(court concluded nothing would be gained by imposing fiduciary duty since all other legal concepts were sufficient to impose liability).

45. Carter Equip. Co. v. John Deere Indus. Equip. Co., 681 F.2d 386 (5th Cir. 1982).

46. 681 F.2d 386 (5th Cir. 1982).

47. *Id.* at 386, n. 6.; *see also* Phillips v. Chevron U.S.A., Inc., 792 F.2d 521, 524-25 (5th Cir. 1986)(court, bound by Mississippi law, obligated to recognize previous cases holding that existence of fiduciary relationship is question of fact).

48. Picture Lake Campground, 497 F. Supp. at 869 (business relationship imposed duty upon franchisor to deal fairly with franchisee, but no fiduciary duty existed); *see also* Arnott v. American Oil Co., 609 F.2d 873, 891 (8th Cir. 1979)(Bright, J., concurring and dissenting)(no fiduciary relationship existed; relationship between franchisor and franchisee was business relationship).

3. Summary

Authority and logic are absent from the argument for imposing a fiduciary, confidential, or special obligation on the parties, dealing at arm's length, during the negotiation process prior to the establishment of the franchise relationship. In the absence of a fiduciary, confidential, or special relationship, no duty to disclose superior information would exist during the negotiation process. Even under the broad statements contained in the *Arnott* decision, it is the establishment of the franchise relationship itself that arguably gives rise to the fiduciary obligation between the parties. Even assuming, arguendo, that a fiduciary duty is inherent to a franchise relationship, it does not follow that such a duty predates the contract actually establishing the relationship.[49] Thus, no duty to disclose arises, under the fraud analysis, prior to the time the contract is signed. A party induced by fraud to enter a contract may exercise the rights created by the bargain and recover damages for fraud, or rescind the contract, return the consideration received, and recover what has been paid.

B. *Texas Deceptive Trade Practices-Consumer Protection Act*

The DTPA has formed the basis for numerous suits between franchisors and franchisees.[50] The Act provides broad remedies for violations and was specifically enacted to remove from consumer transaction litigation the strict proof requirements and defenses that are typically attendant to fraud and contract actions.[51]

---

49. Commentators have argued for the imposition of a fiduciary standard between franchisor and franchisee without specifically discussing the imposition of such a standard on the parties prior to the entry of the contractual relationship. *See* Brown, *Franchising—A Fiduciary Relationship*, 49 Tex. L. R. 650, 663-75 (1971).

50. Burk Royalty Co. v. Walls, 616 S.W.2d 911, 920 (Tex. 1981); *see also* Trenholm v. Ratcliff, 646 S.W.2d 927, 933 (Tex. 1983)(citing *Burke Royalty*). It should be noted that the jury in *Trenholm* found Ratcliff made false representations with malice. After reviewing the evidence, the court concluded that there was some evidence to support a jury inference that Ratcliff made the misrepresentations with conscious disregard for the rights of Trenholm. *See id.* at 933.

51. *See* Smith v. Baldwin, 611 S.W.2d 611, 616 (Tex. 1980)(DTPA not intended as codification of common law; intended to ease burden of proof and abrogate defenses in common law consumer litigation); Woo v. Great Southwestern Accceptance Corp., 565 S.W.2d 290, 298 (Tex. Civ. App.—Waco 1978,writ ref'd n.r.e.)(DTPA intended to circumvent common law burdens of proof); *see also* TEX. BUS. & COM. CODE ANN. § 17.44 (Vernon 1987)(DTPA construed liberally to provide efficient procedures to secure consumer protection); Singleton v. Pennington, 606 S.W.2d 682, 686 (Tex. 1980)(discussing policies of Act including policy of liberal application to provide efficient and economical protection procedures).

The DTPA will usually be employed as a weapon by the franchisee when suing the franchisor since it requires the plaintiff to be a "consumer" as defined by statute.[52] Even though the purchase of a franchise may primarily involve the purchase of an intangible business concept, rather than physical property, it has been held that the franchisee qualifies as a consumer where the business encompassed both tangible personal property and services purchased for use in the function of the business.[53] Similarly, when a franchisee purchases an ongoing business from a prior franchisee, the second franchisee may assert a claim under the DTPA for damages or rescission against the franchisor if violations of the Act were producing causes of the damages.[54]

Other franchise relationships, such as that of manufacturer/distributor or manufacturer/dealer, may contemplate the purchase of goods or services by the dealer or distributor from the manufacturer for resale to the public.[55] In anticipation of such a purchase, the dealer/distributor may incur set up costs and expenses in preparation for the purchase of goods and services from the manufacturer. If, prior to the time the goods and services are sold by the franchisor to the franchisee, a violation of the Act by the franchisor is discovered,

---

52. *See* Staley v. Terns Service Co., 595 S.W.2d 882, 883-84 (Tex. Civ. App.—Waco 1980, writ dism'd)(plaintiffs, purchasers of collection agency franchise, successful in suit against seller who misrepresented quality of services seller would provide); United Postage Corp. v. Kammeyer, 581 S.W.2d 716, 721 (Tex. Civ. App.—Dallas 1979, no writ)(purchaser of stamp vending machines was a consumer of "goods" under the DTPA and entitled to treble damages); Woo v. Great Southwestern Acceptance Corp., 565 S.W.2d 290, 291, 298 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.)(purchaser of distributorship entitled to recover greatest amount of damages proved, which can include more than just purchase price of franchise); *see also* TEX. BUS. & COM. CODE ANN. § 17.50 (Vernon 1987)(allowing"consumer" to bring action for violations of Act). The statute provides:

> 'Consumer' means an individual, partnership, corporation, this state, or a subdivision or agency of this state who seeks or acquires by purchase or lease, any goods or services, except that the term does not include a business consumer that has assets of $25 million or more, or that is owned or controlled by a corporation or entity with assets of $25 million or more.

Id. at § 17.45(4).

53. Wheeler v. Box, 671 S.W.2d at 78-79 (business entity itself was intangible but encompassed tangible personal property and services to be used in business functions).

54. *See* Aetna Cas. & Surety Co. v. Martin Surgical Supply Co., 689 S.W.2d 263, 267 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.)(supplier of surgical equipment consumer); *cf.* Big H Auto Auction, Inc. v. Saenz Motors, 665 S.W.2d 756, 758-59 (Tex. 1984)(auto dealer who bought cars for resale was consumer).

55. TEX. BUS. & COM. CODE ANN. § 17.45 (Vernon 1987)("consumer" defined as one who "seeks or acquires" goods or services by purchase or lease).

the franchisee may still qualify as a consumer in an action for damages under the DTPA, since the statutory language simply requires that a person "seek or acquire" goods or services.[56] In other words, the contemplated purchase transaction need not be consummated for a party to maintain standing as a consumer:

> Indeed, the essential wrong in many consumer cases is that the defendant refuses to complete the transaction as represented, thereby preventing the consumer from acquiring the goods or services in question.[57]

The unlawful acts and practices prohibited by the Act are set forth in Section 17.46 and Section 17.50. Section 17.46 specifically prohibits a broad range of conduct and should be closely scrutinized in each case. Special attention should be given to subsection (b)(12). This section could provide a powerful weapon to the plaintiff who asserts that representations were made that a franchise agreement would grant the franchisee the right to distribute all of the products of a particular franchisor and, later, the franchisee is denied the right to purchase some of the products manufactured by the franchisor.

Also noteworthy is subsection (b)(23) which makes actionable:

> The failure to disclose information concerning goods and services which was known at the time of the transaction if such failure to disclose such information was intended to induce the consumer into a transaction into which the consumer would not have entered had the information been disclosed.[58]

Under common law fraud principles, liability for failure to disclose only arises upon breach of a duty to disclose arising from of a fiduciary or confidential relationship. Under the DTPA, no such predicate relationship need exist as the basis for such a duty to disclose. Rather, the complaining party must simply qualify as a consumer to maintain the action. It should be noted that subsection (b)(23) is different from other sections in that the prohibited failure to disclose must concern information about "goods or services" and the party failing to disclose must have done so knowingly.

Section 17.50(a)(3) provides relief for any consumer damaged by any unconscionable action or course of action[59] which, to a person's

---

56. *See id.*

57. Bragg, Maxwell & Longley, *Texas Consumer Litigation*, § 2.01 (2d ed. 1983)(citing Anderson v. Havins, 595 S.W.2d 147 (Tex. Civ. App.—Amarillo 1980, writ dism'd)).

58. TEX. BUS. & COM. CODE § 17.46(b)(23) (Vernon 1987).

59. *Id.* at § 17.50(a)(3) (unconscionability actionable under DTPA).

detriment:

(A) takes advantage of the lack of knowledge, ability, experience, or capacity of the person to a grossly unfair degree; or
(B) results in a gross disparity between the value received and consideration paid, in a transaction involving transfer of consideration.[60]

This section provides broad language into which a party may fit a number of factual situations, both at the inception of the franchise relationship and during the course of the ongoing interaction between the parties.[61]

The DTPA provides a broad range of remedies to a consumer and there is great flexibility in the application of common law damage concepts. As noted by one court in a suit involving the purchase of a distributorship:

> [w]e believe the Act was intended to permit the adversely affected plaintiff to recover the greatest amount of actual "damages" he has alleged and established by proof as factually caused by the defendant's conduct.[62]

In *Woo v. Great Southwestern Acceptance Corp.*,[63] the court allowed the distributor a recovery of the total amount paid for the distributorship less small profit made by the distributor on the sale of certain merchandise. The court indicated that the distributor would have also recovered the expenses incurred in opening and maintaining three offices while attempting to operate the distributorship had the plaintiff offered proof as to the reasonable and necessary nature of the expenses.[64]

"Actual damages" does, however, mean common law damages.[65] In addition to providing for recovery of actual damages and addi-

---

60. *Id.* at § 17.45(5).

61. For instance, in a situation where the franchisee continues to pay a franchise fee on a regular basis, but the franchisor continues to impose harsher and harsher performance conditions on the franchisee in order to maintain itself as a franchisee, while at the same time reducing its services to the franchisee, it could be argued the result to the franchisee is a gross disparity between the value of what is received and the consideration being paid.

62. Woo v. Great Southwestern Acceptance Corp., 565 S.W.2d 290 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.).

63. 565 S.W.2d 290 (Tex. Civ. App. —Waco 1978, writ ref'd n.r.e.).

64. *Id.* at 298 (by allowing plaintiff to recover greatest amount of actual damages proved, Act's purposes of encouraging consumer litigation and deterring unlawful conduct advanced).

65. Smith v. Kinslow, 598 S.W.2d 910, 915 (Tex. Civ. App.—Dallas 1980, no writ) (where Act did not define "damages," interpreting "actual damages" to mean common-law damages).

tional damages up to three times the actual damages, Section 17.50 (b) provides that a prevailing consumer may obtain injunctive relief; "orders necessary to restore to any party to the suit any money or property, real or personal, which may have been acquired in violation" of the Act; and "any other relief which the court deems proper . . . ."[66] Thus, the Act recognizes the equitable remedy of rescission and restitution.[67] According to case law under the Act, to obtain rescission and restitution a party must tender, or offer to tender, the value of the benefits received during the existence of the relationship.[68] Furthermore, awarding both actual damages based on a recovery of benefits under the contract and restoration of consideration paid based on rescission are not permissible, since the remedies are mutually exclusive.[69]

Also potentially available to an aggrieved franchisee are the provisions of the Texas Business Opportunities Act.[70] Generally, the Business Opportunities Act is designed to set up certain registration and filing requirements[71] for sellers or lessors of "business opportunities" involving "the sale or lease of any products, equipment, supplies or services," [72] to define prohibited acts by such sellers or lessors,[73] to specify statutory disclosure requirements to the buyer[74] and to establish remedies under Section 17.46 of the DTPA.[75] Special care must be taken by the complaining party to insure that the "business opportunity" being sold or leased does not fall within one of the specific

66. *Woo* at 915 (interpreting restoration of consideration paid as statutory recognition of rights of recission and restitution).

67. *Id.* (under Act recission and restitution available to complaining party who agrees to recover consideration paid, avoid contract, and surrender benefits thereunder).

68. *See id.*

69. David McDavid Pontiac, Inc. v. Nix, 681 S.W.2d 831, 835 (Tex. App.—Dallas 1984, writ ref'd n.r.e.)(purchaser of automobile could not recover difference between automobile as represented and as sold in addition to recovering consideration paid for automobile actually purchased).

70. TEX. REV. CIV. STAT. ANN. art. 5069-16.01-.17 (1987).

71. TEX. REV. CIV. STAT. ANN. art. 5069-16.08 (1987)(outlining disclosure statements which must be filed in secretary of state's office).

72. TEX. REV. CIV. STAT. ANN. art. 5069-16.05(2) (1987)(definition of "business opportunities").

73. TEX. REV. CIV. STAT. ANN. art. 5069-16.15(a) (1987)(list of prohibited acts).

74. TEX. REV. CIV. STAT. ANN. art. 5069-16.09 (1987)(disclosure statement must be filed ten days before contract is signed or ten days before consideration is received).

75. TEX. REV. CIV. STAT. ANN. art. 5069-16.15(b) (1987)(defining any violation of Act as "false, misleading, or deceptive act or practice within the meaning" of Deceptive Trade Practices Act).

statutory exemptions from application of the Act.[76] If the statutory requisites of a "business opportunity" are met, such a cause of action should also be considered, since a mere failure to register the business opportunity with the secretary of state or a failure to give the purchaser the statutorily prescribed disclosure statement will establish a cause of action for damages or rescission under the DTPA. The franchisee would also be entitled, under such circumstances, to attorney fees and costs.[77]

IV. PERFORMANCE DISPUTES DURING THE ONGOING RELATIONSHIP

A. *Background*

During the course of the ongoing franchise relationship, disputes arise that require court adjudication. Where the specific contract between the parties establishes express performance obligations, a suit for simple contract breach for failure to perform will provide adequate remedy and is beyond the scope of this article. In some cases one party may complain that the enforcement of a specific contract term would yield unconscionable results, and that party may seek to nullify the effects of such a provision.[78] Such cases usually arise in the franchise context when the franchisor seeks to terminate the franchise relationship pursuant to express contract terms.[79] In addition, claims of fraud or violations of the Deceptive Trade Practices Act must also be considered when reviewing a dispute arising during the ongoing relationship.[80]

---

76. TEX. REV. CIV. STAT. ANN. art. 5069-16.06 (1987).

77. *See* TEX. BUS. & COM. CODE ANN. § 17.50(d) (Vernon 1987).

78. *See* Zapatha v. Dairy Mart, Inc., 408 N.E.2d 1370, 1375 (Mass. 1980)(holding that franchise agreement authorizing termination of franchise relationship without cause on ninety days notice not unconscionable). In *Zapatha*, the court expressly recognized the principle that a contract provision allowing termination without cause is not per se unconscionable. *See id.* at 1376; *see also* Div. of Triple T. Serv., Inc. v. Mobil Oil Corp., 304 N.Y.S. 2d 191, 201 (Sup. Ct. 1969)(provision whereby either party could termination retail dealer contract at end of original three year term or any successive renewal period on ninety days notice held not unconscionable).

79. *See Zapatha*, 408 N.E.2d at 1372 (allegation of unconscionability based upon contract provision permitting termination without cause); *see also Div. of Triple T Serv. Inc.*, 304 N.Y.S. 2d at 194-95 (plaintiff alleged defendant unconscionably failed to renew franchise in spite of contract provision expressly permitting termination of relationship at end of current lease term). For further discussion of unconscionability of franchise agreements, see text accompanying footnotes 169 through 187.

80. For analysis of these theories, see text accompanying footnotes 17 through 77.

Two major theories merit close scrutiny but have yet to be clearly defined by Texas courts: (1) the claim that a fiduciary duty inherently exists within a franchise relationship;[81] and (2) the claim that the parties share duties of good faith and fair dealing toward one another in their performance of the contract.[82] Although courts in other jurisdictions have yet to clearly and concisely define these two theories in the franchising context, it will be shown herein that the two theories closely parallel one another and, in fact, merge into one concept[83] that simply establishes a duty of good faith requiring compliance of each party.

B. *Origins of the Fiduciary Duty Concept in Franchise Cases*

According to the United States Court of Appeals for the Eighth Circuit in *Arnott v. American Oil Co.*,[84] "[i]nherent in a franchise relationship is a fiduciary duty."[85] The *Arnott* court affirmed a jury finding that the defendant franchisor had breached a fiduciary duty by terminating a lease agreement[86] without good cause and by failing to deal with the plaintiff in good faith during the term of the lease agreement. The need perceived by the court for the imposition of the higher standard of conduct required of a fiduciary was based on three factors: (1) both parties shared a common interest and profit from the

---

81. The Eighth Circuit first proposed that a fiduciary duty was inherent in a franchise relationship in Arnott v. American Oil Co., 609 F.2d 873, 881 (8th Cir.), *cert. denied*, 446 U.S. 918 (1979). Numerous courts have subsequently recognized this same concept. *See, e.g.*, Phillips v. Chevron U.S.A., Inc., 792 F.2d 521, 523-24 (5th Cir. 1986); Walker v. U-Haul Co. of Mississippi, 734 F.2d 1068, 1075 (5th Cir. 1984).

82. *See, e.g.*, Domed Stadium Hotel, Inc. v. Holiday Inns, Inc., 732 F.2d 480, 485 (5th Cir. 1984)(holding that franchise relationship encompasses obligation of good faith and fair dealing inherent in every contract); Carter Equip. Co. v. John Deere Indus. Equip. co., 681 F.2d 386, 392 n.12 (5th Cir. 1982)(finding that Mississippi law merges concept of good faith and fair dealing with that of fiduciary duty); Murphy v. White Hen Pantry Co., 691 F.2d 350, 355 and nn. 4-5 (7th Cir. 1982)(finding fiduciary duty in franchise relationship merely a duty of good faith and fair dealing); *see also* ABA Distrib., Inc. v. Adolph Coors Co., 542 F. Supp. 1272, 1285-86 (W.D. Mo. 1982); Picture Lake Campground, Inc. v. Holiday Inns, Inc., 497 F. Supp. 858, 869 (E.D. Va. 1980); Newark Motor Inn Corp. v. Holiday Inns, Inc., 472 F.Supp. 1143, 1151-52 (D.N.J. 1979).

83. The Fifth Circuit, in interpreting Mississippi law, suggested that the duty of good faith and fair dealing merges with the concept of fiduciary duty in *Carter Equip. Co.*, 681 F.2d at 392 n.12.

84. 609 F.2d 873 (8th Cir.), *cert. denied*, 446 U.S. 918 (1979).

85. *Id.* at 881.

86. *See id.* at 880. Arnott operated a service station as a franchise of Standard Oil under a one year lease and successive renewals. *See id.* at 877.

activities of the other; (2) the franchisee built the good will of his own business, as well as the business of the franchisor; and (3) a growing number of states had adopted legislation preventing franchise termination in the absence of good cause for the termination.[87] Although the imposition of a fiduciary duty in a franchising relationship had some support from commentators,[88] the Eighth Circuit appears to be the first court to have adopted this higher standard of conduct in such a context. Other courts have been reluctant to acknowledge the existence of the true fiduciary concept in the franchise setting by distinguishing *Arnott* whenever possible.[89] The courts that distinguish the *Arnott* decision do so because of two troubling aspects: (1) the mislabeling of the standard of conduct of a franchisor as "fiduciary;" and (2) the use of a fiduciary duty concept to impose liability upon a franchisor for the exercise of his express contractual rights.

The first problem presented by the court's opinion in *Arnott* is the use of the "fiduciary duty," label on the standard of conduct imposed upon the franchisor attempting to terminate the contract in accordance with its express terms. The district court in *Arnott* expressly instructed the jury "that a fiduciary relationship existed between" the parties.[90] Several courts, however, have indicated that the definition

---

87. *Id.* at 881-83; *see also* Shell Oil Co. v. Marinello, 294 A.2d 253, 261 (N.J. Super. Ct. Ch. Div. 1972), *aff'd*, 307 A.2d 598 (N.J. Sup. Ct. 1973), *cert denied*, 415 U.S. 920 (1974)(reasoning that franchisee's interest extends beyond that of mere tenant since all investments of time and money intrinsically dependant upon maintaining relationship with franchisor); Atlantic Richfield Co. v. Razumic, 390 A.2d 736, 742 (Pa. 1978)(franchisee furthers good will of franchisor as well as himself); Arnott, 609 F.2d at 883 (recognizing discernible trend toward prohibiting unfair or inequitable practices by franchisors).

88. *See generally, e.g.*, Brown, *Franchising: A Fiduciary Relationship*, 49 TEXAS L. REV. 650, 663-72 (1971)(arguing that basis for fiduciary obligation is "pervasive power of control" over franchisee that exists in franchisor); Brown & Cohen, *Franchise Equities*, 63 MASS. L. REV. 109, 110-11 (1979)(after franchise relationship exists, "status" of that relationship requires dealings in good faith between parties).

89. *See, e.g., Domed Stadium Hotel, Inc.*, 732 F.2d at 485 (distinguishing *Arnott* as arising from a wrongfully terminated franchise, whereas the instant case involved an ongoing relationship); Murphy v. White Hen Pantry Co., 691 F.2d at 355 (distinguishing the franchise termination in *Arnott* from the continuing franchise relationship in the case at bar); *Picture Lake Campground, Inc.*, 497 F.Supp. at 869 (holding the fiduciary duty found in *Arnott* merely a "duty of good faith and fair dealing").

90. Arnott v. American Oil Co., 609 F.2d at 881 n.6. The trial court instructed the jury:

> You are instructed that a fiduciary relationship existed between the defendant and the plaintiff. A fiduciary relationship is one founded on trust or confidence placed by one person in the integrity and fidelity of another person. Out of such a relationship, the law requires that neither party exert undue influence or pressure upon the other, take selfish advantage of his trust or deal with the subject matter of the trust in such a way as to

of the fiduciary duty standard imposed in *Arnott* is nothing more than the general contract principle that parties performing a contract must excercise good faith and fair dealings.[91] Since the standard is imposed on the parties to contracts governed by the Uniform Commercial Code,[92] the origin of the duty imposed upon the franchisor in *Arnott* is in the Code, rather than in the fiduciary duty concept. In addition to the requirement of good faith and fair dealing, courts have not had trouble applying other provisions of the Uniform Commercial Code to a franchise relationship, whether by direct application or by analogy.[93]

The same concern over mislabeling the duty of good faith and fair dealing as a "fiduciary duty," led the district court in *Picture Lake Campground, Inc. v. Holiday Inns, Inc.*[94] to note, "It is not the fiduciary duty traditionally found in the trustee-beneficiary or attorney-client relationships that requires the utmost good faith and prohibits self-dealing on the party of the fiduciary."[95] Instead, the court noted that a franchise relationship is inherently a business relationship[96] and, while each party may serve the interest of the other, each party may also seek its own interest in the business transaction.[97] The district court noted that the parties to the agreement had to deal fairly

---

benefit himself or prejudice the other except in the exercise of the utmost good faith and with the full knowledge and consent of the other person involved.

Id.

91. *See Domed Stadium Hotel, Inc.*, 732 F.2d at 485 (finding *Arnott* court's analysis actually an application of contract principle of good faith and fair dealing); Murphy v. White Hen Pantry Co., 691 F.2d at 355 (jury instruction in *Arnott* reveals merely imposition of basic contract principles).

92. *See* TEX. BUS. & COM. CODE ANN. 1.203 (Tex. UCC)(Vernon 1968)(imposing obligation of good faith in performance of every contract); *see also id.* § 2.103(a)(2)(definition of good faith).

93. *See, e.g.*, Corenswet, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129, 134-35 (5th Cir.) *cert. denied*, 444 U.S. 938 (1979)(applying Code rules of construction to franchise contract); Rockwell Engineering Co., Inc. v. Automatic Timing and Controls Co., 559 F.2d 460, 463 (7th Cir. 1977)(construing franchise agreement in light of Code provision regarding absence of specific time and notice provisions); Aaron E. Levine and Co., Inc. v. Calkraft Paper Co., 429 F.Supp. 1039, 1048-49 (E.D. Mich. 1976)(terms of franchise agreement analyzed according to Code provision regarding manner of accepting offers by which contract may be formed); *Zapatha*, 408 N.E.2d at 1374-76 (Code provisions applied to franchise agreement by analogy rather than by express application of Art. 2).

94. 497 F. Supp. 858 (E.D. Va. 1980).

95. *Id.* at 869.

96. *See id.* (holding franchise is business relationship with simply the duty of fair dealing rather than fiduciary duties).

97. *See id.* (quoting *Arnott*, 609 F.2d at 981 (Bright, J., dissenting)).

with each other, but the court was unwilling to impose a fiduciary duty, with all of the obligations and responsibilities pertaining to such a duty.[98] Because of the existing duty of good faith and fair dealing, the court had no incentive to create an additional cause of action for the same conduct, but based upon the concept of breach of a fiduciary duty.[99]

The opinion in *Picture Lake Campground* is well reasoned. Since the franchise relationship is essentially a business one, the parties must be free to seek their own interests in performing their obligations under the agreement. If the traditional concept of fiduciary duty is involved, parties would not be able to pursue their own business interests without potentially violating their fiduciary obligations. For this reason, courts have been unwilling to prevent parties to franchise agreements from seeking their own interests during the franchise relationship.[100]

The second major concern with the analysis and decision in *Arnott* is the court's use of the fiduciary duty concept to impose liability upon the franchisor who expressly excercises its contract right to terminate the relationship. At least two courts have proposed that the *Arnott* fiduciary duty concept applies, if at all, to franchise termination cases rather than to disputes arising during an ongoing relationship.[101] As noted by the Fifth Circuit in *Domed Stadium Hotel, Inc. v. Holiday Inns, Inc.*,[102] the fiduciary duty concept has been applied only in termination cases where courts have refused to give literal effect to the termination provisions expressed in the franchise agreement.[103] This distinction is critical, since it identifies that the *Arnott* court was primarily concerned with the oppressive results suffered by franchisees

98. *See id.* (court held that imposition of fiduciary duties inappropriate because of other remedies available to franchisees).

99. *See id.* (state law provided for either criminal actions, commission actions or civil remedies based on duty of good faith).

100. *See Domed Stadium Hotel, Inc.*, 732 F.2d at 485 (holding franchisor could not be prevented from acquiring other hotels which competed with franchisee by imposition of fiduciary obligations); *cf.* Newark Motor Inn Corp., 472 F. Supp. at 1152 (holding franchisors' usual economic superiority not restricted by fiduciary duties).

101. *See Domed Stadium Hotel, Inc.*, 732 F.2d at 485 (distinguishing *Arnott* as applying only to alleged wrongful termination of franchise); Murphy, 691 F.2d at 355 (finding that *Arnott* concerned termination of franchise relationship rather than ongoing franchise).

102. 732 F.2d 480, 485 (5th Cir. 1984).

103. *See id.* (declining to find fiduciary duties in franchise relationship not involving alleged wrongful termination).

when franchisors exercise contractual termination rights.[104]

The duty of good faith and fair dealing, whether arising from a fiduciary duty or the provisions of the UCC, proves unsatisfactory as a standard for prevention of oppressive contract enforcement. Neither concept justifies overriding a party's right to rely on the contract's terms.[105] The duty of good faith and fair dealing scrutinizes a party's conduct and motivation; to impose liability under this standard on a party who performs in conformity with an express contractual right injects unreasonable uncertainty into the law of contracts by placing a party at risk every time he seeks performance of the contract.[106] Such a result is beyond acceptable public policy.[107] A more appropriate remedy is the unconscionability doctrine, embodied in section 2.302 of the Texas Business and Commerce Code, which focuses on the contract provision itself and protects a party from enforcement of a contract clause which produces oppressive results.[108]

C. *Duty of Good Faith and Fair Dealing as Embodied in the Texas Business and Commerce Code*

Under section 1.203 of the Texas Business and Commerce Code (Code) "[e]very contract or duty within this title imposes and obligation of good faith in its performance or enforcement."[109] Section 1.202(19) defines "good faith" as "honesty in fact in the conduct or transaction concerned."[110] Under Article 2 of the code, good faith "in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."[111] In construing the good faith requirements of the Code, Texas cases

---

104. *See Arnott*, 609 F.2d at 882-83 (investment of franchisee's time and money created expectation of continued renewal of lease by franchisor which, in good faith, could not be terminated without cause).

105. *See Carter Equip. Co.*, 681 F.2d at 392 n.14 (performance according to contract terms cannot be breach of fiduciary duty); Corenswet, Inc., 594 F.2d at 138 (good faith provision of UCC cannot be used to strike express terms in contracts); Maddox Motor Co. v. Ford Motor Co., 23 S.W.2d 333, 338 (Tex. Comm'n App. 1930, opinion adopted)(express contract terms providing for termination of dealership agreement on option of either party not contrary to covenant of good faith).

106. *See English*, 660 S.W.2d at 522 (applying concept of good faith in every contract would subject party to liability for suing for performance of contract terms).

107. *See id.* (concept contrary to adversary system and settled law).

108. *See* text accompanying footnotes 169 through 187.

109. TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC)(Vernon 1968).

110. *Id.* § 1.201(19).

111. *Id.* § 2.103(a)(2).

"have required a finding of bad faith before imposing liability" on a party for breach of these provisions.[112] The bad faith requirement for imposing liability under the Code should be satisfied by a jury finding that the party did not honestly believe he had a right to act or fail to act.[113]

D. *Development of the Tort Duty of Good Faith and Fair Dealing in Texas*

The scope of the concepts of a tort duty of good faith and fair dealing and the contractual obligation of good faith and fair dealing has broadened in Texas in recent years. In *English v. Fischer*[114] the Texas Supreme Court confronted the argument that in every contract an implied covenant of good faith and fair dealing requires "that neither party will do anything which injures the right of the other party to receive the benefits of the agreement."[115] In *English* the plaintiff argued that this duty was implied as a covenant in every contract and was breached by the defendant when he exercised one of his rights granted under a deed of trust agreement between the parties. The court refused to hold the defendant liable for relying on his contractual rights and refused to extend the proposed implied covenant to all contracts.[116] In refusing to impose such a standard, the court based its decision upon the policy of relying upon settled rules of law, thereby avoiding case-by-case analyses.[117] The court's opinion in

---

112. *See* Richardson Co. v. First Nat'l Bank in Dallas, 504 S.W.2d 812, 816 (Tex. Civ. App.—Tyler 1974, writ ref'd n.r.e.)(breach of good faith required actual knowledge of circumstances amounting to bad faith); Riley v. First State Bank, Spearman, 469 S.W.2d 812, 816-17 (Tex. Civ. App.—Amarillo 1971, writ ref'd n.r.e.)(test for breach of good faith was knowledge of facts creating circumstances of bad faith); *see also English*, 660 S.W.2d at 527 (Kilgarlin, J., dissenting)(construing violation of good faith as requiring party's bad faith).

113. *See English*, 660 S.W.2d at 527 (Kilgarlin, J., dissenting)(jury instruction regarding party's honest belief whether she had right to insurance proceeds would amount to test of bad faith)

114. 660 S.W.2d 521(Tex. 1983).

115. *Id.* at 522.

116. *See id.* (reasoning that agreement between parties, as set out in contract, should be interpreted and enforced by court).

117. *Id.* The majority opinion stated that:

> [t]his concept is contrary to our well-reasoned and long-established adversary system which has served us ably in Texas for almost 150 years. Our system permits parties who have a dispute over a contract to present their case to an impartial tribunal for a determination of the agreement as made by the parties and embodied in the contract itself. To adopt a laudatory sounding theory of good faith and fair dealing' would place a party under the onerous threat of treble damages should he seek to compel his adversary to

English makes it clear, that to the extent a party exercises a right granted by a contract, the Texas Supreme Court is unwilling to adopt a theory placing a party in jeopardy of liability for exercising that right. This is not to say that *English* should be interpreted as eliminating the tort duty of good faith and fair dealing in certain types of contractual relationships. In his concurring opinion, Justice Spears forshadowed the later development of imposing liability upon one party to a contract based upon "special relationships" founded either upon trust between the parties, or imposed by the courts as a result of the imbalance of bargaining power.[118] An examination of most cases cited by Justice Spears in his concurrence reflects court analyses based on traditional tort concepts of fiduciary duty in relationships created or governed by a contract.[119] Justice Spears argued that the majority's opinion neither created an implied duty of good faith and fair dealing, nor abolished the requirement of good faith and fair dealing incumbent within a certain special relationships. He therefore argued that the majority opinion should not be read so broadly as to eliminate the tort duty of good faith and fair dealing from its application to certain relationships that had been created or governed by a contract.[120]

The Texas Supreme Court later adopted Justice Spears' analysis in

---

perform according to the contract terms as agreed upon by the parties. The novel concept advocated by the courts below would abolish our system of government according to settled rules of law and let each case be decided upon what might seem "fair and in good faith," by each fact finder. This we are unwilling to do.

Id.

118. *Id.* at 524 (Spears, J., concurring). Justice Spears argued that:

Texas courts have read a duty of good faith and fair dealing into many types of contractually-based transactions. The common thread among the cases in which courts have done so is a special relationship between the parties to the contract. That special relationship either arises from the element of trust necessary to accomplish the goals of the undertaking, or has been imposed by the courts because of an imbalance of bargaining power. . . .

In all cases cited above, the duty of good faith and fair dealing springs from the relationship, not from the contract . . . .

Id.

119. *See, e.g.*, Stowers Furniture Co. v. American Indemnity Co., 15 S.W.2d 544, 547-48(Tex. Comm'n App. 1929 holding approved)(insurance company had duty to try, in good faith, to settle for benefit of insured); Schlitter v. Smith, 101 S.W.2d 543, 545(Tex. Comm'n App. 1937, opinion adopted)(grantee of mineral interest must act with utmost fair dealing towards grantor/royalty owner); Fitzgerald v. Hull, 237 S.W.2d 256,265 (Tex. 1951)(joint adventurers have mutual duty of scrupulous honesty and good faith).

120. *See English*, 660 S.W.2d at 524-24 (Spears, J., concurring)(noting that majority opinion, which found no duty of good faith in mortgagor/mortgagee relationship, did not affect other certain relationships involving good faith obligations beyond their control).

Arnold v. National County Mutual Fire Insurance Company.[121] In *Arnold* good faith and fair dealing existed in a contractual relationship between an insurance carrier and its insured based upon the "special relationship" between the parties.[122] The "special relationship" was founded upon policies of unequal bargaining power inherent in insurance contracts and of protecting the insured in these relationships.[123] Thus, the establishment of a "special relationship" between certain parties gives rise to the imposition of a tort duty of good faith and fair dealing. The relationship becomes "special" when it is shown that there is: (1) an "element of trust necessary to accomplish the goals of the undertaking"; (2) an imbalance of bargaining power between the parties; or (3) a party who may have exclusive control over an important element of the relationship.[124] Mere subjective feelings of trust by one party, however, are not sufficient to transform an arm's length transaction into one involving a special relationship.[125] Once the special relationship has been established, as a matter of law[126] or by the

---

121. 725 S.W.2d 165 (Tex. 1987)(citing Justice Spears' concurring opinion *English* for the proposition that duty of good faith between parties to a contract arises from certain special relationships).

122. *Id.* at 167. The court stated that:

> While this court has declined to impose and implied *covenant* of good faith and fair dealing in every contract, we have recognized that a duty of good faith and fair dealing may arise as a result of a special relationship between the parties governed or created by a contract. . . .

Id.

123. *Id.* The court stated that:

> In the insurance context a special relationship arises out of the parties' unequal bargaining power and the nature of insurance contracts which would allow unscrupulous insurers to take advantage of their insureds' misfortunes in bargaining for settlement or resolution of claims.

Id.; *see also* Manges v. Guerra, 673 S.W.2d 180, 183 (Tex. 1984)(holding that relationship of parties, rather than contract, gives rise to fiduciary duty).

124. *See Arnold*, 725 S.W.2d at 167 (duty of good faith imposed because of unequal bargaining power between parties to insurance contract and insurance company's exclusive control over payment of claims); *English*, 660 S.W.2d at 524 (Spears, J., concurring)(either trust element present in relationship or parties unequal bargaining power could give rise to special relationship requiring good faith).

125. *See* Thigpen v. Locke, 363 S.W.2d 247, 253 (Tex. 1962)(grantor's subjective trust that grantee had them sign lease rather than deed did not give rise to special fiduciary relationship).

126. *See,e.g., Arnold*, 725 S.W. 2d at 167 (holding special relationship exists among parties to insurance contract); Int'l Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567, 576 (Tex. 1963)(officers and directors of corporation held to have fiduciary duty to corporation under equity principles); Kinzbach Tool Co., Inc. v. Corbett-Wallace Corp., 160 S.W.2d 509, 513

trier of fact,[127] *Arnold* makes clear that exemplary damages and mental anguish are recoverable for breaches of the tort duty of good faith and fair dealing.[128]

Based upon Justice Spears' statement in his concurring opinion in *English v. Fisher*, that the tort duty of good faith and fair dealing is "similar" to the Business and Commerce Code duty of good faith,[129] logic dictates that the standard of conduct under the tort duty is similar to the standard of conduct imposed by the Texas Business and Commerce Code. This result is bolstered by the arguments advanced by Justices Kilgarlin and Ray, in their dissenting opinion in *English v. Fisher*, wherein they argue that the definition to be submitted to the jury regarding the tort duty of good faith and fair dealing should track the language in the Business and Commerce Code.[130] The Justices further argue that the instructions regarding the tort duty of good faith and fair dealing submitted to the jury in *English* imposed "a much greater burden" on the defendant than the Code's requirement of good faith and fair dealing.[131] "Good faith" under the Code, they insisted, means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."[132] Justices Kilgarlin and Ray correctly noted that under Code section 2.103(a)(2), Texas courts require the jury to find bad faith before imposing liabil-

---

(Tex. 1942)(holding that employee acting as agent for employer in negotiating a purchase had fiduciary obligation to employee).

127. *See* Schiller v. Elick, 240 S.W.2d 997, 999 (Tex. 1951)(holding that issue of existence of fiduciary relationship between property owners and bank employee who had agreed to help find buyer for land was question of fact); Ginther v. Taub, 570 S.W.2d 516, 525 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.)(whether fiduciary relationship existed between assignors of oil and gas lease and their assignees was fact question).

128. *See Arnold*, 725 S.W.2d at 168 (court held that, as with any other tort, damages for mental anguish and exemplary damages may be recovered for breach of good faith).

129. *See English*, 660 S.W.2d at 524-25 (Spears, J., concurring)(noting duty of good faith arises from special relationships and contracts under UCC); *see also* TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC)(Vernon 1968)("Every contract . . . within this title imposes an obligation of good faith in its performance . . .").

130. *See English*, 660 S.W.2d at 527 (Kilgarlin, J., dissenting)(observing that because TEX. BUS. & COMM. CODE good faith as "honesty in fact," retrial of case should measure party's good faith by her honest belief is her right to insurance proceeds); *see also* TEX. BUS. & COM. CODE ANN. § 1.201 (19) (Tex. UCC)(Vernon 1968)(" 'Good faith' means honesty in fact").

131. *See English*, 660 S.W.2d at 527 (Kilgarlin, J., dissenting)(arguing issue of party's good faith improperly submitted to jury and suggesting proper test of good faith).

132. *See id.* (quoting TEX. BUS. & COM. CODE ANN. § 2.103(a)(2) (Tex. UCC)(Vernon 1968)).

ity.[133] Therefore, the standard of conduct required by the tort duty of good faith and fair dealing, and the Code duty of good faith, are merged into one standard of care.[134]

E. Summary

The Eighth Circuit in *Arnott* found an inherent fiduciary duty in franchise relationships which is really nothing more than imposing the duties of good faith and fair dealings upon the parties to the franchise agreement.[135] This duty has been applied in transactions governed by the Texas Business and Commerce Code.[136] The supreme court has also indicated that this duty may arise as a result of a special relationship between parties governed by or created by contracts in a tort-type cause of action.[137] The standard of conduct that applies under the tort and contract duties appear identical.[138]

In contrast to the decision in *Arnott*, Texas law is clear that neither

---

133. *See* text and citations accompanying ftn. 112.

134. *See Carter Equip. Co.*, 681 F.2d at 392 n.12 (similar analysis of good faith requirements under Mississippi law).

135. *See* Arnott v. American Oil Co., 609 F.2d 873, 883-4 (8th Cir. 1979). A South Dakota statute prohibits unfair or inequitable dealings by a franchisor. *Id.* at 883. *See also* S. D. CODIFIED LAWS ANN. § 37-5A-66(7)(1986). Thus, the court reasoned, South Dakota law indicates that a fiduciary relationship exists between a franchisor an franchisee requiring good faith and fair dealing. *See* Arnott v. American Oil Co., 609 F.2d at 883-4.

136. *See, e.g.*, TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC) (Vernon 1968) (good faith implied in every U.C.C. type contract); TEX. BUS. & COM. CODE ANN. § 2.103(2) (Tex. UCC) (Vernon 1968) (defining "good faith"). *See also* English v. Fischer, 660 S.W.2d 521, 525 (Tex. 1983) (Spears, J., concurring) (good faith and fair dealing applies to Texas Business and Commerce Code contracts).

137. *Cf.* English v. Fischer, 660 S.W.2d 521, 522 (Tex. 1983). The Texas Supreme Court expressly held that the duties of good faith and fair dealing are not implied in every contract. *Id.* Therefore, these duties arise out of the relationship and not the contract to create this tort-type cause of action. *See, e.g.*, Amoco Production Co. v. First Baptist Church of Pyote, 611 S.W.2d 610, 610 (Tex. 1980)(per curiam)(lessee has implied duty to lessor to market gas in good faith); Fitz-Gerald v. Hull, 150 Tex. 39, 237 S.W.2d 256, 264-5 (1951) (joint venturers owe utmost good faith and honesty to each other); Kinzbach Tool Co., Inc. v. Corbett-Wallace Corp., 138 Tex. 565, 160 S.W.2d 509, 513 (1942)(duties of fair dealing and good faith imposed upon trusted employee); Johnson v. Peckam, 132 Tex. 148, 120 S.W.2d 786, 787 (1938) (partners are mutual confidential agents requiring good faith and fair dealing); Stowers Furniture Co. v. American Indemnity Co., 15 S.W.2d 544 (Tex. Comm'n App. 1929, opinion adopted) (insurers must deal with insureds fairly and in good faith).

138. *Compare* Fitz-Gerald v. Hull, 150 Tex. 39, 237 S.W.2d 256, 264 (1951) (joint venturers owe "utmost good faith, fairness, and honesty in their dealings") *with* English v. Fischer, 660 S.W.2d 521, 527 (Tex. 1983) (Kilgarlin, J., dissenting) (discussing UCC definition of "good faith" as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade").

the tort nor the contract duty of good faith and fair dealing can be utilized to impose liability on a party for the exercise of express contract rights.[139] The excellent public policy behind this principle was clearly expressed by the Fifth Circuit in *Carter Equipment Co. v. John Deere Industrial Equipment Co.*[140] The primary policy is that a contract cannot be breached by a party rightfully protecting his interests, if his actions comply with the contract's terms.[141] Although the Fifth Circuit in *Carter* was interpreting Mississippi law, where the issue of fiduciary duty is a question of fact, the concepts of fiduciary duty and duty of good faith and fair dealing were merged into one standard of conduct.

A critical issue yet to be resolved by the Texas courts, however, is whether the tort concept of good faith and fair dealing will be an alternative or duplicative remedy in situations where the franchise relationship is governed by the good faith and fair dealing requirements of the Texas Business and Commerce Code.

V. Disputes Involving Termination of the Franchise Relationship

A. *Background*

Most reported cases involving franchise disputes concern termination or nonrenewal of the franchise agreement by the franchisor. Often a franchisee invests significant sums of money and personal effort promoting the sales of a product or service while building the good will of the franchisee and franchisor over an extended period of time.[142] Most franchise agreements contain provisions allowing one

---

139. *See* English v. Fischer, 660 S.W.2d at 522 (Texas Supreme Court explicitly refusing to imply good faith and fair dealing to vary terms of contract).

140. 681 F.2d 386 (5th Cir. 1982).

141. *Id.* at 392 n.14 (citing Corenswet, Inc. v. Amana Refirigeration Co., Inc., 594 F.2d 129 (5th Cir. 1979), *cert. denied*, 444 U.S. 938 (1979)). The court noted that:

> If the parties, in seeking their individualized interests, comply with the terms of a contract in which they are also parties, it would be difficult to find a breach of a fiduciary duty. Although fiduciaries have mutual interest, they also have individual goals. If part of their relationship is set out in a contract, the parties have affirmatively recognized, in part, those individual interests. Unless the contractual terms are unconscionable, illegal, or violative of public policy, fiduciaries, as a practical matter, acknowledge that activity in conformance with the terms of the contract cannot amount to misconduct that constitutes a breach of a fiduciary duty.

Id.

142. *See, e.g.*, Arnott v. American Oil Co., 609 F.2d 873, 882 (8th Cir. 1979)(because

or both parties to terminate the relationship, with or without cause, upon some type of express notice of intent to terminate.

It is not surprising then, that when a franchisor gives notice of an intention to terminate the relationship or fails to renew the franchise agreement, even where the agreement expressly provides for a right to do so, litigation ensues whereby the franchisee attempts to maintain continuation of the business arrangement or seeks damages for the inability to continue the business. Likewise, it is predictable that, when faced with the application of an express contract term, the effect of which will be to prevent a franchisee from continuing to earn a living, the courts create legal fictions to avoid what is perceived as a harsh or unfair result.[143] Many of these theories have made the franchisor's reliance on contract termination rights either more difficult or more expensive. Examples of such theories applied by the courts include: (1) a clause allowing termination at will may not be exercised in bad faith;[144] (2) a covenant requiring good cause for termination may be implied even where the contract expressly allows termination at any time;[145] (3) a clause allowing termination "for any reason" should be construed to mean "any good reason or just reason";[146] (4) absent a clause expressly providing for termination rights, a franchisor may not refuse to continue the relationship arbitrarily;[147]

---

franchisee builds good will of business, franchisor has duty not to arbitrarily terminate franchise); Corenswet, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129, 132 (5th Cir. 1979) (franchisee spent over 1.5 million dollars developing market for franchisor's products); Atlantic Richfield Co. v. Razumic, 390 A.2d 736, 740-41 (Pa. 1978)(franchisee spent own funds on franchisor's promotions, purchased products from franchisor, required to operate station 24 hours per day by franchisor); Shell Oil Co. v. Marinello, 307 A.2d 598, 601 (N.J. 1973)(franchisee's personality, efforts, and good will of major importance).

143. *See Marinello*, 307 A.2d at 601 (court held parties with unequal bargaining power lost freedom to contract and contracts between such parties could be void as against public policy); Seegmiller, 487 P.2d at 894 (franchise contract drawn up by and protecting franchisor held not subject to arbitrary cancellation).

144. *See* RLM Assocs. v. Carter Mfg. Corp., 248 N.E.2d 646, 646 (Mass. 1969)(desire to avoid paying commission implies termination of contract in bad faith). *But see Corenswet Inc.*, 594 F.2d at 138-39 (unconscionability, rather than bad faith, should be test in determining enforcement of termination clause).

145. *See Marinello*, 307 A.2d at 603 (public policy requires that good cause be implied in termination clause).

146. *See* Dubis v. Gentry, 184 S.W.2d 369, 371 (Tenn. 1945)(contract which provided that lessee could terminate "for any reason" other than willful refusal to perform, construed as requiring good cause for termination).

147. *See Atlantic Richfield Co.*, 390 A.2d at 743 (where service station lease contact stated three year occupancy period but no express termination rights, lessor oil company could

and (5) the oppressive results of the enforcement of contract termination provisions should be prohibited by use of the unconscionability doctrine of the UCC.[148]

Some decisions where such theories have been applied impose financial liability on the franchisor for exercising an express contract right to terminate.[149] Furthermore, where the contract expressly allows for termination at any time, the imposition by the courts an implied covenant that termination will only be allowed upon a showing of good cause is clearly beyond the scope of the agreement originally contemplated by the parties. However, such a covenant is believed necessary by some courts to prevent oppressive results to the franchisee.[150] To date, Texas courts have seldom imposed implied covenants to restrict the right to invoke express contract provisions. An examination of Texas case law involving termination rights reflects an attempt at achieving a balance that affords a franchisor some security associated with reliance on the written contract, while protecting the franchisee from a termination that would have an unreasonably oppressive result.

B. *Existing Texas Law Regarding Franchise Termination*

The express terms of the franchise agreement must be closely scrutinized to determine the rights, obligations and remedies available to the parties involved in a termination dispute in Texas.[151] If the contract allows termination at will by either party, and the contract was entered into at arm's length, the exercise of such right to terminate

---

not arbitrarily end lessee's occupancy and recover possession of station, because of good faith and lessee's expectations).

148. *See Corenswet*, 594 F.2d at 138-39 (holding UCC unconscionability provision applicable to prevent unfair termination of distributorship contracts); *Zapatha*, 408 N.E.2d at 1375-78 (express termination provision in contract held not unconscionable under UCC definition as parties had notice of possible termination under contract terms).

149. *See Arnott*, 609 F.2d at 883-84 (termination of franchise contract held unfair and inequitable, liability imposed on franchisor).

150. *See Marinello*, 307 A.2d at 601-02 (holding oil company required to act in good faith in terminating dealership contract); *Seegmiller*, 437 P.2d at 894 (imposing liability on franchisor for failure to act fairly in terminating franchise relationship).

151. *Compare* Prince v. Miller Brewing Co., 434 S.W.2d 232, 237-39 (Tex. Civ. App.—Houston [1st Dist.] 1968, writ ref'd n.r.e)(holding express contract provision allowing termination of contractual relationship by either party could be exercised by franchisor without liability) *with* Carlson Machine Tools, Inc. v. American Tool, Inc., 678 F.2d 1253, 1262 (5th Cir. 1982)(holding that contract provision allowing either party to terminate dealership agreement during first year for "just cause" had to be exercised without fraud or bad faith).

will not be actionable, unless enforcement of the termination right is contrary to equity and good conscience or the termination clause is fraudulently exercised.[152] Texas courts have consistently refused to imply a covenant that good cause must exist for the termination if the contract is silent as to whether cause is required.[153] If the contract allows one party to terminate upon dissatisfaction with the performance of the other party, the reasonableness of the dissatisfaction is not questionable, but the dissatisfaction may not be fraudulent or in bad faith.[154]

As a matter of public policy, the courts consistently enforce the intention of the parties as expressed in the written franchise agreement; therefore, it follows that there can be no liability to a party for exercising an express termination right.[155] Furthermore, the good

---

152. *See* Maddox Motor Co. v. Ford Motor Co., 23 S.W. 2d 333, 338 (Tex. Comm'n App. 1930, holding approved)(dealership contract providing for termination at one party's election held enforceable if "not contrary to equity and good conscience"); *Prince*, 434 S.W. 2d at 239 (court noted in dicta that contract providing for termination of franchise relationship on notice by either party was enforceable as "not contrary to equity and good conscience"); Jones v. Chester, 363 S.W. 2d 150, 155 (Tex. Civ. App.—Austin 1962, writ ref'd n.r.e.)(in action between doctors practicing jointly in clinic, court held contracts providing for termination of relationship by either party at will was enforceable if fair and equitable); Haley v. Nickels, 235 S.W. 2d 683, 685 (Tex. Civ. App.—Austin 1950, writ ref'd n.r.e.)(parties may contract to terminate franchise relationship at election of one, and such contract is enforceable if not unfair, inequitable, or unconscionable).

153. *See* Wood Motor Co. v. Nebel, 238 S.W. 2d 181, 185 (Tex. 1951)(express provision for termination of relationship by notice, on desire of either party, was not construed as requiring just cause for termination); *Prince*, 434 S.W. 2d at 240 (court refused to imply provision in franchise contract that option of termination at will be exercised in good faith)(quoting Bushwick-Decatur Motors, Inc. v. Ford Motor Co., 116 F.2d 675, 677 (2nd Cir. 1940)).

154. *See Carlson*, 678 F.2d at 1262 (party's ability to terminate contract for "just cause" subject to rule that termination not be exercised fraudulently or in bad faith); Woodard v. General Motors Corp., 298 F.2d 121, 126 (5th Cir. 1962)(stating rule that, where contract relationship may be terminated on dissatisfaction of one party, his dissatisfaction need not be reasonable as long as in good faith and not fraudulent); Kree Institute of Electrolysis, Inc. v. Fageros, 478 S.W. 2d 569, 572 (Tex. Civ. App.—Waco 1972, no writ)(contract provision allowing termination for unsatisfactory business, and expressly leaving determination of satisfaction to employer, enforceable if exercised in good faith, regardless of employer's reasonableness); Golden State Mutual Life Ins. Co. v. Kelley, 380 S.W. 2d 139, 141 (Tex. Civ. App.—Houston 1964, writ ref'd n.r.e.)(contract providing for termination of business relationship if, in parent company's opinion, production insufficient, was enforceable regardless of parent company's reasonableness in determining insufficiency, only subject to requirement that termination be made in good faith); Coker v. Wesco Materials Corp., 368 S.W. 2d 883, 884 (Tex. Civ. App.—Eastland 1963, no writ)(court held employment contracts could be terminated on employer's dissatisfaction with performance, if dissatisfaction based on good faith).

155. *See Wood Motor Co.*, 238 S.W. 2d at 185-86 (finding no liability on part of party who terminated contract at will according to express contract provision); *accord English*, 660 S.W.

faith and fair dealing requirement of the Texas Business and Commerce Code[156] cannot be utilized to override express contract terms.[157]

Texas law regarding a party's right to terminate a franchise agreement where the agreement contains no express right to terminate is undecided. At least one jurisdiction utilizes the good faith and fair dealing requirements of the UCC to prevent termination of the franchise without good cause where the written agreement contains neither an express right to terminate nor a provision allowing the franchisor to terminate the franchise at will.[158] Under this particular theory, a franchise relationship would continue indefinitely until some action of the franchisee provided cause for a termination of the relationship. This result seems to conflict with section 2.309(b) of the Texas Business and Commerce Code, which provides as follows:

> Where the contract provides for successive performances but is indefinite in duration it is valid for a reasonable time that unless otherwise agreed may be terminated at any time by either party.[159]

The concept embodied in section 2.309(b) is consistent with the established principle that a franchise relationship should be of sufficient

---

2d at 522-23 (holding implied covenant of good faith and fair dealing did not override express mortgage terms which provided that proceeds of insurance policy go to homeowner); *see also Prince*, 434 S.W. 2d at 240 (holding that where valid contract expressed right of termination at will without liablity, reliance damages unavailable, promissory estoppel inapplicable).

156. *See* TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC)(Vernon 1968)("obligation of good faith" provision); *id.* § 2.103 (definition of good faith).

157. *See English*, 660 S.W. 2d at 522 (court declined to imply covenant of good faith in contract with express termination provision). Several courts and commentators have wrestled with the issue of the application of good faith to termination of contractual relationships and arrived at different results. *Compare Corenswet, Inc.*, 594 F. 2d at 136-38 (holding UCC good faith provision inapplicable to contract containing express termination clause) *with* Baker v. Ratzlaff, 564 P. 2d 153, 156-57 (Kan. 1977)(contract containing provision for termination upon party's failure to pay on delivery held subject to good faith covenant of UCC because right of termination inseparable from enforcement of substantive contract terms). *See generally* Gellhorn, LIMITATIONS ON CONTRACT TERMINATION RIGHTS-FRANCHISE CANCELLATIONS, 1967 Duke L. J. 465, 470-71 and n. 22 (noting that UCC good faith provisions inapplicable to franchises in general); Hewitt, GOOD FAITH OR UNCONSCIONABILITY-FRANCHISEE REMEDIES FOR TERMINATION, 29 Bus. Law. 227, 228-35 (1973)(discussing advantages of uniform application of good faith requirement to franchise relationships).

158. Atlantic Richfield Co. v. Razumic, 390 A. 2d 736, 741-42 (Penn. 1978)(court held oil company had duty to deal with lessee in good faith, exercising commercial reasonableness). The *Razumic* court stated that to allow the franchisor oil company to deal in less than good faith with the franchisee would allow the oil company to benefit in the form of increased good will without regard for the franchisee's interests. *See id.*

159. TEX. BUS. & COM. CODE ANN. § 2.309(b)(Tex. UCC)(Vernon 1987).

duration to allow the franchisee a reasonable time in which to recoup the initial investment made in the franchise arrangement.[160] Upon threat of termination or nonrenewal where the agreement is silent on the right to terminate, the franchisee should file suit seeking an injunction against termination or nonrenewal under the Texas Declaratory Judgment Act.[161] Such a suit could seek a declaration from the court as to what constituted a "reasonable time" for continuation of the relationship under the provisions of section 2.309(b) of the code in light of the franchisee's need to recoup the initial investment in the franchise.

Under a line of cases beginning with *Maddox Motor Co. v. Ford Motor Co.*,[162] it has been consistently held that an express termination provision will not be enforced "if contrary to equity or good conscience."[163] In the case of *Prince v. Miller Brewing Co.*,[164] the court indicated that the facts recited therein raised a jury issue concerning whether the enforcement of the termination provision would have been "contrary to equity and good conscience."[165] Since the plaintiff failed to seek remedies for breach of contract, the court refused to reverse the judgment of the trial court in favor of the franchisor.[166] However, the pre-Code decision in *Prince* is important for its recognition that, in some cases, the facts may give rise to an issue as to

160. *Cf.* Zapatha v. Dairy Mart, Inc., 408 N.E.2d 1370, 1377 (Mass. 1980)(recognition of need, in some cases, for franchisees to have reasonable time to recoup initial investment). *See generally* Gellhorn, *Limitations on Franchise Termination Rights—Franchise Cancellations*, 1967 DUKE LAW J. 465, 479-81 (1967)(recognizing courts which borrow from agency law so-called "Missouri doctrine" which disallow termination until franchisee has opportunity to recover expenditures).

161. TEX. CIV. PRAC. & REM. CODE ANN. §§ 37.001-.011 (Vernon 1986 & Supp. 1988). Since one of the purposes of the Act is to prevent the accrual of damages that might be avoided by court intervention, either party may effectively utilize the Act to forestall the damaging impact that may result from the finality of termination.

162. 23 S.W.2d 333 (Tex. Comm'n. App. 1930, holding approved).

163. *Id.* at 338 (when interpreting oral franchise relationship, court recognized principle that contract termination terms are enforceable unlesss violative of equity and good conscience).

164. 434 S.W.2d. 232 (Tex. Civ. App.—Houston [1st Dist.] 1968, writ ref'd n.r.e.).

165. *Id.* at 239 (plaintiff franchisee, who unknowingly paid defendants bribe, sued franchisor for extortion following termination of franchise). The franchisee, in *Prince*, did not raise breach of contract as an issue, and thereby could not later assert bad faith termination of the franchise contract by the franchisor. If the franchisee had done so, however, a jury question would have been raised. *See id.*

166. *Id.* (none of plaintiff's pleadings raised issues of improper cancellation or of fraudulent excercise of cancellation power).

whether the enforcement of the termination provision could be "contrary to equity and good conscience."[167] Prior to the *Prince* decision, the courts simply recognized the exception without an expression or delineation of facts that might give rise to its application. In pleading a case seeking avoidance of a termination provision, the practitioner, following this line of cases, must clearly bring his claim under a breach of contract theory rather than under tort allegations of wrongful termination and fair dealing. The *Prince* court also recognized that placing limitations upon the enforcement of express contract terms was a matter of public policy and, absent legislative authority for doing so, courts should not attempt to redress imbalances in contracts created where an inequality in bargaining power between the parties existed.[168]

C. *Integration of the Business and Commerce Code Provisions Into the Franchise Termination Analysis*

In 1967, the Texas Legislature adopted the Uniform Commercial Code as Title 1 to the Texas Business and Commerce Code.[169] Included within Title 1 is section 2.302, "Unconscionable Contract or Clause." This section empowers the court to hear evidence from the parties regarding the commercial setting, purpose and effect of a specific contract or clause and to determine, as a matter of law, whether the particular contractual clause is unenforceable.[170] The adoption of the unconscionability concept within the Texas Business and Commerce Code provides a definite standard for evaluating when the enforcement of a termination provision is "contrary to equity and good conscience" as contemplated by Texas pre-Code cases.

The express goal of the unconscionability provision is the prevention of oppression and unfair surprise, not a disturbance of the alloca-

---

167. *Id.* (facts of case raised jury issue as to whether contract was terminated using equity and good conscience, but cause of action not based on contract and not presented to appellate court).

168. *Prince*, 434 S.W.2d at 240.

169. TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Tex. UCC)(Vernon 1968 & Supp. 1988).

170. *See* Tri-Continental Leasing Corp. v. Law Office of Richard W. Burns, 710 S.W. 2d 604, 609 (Tex. App.—Houston[1st Dist.] 1985, writ ref'd n.r.e.)(unconscionability presents question of law, decided by considering "entire atmosphere" in which made); *see also* Wade v. Austin, 524 S.W.2d 79, 86 (Tex. Civ. App.—Texarkana 1975, no writ)(general atmosphere surrounding contract execution is important factor in determining unconscionability).

tion of risks because of superior bargaining power.[171]

> The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.[172]

Even though the focus is on facts existing on the date of contracting, this should not prevent a review of the potential oppression to the franchisee upon termination of the contract.[173] Under section 2.302, the party asserting the unconscionability of a termination provision has the burden to show that it had no "meaningful choice" but to accept the termination provision as offered and that the termination provision was unreasonably favorable to the other party.[174]

An excellent example of the application of the unconscionability doctrine in the franchise termination context can be found in *Zapatha v. Dairy Mart, Inc.*.[175] Zapatha, the plaintiff franchisee, filed suit to enjoin the threatened termination of the original franchise agreement.[176] The termination provision allowed either party, after twelve

---

171. TEX. BUS. & COM. CODE ANN. § 2.302 comment 1 (Tex. UCC)(Vernon 1968); Zapatha v. Dairy Mart, Inc., 408 N.E.2d 1370, 1375-76 (Mass. 1980)(quoting § 2.302 comment 1); Division of Triple T Service, Inc. v. Mobil Oil Corp., 304 N.Y.S.2d 191, 201-02 (N.Y. App. Div. 1969)(test is whether party is unfairly surprised, not allocation of risks due to superior bargaining power); *but see* Corenswet, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129, 139 (5th Cir.)(focus of Code's unconscionability doctrine is to prevent economic overreaching through the use of superior bargaining power to obtain grossly unfair advantage),*cert. denied*, 444 U.S. 938 (1979).

172. TEX. BUS. & COM. CODE ANN. § 2.302 comment 1 (Tex. UCC)(Vernon 1968). For a discussion of how the terminated party can show the effects of termination at the time it occurs, see generally Caine, *Termination of Franchise Agreements: Some Remedial for Franchises Under the Uniform Commercial Code*, 3 CUMB.-SAM. L. REV. 347, 349 (1972).

173. *Zapatha*, 408 N.E.2d at 1377 (no oppression where no potential for forfeiture of loss of investment).

174. *Corenswet*, 594 F.2d at 139 n.12 (proof required to show unconscionability); Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965)(unconscionability recognized as absence of meaningful choice with contract terms unreasonably favorable to other party); Blalock Machinery & Equipment Co., Inc. v. Iowa Mfg. Co. of Cedar Rapids, 36 U.C.C. Rep. Serv. (Callaghan) 753, 759 (N.D. Ga. 1983)(plaintiff must show no "meaningful choice" to accept contract unreasonably favorable to defendant).

175. 408 N.E.2d 1370 (Mass. 1980).

176. *Id.* at 1373. Zapatha originally executed a franchise and license agreement in November, 1973. Pursuant to such agreement, Dairy Mart, the franchisor, agreed to furnish the building and equipment for operation of a convenience store, as well as pay for rent and other costs of operation; and Zapatha agreed to pay a franchise fee based on a percentage of the store's gross sales. Additionally, Zapatha agreed to pay for the starting inventory, maintain a minimum stock of saleable merchandise, and pay taxes and employee's wages.

months, to terminate the agreement upon ninety days written notice.[177] The next year Zapatha executed a new agreement and changed the physical location of his store.[178] In November, 1977, Dairy Mart presented a new form of franchise agreement to Zapatha for execution. Some of the terms were less favorable to the franchisee and Zapatha refused to sign the new agreement. A few months later Dairy Mart gave Zapatha notice that the original contract was being terminated effective ninety days from the date of notice and it offered to repurchase Zapatha's inventory pursuant to the terms of the original agreement.[179]

Zapatha filed suit against Dairy Mart to prevent termination, of the November, 1973 contract alleging that the termination provision was unconscionable under section 2.302 of the Code and that Dairy Mart had breached its obligation of good faith and fair dealing under sections 1.201(19) and 2.103(1)(b) of the Code.[180] While the district

---

177. *Id.* at 1372-73. If Dairy Mart terminated without cause, it agreed to repurchase the saleable merchandise at eighty percent of its retail value. The Dairy Mart representative advised Zapatha to take the agreement to an attorney for review, but he also told Zapatha that the terms of the franchise agreement were nonnegotiable. *Id.* The Zapathas never consulted an attorney before signing the agreement. Mr. Zapatha testified that he interpreted the termination clause to mean that the franchise agreement could only be terminated by a showing of cause. *See id.*

The termination clause, in *Zapatha*, in the franchise agreement provides:

> (9) the term of this Limited Franchise and License agreement shall be for a period of Twelve (12) months from date hereof, and shall continue uninterrupted thereafter. If DEALER desires to terminate after 12 months from date hereof, he shall do so by giving COMPANY a ninety (90) day written notice by Registered Mail of his intention to terminate. If COMPANY desires to terminate, it likewise shall give a ninety (90) day notice, except for the following reasons which shall not require any written notice and shall terminate the Franchise immediately:
>
> (a) Failure to pay bills to suppliers for inventory or other products when due.
>
> (b) Failure to pay Franchise Fees to COMPANY.
>
> (c) Failure to pay city, state or federal taxes as said taxes shall become due and payable.
>
> (d) Breach of any condition of this Agreement.

Id. at 1373 n.4.

178. *Id.* The new franchise agreement was identical to the previous agreement except for the change of location. *See id.*

179. *Id.* Mr. Zapatha testified that he objected to new provisions such as the right for Dairy Mart to relocate an operator to a new location at its option, and the provision that the store increase its hours. Other provisions burdened the franchisee further, such as requiring the operator to pay any future increases in heat and electricity costs. Some of the provision changes may have benefited the franchisee. *See id.*

180. *Id.* at 1374.

court agreed with Zapatha,[181] the appellate court applied the good faith and unconscionability policies to the franchise agreement by analogy,[182] and held for Dairy Mart, finding that there was no potential in the termination provision for unfair surprise to Zapatha and no element of unfairness in the agreement by inclusion of the termination clause.[183] Since the contract provisions in *Zapatha* only called for a minimal original investment by Zapatha and there was no potential for forfeiture or loss of investment on his part at termination, the court resolved that there was no oppression to Zapatha by inclusion of the termination clause and, thus, no unconscionability with regard to the termination provision.[184] The court further concluded that by terminating the agreement there was no failure by Dairy Mart to act in good faith, or to observe reasonable commercial standards of fair dealing in the trade as required by section 2.03(1)(b) of the Code.[185] As noted by the court, the sole test of "honesty in act" under the Code is whether a person has been honest, and the definition does not include a broader, objective standard of "decency, fairness, or reasonableness in performance or enforcement."[186]

By using the Code doctrines of unconscionability and good faith to analyze the contract provisions and the conduct of the franchisor, the *Zapatha* court reached an equitable result for the parties under the agreement. The franchisee had little investment to protect, and what investment had been made was already adequately protected. Thus, no oppression would result to the franchisee by enforcement of the

181. *Id.* at 1372. Zapatha was allowed to continue operation of the store during the pendency of the Dairy Mart appeal. *Id.* The court believed that if it did not apply the Code to the entire contract, instead of only the provisions that dealt with goods, it could possibly cause "inconsistent and unsatisfactory consequences." *See id.* at 1375.

182. *Id.* at 1375; *see also* Commonwealth v. DeCotis, 316 N.E.2d 748, 754-55 (Mass. App. 1974)(applying UCC unconscionability provision to consumer's resale of mobile home by analogy).

183. *Id.* at 1373. Regarding § 2.302, unconscionability must be determined on a case-by-case basis since the Code contains no clear definition of unconscionability. This logic seems clearly correct since the facts of each case, as well as the specific contract language and its potential effects, will determine when contract enforcement may lead to unfair surprise or oppression in any particular case. *Id.*

184. *Id.* at 1376-77 (ninety days notice of termination, plainly stated in contract, held not unfair or unreasonable).

185. *Id.* at 1377 (provision that franchisor purchase all saleable items from franchisee on termination of relationship prevented forfeiture).

186. *Id.* at 1378 (facts indicated franchisor acted honestly in terminating franchise relationship).

termination provision. Similarly, the franchisor had a legitimate interest in terminating its relationship, since Zapatha would not agree to the terms of the proposed November 1977 franchise agreement. The case-by-case approach in *Zapatha* allows the court to decide unconscionability based on the facts of each case, with the emphasis on potential oppression to the franchisee by enforcement of the termination provision.[187]

The section 2.302 analysis suggested by the Texas Business and Commerce Code should replace the jury issue discussed in the *Prince* case regarding whether enforcement of a termination provision is contrary to equity and good conscience. The legislature has adopted a procedural and substantive method for determining whether the enforcement of a contract provision will result in oppression to one of the parties. The policy of oppression prevention remains the same in each case. The analysis of determining an oppressive result will vary depending on the facts involved in each case and the express language contained in the agreement. But until Texas courts merge the policies and procedures outlined by the Code with the pre-Code law, as set forth in the *Prince* case, prudence dictates that the practitioner should assert the alternative theories that enforcement of the termination provision is unconscionable under the Code and that enforcement is also contrary to equity and good conscience.

187. *Compare Zapatha*, 408 N.E.2d at 1376-77 (analyzing franchise agreement on case by case basis regarding oppressive contract terms which could lead to unconscionability) *with* Ashland Oil, Inc. v. Donahue, 223 S.E.2d 433, 440 (W. Va. 1976)(holding termination clause in dealership contract, which could be exercised only by oil company, unconscionable on its face); *Corenswet*, 594 F.2d at 138-39 (unilateral termination provision in franchise agreement in favor of franchisor held unconscionable as "economic overreaching"). For a discussion by the Texas Supreme Court of certain covenants contained in franchise agreements, see Hill v. Mobile Auto Trim, Inc., 725 S.W.2d 168, 170-171 (Tex. 1987).