

**FRANCHISE GOODWILL: TAKE A SAD SONG AND MAKE IT BETTER**

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*The end of a franchisor-franchisee relationship is often like a divorce, with the parties engaged in a heated battle over the ownership of the franchise goodwill. In this debate, the same franchisors or franchisees often change their positions on goodwill ownership depending on current needs.*

*This Article analyzes cases in many areas of franchise law to determine why franchisors and franchisees engage in such inconsistent reasoning, what the consequences are for franchising, and if there are ways to produce a more logical and efficient form of analysis and debate. In addressing the most contentious issues of franchising, adherence by litigants and courts to a logical, systemic framework could improve the resolution process for individual cases and clarify standards of practice for all franchising matters. This Article proposes a standard intended to reduce major stresses in franchise relationships—the sad songs of franchising—by quickly and fairly resolving the ownership of goodwill.*

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INTRODUCTION

*“When I use a word,” Humpty Dumpty said in a rather scornful tone, “it means just what I choose it to mean—neither more nor less.”<sup>1</sup>*

Like a marriage, a franchise relationship can end poorly. A franchise “divorce” may produce long-term problems affecting the parties’ ability to conduct business. As in a dissolving marriage, the franchise dispute often centers on ownership: who gets what? Singing the sad refrain of remorse, the buyer (franchisee) or seller (franchisor) laments spending blood, sweat, and tears building a business only to have the other party claim title to what was built. At the dispute’s core is a clash over goodwill that frequently exposes glaring inconsistencies in the parties’ understanding of their relationship.

A willful or blind insistence on consistency is not necessarily the best policy.<sup>2</sup> For most areas of law and business, however, the inconsistent application of principles, perhaps based on the parties’ own self-contradictory narratives about the nature of their enterprise, can diminish the reliability of individual or public expectations. Facts matter. Accordingly, determining the particulars of different narratives is essential.<sup>3</sup> In franchising, the “stories” that matter usually revolve around fundamental, make-or-break issues such as

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1. LEWIS CARROLL, THROUGH THE LOOKING-GLASS, AND WHAT ALICE FOUND THERE 132 (1893) (emphasis omitted).  
2. As my great, great, great, great-uncle, Ralph Waldo Emerson (1803–82), famously put it, “[a] foolish consistency is the hobgoblin of little minds, adored by little statesmen and philosophers and divines. With consistency a great soul has simply nothing to do. He may as well concern himself with his shadow on the wall.” RALPH WALDO EMERSON, *Self-Reliance*, in ESSAYS 35, 47 (1841).  
3. See ABRAHAM L. DAVIS, THE UNITED STATES SUPREME COURT AND THE USES OF SOCIAL SCIENCE DATA 28–30 (1973) (discussing Justice Louis D. Brandeis’s staunch belief in, and practice of, gathering facts as effectively the sole basis for judicial reasoning and decision making). See also *Ricketts v. Pa. R.R. Co.*, 153 F.2d 757, 761–62 n.6 (2d Cir. 1946) (Frank, J., concurring) (“It is the uncertainty about the ‘facts’ that creates most of the unpredictability of decisions.”); FELIX FRANKFURTER, *The Zeitgeist and the Judiciary*, in LAW AND POLITICS: OCCASIONAL PAPERS OF FELIX FRANKFURTER 3, 6 (Archibald MacLeish & E.F. Prichard, Jr., eds., 1939) (stating in an address in 1912 that “[i]f facts are changing, law cannot be static.”).

markets, territory,<sup>4</sup> competition,<sup>5</sup> and termination,<sup>6</sup> with the creation, ownership, and value of the business frequently a crucial question for the disputants.

The aforementioned value both arises from and is goodwill. Franchisor-franchisee quarrels often involve shifting assertions about the nature of goodwill. The franchisors and franchisees employ inconsistent arguments when confronting issues such as termination, nonrenewal, trademark infringement, noncompete covenants, antitrust tying, vicarious liability, taxes, and other legal topics. Indeed, the same dueling franchisors and franchisees often switch arguments depending on the situation. A party to a franchise contract in one context will assert that the franchisee purchased specific rights, including goodwill, as part of a “franchise package.” In another circumstance, the same party will declare that goodwill is severable from both the trademark and the franchise, and therefore, the franchisee purchased no goodwill.

Using case law to examine this inconsistent reasoning in arguments about goodwill, this Article proceeds to analyze the debate and propose a solution. Part I of this Article discusses understandings of goodwill in franchise relationships in both international and U.S. case law, as well as in franchise contracts. Part II analyzes a series of common disputes among franchisors and franchisees to highlight their inconsistent arguments about goodwill. Part III proposes an allocation of goodwill to serve as a stronger foundation for resolving future disputes. To further that goal, the author recommends a standard intended to reduce these arguments by quickly and fairly resolving the ownership of goodwill.

## I. GOODWILL

*Goodwill is the one and only asset that competition cannot undersell or destroy.*<sup>7</sup>

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4. See, e.g., Robert W. Emerson, *Franchise Encroachment*, 47 AM. BUS. L.J. 191 (2010).

5. See, e.g., Robert W. Emerson, *Franchising Covenants Against Competition*, 80 IOWA L. REV. 1049 (1995) [hereinafter Emerson, *Franchising Covenants Against Competition*].

6. See, e.g., Robert W. Emerson, *Franchise Termination: Legal Rights and Practical Effects When Franchisees Claim the Franchisor Discriminates*, 35 AM. BUS. L.J. 559 (1998) [hereinafter Emerson, *Franchise Termination*].

7. JONATHAN YATES, ALL-TIME ESSENTIALS FOR ENTREPRENEURS: 100 THINGS TO KNOW AND DO TO MAKE YOUR IDEA HAPPEN 60 (2009) (quoting Karl Ludwig Börne, German satirist and political writer (1786–1837)).

A. *The Franchise Contract and Maintenance of Customer Loyalty*

Goodwill is the loyalty that a business earns from its customers.<sup>8</sup> Franchise agreements almost always state that the franchisor has developed substantial goodwill, with the franchisee's use of that goodwill serving as a rationale for the franchisor to subject the franchisee to many, sometimes stringent, requirements.<sup>9</sup> The author reviewed one hundred fast-food, restaurant, and ice cream parlor franchise agreements dated from August 2007 to April 2011 and found that 95 percent contain a clause in which the franchisor declares it has developed goodwill for the benefit of the franchise system.<sup>10</sup> Controls over franchisee behavior are thus necessary to maintain this goodwill.<sup>11</sup>

Examination of some representative clauses in franchise agreements shows how much a franchisor typically requires a franchisee's steadfast compliance with all contractual terms, including a franchise operations manual, to maintain goodwill. For example, the Atlanta Bread Company franchise agreement states:

Compliance by all Franchisees with the foregoing standards and policies in conjunction with the use of Franchisor's trade names, service marks, trade dress and trademarks provides the basis for the wide public acceptance of the System and its valuable goodwill. Accordingly, strict adherence by all Franchisees to all aspects of the System is required at all times.<sup>12</sup>

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8. State Dep't of Transp. v. Cowan, 103 P.3d 1, 5 (Nev. 2004) ("While different jurisdictions vary slightly in their definitions of goodwill, the term generally is used to describe that component of value attributed to a business's reputation in the community, loyal customer base and ability to attract new customers." (citing 8A PATRICK J. ROHAN & MELVIN A. RESKIN, NICHOLS ON EMINENT DOMAIN § 29.01[1] (3d ed. 2004))); Dugan v. Dugan, 457 A.2d 1, 3 (N.J. 1983) (noting that "goodwill is essentially reputation that will probably generate future business"); DAVID LOGAN SCOTT, WALL STREET WORDS: AN A TO Z GUIDE TO INVESTMENT TERMS FOR TODAY'S INVESTOR 170 (2003) ("A business may build goodwill over time as loyalty builds among its customer base.").

9. HAROLD BROWN, FRANCHISING: REALITIES AND REMEDIES § 4.02(1)(c) (rev. ed. 2010).

10. See Robert W. Emerson, Franchise Phrasing: Strong Words, but Weak Faith (May 19, 2012) (unpublished manuscript) (on file with author).

11. See *id.*

12. ATLANTA BREAD CO. INT'L, INC. FRANCHISE AND LICENSE AGREEMENT art. 3.1 (2006), available at <http://134.186.208.233/caleasi/PDFDocs/%7B9E43FBDA-1737-47F5-BFC9-914A2D3E7A7F%7D.PDF>. See also HUNGRY HOWIE'S PIZZA & SUBS, INC. FRANCHISE AGREEMENT, Recital D (2008), available at <http://134.186.208.233/caleasi/PDFDocs/%7B822903F8-C54A-430F-878C-031D350E8355%7D.PDF>; TWO MEN & A TRUCK INT'L, INC. FRANCHISE AGREEMENT (2008), available at <http://134.186.208.233/caleasi/PDFDocs/%7BD4B275C7-7AAC-4DD1-979F-2812B9F5E420%7D.PDF>; BLIMPIE OF CAL., INC. TRADITIONAL RESTAURANT FRANCHISE AGREEMENT, available at <http://134.186.208.233/caleasi/PDFDocs/%7B61D98F1B-5C9D-481B-B366-8F006EDB0620%7D.PDF>. California customer goodwill law does not require

The classic, locational definition of goodwill assumes that “old customers will resort to the old place,”<sup>13</sup> and that it is the “disposition of a pleased customer to return to the place where he has been well treated.”<sup>14</sup> In its more generalized meaning, goodwill arises from or relates to the brand itself. This reputational goodwill is the part of a franchise’s value that “inheres in the fixed and favorable consideration of customers, arising from an established and well-known and well-conducted business.”<sup>15</sup> As an example, for a franchisee of McDonald’s—probably the best-known franchise worldwide—the goodwill is the value attributed to continuing customer patronage<sup>16</sup> (i.e., an expectation that “flows from the implementation of the McDonald’s system and association with the McDonald’s name and trademark”).<sup>17</sup>

Of all the characteristics of a successful franchisee-operated business, customer loyalty may be the most important. Franchisors depend on their franchisees’ strong work ethic and fidelity to the franchise system—be it to the way of doing business or, specifically, to the business’s key brands or services. In turn, franchisees and franchisors need customers who know of and seek out that ostensibly *special* product or service that their franchise system alone provides. Positive consumer opinions and brand loyalty are essential to any successful business, including a franchise system.<sup>18</sup>

The franchisor’s and franchisee’s devotion to the ultimate product delivered to their customers helps them to acquire and retain customer loyalty. This is the goodwill of the system’s owners and operators toward the system’s brand, which is then reciprocated by

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franchisors to use this language. The same goodwill language would be used for that franchisor’s franchising agreements in other states.

13. *Canterbury v. Comm’r*, 99 T.C. 223, 247 (1992) (quoting *Hous. Chronicle Publ’g Co. v. United States*, 481 F.2d 1240, 1247 (5th Cir. 1973)). The classic definition of goodwill is “locational” goodwill: “nothing more than the probability that the old customers will resort to the old place.” Irene Calboli, *Trademark Assignment “with Goodwill”: A Concept Whose Time Has Gone*, 57 FLA. L. REV. 771, 812 n.217 (2005) (quoting *Crutwell v. Lye*, 34 Eng. Rep. 129, 134 (1810)).

14. *Schwegmann Bros. Giant Super Mkts. v. Eli Lilly Co.*, 205 F.2d 788, 797 (5th Cir. 1953) (Holmes, J., dissenting).

15. *Des Moines Gas Co. v. City of Des Moines*, 238 U.S. 153, 165 (1915).

16. *See Canterbury*, 99 T.C. at 247–48.

17. *Id.* at 248.

18. In fact,

[r]esearch shows that brands can serve as viable relationship partners for consumers. Relations between consumers and brands are characterized in terms of intimacy, interdependence, commitment, love, and passion. Several studies confirm that consumers incorporate brands into their lives as tools for shaping and expressing their own identities, and for perceiving the identities of others.

customer goodwill toward the system.<sup>19</sup> Indeed, perhaps both franchisor and franchisee should be seen as joint owners of the goodwill. In *Arnott v. American Oil Co.*,<sup>20</sup> for example, the Eighth Circuit recognized a duty on the part of a franchisor not to act arbitrarily in terminating a local franchise contract, because when a franchisee builds the goodwill of his or her own business, the franchisee is concurrently building the franchisor's goodwill.<sup>21</sup>

The problems of double-sided moral hazard (i.e., that both franchisor and franchisee may behave opportunistically and engage in wrongful behavior to maximize their own profits)<sup>22</sup> illustrate that both a franchisor and its franchisees have an interest in the system's goodwill. On the one hand, we have the problem of franchisee free-riding off of the system's reputation.<sup>23</sup> For example, a franchisee might lower its costs and the quality of its goods or services but increase profits from a customer base that is principally one-time customers, as with a fast-food franchisee along an interstate highway. For the short term, at least, its profits might rise.<sup>24</sup> In the long term, it could lose a substantial amount of local goodwill.

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19. As developed by leading longtime franchise lawyers, Brian Schnell and William L. Killion, the five habits of a highly successful franchisor are:

1. Maintaining an undying devotion to the brand.
2. Balancing the interests of the franchisor, franchisee, and system as a whole.
3. Stacking the deck with "ace" franchisees.
4. Obsessing over the franchisee's bottom line.
5. Empowering the franchisee.

William L. Killion, *The Five Habits of the Highly Successful Franchisor*, 25 *FRANCHISE L.J.* 2, 2 (2005). The first characteristic concerns conduct directly oriented toward generating goodwill.

20. 609 F.2d 873, 882 (8th Cir. 1979).

21. *Id.*

22. See Sugato Bhattacharyya & Francine Lafontaine, *Double-Sided Moral Hazard and the Nature of Share Contracts*, 26 *RAND J. ECON.* 761 (1995) (showing that the benefits of franchise-contract customization are low because of double-sided moral hazard).

23. In the franchising context, free-riding may be a temptation to some franchisees that is only avoided by franchisor vigilance in monitoring the franchise network:

A franchisee who reduces the quality of the good or service he offers for a given price might increase his own profits, yet by disappointing buyers' expectations he could reduce by a greater amount the net returns to the common intangible goodwill asset—maintained by the franchisor and used jointly by his other franchisees.

Richard E. Caves & William F. Murphy, *Franchising: Firms, Markets, and Intangible Assets*, *S. ECON. J.* 572, 577 (1976) (discussing free-riding franchisees).

24. See Benjamin Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 *AM. ECON. REV.* 356, 358–59 (1980) ("[T]here is an incentive for an individual opportunistic franchisee to cheat the franchisor by supplying a lower quality of product than contracted for. Because the franchisee uses a common trademark, this behavior depreciates the reputation and hence the future profit stream of the franchisor.").

A franchisor, on the other hand, is at risk of opportunism.<sup>25</sup> If a franchisor can charge large, upfront franchise fees, substantial initial training fees, and other early lump-sum payments, it may have no incentive to maintain product quality and reputation. It may also choose to do little to oversee the work of its franchisees or company-owned units, fail to innovate and respond to market changes, and carry out little, if any, advertising. An overly grasping franchisor may simply require franchisees to pay more than a competitive, market-based amount throughout the term of the franchise for franchisor-supplied goods or services.<sup>26</sup>

The franchisor's interest in the system's goodwill is obvious. Diminished trademark values hurt the franchisor's ability to expand its line of business. Franchisees also depend on customer goodwill toward the network as a whole. Ironically, because franchisees might try to free ride, *all* franchisees have an ownership interest in the franchise system's goodwill. Otherwise, the "innocent" non-free-riders have an asymmetric burden, including loss of profits and property value to other franchisees or to the franchisor's opportunism, with no corresponding benefit in increased systemic value ascribed to each unit owner when the system's reputation rises.

It seems that almost any goodwill controversy between a franchisor and its franchisee arises from the simple fact that the franchisor has goodwill that the franchisee, in effect, purchases or rents from the franchisor. The franchisee may think she now owns and can further develop the goodwill, while the franchisor believes that all the franchisee received was temporary access to what the franchisor actually holds: the systematic goodwill associated with its trademark.<sup>27</sup> Problems arise when franchisees innovate or otherwise

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25. See Antony W. Dnes, *Franchise Contracts, Opportunism and the Quality of Law*, 3 ENTREPRENEURIAL BUS. L.J. 257 (2009).

26. See G. Frank Mathewson & Ralph A. Winter, *The Economics of Franchise Contracts*, 28 J.L. & ECON. 503 (1985); R. Preston McAfee & Marius Schwartz, *Opportunism in Multilateral Vertical Contracting: Nondiscrimination, Exclusivity, and Uniformity*, 84 AM. ECON. REV. 210 (1994).

27. French courts have dealt extensively with the issue of goodwill ownership with respect to franchise agreements. In 2010, the Court of Cassation ruled on a dispute between Florelys Beauté, a former, long-term franchisee (over fifteen years) of the perfume and beauty products franchisor, Yves Rocher. Florelys Beauté argued that it had its own customer goodwill (*fonds de commerce*). Yves Rocher contended that when the franchisee did not renew its agreement with the franchisor, the franchise had lost any goodwill associated with the franchised business. In effect, Yves Rocher contended, the franchisor took away, upon the franchise's cessation, all goodwill. The franchisor argued that the franchisee sold the goodwill of the original franchisor by not renewing the franchise agreement. The French high court held, however, that a franchise contract does not exclude the existence of goodwill owned by the franchisee. See Cour de cassation [Cass.] [supreme court for judicial matters] com., Mar. 23, 2010, Bull. civ. IV, No. 09-11.029 (Fr.). This is a continuation of reasoning found in earlier French cases. See Dubarry Le Douarin Veil, *A Question of Goodwill*, INT'L L.

attract customer attention, if not loyalty, but the franchisor either dismisses the value of such contributions or attributes them to the system as a whole. Essentially, the franchisor believes that it owns the systemic goodwill and any goodwill created as a result of the expansion of the franchise, including local community goodwill developed by individual franchisees.

Just as American franchise law sometimes distinguishes between types of goodwill,<sup>28</sup> French law separates the ideas of “national goodwill” belonging to the franchisor and “local goodwill” belonging to the franchisee.<sup>29</sup> “Local goodwill” must meet certain economic, spatial, and legal criteria to be recognized by the courts.<sup>30</sup> The franchisee must also run the business himself at the franchisee’s own risk,<sup>31</sup> and local customers must be drawn to the franchisee’s location due to the franchisee’s own efforts to attract them.<sup>32</sup> Finally, the franchisee must own the assets used to attract customers, including the property where the franchise is located, the stock, and the equipment.<sup>33</sup> French franchisee advocates argue

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OFF. (Oct. 23, 2001), <http://www.internationallawoffice.com/newsletters/Detail.aspx?g=0f07e339-9231-4f7a-9186-54f0ab907517> (discussing a French court of appeals case that held that the franchisor owns national or regional goodwill, while the franchisee owns local goodwill, with ownership centered on whether and where a party has invested money and taken risks). See *infra* Part II.C.

28. In some states, the franchise relationship laws “may reflect the perception that a franchisee also develops a goodwill in the business . . . [that] is separate and distinct from the goodwill inherent in the licensed trademarks.” Thomas M. Pitegoff & M. Christine Carty, *Franchise Relationship Laws*, in FUNDAMENTALS OF FRANCHISING 183, 210 (Rupert M. Barkoff & Andrew C. Selden eds., 3d ed. 2008); see *supra* notes 14–19 and accompanying text (concerning locational, reputational, and brand goodwill). Both courts and statutes support the separation of goodwill into different categories. See HAW. REV. STAT. ANN. § 482E-6(3) (LexisNexis 2010); *LaGuardia Assocs. v. Holiday Hospitality*, 92 F. Supp. 2d 119, 125 (E.D.N.Y. 2000) (“[T]he franchisor is essentially lending its national goodwill to the franchisee [and t]he franchise . . . generates local [customer] goodwill.”).

29. Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Mar. 27, 2002, Bull. civ. III, No. 00-20732 (Fr.) (known as the Trevisan judgment). See also Cour d’appel [CA] [regional court of appeal] Chambéry, com., Oct. 2, 2007, No. 06-1561 (Fr.) (another unusually well-known case, called *SA Andey c/ SAS Vanica*).

30. Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Mar. 27, 2002, Bull. civ. III, No. 00-20732 (Fr.); Cour d’appel [CA] [regional court of appeal] Chambéry, com., Oct. 2, 2007, No. 06-1561 (Fr.).

31. Franchisors carrying the risk also own the national goodwill. In *SA Andey c/SAS Vanica*, the French appellate court noted that the financial costs associated with a franchise reward card, which recompensed customer loyalty to a particular franchise location, were assumed by the franchisor and thus constituted “national goodwill” owned by the franchisor. Cour d’appel [CA] [regional court of appeal] Chambéry, com., Oct. 2, 2007, No. 06-1561 (Fr.).

32. Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Mar. 27, 2002, Bull. civ. III, No. 00-20732 (Fr.).

33. *Id.*

that these and other laws and practices regarding goodwill are grossly unfair to franchisees.<sup>34</sup>

In line with the franchisor's views, the franchise contract often broadly defines the franchisor's rights, including express provisions for an expansive interpretation of goodwill and the franchisor's ultimate retention thereof.<sup>35</sup> Thus, the franchisor sets forth for itself an ownership stake extending to all emanations from the original goodwill, even though the new franchisee may have developed a new idea or interest.<sup>36</sup> Similar provisions are found in almost any franchise agreement.<sup>37</sup>

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34. See, e.g., MONIQUE BEN SOUSSEN, *Les Clauses D'agrément et de Préemption*, in LA PROTECTION DU FRANCHISE AU DÉBUT DU XXIÈME SIÈCLE, ENTRE RÉALITÉ ET ILLUSIONS 167, 169–73 (Nicolas Dissaux & Romain Loir eds., 2009) (concluding that the franchisor can abuse its powers under “right of approval” and preemption clauses to keep the franchisee from selling his goodwill to anyone except the franchisor itself at a drastically reduced price, that neither legislation nor court doctrine has produced rules to protect the franchisee, and that—unless the contract mandates it—courts have not required the franchisor to explain its decisions). It is regularly observed that under the French law of goodwill, the franchise system's or the particular franchisee's supposed clientele are not as important as the individual qualities of the franchisee (e.g., his know-how, the site of the outlet retail store, and how he orders goods). The clientele were long considered an essential part of the goodwill when, as noted franchise lawyer Dominique Baschet suggested, the clientele were actually more of a consequence of that goodwill. See DOMINIQUE BASCHET, *LA FRANCHISE: GUIDE JURIDIQUE, CONSEILS PRATIQUES* (2005).

35. In effect, almost all franchisors control, or at least try to control, all goodwill somehow related to the franchise system or even particular franchised units. Franchise contracts contain express provisions reserving the goodwill to the franchisor. A recent survey of franchise contracts showed that ninety-five percent contain a clause in which the franchisor states it has developed goodwill for the benefit of the franchised system, with controls over franchisee behavior thus necessary to maintain this goodwill (data on file with author). See Emerson, *supra* note 10; *infra* notes 36–39.

36. For example, “The Big Mac®, Filet-O-Fish® and Bacon & Egg McMuffin® have all been developed from ideas generated by franchisees around the world. Indeed, the idea for the Kiwi burger came from one of our franchisees in the Hamilton region” of New Zealand. *Franchisees: A Golden Opportunity*, McDONALD'S N.Z., <http://mcdonalds.co.nz/about-us/franchisees> (last visited July 3, 2012).

37. In effect, almost all franchisors control, or at least try to control, all goodwill related to the franchise system or particular franchised units. Franchise contracts contain express provisions reserving the goodwill to the franchisor. A recent survey of franchise contracts showed that 95 percent contain clauses in which the franchisor states that it has developed goodwill for the benefit of the franchised system, with controls over franchisee behavior thus necessary to maintain this goodwill (data on file with author). See Emerson, *supra* note 10. Nearly all franchise contracts contain clauses demarcating the franchisor's ownership of the trademark and concomitant restrictions on franchisee use of the trademark. See Robert W. Emerson, *Franchise Contract Clauses and the Franchisor's Duty of Care Toward Its Franchisees*, 72 N.C. L. REV. 905, 974 (1994) [hereinafter Emerson, *Franchise Contract Clauses*] (95 percent of franchise contracts examined in 1993); Emerson, *supra* note 10 (95 percent of franchise contracts examined in 2011). Large majorities of the contracts require that terminated franchisees return to the franchisor all trademarked supplies, signs, stationery, forms, or other materials. See Emerson, *Franchise Contract Clauses*, *supra*, at 974 (78 percent of 1993 contracts); Emerson, *supra* note 10 (79 percent of 2011 contracts). Furthermore, a growing number of contracts proclaim that all franchisee concepts become the franchisor's exclusive property.

Because the franchisee pays a premium to “rent” the system’s goodwill throughout his franchise term, courts may rely on the franchise agreement to conclude that the franchisor owns the intangible improvements of the franchise. Therefore, the goodwill of the franchisee may be taken for the franchisor’s benefit.<sup>38</sup>

## *B. International and U.S. Case Law Concerning Goodwill in Franchising*

### 1. Other Nations’ Holdings on Goodwill

The courts in the United States have been inconsistent in determining whether goodwill remains predominantly with the trademark and the franchisor<sup>39</sup> or whether goodwill can be sold to and developed by the franchisee as part of a franchise package.<sup>40</sup> These differences of opinion are also found internationally. For example, an Australian court has noted that a franchise fee might, in effect, be a payment for goodwill.<sup>41</sup> Moreover, a leading British franchise lawyer has recognized that the initial franchise fee is attributable to the value, for the new franchisee, of joining a franchised network and obtaining the trade name and goodwill associated with that network.<sup>42</sup>

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*See* Emerson, *Franchise Contract Clauses*, *supra* at 974 (only 3 percent of the 1993 contracts); Emerson, *supra* note 10 (52 percent of 2011 contracts).

38. *See* Beitzell & Co. v. Brown-Forman Corp., No. 87-2790, 1988 WL 66194 (D.D.C. June 17, 1988).

39. *See* Shell Oil Co. v. A.Z. Servs., Inc., 990 F. Supp. 1406, 1417 (S.D. Fla. 1997) (finding that the defendant’s removal of the plaintiff-franchisor’s trademark and cessation in the sale of its products would cause irreparable harm from the loss to the plaintiff of brand-loyal customers absent a preliminary injunction).

40. *See* Arnott v. Am. Oil Co., 609 F.2d 873, 884 (8th Cir. 1979) (upholding a jury verdict against defendant-franchisor for terminating plaintiff’s lease and subsequently evicting plaintiff from service station without good cause). Franchisors typically contend that franchisees simply are using the franchisor’s goodwill, not developing any of their own—at least not enough that the franchisee could sell it independent of the franchisor’s own “developmental” rights as the originator of the franchise concept and system. As franchisee advocate Harold Brown notes, “[f]or many years the major auto factories have flatly prohibited their dealers from making any charge for the ‘goodwill’ of their dealership, confining them to a selling price for their net tangible assets.” BROWN, *supra* note 9, at § 8.05(4)(d). Under that “no goodwill” approach, a dealer simply “buys a job”: he cannot make a profit when he sells a dealership for his investments in reputation or other intangibles, and any profits the dealers make before selling their dealerships are analogous to bonuses paid to employees. *Id.* (Tangible assets mean only matters such as equipment and inventory. *Id.*)

41. *In re Floan & Copperart Pty. Ltd.*, slip op. at 56 (Fed. Ct. New South Wales Dist., Aug. 9, 1990) (LEXIS, Commonwealth & Irish Cases Combined File).

42. MARTIN MENDELSON, *THE GUIDE TO FRANCHISING* 134 (7th ed. 2004). More generally, as a matter of good accounting practice, one may treat goodwill as paid for via the initial franchise fee. Michael Sack Elmaleh, *The Effect of Sales Terms on Goodwill, Risk and Return in*

In France, on the other hand, a franchisee's right to receive the franchise system's goodwill<sup>43</sup> can drastically affect the franchisor, with franchisees or other lessees of business locations having automatic renewal rights if they are the true owners of the goodwill.<sup>44</sup> The answer to the key question—which party owns the customer goodwill—depends on the court and the circumstances,<sup>45</sup> with a major underlying factor being franchisee autonomy or lack thereof.<sup>46</sup>

Obviously, in France, the franchisors work hard to ensure that their contracts clearly state that the franchisee has neither purchased nor developed the goodwill for its location.<sup>47</sup> It seems, however, that the trend of the French case law and commentary during this past decade has favored the franchisee's rights to the franchise goodwill,<sup>48</sup> and thus to lease renewal.<sup>49</sup> Indeed, a number of commentators have interpreted a key French Supreme Court decision,

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*Transfers of Closely Held Accounting Practices*, 3 J. BUS. VALUATION & ECON. LOSS ANALYSIS 1, 16 (2008) (emphasis added), available at [http://works.bepress.com/michael\\_sack\\_elmaleh/3](http://works.bepress.com/michael_sack_elmaleh/3) (“[P]ayments based on *retained clients* or percentages of gross sales are more akin to franchise agreements than equity investments in publicly traded securities. Practice goodwill has a positive market value as long as a buyer can convert the gross income stream from the acquired practice into either additional compensation or additional profit.”).

43. An inexact French term for business goodwill is *les fonds de commerce* (generally translated as “business assets”) or *l’achalandage* (also translated as “traffic”).

44. Remi Delforge, *New Trends in French Case Law: The Growing Recognition of the Independence of Franchisees*, 2 INT’L J. FRANCHISING & DISTRIBUTION L. 37, 42–43 (2000) (citing the Decree of September 30, 1953).

45. See BASCHET, *supra* note 34, at 211–29; GILLES THIRIEZ & JEAN-PIERRE PAMIER, GUIDE PRATIQUE DE LA FRANCHISE 88–90 (4th ed. 2004). There are many cases on point. BASCHET, *supra* note 34, at 212–22, 226–27.

46. Professor Didier Ferrier, the foremost commentator on French distribution law, has stated that “as the franchisee’s autonomy is almost nil, the franchisee must respect all of the franchisor’s standards and cannot develop its own customers,” referencing the holdings of two ordinary courts of original jurisdiction (*tribunaux de grande instance*). DIDIER FERRIER, DROIT DE LA DISTRIBUTION 365 (6th ed. 2012). Limits on franchisee activities could mean that the franchisee is not entitled to renew her lease of the franchised premises. *Id.* Still, leading commentators find that French case law condemns this “solution” (no right to renew) because “even if the franchisee uses the franchisor’s brand and applies the franchisor’s standards, the franchisee engages in business, assumes the risks of this activity, and has the sole ‘title’ to the customer.” *Id.*

47. Interviews with Didier Ferrier, Professor of Law, Université de Montpellier, in Montpellier, Fr. (Oct. 7, 2010 & June 8, 2012); Interview with Alex Raymond, Legal Counsel, Fédération française de la franchise, in Paris, Fr. (Oct. 1, 2010).

48. BASCHET, *supra* note 34, at 214–29. Thiriez and Pamier are more inclined to see the goodwill issue as not necessarily leaning in the French franchisee’s favor, but they mention only three cases that support this view. Their backgrounds are as a franchisor-consultant and a franchise-distribution business journalist, respectively, not as lawyers or law professors. THIRIEZ & PAMIER, *supra* note 45, at 88–90. They simply conclude that the ownership of goodwill is a matter of much debate and case law. *Id.* at 345 (defining and discussing *les fonds de commerce*).

49. Professor Philippe le Tourneau discusses the matter extensively in his highly regarded treatises on French franchise law. PHILIPPE LE TOURNEAU, LES CONTRATS DE

the Trevisan Judgment of 2002, to mean that the franchisee almost certainly owns his own business, has rights to his customers, and—inasmuch as development and retention of franchising clientele is the core reason for the franchise system—possesses the sort of customer goodwill that should insulate the franchisee from unfair nonrenewals.<sup>50</sup>

Though one can find similarities across borders—e.g., Canadian franchisors evidently view goodwill and trademarks as American franchisors do<sup>51</sup>—there simply are no international solutions, even among nations with similar cultures and legal systems. As a business matter, one may contend that the solution is to analyze features such as the strength of the brand, the length of time a franchisee has put into and, presumably, built a business, and the amount of repeat business, among other variables, but the necessary legal standards are either absent or unclear. For example, the European Franchise Federation, the leading trade organization for European franchisors, has constituents from dozens of member states, with those states failing to share a common view on even the most basic franchise law matters, such as whether franchising should be statutorily regulated and, if so, how.<sup>52</sup>

It is true that the European perspective tends to be more “pro-franchisee.” For example, a European Union study group drafted a Common Frame of Reference with a proposed law providing indemnity for each party’s goodwill if that party’s business volume was increased by the other party—even when the contract was terminated for non-performance of one party and the franchisor would

FRANCHISAGE 148–51 (2d ed. 2007) (discussing, inter alia, the Trevisan judgment). The matter is not fully established in jurisprudence—including the commentary of the courts and the professoriate—despite (1) Prof. Le Tourneau’s eminent status, (2) the concurrence of other leading commentators, see e.g., FRANÇOIS-LUC SIMON, THÉORIE ET PRATIQUE DU DROIT DE LA FRANCHISE 263–64 (2009), and (3) the apparent trends.

50. Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Mar. 27, 2002, Bull. civ. III, No. 00-20.732 (Fr.). See also *supra* notes 29–33 and accompanying text.

51. See, e.g., Lee Muirhead, *Canadianizing Franchise Agreements*, 12 FRANCHISE L.J. 103, 106 (1993) (“Franchisees should acknowledge that they acquire no right, title or interest in the trademarks and that goodwill associated with the trademarks enures exclusively to the benefit of the franchisor.”). See also Peter Snell, *The Canadian Franchise Agreement*, in FUNDAMENTALS OF FRANCHISING—CANADA 97, 128–29 (Peter Snell & Larry Weinberg eds., 2005) (noting that a franchisee’s right to use the franchisor’s trademark “will be restricted by such things as [franchise contract clauses stating] the franchisee acquires no right, title, or interest in and to the trade-marks and all goodwill associated with the trade-marks enures to the benefit of the franchisor; [and] the franchisee agrees not to dispute . . . the ownership or enforceability of the trade-marks [nor to] attempt to affect the value of the goodwill relating to the trade-marks”). This Article proposes a judicial recognition of franchisee rights to “local” goodwill based on customers’ desire to visit a particular business site. See *infra* Part III.

52. Mark Abell, *An Uncivil Code in the EU?*, LJN’s FRANCHISING BUS. & L. ALERT, Feb. 2006, at 1, 6.

be obliged to repurchase the franchisee's stock at the end of the contract.<sup>53</sup> Similarly, the International Chamber of Commerce, a European-based organization, issued a revised version of its Model International Franchise Contract (MIFC) in June 2011. Despite MIFC provisions proclaiming the franchisor's right to goodwill from the franchisor's trademark, the MIFC contains introductory remarks indicating that "courts may in some exceptional cases find a way to grant the franchisee a goodwill indemnity or similar remuneration in case of contract termination (or refusal to renew the contract)."<sup>54</sup> Some MIFC clauses restrict the forms of franchisor encroachment on franchisee markets;<sup>55</sup> give the franchisee renewal,<sup>56</sup> know-how,<sup>57</sup> and notification rights;<sup>58</sup> extend the usual time frame for franchisees to cure a breach;<sup>59</sup> grant and afford the franchisee

53. *Id.* at 2.

54. INT'L CHAMBER OF COMMERCE, MODEL INTERNATIONAL FRANCHISING CONTRACT 15 (2011) (discussing rules protecting the franchisee). Besides franchise-specific law, found in thirty-five different countries, *International Franchising Laws*, INT'L FRANCHISE ASS'N, <http://www.franchise.org/IndustrySecondary.aspx?id=45874> (last visited Jan. 29, 2013), most countries have laws which more generally reach franchising. The International Chamber of Commerce's (ICC's) introduction to the Model Contract mentions three types of national laws generally applying to contracts that may reach franchisees specifically: (1) disclosure obligations applying generally to pre-contractual relations, as in Germany and Austria; (2) treatment of non-businessperson franchisees as consumers (e.g., for purposes of the right to withdraw from a contract); and (3) the above-quoted remuneration of terminated or nonrenewed franchisees for their goodwill). INT'L CHAMBER OF COMMERCE, *supra*.

55. INT'L CHAMBER OF COMMERCE, *supra* note 54, at 26 & n.16 (Model Contract Article 7.2) (noting that unless stated otherwise, the franchisor's grant of territory to the franchisee effectively bars the franchisor from engaging the public through other channels in that region, such as the Internet).

56. *Id.* at 39 (Model Contract Article 25.1A (AB)) (providing that the franchisee may have the right to an unlimited number of renewals regardless of whether the franchisor consents).

57. *Id.* at 9 (Introduction—Core Elements of Franchising) (stating that the franchisor's licensed know-how must be "continuously updated," including via development and constant upgrading of a training support system).

58. *Id.* at 29 (Model Contract Article 12.1) (stating that the franchisee has the right to speedy notification about changes to the franchise system and to be (i) free of royalties obligations or other charges for making use of these systemic "improvements," (ii) able "to refuse to conform to changes which imply unreasonable costs," and (iii) hold the right to terminate the contract upon notice to the franchisor). The notice requirement that comes into play before a franchisor may assign its franchise contract may be of special note. *Id.* at 42 (Model Contract Article 29) (stating that the franchisor has the duty to inform the franchisee at least ten days before the date upon which the franchisor is to transfer the contract and the franchise system to a third party). Most buyers, however, would object to giving the franchisee notice of an impending purchase. E-mail from John R.F. Baer, Partner, Greensfelder, Hemker & Gale, P.C., to author (July 20, 2011, 9:14 EST) (on file with author).

59. The time frame for franchisees to cure any breach, even something very serious such as a failure to pay royalties or other charges owed, is relatively long—thirty days. INT'L CHAMBER OF COMMERCE, *supra* note 53, at 40 (Model Contract Article 26.1). In the United States there are often shorter periods for failure to make payments. Emerson, *supra* note 10; Emerson, *Franchise Contract Clauses*, *supra* note 37, at 971.

training opportunities;<sup>60</sup> and even create a franchisor duty in certain circumstances to refund the initial fee.<sup>61</sup>

## 2. U.S. Courts: The PMPA and Community Goodwill or Trademark Goodwill

Even within the United States, courts treat issues related to goodwill differently. For instance, in *Lee v. Exxon Co.*,<sup>62</sup> the court considered whether goodwill was part of a sale between the franchisor and the franchisee. It noted that franchisor Exxon had conducted a marketing study for a geographic area including franchisee Jeffrey W. Lee, Sr.'s direct-supplied franchise in Florence, South Carolina. Based on that study, Exxon "made an informed business decision . . . [to] convert all direct-supplied retail sites to distributor-supplied retail sites."<sup>63</sup> Exxon decided not to renew its franchise agreement with Lee but did end up offering to sell back the franchise site to him for the same price as the highest bid Exxon received. Lee chose to exercise this option, but then sued Exxon for alleged violations of the Petroleum Marketing Practice Act (PMPA).<sup>64</sup> Specifically, Lee complained that Exxon made its offer in bad faith, because the selling price included goodwill that he had built up over time as the franchisee,<sup>65</sup> forcing him to buy goodwill that he had developed himself.<sup>66</sup>

The court found that goodwill was not part of the sale,<sup>67</sup> and that under the PMPA, a franchisor may terminate or decline to renew a

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60. The franchisee is entitled to receive the franchisor's know-how, assistance (e.g., in distribution and management), and training. INT'L CHAMBER OF COMMERCE, *supra* note 54, at 9, 21 (Model Contract Article 4.1(b) on know-how, training, and assistance), 28 (Model Contract Article 10.1 on know-how), 29 (Model Contract Article 13.2 on franchisor-paid initial training of the franchisee).

61. *Id.* at 10 (Introduction—the Need for Uniform Standards of Operation) (stating that the franchisor should refund the initial fee less its expenses if it terminates a franchisee who has not, even after training, risen to an adequate standard of operations).

62. 867 F. Supp. 365, 367 (D.S.C. 1994).

63. *Id.* at 368.

64. *Id.* at 366. The PMPA, enacted in 1978, instituted an industry-specific approach, concerning termination or nonrenewal of gas station dealerships. See Petroleum Marketing Practices Act, Pub. L. No. 95-297, 92 Stat. 337 (codified at 15 U.S.C. §§ 2801–2806 (2006)), Principles of PMPA interpretation may also be applied to non-petroleum franchise cases. For a recent PMPA case involving constructive termination, see *Mac's Shell Serv., Inc., v. Shell Oil Prod. Co.*, 130 S. Ct. 1251, 1252 (2010).

65. *Lee*, 867 F. Supp. at 367.

66. *Id.* at 368.

67. The court concluded that the franchisee had not given any evidence for his claim that goodwill attached to the sale. *Id.* It further noted, "Plaintiff's 'goodwill' theory is not a recognized basis to vitiate or reform the sale to him." *Id.*

franchise agreement without incurring liability to the franchisee for goodwill.<sup>68</sup> The court held that when buying out or selling to a PMPA franchisee,<sup>69</sup> a PMPA franchisor is not required to include the goodwill built up by the franchisee in the fair market price offered because the price need only be what a disinterested party would pay.<sup>70</sup> The court reasoned that an “actual price, agreed to by a willing buyer and a willing seller, is the most accurate gauge of the value the market places on a good.”<sup>71</sup> Thus, to value *the franchise* by looking at information other than the franchise’s fair market value would be speculative.<sup>72</sup>

In contrast to *Lee*, the court in *Atlantic Richfield Co. v. Razumic*<sup>73</sup> declared that a franchisee does create goodwill for the franchise,

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68. *Id.* In Massachusetts’ 2007–2008 legislative session, Senate Bill No. 142, which was not enacted,

would [have] allow[ed] franchisees to form their own independent associations and would prohibit franchise termination or non-renewal without “good cause.” Sixty-day notification of intent to terminate or non-renew would [have been] mandatory, and the franchisor would [have been] required to repurchase inventory and supplies, and to provide compensation for goodwill in most situations.

*News Briefs*, LJN’S FRANCHISING BUS. & L. ALERT, Nov. 2007, at 7.

69. The latter was the case in *Lee v. Exxon*, where the franchisor did not renew the agreement with franchisee Lee, but then offered Lee the right to purchase the franchise on the same terms extended to, and for the same total purchase price offered by, the highest bidder for the new franchise at the location Lee had previously leased. *See Lee*, 867 F. Supp. at 366.

70. *Id.* at 368 (“Congress has, through the PMPA, declared that where a franchisor follows the provisions of the PMPA, the franchisor may terminate or non-renew a franchise without incurring any liability to the franchisee, including any payments for loss of alleged goodwill.”); *cf. Rhodes v. Amoco Oil Co.*, 143 F.3d 1369, 1372 (10th Cir. 1998) (discussing the requirement of a bona fide offer under the PMPA as an objective standard requiring offers to be in the range of possible fair market values).

71. *Lee*, 867 F. Supp. at 368.

72. *Id.* (quoting *Keener v. Exxon Co.*, 32 F.3d 127, 132 (4th Cir. 1994) for the proposition that to look at information other than the agreed-upon price to determine some other supposed market value, such as that for goodwill, “is necessarily speculative”). But from an accounting perspective, goodwill may not be so speculative. According to accounting expert John W. Day, goodwill is defined as

the difference between the value of a business enterprise as a whole and the sum of the current fair values of its identifiable tangible and intangible net assets. Net assets are the assets that are left after subtracting the company’s liabilities. Goodwill is only recorded when its amount is substantiated by an arm’s-length transaction. Goodwill cannot be sold or acquired separately but has to be included in a purchase with the net assets of a business enterprise.

JOHN W. DAY, THEME: VALUING GOODWILL, REAL LIFE ACCOUNTING FOR NON-ACCOUNTANTS 1 (2008), available at [http://www.reallifeaccounting.com/pubs/Article\\_Theme\\_Valuing\\_Goodwill.pdf](http://www.reallifeaccounting.com/pubs/Article_Theme_Valuing_Goodwill.pdf). Thus, an accountant would find that good will can be quantified into a clear dollar figure.

73. 390 A.2d 736, 742 (Pa. 1978). In subsequent cases, the Pennsylvania Supreme Court has never challenged that part of the holding. *See Harnish v. Sch. Dist. of Phila.*, 732 A.2d 596, 598 (Pa. 1999); *Lasday v. Allegheny Cnty.*, 453 A.2d 949, 952 n.3 (Pa. 1982).

benefiting both the franchisor and the franchisee. That is, by operating a gasoline service station, the franchisee knew “that his good service [would] in many instances produce regular customers. He also realize[d], however, that much of his trade [would] be attracted because his station offer[ed] the products, services, and promotions of the well-established and well-displayed name ‘Arco.’”<sup>74</sup> Because the franchisee’s actions enhanced the goodwill of the franchisor, the franchisee could expect the franchisor to act “in good faith and in a commercially reasonable manner.”<sup>75</sup> The court further noted that the arbitrary termination of a franchise relationship by a franchisor would allow a franchisor to, in essence, steal the goodwill the franchisee builds over time.<sup>76</sup>

The *Lee* court seemed to advance the point that some goodwill is severable from the sale of a franchise, rather than part of a franchise package that is sold to the franchisee. Essentially, while the *Lee* court took the position that the franchisee bought only tangible assets and not goodwill, the *Razumic* court recognized the goodwill that the franchisee built and contributed to the franchise also contributed to the goodwill of the whole business.<sup>77</sup>

To add to the confusion, courts in recent cases have taken a bifurcated approach to determining the rightful owner of goodwill. In *Bray v. QFA Royalties LLC*, the court granted the franchisee’s motion for a preliminary injunction and prohibited Quiznos from terminating a franchisee for conduct that in Quiznos’s “sole judgment” materially impaired its goodwill.<sup>78</sup> The court examined two types of goodwill: (1) the “business goodwill,” also referred to as the “community goodwill,” which the franchisees claimed they would lose if Quiznos were allowed to terminate the agreement; and (2) the goodwill associated with the Quiznos brand (“trademark goodwill”), which Quiznos contended would be materially impaired if the termination were not immediate.<sup>79</sup> The court granted the franchisee’s motion, reasoning that to allow Quiznos to terminate the franchise agreement would cause irreparable harm to the franchisee’s community goodwill.<sup>80</sup> The court further found that the

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74. *Razumic*, 390 A.2d at 742.

75. *Id.*

76. *Id.*

77. See generally Benjamin A. Levin & Richard S. Morrison, *Who Owns Goodwill at the Franchised Location?*, 18 FRANCHISE L.J. 85, 116–17 (1999) (discussing the personal effort and time, including customer relations, that franchisees often seek to develop their own business goodwill; further noting several court decisions recognizing that franchisees may own local goodwill).

78. 486 F. Supp. 2d 1237, 1252, 1254–55 (D. Colo. 2007).

79. *Id.* at 1249–50.

80. *Id.* at 1249.

evidence was insufficient to show that a continued relationship between Quiznos and the franchisee would materially harm Quiznos' trademark goodwill.<sup>81</sup> In so ruling, the court implicitly recognized the ownership of the two different but related types of goodwill—the “community goodwill” owned by the franchisee and the trademark goodwill owned by the franchisor.<sup>82</sup>

### C. Form Contracts and Opportunism

“You f—ed up—you trusted us!”<sup>83</sup>

With cases such as *Razumic* and *Lee*, the courts have done little to inform franchisors and franchisees whether goodwill is severable. These and other judicial opinions<sup>84</sup> have thus given rise to inconsistent assertions by both franchisors and franchisees. Because of these inconsistencies, franchisees appear to be at a higher risk of being taken advantage of by a franchisor. Due to the unequal bargaining power of the “take it or leave it” form contracts,<sup>85</sup> franchisees risk losing to franchisors their investment of both time and

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81. *Id.* at 1250–51. It should be noted that the decision in *Bray* was called into question in *SBM Site Services, LLC v. Garrett*, No. 10-CV-00385-REB-BNB, 2010 WL 749823, at \*1 (D. Colo. Mar. 4, 2010). The court found that the leniency of the preliminary injunction standard set by *Bray* was “particularly disfavored” by courts because it seeks to provide the moving party with all the relief it would receive following a verdict on the merits. *Id.* at \*1.

82. In essence, the court ruled in favor of “community goodwill” when it found no impairment of “trademark goodwill.” This leads one to wonder if the court would have ruled the same way if it had detected an impairment of trademark goodwill. *Bray*, 486 F. Supp. 2d at 1250–51. See also *Pirtek USA, LLC v. Zaetz*, 408 F. Supp. 2d 81, 83 (D. Conn. 2005). The franchisor, Pirtek, moved for a preliminary injunction to enforce a non-compete agreement with Zaetz, an ex-franchisee, alleging that Zaetz violated the noncompete agreement between Pirtek and Zaetz by illegally transferring goodwill to his son. *Id.* at 83–84. The court reasoned that a new Pirtek franchise operating in the same territory as Zaetz’s continued to develop Pirtek’s goodwill; therefore, any loss in goodwill caused by Zaetz’s son opening a competing business at the former Pirtek site was not tantamount to irreparable harm. *Id.* at 86. Like the court in *Bray*, the *Pirtek* court seems to have recognized that a franchisee can further develop a franchisor’s trademark goodwill. Contrary to *Bray*, the court, in discussing Pirtek’s loss of goodwill and stating that such loss could be compensated with money damages, implied that eventually all goodwill belongs to the franchisor. See *id.*

83. NATIONAL LAMPOON’S ANIMAL HOUSE (Universal Pictures 1978) (fraternity rush chairman Eric “Otter” Stratton’s cheerful explanation to a pledge, freshman Kent “Flounder” Dorfman, for why Flounder was to blame when fraternity members wrecked the brand new Cadillac that Flounder had borrowed from his brother).

84. See, e.g., *Arnott v. Am. Oil Co.*, 609 F.2d 873, 882 (8th Cir. 1979); *Bray*, 486 F. Supp. 2d at 1247–51; *Pirtek*, 408 F. Supp. 2d at 86.

85. Courts have continued to note that although franchise agreements are commercial contracts, they exhibit “many of the attributes of consumer contracts.” *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257, 1282 (9th Cir. 2006). The Ninth Circuit wrote:

money in enhancing the goodwill of a franchise.<sup>86</sup> Indeed, modern courts and commentators widely assume that almost no one—consumers, businesspersons, or even lawyers and law professors—actually bothers to read form contracts, let alone negotiate over the terms.<sup>87</sup> Empirical studies support this conclusion.<sup>88</sup> And while remarking upon the extreme length and complexity of forms covering numerous, probably unfathomable contingencies, scholars have noted:

[F]or most consumer transactions, the close reading and comparison needed to make an intelligent choice among alternative forms seems grossly arduous. Moreover, many of the terms concern risks that in any individual transaction are unlikely to eventuate. . . . In the circumstances, the rational course is to focus on the few terms that are generally well publicized and of immediate concern, and to ignore the rest.<sup>89</sup>

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The relationship between franchisor and franchisee is characterized by a prevailing, although not universal, inequality of economic resources between the contracting parties. Franchisees typically, but not always, are small businessmen or businesswomen or people . . . seeking to make the transition from being wage earners and for whom the franchise is their very first business. Franchisors typically, but not always, are large corporations. The agreements themselves tend to reflect this gross bargaining disparity. Usually they are form contracts the franchisor prepared and offered to franchisees on a take-[it]-or-leave-it basis.

*Id.* (quoting *Postal Instant Press, Inc. v. Sealy*, 51 Cal. Rptr. 2d 365, 373 (Cal. Ct. App. 1996)).

86. The unequal bargaining power contains within itself “the seeds of abuse.” *Nagrampa*, 469 F.3d at 1282 (quoting *Postal Instant Press, Inc. v. Sealy*, 51 Cal. Rptr. 2d 365, 373 (Cal. Ct. App. 1996)). In *Nagrampa*, franchisor MailCoups’ parent company, Advo, was a large corporation that had \$208,553,000 in assets and \$1,016,492,000 in revenues in 1997. Franchisee *Nagrampa* had a yearly salary of about \$100,000 and had never owned her own business. *Id.* at 1282–83. The Court found that MailCoups had presented the franchise contract on a take-it-or-leave-it basis. *Id.* at 1283.

87. Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1174, 1179 & n.22 (1983) (reporting that over the previous few years, he had asked many lawyers and law professors “whether they ever read various form documents, such as their bank-card agreements; the great majority of even this highly sophisticated sample do not”); Corneill A. Stephens, *Escape from the Battle of the Forms: Keep It Simple, Stupid*, 11 LEWIS & CLARK L. REV. 233, 239 (2007) (“[S]tandard preprinted terms rarely, if ever, are read by anyone involved in the transaction.”); see RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. b (1979); cf. Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 58–59 (1963) (contending, inter alia, that preservation of business relationships rather than legal doctrine is the predominant factor in the behavior of businesspeople).

88. Rakoff, *supra* note 87, at 1179.

89. *Id.* at 1226 (“The ideal adherent who would read, understand, and compare several forms is unheard of in the legal literature and, I warrant, in life as well.”). The undetected terms may later be revealed to the consumer in the form of bewildering fees and charges seemingly thrust upon him or her without warning. See, e.g., Tony Pugh, *Consumers Fight Rising Use of Hidden Fees*, SEATTLE TIMES, Mar. 2, 2008, [http://seattletimes.com/html/nationworld/2004254420\\_hiddenfees02.html](http://seattletimes.com/html/nationworld/2004254420_hiddenfees02.html) (citing a 2006 study by the Ponemon Institute, an independent business-research firm, which concluded that each adult annually pays an average

Franchisees are like these consumers,<sup>90</sup> especially as many are not even represented by counsel.<sup>91</sup> With the franchise contract typically being over sixty pages long,<sup>92</sup> state- or FTC-required disclosures frequently being much longer, and lengthy and detailed franchisor-issued operational manuals constantly being updated, the paperwork may read like a multi-volume phone directory—almost as long and just about as exciting. It is rife with opportunities for the franchisor to insert language that is advantageous to its own purposes.

Once the franchisee commits to the franchisor-crafted contract, “franchisor opportunism”<sup>93</sup> often results in a Hobson’s choice for franchisees: acquiescence to, and uneasy dependence upon, the franchisor, or a separation from the franchisor accompanied by relative franchisee indigence. The objecting franchisees risk the termination or nonrenewal of their franchised sites, thus forfeiting future profits—the only likely gains from their initial investments.<sup>94</sup>

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of \$942 in hidden fees and surcharges). Some consumer advocates proclaim these fees, not identity theft, are the “fastest growing white-collar crime in [the United States].” BOB SULLIVAN, GOTCHA CAPITALISM: HOW HIDDEN FEES RIP YOU OFF EVERY DAY—AND WHAT YOU CAN DO ABOUT IT 6 (2007). Consumers outraged by so-called petty charges now increasingly do more than vent: they sometimes join class-action lawsuits. Pugh, *supra*.

90. See, e.g., *Sims v. Honda Motor Co., Ltd.*, 623 A.2d 995, 1003 (Conn. 1993) (allowing parol evidence to interpret a general release, because the types of contracts arising out of a franchise agreement are “more akin to a consumer transaction than a commercial transaction”).

91. Robert W. Emerson, *Franchisees Without Counsel: Presumed Competent?* (Dec. 11, 2012) (unpublished manuscript) (on file with author) (discussing data from a 2009 survey of franchisor counsel showing that the figure may be as high as 50 percent of all franchisees); Andrew C. Selden & Rupert M. Barkoff, *Counseling Franchisees*, in *FUNDAMENTALS OF FRANCHISING* 289, 291 (Rupert M. Barkoff & Andrew C. Selden eds., 3d ed. 2008). The experience of many franchise law commentators is that someone who decides to spend tens or even hundreds of thousands of dollars investing in a franchise may still balk at spending a fraction on hiring counsel, particularly if that person believes there is no value in trying to negotiate. BROWN, *supra* note 9, at § 1.03[4]. In practice, laypersons are likely to view form contract terms as “private ‘law’—not subject to alteration or considered scrutiny.” Amy J. Schmitz, *Dangers of Deference to Form Arbitration Provisions*, 8 *NEV. L.J.* 37, 45 (2007). Schmitz further notes that “[a]s a practicing attorney and now as a teacher, individuals continually tell me that they view form terms like ‘law’ not subject to modification or challenge.” *Id.* at 45 n.52.

92. Emerson, *supra* note 10.

93. Boyd Allan Byers, Note, *Making a Case for Federal Regulation of Franchise Terminations—A Return-of-Equity Approach*, 19 *IOWA J. CORP. L.* 607, 621 (1994) (“The franchising structure lends itself to franchisor opportunism. By exercising its termination power, the franchisor can unfairly capitalize on local goodwill built up by the franchisee through its investment of capital and labor. The franchisee’s sunk investment also permits the franchisor to engage in opportunism short of actually exercising its termination power, as the threat of termination itself enables the franchisor to appropriate a portion of the franchisee’s sunk investment for itself.”).

94. See, e.g., *N.J. Am., Inc. v. Allied Corp.*, 875 F.2d 58, 62 (3d Cir. 1989) (“The franchisee’s often substantial specific investment thus creates an opportunity for post-contract opportunistic behavior by the franchisor. The franchisor can threaten to close down the

Thus, “[b]y exercising its termination power, the franchisor can unfairly capitalize on local goodwill built up by the franchisee through its investment of capital and labor. . . . [T]he threat of termination itself enables the franchisor to appropriate a portion of the franchisee’s sunk investment for itself.”<sup>95</sup> Indeed, the franchisor would still benefit from local or community goodwill by having customers continue to patronize the business establishment (now a company outlet or a refranchised unit) that is still seen by customers as the original, local licensee, even though the original franchisee’s license has been terminated and the proprietor who helped to build that community goodwill is gone.

This franchisee quandary is not limited to cases of termination or nonrenewal of a franchise agreement. In *Little Caesar Enterprises, Inc. v. Smith*,<sup>96</sup> franchisees of the national restaurant chain brought an antitrust tying action against their franchisor.<sup>97</sup> After entering into a long-term franchise agreement, signing future noncompete covenants, and investing substantially in approximately four hundred franchised sites, the franchisees contended that they had become “locked in” to purchasing logoed products and other goods exclusively from the franchisor.<sup>98</sup> They alleged that the distribution system failed to create opportunities for competitive product distributors, resulting in supracompetitive prices for the logoed products.<sup>99</sup>

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franchisee at any time regardless of the cost to the franchisee, and this threat may be sufficient to allow the franchisor to divest the franchisee of the profits that would be produced by the franchisee’s specific investment.”)

95. Byers, *supra* note 93, at 621. See generally Benjamin Klein & Lester F. Saft, *The Law and Economics of Franchise Tying Contracts*, 28 J.L. & ECON. 345, 356 (1985) (cited by *Allied Corp.*, 875 F.2d at 62); Scott D. Makar, *In Defense of Franchisors: The Law and Economics of Franchise Quality Assurance Mechanisms*, 33 VILL. L. REV. 721, 760 (1988) (cited by *Allied Corp.*, 875 F.2d at 62); Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519, 529 (1983) (cited by *Allied Corp.*, 875 F.2d at 62).

96. 34 F. Supp. 2d 459 (E.D. Mich. 1998).

97. *Id.* at 463.

98. *Id.* at 463–64. In defining the concept of “locked-in,” the court referred to PHILLIP E. AREEDA ET AL., ANTITRUST LAW 146 (1990):

[Areeda et al.] note that a franchisee may become “locked in” after investing in realty, training, advertising, and development of goodwill for the franchise product, which sunk costs may not be “wholly or even partially useful for any alternative occupation.” Thus, a later threat to withdraw the trademark can acquire coercive force after the franchisee invests substantially and irreversibly in developing the franchise.

*Little Caesar*, 34 F. Supp. 2d at 488. *But see infra* notes 102–103 and accompanying text (noting no lock-in on the facts presented in the *Little Caesar* case itself).

99. *Little Caesar*, 34 F. Supp. 2d at 465.

The plaintiffs in *Little Caesar Enterprises, Inc.* also contended that they were initially unaware that the franchisor's licensing agreement granted a subsidiary the exclusive right to market logoed products, such as cups, packaging, and condiments, to franchisees.<sup>100</sup> Since these franchisees tended to purchase all products for their restaurant from that one supplier, they argued that the logoed-products agreement effectively extended to all marketable goods from the franchisor's distributor.<sup>101</sup> This, they reasoned, created an illegal tie between continuing the operation of the franchise and purchasing all of their goods from the franchisor's wholly owned distributor.<sup>102</sup>

A special master noted that a franchisee might become "locked in" to a franchise system after significant investments in real estate, training, and development of goodwill, which may not be transferable to another operation.<sup>103</sup> But the special master ruled that the distributor restrictions were either "generally known or easily knowable" at the time the plaintiffs agreed to the franchise agreement.<sup>104</sup> Still, what if the franchisee sponsored local youth sports, bands, or any number of other community activities at great time and expense<sup>105</sup> to develop local goodwill? Upon recognizing that such actions would be in vain in terms of building the franchisee's own goodwill or public relations, the franchisee likely would choose to spend money otherwise. This may be a good business decision in terms of working with the franchisor, but it is a bad choice in terms of encouraging community volunteerism and local philanthropic works, at least from these fragile businesses.

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100. *Id.* at 464–65. The franchisees, however, only became aware of the agreement years later.

101. *Id.*

102. *Id.* at 464.

103. *Id.* at 488.

104. *Id.* at 506 & n.63 (implying that plaintiffs could have found out about distributor restrictions beforehand from existing franchisees, since their contact information was given in the offering circular).

105. For example, in Rockland, Massachusetts, two pizza franchisees from Rockland—Domino's Pizza and Papa John's Pizza—have sponsored Rockland Youth Soccer. *Rockland Youth Soccer: Sponsors*, ROCKLAND YOUTH SOCCER, <http://www.eteamz.com/RocklandYouthSoccer/sponsors/> (last visited July 3, 2012), *See also Lexington Dolphins: Team Sponsor Savings Center*, LEXINGTON DOLPHINS, <http://www.lexingtondolphins.org/SpecViewAll.jsp?team=ksld> (last visited Aug. 27, 2012) (listing among its sponsors franchised outlets in Lexington, Kentucky for Cold Stone Creamery and bd's Mongolian Grill). Indeed, sponsors go to all manner of charitable and community endeavors. *See, e.g., Faulkner BMW in the Community*, FAULKNER BMW, <http://www.faulknerbmw.com/dealer/faulknerbmw/community.cfm> (last visited Aug. 27, 2012) (indicating how the BMW auto franchisee in Lancaster, Pennsylvania sponsors home building funds, athletic tournaments, the performing arts, highway litter control, and the Junior League of Lancaster).

Franchisor-franchisee quarrels over the ownership of goodwill can be resolved in a systematic fashion, despite judicial indecision on the topic. The parties can agree to settle current disputes, deterring future conflicts about the interpretation or development of goodwill, and a comprehensive resolution can occur via these negotiations.<sup>106</sup> For example, after more than three years of talks, the Southland Corporation's 7-Eleven franchise system and its franchisee association reached an agreement on a new standard contract in 2005.<sup>107</sup> One of the main franchisee requests was to extend the franchise term. Although 7-Eleven had long abided by a ten-year term—the usual length in all of its franchise contracts—it consented to a fifteen-year one instead.<sup>108</sup> This gave franchisees not only more time to recoup their investment, but also more time to help increase the ongoing business's "goodwill"—something particularly important if the franchisee tried to sell its branch.<sup>109</sup> The franchisor evidently concluded that reduced flexibility was more than compensated for by improved relations with longer-term, higher-performing franchisees.<sup>110</sup>

#### D. Inconsistent Narratives: An Overview

Whether arguing policy, seeking judicial relief, or soliciting public support, squabbling franchisors and franchisees have often engaged in inconsistent depictions of franchising, with each party's portrayal of the franchising concept changing to suit each party's purpose at that moment. Both parties tailor their arguments either to advance the position that goodwill is part of a franchise package sold to the franchisee or to posit that goodwill is severable from the

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106. These systematic negotiations can be between the franchisor and a franchisee association representing its franchisees. A listing of seventy-eight of the larger franchisee associations for seventy-five different franchised systems is the Franchisee Association Registry maintained by the American Association of Franchisees and Dealers (AAFD). See *Franchise Association Registry*, AM. ASS'N OF FRANCHISEES & DEALERS, <http://id-portal.com/franchiseassociationregistry.php> (last visited July 3, 2012). In addition, a listing of over seventy brand-specific franchisee associations is maintained by the International Association of Franchisees and Dealers. See *Directory of Independent Franchisee Associations*, INT'L ASS'N OF FRANCHISEES & DEALERS, <http://www.franchise-info.ca/about/directory-of-independent-franchisee-associations.html> (last visited July 3, 2012).

107. Michael R. Davis, *How 7-Eleven Developed a New System-Wide Franchise Agreement: Process and Results*, LJN'S FRANCHISING BUS. & L. ALERT, Sept. 2005, at 1.

108. *Id.* at 5.

109. *Id.*

110. *Id.* Of course, a franchisor's willingness to negotiate goodwill may depend on relative bargaining power. A franchisor may only be willing to negotiate if it decides that it will gain from resolving present and future conflicts about something—goodwill—which often seems rather intangible.

trademark and retained by the franchisor, depending on the subject. This Article analyzes numerous issues that frequently arise in franchise litigation that feature these inconsistencies, such as termination,<sup>111</sup> nonrenewal,<sup>112</sup> trademark infringement,<sup>113</sup> noncompete covenants,<sup>114</sup> antitrust tying,<sup>115</sup> vicarious liability,<sup>116</sup> taxes,<sup>117</sup> and equitable estoppel.<sup>118</sup>

Franchisors, for example, often assert that goodwill is included in the franchise package (and thus, in effect, sold to the franchisee) in cases involving termination, trademark infringement, antitrust tying, and taxes.<sup>119</sup> In other cases concerning the same, the

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111. See, e.g., Uri Benoliel, *The Expectation of Continuity Effect and Franchise Termination Laws: A Behavioral Perspective*, 46 AM. BUS. L.J. 139 (2009); Robert W. Emerson, *Franchise Selection and Retention: Discrimination Claims and Affirmative Action Programs*, 40 ARIZ. L. REV. 511 (1998) [hereinafter Emerson, *Franchise Selection and Retention*]; Emerson, *Franchise Terminations*, *supra* note 6.

112. See, e.g., Craig R. Tractenberg et al., *Legal Considerations in Franchise Renewals*, 23 FRANCHISE L.J. 198 (2004).

113. See Emerson, *Franchise Contract Clauses*, *supra* note 37, at 974 (listing the percentage of franchise contracts that contain specific trademark language).

114. See, e.g., Emerson, *Franchising Covenants Against Competition*, *supra* note 5; Peter J. Klarfeld & Mark S. VanderBroek, *Law on Covenants Against Competition Shifts Toward Greater Enforceability by Franchisors*, 31 FRANCHISE L.J. 76 (2011).

115. See, e.g., Uri Benoliel, *The Behavioral Law and Economics of Franchise Tying Contracts*, 41 RUTGERS L.J. 527 (2010); Arthur I. Cantor & Peter J. Klarfeld, *An Unheralded Stake Through the Heart of Siegel v. Chicken Delight and a New Climate for Franchise Tying Claims*, 28 FRANCHISE L.J. 11 (2008); Robert W. Emerson, *Franchising and Consumers' Beliefs About "Tied" Products: The Death Knell for Krehl?*, 45 FLA. L. REV. 163 (1993) [hereinafter Emerson, *Franchising and Consumers' Beliefs About "Tied" Products*].

116. See, e.g., Robert W. Emerson, *Franchisors' Liability when Franchisees Are Apparent Agents: An Empirical and Policy Analysis of "Common Knowledge" About Franchising*, 20 HOFSTRA L. REV. 609 (1992) [hereinafter Emerson, *Franchisors' Liability When Franchisees Are Apparent Agents*]; Joseph H. King, Jr., *Limiting the Vicarious Liability of Franchisors for the Torts of Their Franchisees*, 62 WASH. & LEE L. REV. 417 (2005).

117. See e.g., *Dunkin' Donuts, Inc. v. Martinez*, No. 01-3589-Civ., Bus. Franchise Guide (CCH) ¶ 12,507 (S.D. Fla. Feb. 21, 2003).

118. See, e.g., Kerry L. Bundy & Scott H. Ikeda, *How Waiver, Modification, and Estoppel May Alter Franchise Relationships*, 30 FRANCHISE L.J. 3, 4-5 (2010); Robert W. Emerson, *The Franchisee's Response to a Franchisor That is Curtailing Its Services*, 3 SOUTHEASTERN J. LEGAL STUD. BUS. 93 (1994).

119. See *infra* Part II; *Pappan Enters. v. Hardee's Food Sys., Inc.*, 143 F.3d 800, 806 (3d Cir. 1998) (granting a preliminary injunction against franchisee use of the trademark after finding that on "balancing the hardships to the parties, . . . any injury [the franchisee] might suffer as a result of the issuance of a preliminary injunction is outweighed by the irreparable harm [franchisor] would continue to suffer as a result of [franchisee's] non-consensual use of the . . . marks"); *Cal. Glazed Prods., Inc. v. The Burns & Russell Co. of Balt. City*, 708 F.2d 1423, 1430 (9th Cir. 1983) ("We conclude that the desirability of the trademark and the quality of B&R's components represented by the trademark are inextricably interrelated in the consumer's mind in a manner that precludes finding that the trademark is a separate item for tie-in purposes."); *Vander Vreken v. Am. Dairy Queen Corp.*, 261 F. Supp. 2d 821, 825 (E.D. Mich. 2003) (granting a preliminary injunction after finding that franchisor "will suffer irreparable harm to its reputation and goodwill" whereas the franchisee's loss may be fully compensable through money damages); *Dunkin' Donuts, Inc. v. Benita Corp.*, No. 97 C

franchisor maintains that goodwill is severable and retained by the franchisor despite the issuance of a franchise to the franchisee.<sup>120</sup> These shifting arguments have persuaded courts to come to different conclusions, as in *Lee* and *Razumic*, and have thus led to erratic results.

The inconsistent consequences cause confusion in the legal community and uncertainty about the outcome of any new case.<sup>121</sup> Sometimes, the inconsistency is found even in the very contract that the franchising parties sign and later invoke in court.<sup>122</sup> These internal contradictions are not to be confused with the variance that may exist between two or more sources—namely, between precontractual statements and the written language in a franchise agreement itself. The latter discrepancy has often been an issue in franchising<sup>123</sup> and is usually a matter resolved via integration clauses

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2934, 1998 WL 67613 (N.D. Ill. Feb. 10, 1998) (granting a preliminary injunction against the franchisee's use of the franchisor's name or mark after finding that the franchisee's uncontrolled use could result in irreparable injury to the franchisor's goodwill); *Jack Walters & Sons Corp. v. Morton Bldgs., Inc.*, No. 78-C-329, 1983 U.S. Dist. LEXIS 18644 (E.D. Wis. Mar. 11, 1983) (granting franchisor's motion for summary judgment after finding that the franchisor's trademark was inseparably linked to the franchisor-supplied materials and the finished product); *Int'l Multifoods Corp. & Affiliated Cos. v. Comm'r*, 108 T.C. 25 (1997) (holding that the goodwill inherent in the Mister Donut business in Asia and the Pacific was embodied in, and not severable from, the plaintiff franchisor's interest and trademarks that were conveyed to the defendant, and that the income attributable to the sale of plaintiff franchisor's interest and trademarks constituted U.S. source income).

120. See *Drexel v. Union Prescription Ctrs., Inc.*, 582 F.2d 781, 786 (3d Cir. 1978) (reversing an order for summary judgment to allow further determination by the trial court as to the relationship between the franchisor and the franchisee where the franchisor defended a tort suit by claiming that the agreement merely allowed franchisee to act as an independent contractor with access to the franchisor's mark); *Consumer Sales & Mktg., Inc. v. Digital Equip. Corp.*, No. 95 C 5049, 1995 WL 548765, at \*3 (N.D. Ill. Sept. 13, 1995) (granting franchisee's petition for a temporary restraining order to prevent the franchisor from terminating the franchise agreement); *Canterbury v. Comm'r*, 99 T.C. 223, 249 (1992) ("We find that petitioners acquired no goodwill that was separate and apart from the goodwill inherent in the McDonald's franchise."); *Lieb v. Comm'r*, 33 T.C.M. (CCH) 1231, 1238 (1974) ("Moreover, we are firmly convinced that Radio had no goodwill to sell. This Court has previously held that where, as here, a business sells brand name products pursuant to a nontransferable franchise which is terminable at will by the franchisor upon sufficient notice, the franchisee can possess no goodwill, for goodwill, if any, is inextricably connected to the franchise and ceases to exist when the franchise terminates.") (citations omitted).

121. See Gaylen L. Knack & Ann K. Bloodhart, *Do Franchisors Need to Rechart the Course to Internet Success?*, 20 FRANCHISE L.J. 101, 142 (2001) ("Some courts do not attribute all goodwill to the franchisor . . ."); Levin & Morrison, *supra* note 77, at 120 (noting differing legal views on analyzing goodwill ownership—contract versus equity theory, for example); Clay A. Tilack & Mark E. Ashton, *Who Takes What: The Parties' Rights to Franchise Materials at the Relationship's End*, 28 FRANCHISE L.J. 88, 124–25 (2008).

122. See *Carlock v. Pillsbury Co.*, 719 F. Supp. 791 (D. Minn. 1989); *infra* notes 127–135 and accompanying text.

123. See Debra Burke & E. Malcolm Abel, II, *Franchising Fraud: The Continuing Need for Reform*, 40 AM. BUS. L.J. 355 (2003); Robert W. Emerson, *Franchising and the Parol Evidence Rule*, 50 AM. BUS. L.J. \_\_\_\_ (2013).

and merger clauses;<sup>124</sup> it is also a topic now partially addressed in the recent revision of the Federal Trade Commission (FTC) rule on franchising.<sup>125</sup> But the parol evidence rule<sup>126</sup> cannot resolve franchisor-franchisee disputes about varying terms *in the same writing*. Instead, other principles of interpretation, including perhaps a common-sense understanding of boilerplate language, have preserved a franchisor's right to talk out of both sides of its mouth, even within the same document.

*Carlock v. Pillsbury Co.*<sup>127</sup> exemplifies this question of contract interpretation. There, the franchisees quoted a recital in their franchise agreement: "Franchisee acknowledges that the Franchisor has created unique products of the highest quality, sold in the finest establishments."<sup>128</sup> The *Carlock* plaintiffs were franchisees of Haagen-Dazs "shoppes" who argued that the recital created a legal duty on franchisor Haagen-Dazs' part to distribute its products only

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124. A written agreement's "integration clause" states that the contract, as written, "represents the parties' complete and final agreement and supersedes all informal understandings and oral agreements relating to the subject matter of the contract." BLACK'S LAW DICTIONARY 880 (9th ed. 2009). A "merger clause" provides that all prior agreements of the parties have been merged into the written document. BLACK'S LAW DICTIONARY 989 (6th ed. 1990). Contracts often have a clause containing both elements of "merger" and "integration," and courts rarely distinguish between merger clauses and integration clauses. Joseph Wylie, *Using No-Reliance Clauses to Prevent Fraud-in-the-Inducement Claims*, 92 ILL. B.J. 536, 537 n.1 (2004). See also *Wall v. CSX Transp., Inc.*, 471 F.3d 410, 415 n.4 (2d Cir. 2006) (citing both New York and Pennsylvania law); *Carousel's Creamery, L.L.C. v. Marble Slab Creamery, Inc.*, 134 S.W.3d 385, 395 (Tex. Ct. App. 2004) (referring to "the merger/integration clause contained within the franchise agreement"). Indeed, the more recent editions of Black's Law Dictionary now simply define "merger clause" by referring the reader to the definition for "integration clause." BLACK'S LAW DICTIONARY 1079 (9th ed. 2009); BLACK'S LAW DICTIONARY 1010 (8th ed. 2004); BLACK'S LAW DICTIONARY 1003 (7th ed. 1999).

125. 16 C.F.R. § 436.9(h) (2008) (barring a franchisor's use of integration clauses to disclaim authorized statements made in its disclosure documents or in the ancillary exhibits or attachments).

126. This key tenet of contract interpretation bars extrinsic terms, written or oral, that are agreed upon contemporaneous to or before a totally integrated writing. See JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS 108-09 (6th ed. 2009). See also BLACK'S LAW DICTIONARY 1227 (9th ed. 2009) (defining the parol evidence rule as "[t]he common-law principle that a writing intended by the parties to be a final embodiment of their agreement cannot be modified by evidence of earlier or contemporaneous agreements that might add to, vary, or contradict the writing"). The theories advanced to justify the parol evidence rule are (1) "[i]f the parties intend[ed] the writing to be final and complete, they intend to supersede their prior agreements," (2) "sound policy requires that prior and contemporaneous oral agreements are suspect" if not included in the writing, and (3) that "the writing deserves a preferred status against potential perjury" regarding oral aspects of an alleged agreement. JOHN D. CALAMARI & JOSEPH M. PERILLO, CONTRACTS 187 (3d ed. 1999).

127. 719 F. Supp. 791 (D. Minn. 1989).

128. *Id.* at 802.

through “upscale” retailers. By failing to do so, the plaintiffs argued, the franchisor allegedly committed, among other things, misrepresentation and breach of contract.<sup>129</sup> In dismissing the franchisees’ claims, the court recognized that the recitals were “only precatory language” meant to recognize Haagen-Dazs’ past efforts to create goodwill, and did not purport to impose any future obligation on Haagen-Dazs.<sup>130</sup>

The *Carlock* court recognized that if the recitals were interpreted as suggested by the franchisees, the meaning would conflict with a provision in the body of the franchise agreements.<sup>131</sup> That provision specifically reserves to the franchisor the right to distribute Haagen-Dazs products “through not only Haagen-Dazs Shoppes, but through any other distribution method, which may from time to time be established.”<sup>132</sup> Ruling for the franchisor, the court found that this explicit, contractual clause reserved distribution rights solely to Haagen-Dazs.<sup>133</sup> It declared that the Haagen-Dazs franchise agreement “does not bind the franchisor to any particular marketing strategy. Plaintiffs’ claim that the franchisors breached the agreement by distributing Haagen-Dazs through outlets that were not ‘up-scale’ will therefore be dismissed.”<sup>134</sup> Such a claim could not be sustained because the contract provision expressly reserved to Haagen-Dazs the right to use any distribution method it might establish.<sup>135</sup>

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129. *Id.* at 802, 816. The idea of goodwill directly relates to the retail “shoppes” and the fineness of the product itself, which trigger for customers a highly positive association with the brand Haagen-Dazs. Customers who frequent Haagen-Dazs shops arguably do so because they expect to get a particular kind of experience that they attribute to Haagen-Dazs ice cream and the surrounding social environment. This experience, the franchisees argued, was being destroyed through brand dilution. *See id.* at 816.

130. *Id.* at 816. *See* BLACK’S LAW DICTIONARY 1295 (9th ed. 2009) (defining “precatory” words as “requesting, recommending, or expressing a desire for action, but usu[ally] in a nonbinding way”; offering as an example of “precatory language” the phrase “it is my wish and desire to”).

131. *Carlock*, 719 F. Supp. at 816.

132. *Id.* (quoting the franchise agreement).

133. *Id.*

134. *Id.*

135. *Id.* *See also* Burger King Corp. v. Hinton, Inc., 203 F. Supp. 2d 1357, 1363 (S.D. Fla. 2002) (rejecting the franchisees’ argument that introductory paragraphs to various exhibits to their franchise agreement were evidence of Burger King’s obligation to provide franchisees with general support).

## II. SUBJECTS OF DISPUTE

*This is a rotten argument, but it should be good enough for [t]heir lordships on a hot summer afternoon.*<sup>136</sup>

This Article focuses on some of the most fundamental concerns of franchising as they relate to goodwill: termination, nonrenewal, trademark infringement, noncompete covenants, antitrust tying, vicarious liability, taxes, and equitable estoppel. In each area, one can find inconsistent approaches with regard to who owns the goodwill, franchisor or franchisee.<sup>137</sup> I now consider these areas.

## A. Termination

This section discusses cases of termination of contracts in which the courts found that the goodwill of the franchisor had been damaged and cases in which courts found the same for the franchisee. Returning to the discussion of inconsistent arguments used by both parties,<sup>138</sup> both franchisors and franchisees alternatively argued for ownership of goodwill depending on the circumstances of the case. Similarly, these inconsistent arguments highlight the difficulties inherent in termination disputes that arise because ownership of goodwill is unclear from the beginning.

First, in *Jack Walters & Sons Corp. v. Morton Buildings, Inc.*,<sup>139</sup> a seminal case on termination, the franchisor argued that the franchise agreement included goodwill, while the franchisee attempted to persuade the court that it had simply purchased materials from the franchisor, not goodwill.<sup>140</sup> Under the terms of the franchise agreement, the franchisor, Morton Buildings, Inc., tied construction-building material to the trademark by requiring the franchisee to purchase certain materials from franchisor-approved distributors, even at higher costs.<sup>141</sup> The franchisee, Jack Walters &

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136. SIR ALEC DOUGLAS-HOME, *THE WAY THE WIND BLOWS* 204 (1976) (reciting an annotation to a ministerial brief said to have been inadvertently read in the House of Lords).

137. Different approaches to ownership of goodwill are found across nations. For example, although under U.S. franchise law ownership of goodwill is often unclear, French law enables a franchisor to assign his “fonds de commerce” (the goodwill) to the franchisee. Without the goodwill, the French franchisee could be regarded as simply an agent or employee of the franchisor. SIMON, *supra* note 49, at 261–64; LE TOURNEAU, *supra* note 49, at 149–51.

138. See *supra* Part II.D.

139. No. 78-C-329, 1983 U.S. Dist. LEXIS 18644 (E.D. Wis. Mar. 11, 1983), *cautionary treatment aff'd*, 737 F.2d 698 (7th Cir. 1984).

140. *Id.* at \*17–19.

141. *Id.* at \*6.

Sons Corporation (hereinafter Jack Walters), bought materials from unapproved distributors and sold them under its own name alongside the more costly franchisor product.<sup>142</sup> The franchisor terminated the franchise agreement, arguing that Jack Walters had damaged Morton's goodwill by associating an inferior product with the Morton brand,<sup>143</sup> and the franchisee brought suit for antitrust tying violations.<sup>144</sup>

The franchisee argued that Morton's products were simply materials,<sup>145</sup> because the franchisee always did business under its own name, though it sometimes indicated that it sold the franchisor's products.<sup>146</sup> The franchisor, on the other hand, contended that the consumers of the Morton brand not only purchased the tangible materials but also the representation of quality that is associated with the Morton trademark.<sup>147</sup> Essentially, the franchisor argued that the franchisee had purchased goodwill.

The court agreed with Morton, finding that Jack Walters had purchased more than materials and had instead bought an inseparable franchise package,<sup>148</sup> which included the quality of the franchisor's trademark as well as the quality of the products the franchisor's trademark represented.<sup>149</sup> The court took the view that consumers specifically purchased the franchisor's product, regardless of whether the franchisee or another person or business sold it.<sup>150</sup>

In another termination case, *Gorenstein Enters., Inc. v. Quality Care-USA, Inc.*,<sup>151</sup> brothers Sam and David Gorenstein defaulted on their royalty obligations shortly after obtaining a home health care franchise from Quality Care.<sup>152</sup> Quality Care terminated the Gorensteins' franchise soon thereafter and demanded that they cease using Quality Care's trademark.<sup>153</sup> The Gorensteins ignored the

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142. *Id.* at \*8.

143. The franchisor is arguing that when the franchisee does not buy the building material associated with the franchisor's preapproved material distributors, an unhappy customer could associate this lack of conformity with the franchisor's brand itself. *Id.* at \*8-9. As discussed below, the franchisor's image rests on more than just the quality of tangible material.

144. *Id.* at \*9.

145. *Id.* at \*27.

146. *Id.* at \*6.

147. *Id.* at \*27-28.

148. The franchise and its fundamental products are all one package, so a sale of the franchise and the linked products cannot be a tie-in. Emerson, *Franchising and Consumers' Beliefs About "Tied" Products*, *supra* note 115.

149. *Jack Walters*, 1993 U.S. Dist. LEXIS 18644, at \*20-21.

150. *Id.* at \*32-33.

151. 874 F.2d 431 (7th Cir. 1989).

152. *Id.* at 433.

153. *Id.*

demand, continued using the trademark, and sued Quality Care seeking rescission of the franchise agreement.<sup>154</sup> Quality Care removed the suit to U.S. district court and successfully moved for a preliminary injunction. The Gorensteins then dismissed the suit and refiled it as a counterclaim seeking rescission of the franchise agreement, on the ground that Quality Care induced the Gorensteins to accept it by false representations.<sup>155</sup>

The appellate court ruled that once a franchise is properly terminated, the franchisee is no longer permitted to use the franchise trademark.<sup>156</sup> Indeed, the court soundly rebuffed the franchisees' position, which it characterized as "holding the trademark hostage as a bargaining tactic to pressure Quality Care into renegotiating the franchise or settling the suit."<sup>157</sup> In effect, the court found that from the start of the franchise onward, the goodwill associated with Quality Care's trademark remained inseparable from that trademark, with the franchisor having the right to maintain complete control over both trademark and goodwill.<sup>158</sup>

In a third termination case, *Consumer Sales & Marketing, Inc. v. Digital Equipment Corp.*,<sup>159</sup> which focused on loss of goodwill for the franchisee, the franchisor reasoned that any injury to the franchisee's goodwill was hollow, because any goodwill obtained by the franchisee arose from preexisting business relationships between the franchisor and its retailers. Indeed, the franchisor argued that an alleged impact on franchisee goodwill was impossible because the franchisee solicited purchase orders from the franchisor's retailers, which had executed agreements with *the franchisor*.<sup>160</sup> The franchisor notified the franchisee on August 1, 1995 that it intended to terminate the franchise, pursuant to the franchise agreement, effective August 31, 1995. The franchisee responded by seeking and receiving a temporary restraining order (TRO),<sup>161</sup> which the franchisor appealed.<sup>162</sup> In opposition, the franchisee declared that it would suffer irreparable damage to its goodwill if the court overturned the TRO.<sup>163</sup> The court agreed and held that the balance of hardship favored the franchisee over the franchisor.<sup>164</sup>

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154. *Id.*

155. *Id.* at 433-34.

156. *Id.* at 435.

157. *Id.*

158. *Id.* at 435-39.

159. 95 C 5049, 1995 WL 548765 (N.D. Ill. Sept. 13, 1995).

160. *Id.* at \*4.

161. *Id.* at \*1.

162. *Id.*

163. *Id.* at \*3.

164. *Id.* at \*7.

Although the franchisor did not recognize any interest that the franchisee might have in the goodwill of the franchisor's trademark, whether purchased or developed by the franchisee, the court disagreed.<sup>165</sup> Clearly, courts have inconsistent approaches to determining the ownership of goodwill in termination cases.

### B. Nonrenewal

Most franchise agreements are set for a fixed period<sup>166</sup> and do not grant the franchisee even a qualified right to renew the contract in its initial form, subject to the acceptance of a new form contract of the franchisor's choosing.<sup>167</sup> Even agreements granting renewals can be problematic for franchisees, as franchisors may insist upon new contract terms requiring further expenditures by the franchisees.<sup>168</sup>

These pro-franchisor contracts often run afoul of practice and law outside the United States. For example, in France, regardless of goodwill concerns, franchise agreements sometimes state that they are automatically renewed if neither party provides notice within a certain period before the conclusion of the franchise term.<sup>169</sup> Even without such a provision, if the parties continue to operate a

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165. Evaluating goodwill in terms of calculating the damages to award a wrongly terminated franchisee still may be a problem for courts. For example, one method suggested as an approach for determining damages focuses on excess earnings as a means to measure goodwill. ROGER D. BLAIR & FRANCINE LAFONTAINE, *THE ECONOMICS OF FRANCHISING* 287 (2005). The earnings are "excess" in that they are those earnings "above those necessary to keep resources invested in [the business] enterprise." *Id.* Professors Blair and Lafontaine note that these earnings constitute profits, and "[t]he capitalized value of these excess earnings represents goodwill." *Id.* While contending that this approach to computing damages "could provide a reasonably good approximation to the franchised outlet's value," they acknowledge that its "major shortcoming" is that the franchisee's effort may not be properly accounted for, that the franchisee must have included a salary for himself (instead of just taking a draw of profits), and that salary must be "commensurate with the cost of [the franchisee's] time in the calculation of his cash flows." *Id.* Otherwise, goodwill and the franchised outlet's value will not be accurately decided. Obviously, there are a lot of "ifs" in these calculations and in rewarding franchisees for goodwill. For example, especially early on in a franchise, how many franchisees properly pay themselves salaries apart from taking occasional draws on profits, if any?

166. Emerson, *Franchise Contract Clauses*, *supra* note 37, at 973 (stating that 87 percent of franchise contracts examined in 1993 had a set term of five years or more, with the median term being fifteen years); Emerson, *supra* note 10 (stating that 97 percent of franchise contracts examined in 2011 had a set term of five years or more, with the median term being ten years).

167. Charles S. Modell & Genevieve A. Beck, *Franchise Renewals—"You Want Me to Do What?"*, 22 *FRANCHISE L.J.* 4, 4 (2002).

168. *Id.*

169. Isabelle MacElhone & Dominique Paillusseau, *France*, in *INTERNATIONAL FRANCHISING LAW FRA-51* (§ 9) (Dennis Campbell ed., 2005).

franchise beyond the term initially agreed upon, then the franchise is “deemed to have been renewed indefinitely under the terms and conditions of the original agreement.”<sup>170</sup> Some nations besides France also make it very difficult for franchisors to prevent a franchisee from renewing his franchise.<sup>171</sup> In Germany, for example, (1) franchisors must show “good cause” to terminate a franchise contract (akin to the franchise-relationship “good cause” provisions found in some U.S. state statutes),<sup>172</sup> and (2) most franchise contracts are considered permanently renewable because they are not fixed in length. A German franchise contract is considered renewed under the same terms of the initial franchise unless one party follows a lengthy and difficult process and gives proper notice to cancel.<sup>173</sup> Similar approaches may be found in numerous countries,

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170. *Id.* at FRA-51 to -52 (§ 9). In Brazil, a franchisee/lessee who accrued locational goodwill also acquired, as in France, a statutory renewal right; however, franchisors succeeded in eliminating that protection. Candida Ribeiro Caffé, *Recent Developments of Franchising in Brazil*, 2 INT’L J. FRANCHISING & DISTRIBUTION L. 159, 164 (2000). Article 5 of European Community Regulation No. 2790/1999 provides that a fixed period agreement that continues to operate becomes an unfixd period agreement, even if the agreement does not include a special provision. JEAN-MARIE LELOUP, *LA FRANCHISE: DROIT ET PRATIQUE* 334–35, 338 (4th ed. 2004).

171. Robert W. Emerson, *Franchising Formulas for Success: Testing Requirements and Goodwill Hunting* (Dec. 27, 2012) (unpublished manuscript) (on file with author). Importantly, however, the refusal to renew a franchise contract in France is not abusive unless done in bad faith. Cour de cassation [Cass.] [supreme court for judicial matters] com., July 5, 1994, Bull. civ. IV, No. 92-17.918 (Fr.). Only in cases of bad-faith refusals to renew will damages be awarded. Cour d’appel [CA] [regional court of appeal] Paris, com. ch., Jan. 12, 2005, No. 2005-277027 (Fr.). See also SIMON, *supra* note 49, at 325 (discussing abusive nonrenewals).

172. The sixteen “good cause” states are Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Michigan, Minnesota, Nebraska, New Jersey, Rhode Island, Virginia, Washington, and Wisconsin. ARK. CODE ANN. § 4-72-204 (2010); CAL. BUS. & PROF. CODE § 20020 (Deering 2010); CONN. GEN. STAT. ANN. § 42-133f (2010); DEL. CODE ANN. tit. 6, § 2552(a) (2010); HAW. REV. STAT. ANN. § 482E-6 (LexisNexis 2010); 815 ILL. COMP. STAT. ANN. 705/19 (LexisNexis 2010); IND. CODE ANN. § 23-2-2.7-1(7) (LexisNexis 2010); IOWA CODE ANN. § 523H.7(1) (West 2010); MICH. COMP. LAWS ANN. § 445.1527(27)(c) (West 2010); MINN. STAT. ANN. § 80C.14(3)(b) (West 2010); NEB. REV. STAT. ANN. § 87-404 (LexisNexis 2010); N.J. STAT. ANN. § 56:10-5 (West 2010); R.I. GEN. LAWS § 6-50-1 et seq. (2010); VA. CODE ANN. § 13.1-564 (West 2010); WASH. REV. CODE ANN. § 19.100.180(2)(j) (West 2010); WIS. STAT. ANN. § 135.03 (West 2010).

173. Olivier Cochet & Thomas Ehrmann, *The Effectiveness of Contractual Self-Enforcement and Implications for the Governance Structure of Franchising Firms*, in *THE ALLOCATION OF DECISION RIGHTS AND THE ROLE OF PRIVATE ENFORCEMENT IN FRANCHISING: PERSPECTIVES AND EMPIRICAL EVIDENCE* 28, 28 n.38 (2005), available at [http://www.http://miami.uni-muenster.de/servlets/DerivateServlet/Derivate-3205/diss\\_cochet.pdf](http://www.http://miami.uni-muenster.de/servlets/DerivateServlet/Derivate-3205/diss_cochet.pdf) (citing MATTHIAS STEIN-WIGGER, *DIE BEENDIGUNG DES FRANCHISEVERTRAGES: EINE RECHTSVERGLEICHENDE STUDIE UNTER BESONDERER BERÜCKSICHTIGUNG DES SCHWEIZERISCHEN, DEUTSCHEN UND AMERIKANISCHEN RECHTS* (1999) (“THE TERMINATION OF THE FRANCHISE AGREEMENT: A COMPARATIVE STUDY WITH PARTICULAR REFERENCE TO THE SWISS, GERMAN AND AMERICAN LAW”). Several legal provisions that constrain contract non-renewal by franchisors further protect German franchisees. These civil and antitrust laws deal with the protection of franchisees’ investments. Bürgerliches Gesetzbuch [BGB] [Civil Code] Aug. 18, 1896, BUNDESGESETZBLATT, Tiel I [BGBL. I] at 2586, as amended, Dec. 4, 2008, §242 (Ger.) (“An obligor has a duty to perform

such as Finland, Iceland, Italy, Japan, Malaysia, Paraguay, and Singapore.<sup>174</sup>

While not advancing franchisee renewal rights to the extent accorded in some foreign jurisprudence, some state lawmakers have enacted legislation to protect franchisees from arbitrary nonrenewal decisions by franchisors.<sup>175</sup> At the federal level, the Petroleum Marketing Practices Act of 1978 (PMPA) creates uniform rules for petroleum franchisee terminations or nonrenewals,<sup>176</sup> preempting relevant state statutes.<sup>177</sup> As for state laws, they typically

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according to the requirements of good faith, taking customary practice into consideration.”), § 307 (noting that “[p]rovisions in standard business terms are ineffective if, contrary to the requirement of good faith, they unreasonably disadvantage the other party to the contract”; that “an unreasonable advantage” may occur when a provision is unclear or incomprehensible; and that, “in case of doubt, [this disadvantage] is assumed to exist if a provision (1) is not compatible with essential principles of the statutory provision from which it deviates, or (2) limits essential rights or duties inherent in the nature of the contract to such an extent that attainment of the purpose of the contract is jeopardised”); Gesetz gegen Wettbewerbsbeschränkungen [GWB] [Act Against Restraints on Competition] Aug. 26, 1998, BGBL. I at 2546, § 26, ¶ 2 (Ger.).

174. Emerson, *supra* note 171. See, e.g., Giuseppe Bologna & Julia Holden, *Italy*, in INTERNATIONAL FRANCHISING LAW, *supra* note 169, at ITA-15 (§ 2[13]) (reporting that absent a written notice of termination at least six months prior to the renewal date, the franchise contract will be automatically renewed on a year-by-year basis, and that without anything to the contrary in the franchise agreement, a nonrenewal would ordinarily entitle the franchisee to compensation for loss of goodwill).

175. See Frank J. Cavico, *The Covenant of Good Faith and Fair Dealing in the Franchise Business Relationship*, 6 BARRY L. REV. 61, 72 (2006). Some statutory rules permit franchisors to terminate a relationship for a “compelling business reason.” *Id.* at 73. An example of this might be *Carte Blanche (Singapore) Pte., Ltd. v. Carte Blanche International, Ltd.*, 888 F.2d 260 (2d Cir. 1989), where the franchisee agreed to sell the franchisor’s credit cards in several Asian countries. *Id.* at 261. The franchisor decided not to renew the agreement and cited as a reason, among other things, the franchisee’s unauthorized usage of the Carte Blanche trademark in the operation of a separate travel business and the advertising for a franchisee-affiliated holding company. *Id.* at 262, 267. The franchisor argued that it was injured by the unauthorized usage. *Id.* at 267. The U.S. Court of Appeals for the Second Circuit, however, agreed with the district court that there was no actionable breach of the franchise agreement resulting from the alleged unauthorized use of the trademark. *Id.* (“The arbitrators concluded that any breach that may have occurred in this regard caused no harm and was immaterial, and the district court determined that they did not exceed their authority in doing so. We agree with the district court.”). It is unknown whether the court would have found that the franchise’s goodwill was severable and retained by the franchisor or that the franchisee had an interest in the goodwill, because it never became a salient issue.

176. A franchisor governed by the PMPA must make any decision to sell a facility and thus choose not to renew a gas station franchise “in good faith and in the normal course of business.” 15 U.S.C. § 2802(b)(3)(D) (2006). Under the PMPA, the burden of showing that a decision against renewing a franchise was made in good faith is on the franchisor, but in opposing summary judgment, the franchisee must present evidence that the franchisor’s decision was a “sham, pretextual, or discriminatory.” *BP W. Coast Prods., LLC v. May*, 347 F. Supp. 2d 898, 904 (D. Nev. 2004).

177. The PMPA does not preempt all state law pertaining to petroleum franchises. *Yonaty v. Amerada Hess Corp.*, No. 3:04-CV-605-FJSDEP, 2005 WL 1460411, at \*3 (N.D.N.Y. June 20, 2005) (termination); *Amoco Oil Co. v. Ervin*, 908 P.2d 493, 503–04 (Colo. 1995) (en banc)

codify or sometimes enhance the implied covenants of good faith and fair dealing that protect franchisees.<sup>178</sup> As one commentator notes, “state legislatures and regulators are concerned that the franchisor may be able to change or manipulate the terms of the franchise relationship to the detriment of the franchisee, especially after the franchisee has invested so much money, time, and effort in franchise-specific development, design, marketing, management, and training.”<sup>179</sup> In effect, the franchisee expends significant resources to create a valuable business—one perhaps with much local goodwill—and thereafter worries that the goodwill could be lost to the franchisor.

Cases comparable to nonrenewal may be those of franchisees selling their business under the strong encouragement, if not compulsion, of the franchisor. Again, matters of goodwill arise just as in nonrenewal cases. In *Frank Coulson, Inc.—Buick v. General Motors Corp.*,<sup>180</sup> the franchisor, General Motors Corporation (GM), refused to credit the franchisee with any goodwill.<sup>181</sup> Here, the franchisor convinced the franchisee, Frank Coulson, age sixty-five, to sell the franchise to Glenn Ralph because the franchisee was “getting old.”<sup>182</sup> Coulson later claimed that GM informed potential buyers of his business’s supposedly imminent nonrenewal, need for repairs, and desperate desire to sell, causing the franchise’s price to plummet.<sup>183</sup> The franchisee further asserted that a potential buyer was willing to pay more than just enough to cover the franchise’s tangible assets, which presumably also would include payment for goodwill.<sup>184</sup> Indeed, Ralph had offered to pay Coulson *over* \$50,000 for both.<sup>185</sup> The franchisor, however, would not permit Ralph or

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(non-renewal). The PMPA, however, does preempt “state-law provisions related to the termination of a franchise that are not identical to the applicable PMPA provisions.” *Yonaty*, 2005 WL 1460411 at \*3.

178. Cavico, *supra* note 175, at 72.

179. *Id.* at 73.

180. 488 F.2d 202 (5th Cir. 1974).

181. *Id.* at 204. Although not specifically covering matters of goodwill, the federal Automobile Dealers’ Day in Court Act provides that an automobile manufacturer may be found liable for failing “to act in good faith in performing or complying with any of the terms or provisions of the franchise, or in terminating, canceling, or not renewing the franchise with said dealer.” See 15 U.S.C. § 1222 (2006).

182. *Frank Coulson, Inc.—Buick*, 488 F.2d at 204. The franchisee had been engaged in selling automobiles for decades. Telephone interview with F. Kendall Slinkman (Mar. 8, 2010). Slinkman was the lawyer for the franchisee-plaintiff, Frank Coulson.

183. *Frank Coulson, Inc.—Buick*, 488 F.2d at 204 (agreeing to sell his dealership assets, Coulson “authorized GM to solicit buyers,” and “GM apparently ‘spread the word’ that Coulson was going out of business”).

184. *Id.*

185. While the franchisor would not let the franchisee sell for anything higher than the tangible assets (because the franchisor did not want the franchisee to profit from goodwill),

anyone else to pay more than what it considered to be the value of the tangible assets alone: \$50,000.<sup>186</sup>

Thus, the franchisor did not recognize any goodwill either purchased from the franchisor in a franchise package or created by the franchisee in the course of business. The jury had found for Coulson on the issue of whether GM maliciously interfered with Coulson and Ralph's contractual negotiations, and GM successfully moved for a judgment notwithstanding a verdict.<sup>187</sup> The appellate court reversed this decision, reinstating the jury's award to Coulson in the amount of \$25,000.<sup>188</sup> The appellate court reasoned that GM overstepped its privilege, which manufacturers have to a certain extent to ensure that new dealers are financially sound, to intervene in Coulson and Ralph's contractual negotiations. It agreed with Coulson that the sales price had excluded goodwill.<sup>189</sup> In support, the appellate court noted that GM's own accountant testified that the dealership's intangible asset value ranged from \$35,000 to \$50,000.<sup>190</sup>

### C. Trademark Infringement

*[G]oodwill [is,] in the law of corporations, a catchall category located on the asset side of a company's balance sheet to make its assets appear to equal its liabilities. It includes valuable intangibles, such as a recognizable brand name.*<sup>191</sup>

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Ralph did pay for more than just the tangible assets. In order to get around this prohibition, Ralph and Coulson made a real estate deal through Ralph's real estate company for \$35,000. *Id.*

186. *Id.* at 206.

187. *Id.* at 203.

188. *Id.* at 203, 207. Originally, the Court of Appeals for the Fifth Circuit, in a two-to-one decision, actually upheld the trial court's decision in favor of the franchisor. The opinion noted, however, that the court reserved the right to reconsider the judgment; shortly thereafter, the court majority in fact did so. It withdrew the original decision and issued a published opinion, *id.* at 202, favoring Coulson, telephone interview with F. Kendall Slinkman, *supra* note 182.

189. *Id.* at 207 (excluding goodwill by imposing a sales price limit of \$50,000—a price giving no credit for any of the dealership's intangible assets). Indeed, after the federal suit had been resolved in Coulson's favor, Coulson sued in state court those who allegedly had interfered, along with GM, with his ability to sell his dealership. Telephone interview with F. Kendall Slinkman, *supra* note 182. Those suits were settled with payments from the defendants to Coulson. *Id.*

190. *Frank Coulson, Inc.—Buick*, 488 F.2d at 207.

191. D. ROBERT WHITE, *WHITE'S LAW DICTIONARY* 46 (1985) (emphasis added).

Trademarks are a key component of franchising and of the goodwill associated with a franchise.<sup>192</sup> By itself, however, trademark licensing does not constitute a franchise.<sup>193</sup> Certainly when a mark or a trade name commands high levels of customer recognition, the brand's goodwill may become the decisive factor behind a franchisee's choice of a particular business to own and operate. As a prominent writer on trademarks opined, "[g]oodwill and its trademark symbol are as inseparable as Siamese Twins who cannot be separated without death to both."<sup>194</sup> As discussed previously, arguments about ownership of trademark goodwill are often inconsistent. Courts sometimes find that they need to protect the goodwill of franchisors against the misuse of the trademark and, at other times, seek to protect the goodwill developed locally by the franchisee.

In two trademark infringement cases, the franchisors argued that goodwill was a part of the franchise package purchased by the franchisee.<sup>195</sup> In *Dunkin' Donuts, Inc. v. Benita Corp.*,<sup>196</sup> the franchise agreement lapsed and the franchisor chose not to renew.<sup>197</sup> Without the franchisor's permission, the franchisee continued to use the

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192. Dan L. Burk & Brett H. McDonnell, *Trademarks and the Boundaries of the Firm*, 51 WM. & MARY L. REV. 345, 385 (2009) ("The centrality of the franchise trademark is reflected in both law and economics."); William A. Finkelstein & Christopher P. Bussert, *Trademark Law Fundamentals and Related Franchising Issues*, in FUNDAMENTALS OF FRANCHISING, *supra* note 91, at 1, 4 (citing *Susser v. Carvel Corp.*, 206 F. Supp. 636 (S.D.N.Y. 1962)) (noting that trademarks are linked to the fostering and protection of goodwill, that "[t]rademark licensing is, in almost all cases, the cornerstone of a franchise system," and that "[f]ranchising, in its simplest terms, is a more sophisticated form of trademark licensing").

193. FTC staff noted that trademark controls are usually "passive," dealing with matters of quality control, while franchise controls are more active, covering the licensee's method of operation, business location, outlet design, and business management matters. Darryl A. Hart, *Recent Staff Advisory Opinions*, LJN's FRANCHISING BUS. & L. ALERT, Sept. 2005, at 1, 6 (summarizing an FTC Informal Staff Advisory Staff Opinion 05-1, dated March 2, 2005). The staff therefore concluded that the limited controls of a hair-care trademark licensor were intended to protect the integrity of the licensor's mark, control the mark's use in signs and advertising, and safeguard the goodwill associated with the mark. *Id.* For example, when the licensor simply wanted bills and taxes to be paid and laws followed, not to control all business operations, the staff found that the licensor's insistence on the continued employment of a particular manager did not rise to the level of control adequate to change the single trademark license into a franchise. *Id.* As in the United States, trademarks constitute an important element of the franchise package or business concept under French law, yet franchise agreements are not solely comprised of trademark licensing. FERRIER, *supra* note 46, at 351.

194. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 18:2 (4th ed. 2012).

195. See *Pappan Enters., Inc. v. Hardee's Food Sys., Inc.*, 143 F.3d 800 (3d Cir. 1998). See also *Dunkin' Donuts, Inc. v. Benita Corp.*, No. 97 C 2934, 1998 WL 67613 (N.D. Ill. Feb. 10, 1998).

196. No. 97 C 2934, 1998 WL 67613 (N.D. Ill. 1998).

197. *Id.* at \*1-2.

franchisor's mark.<sup>198</sup> The franchisor filed for a preliminary injunction to prohibit the franchisee from using the trademark, arguing that the franchise goodwill would be harmed by the franchisee's unauthorized, continued use of the trademark, causing customer confusion.<sup>199</sup> Here, the franchisee's continued use of the trademark would only have affected the franchisor's goodwill if the franchisee had maintained the franchisor's goodwill in the first place.<sup>200</sup>

On the other hand, Dunkin' Donuts' goodwill could be hurt if an ex-franchisee that had been keeping up the franchise goodwill operates its facility in a manner that does not meet the franchisor's standards. In these circumstances, the consumer might be led to believe these lower standards are not isolated to the franchise location but indicative of the entire franchise. After all, "the consumer is entitled to assume an equal level of quality of goods and services sold through many franchised outlets using a single mark. The consumer assumes that quality is as uniform as if each outlet were wholly-owned and operated by employees of a single company."<sup>201</sup>

So the goodwill declines while customers draw the erroneous but understandable conclusion that the national system's quality has gone down, not realizing that the franchisee is now completely independent of the former franchisor. If the goodwill could be considered as leased, it would be severable and retained by the franchisor, and the lessee-franchisee would not be able to impinge upon the franchisor's goodwill. Therefore, without necessarily voicing the specifics of the argument, the franchisor must have been, in effect, averring that the franchisee purchased goodwill in an inseverable franchise package and was now under a duty not to injure that goodwill once the franchise agreement came to an end.

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198. *Id.* at \*2.

199. *Id.* at \*5 ("The public has associated Dunkin' Donuts' marks, trade name, and trade dress exclusively with Dunkin' Donuts' shops and products because of Dunkin' Donuts extensive sales, advertising, and promotion. . . . Dunkin' Donuts argues that its reputation and goodwill will be damaged by Benita's continued unauthorized operation."). As noted in *Gorenstein Enters., Inc. v. Quality Care-USA, Inc.*, 874 F.2d 431, 435 (7th Cir. 1989), discussed *supra* notes 151–158 and accompanying text, a trademark identifies the product, and the mark's owner has a duty to ensure quality control for the goods provided under that trademark.

200. Importantly, the franchisor's goodwill may also be damaged by third parties, such as consumers. For example, a dissatisfied consumer may tell all of her friends about her "bad" experience at the franchised store. Her friends, in turn, may refuse to patronize the local store or any other store in the franchise system. Thus, the overall goodwill of the franchise is tarnished.

201. MCCARTHY, *supra* note 194, at § 3:11.

The court in *Dunkin' Donuts, Inc. v. Benita Corp.* concluded that because the franchisor no longer had control<sup>202</sup> of the former franchisee's operation of a donut shop, there would inevitably be harm to Dunkin' Donuts' reputation and goodwill that "is not easily calculable in monetary terms."<sup>203</sup> When the franchisee asserted that the preliminary injunction would rob him of hard labor and investment, presumably including the building of local goodwill, the court declared that if the franchisee prevailed, then profit, loss, and investment would be easily calculated in monetary terms—in contrast to the difficulty of calculating goodwill.<sup>204</sup> It seems that when the court granted Dunkin' Donuts' preliminary injunction, the court may have seen the "local" goodwill as severable from the franchise package. Rather than purchasing the goodwill, the franchisee may therefore have merely leased that goodwill for the length of its franchise agreement.<sup>205</sup> While the termination of the franchised site would end this lease, the cessation likely would not have been conveyed to the franchise system's loyal customers, especially if the ex-franchisee continued using the franchisor's marks. The franchisor may have been seeking to protect the goodwill associated with those marks in case the ex-franchisee operated the site below the franchise system standards.

Typically, franchisors have sought to prevent franchisees and ex-franchisees from tarnishing their goodwill and trademarks.<sup>206</sup> In another case involving the Dunkin' Donuts franchise, the franchisor accused the franchisees of failing repeated inspections that found that food was stored improperly, the premises were unclean and contained pests, sinks dedicated to hand washing had not been installed, the employees did not demonstrate proper hygiene, and, in

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202. Under both U.S. and French law, the franchisor controls the application of its trademark, name, and business plan. Under French law, however, it is not just the right of the franchisor to do so. Rather, it is the French franchisor's obligation to control his trademark so as to protect the franchise network from any potential injury to the reputation of the franchise. FERRIER, *supra* note 46, at 322.

203. *Dunkin' Donuts, Inc.*, 1998 WL 67613, at \*5.

204. *See id.* at \*6.

205. *See generally* *Acme Valve & Fittings Co. v. Wayne*, 386 F. Supp. 1162, 1165 (S.D. Tex. 1974) (citing *Jones v. Pepsi-Cola Co.*, 223 F. Supp. 650, 653 (D. Neb. 1963)) (drawing a distinction between assignment and licensing of a trademark, in which the owner retains the ownership of the mark while only temporarily granting limited rights to the licensee).

206. *See* *Dunkin' Donuts Franchised Rests. LLC v. KEV Enters.*, 634 F. Supp. 2d 1324 (M.D. Fla. 2009); *Quizno's Corp. v. Kampendahl*, No. 01 C 6433, 2002 U.S. Dist. LEXIS 9124 (N.D. Ill. May 20, 2002); *Dunkin' Donuts, Inc. v. N. Queens Bakery, Inc.*, 216 F. Supp. 2d 31, 39 (E.D.N.Y. 2001). Preliminary injunctions could be sought against a franchisee's or ex-franchisee's nonconsensual use of the marks.

one facility, there were “imminent health hazards.”<sup>207</sup> In yet another case, *Dunkin’ Donuts Franchised Restaurants LLC v. KEV Enterprises, Inc.*, the franchisees were accused of repeatedly failing to supply a sufficient amount of ice cream in their combination stores with Baskin-Robbins.<sup>208</sup> Lastly, in *Quizno’s Corp. v. Kampendahl*, Quiznos charged its franchisee with repeatedly using unclean food equipment and unapproved food products, as well as with other violations relating to safety, sanitation, and store image.<sup>209</sup> These cases demonstrate that even without holding any trademark interests, a franchisee’s violation of the franchisor’s trademark rights could demonstrably hurt the franchisor’s goodwill. Moreover, ex-franchisees have even less of an interest in or ownership rights associated with the franchise than do current franchisees. If an ex-franchisee behaved similarly to the franchisees in the two Dunkin’ Donuts cases or in *Kampendahl*, the ex-franchisee’s continued impermissible use of trademarks could drastically impair the true owner’s goodwill, regardless of whether that owner is the franchisor or a current franchisee.

In *Pappan Enterprises, Inc. v. Hardee’s Food System, Inc.*, the franchisor argued that its goodwill would be irreparably harmed if the franchisee were permitted to continue using the franchisor’s trademark without authorization.<sup>210</sup> The franchisee contended that it would be permanently injured if the court issued a temporary injunction, which could result in a loss of goodwill that the franchisee had already developed for the franchise.<sup>211</sup> As in the cases discussed previously, the court determined that goodwill applied to the trademark and not to any specific restaurant.<sup>212</sup> The *Pappan* court thus took the position that a franchisee neither purchases nor develops goodwill.<sup>213</sup>

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207. *N. Queens Bakery, Inc.*, 216 F. Supp. 2d at 36–38.

208. *KEV Enters.*, 634 F. Supp. 2d at 1327.

209. *Quizno’s Corp.*, 2002 U.S. Dist. LEXIS 9124, at \*5–6.

210. *Pappan Enters., Inc. v. Hardee’s Food Sys., Inc.*, 143 F.3d 800, 803 (3d Cir. 1998).

211. *See id.* at 805–06.

212. *Id.* at 806.

213. *See id.* Indeed, use of trademarks cannot be justified simply as a means to protect a franchisee’s alleged goodwill. In *Sparks Tune-Up Centers, Inc. v. Strong*, No. 92-C-5902, 1995 WL 153277 (N.D. Ill. Apr. 6, 1995), the Strongs failed to make royalty payments, and Sparks terminated the franchise agreement shortly thereafter. *Id.* at \*1. The Strongs continued to use the Sparks trademark in signage and advertising, and Sparks sued for trademark infringement. *Id.* The Strongs claimed that the reason they continued to use the trademark was for fear of losing goodwill. *Id.* at \*6. The court ruled that the Strongs were guilty of trademark infringement, which again implies that the trademark and goodwill are inseverable. *See id.* at \*6–7.

In contrast, the court in *Computer Currents Publishing Corp. v. Jaye Communications*<sup>214</sup> apparently recognized that the franchisee had “cultivated” goodwill through high standards and customer service,<sup>215</sup> and therefore refused to grant the franchisor’s motion for a preliminary injunction that would have prohibited the franchisee from continuing to use the franchisor’s trademark.<sup>216</sup> Accepting the franchisee’s irreparable harm argument, the court reasoned that the potential harm to the franchisee caused by an immediate termination of the franchise far outweighed any potential harm to the franchisor.<sup>217</sup> Specifically, the court held that the “[franchisee] is likely to lose many of the readers and advertisers it has attracted during its eight years of publishing ‘Atlanta Computer Currents,’ as well as the good will [the franchisee] has cultivated.”<sup>218</sup> Thus, the court gave credence to the notion that a franchisee has some degree of ownership over the goodwill that it cultivated.<sup>219</sup>

Sometimes, trademark cases arise in contexts more closely associated with other issues. For example, *Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp.*,<sup>220</sup> one of the most celebrated cases

214. 968 F. Supp. 684 (N.D. Ga. 1997).

215. *Id.* at 690. If it had been enjoined from publishing “Atlanta Computer Currents” in the interim, defendant would likely have lost many of the readers and advertisers that it attracted during its eight years of publishing “Atlanta Computer Currents,” as well as the goodwill defendant cultivated. This obviously would have been detrimental to defendant’s chances of successfully launching a new publication. *Id.*

216. *Id.*

217. *Id.*

218. *Id.* (emphasis added).

219. *Computer Currents* is discussed in Gaylen L. Knack & Ann K. Bloodhart, *Do Franchisors Need to Rechart the Course to Internet Success?*, 20 *FRANCHISE L.J.* 101, 142 (2001). The authors discuss how disputes arise between a franchisor and a franchisee regarding the ownership of customer data collected through a franchisee’s website that contained the franchisor’s trademark. *Id.* When the franchise agreement is silent on ownership of e-data, it behooves the franchisor to assert that it owns all customer data because the data are collected through the goodwill of the franchisor’s trademark. *Id.* Not all courts, however, will take this franchisor-owns-all-goodwill approach. Instead, they may attribute some goodwill to the franchisee, as the court did in *Computer Currents*. *Computer Currents*, 968 F. Supp. at 690. Customer data is collected through goodwill. It is possible that the customer data was collected through the franchisee’s goodwill, not solely through the franchisor’s goodwill. Therefore, it is possible that some courts, absent a clearly delineated contractual arrangement, will rule that the franchisee owns the customer data.

220. 139 F.3d 1396, 1412 (11th Cir. 1998) [hereinafter *Camp Creek II*]. *Camp Creek I* (discussed *infra* text accompanying notes 231–233) was the franchisee’s initial action against the franchisor and related companies in the United States District Court for the Northern District of Georgia. The trial court granted summary judgment for the franchisor, and the franchisee appealed. See *Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp.*, Bus. Franchise Guide (CCH) ¶ 10,775 (N.D. Ga. 1995). In *Camp Creek II*, on a petition for rehearing, the Court of Appeals for the 11th Circuit affirmed in part, reversed in part, and remanded for further proceedings. *Camp Creek II*, 139 F.3d 1396.

concerning encroachment on franchise territory,<sup>221</sup> also involved trademark disputes. In 1990, the franchisee, Camp Creek, entered into a series of agreements with the franchisor, Sheraton, which permitted Camp Creek to operate a Sheraton Inn three and a half miles west of the Atlanta Airport.<sup>222</sup> Another Sheraton franchisee already served the airport market; in 1993, Sheraton bought a Hyatt hotel near the Atlanta Airport and began to operate it as a third Sheraton hotel in that market.<sup>223</sup> This last hotel was franchisor owned, and though each of the three hotels had a slightly different name,<sup>224</sup> Camp Creek argued that each of the three hotels clearly was a “Sheraton” and that each competed against the other two in the Atlanta Airport market.<sup>225</sup>

The “Sheraton–Camp Creek” franchise contract provided no territorial protection for the franchisee.<sup>226</sup> It stipulated that the franchisor would not grant any other license authorizing the use of its names within the geographic area described on an attached schedule that read “site only.”<sup>227</sup> While the contract schedule alone could be read as permitting Sheraton to put other units in the same area as the existing franchisee, the appellate court opted to delve further into the facts.<sup>228</sup> It noted that while Sheraton’s standard-form license agreement contained language expressing Sheraton’s power to compete against the franchisee with company-owned locations, the parties had deleted this language from their contract.<sup>229</sup>

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221. The author’s review of the Westlaw database reveals that as of September 1, 2012, the case had been cited in twenty-seven different federal court cases and in seven cases arising in six different state judicial systems. It had also been discussed in thirty-one different law review articles.

222. *Camp Creek II*, 139 F.3d at 1400.

223. *Id.* at 1401.

224. Camp Creek owned the Sheraton Inn, the other franchisee owned the Sheraton Hotel Atlanta Airport, and the franchisor owned the Sheraton Gateway Hotel Atlanta Airport. *Id.* at 1400–01.

225. Franchisor Sheraton argued that Camp Creek’s profits had improved over time, and thus it had not been harmed by any encroachment. *Id.* at 1405. The court concluded, however, that there was credible evidence indicating that Camp Creek would have been more profitable if there had been no such competition from its franchisor. *Id.* For more on the main topic arising in the case—franchisee territories and markets or the lack thereof—the extensively debated and perhaps most litigated subject in franchising for the past two decades, see Emerson, *supra* note 4.

226. See *Camp Creek II*, 139 F.3d at 1400. In France, territorial exclusivity is not an essential element of a franchise agreement. SIMON, *supra* note 49, at 191. In 2002, the Commercial Chamber of the Court of Cassation held that the lack of a territorial exclusivity clause in a franchise agreement did not give rise to infringement of Article 1134 of the French Civil Code. Cour de cassation [Cass.] [supreme court for judicial matters] com., Nov. 19, 2002, Bull. civ. IV, No. 01-13.492 (Fr.).

227. *Camp Creek II*, 139 F.3d at 1404 n.7.

228. *Id.* at 1404.

229. *Id.*

The parties disagreed about why the provision was removed, but the court seized on the resulting contractual silence as presenting a case in which reasonable people could differ over whether Sheraton's conduct violated its duty of good faith and fair dealing.<sup>230</sup>

To answer this question, the district court noted at trial that after the franchise contract's execution, the franchisor had studied the hotels and their markets.<sup>231</sup> The trial judge, in entering summary judgment on behalf of Sheraton, apparently concluded that these studies were meant to ensure that a new hotel in the same area would not compete in the same market as the existing unit.<sup>232</sup> Based in part on that postcontractual behavior, the trial court maintained that there had been no breach of an implied covenant of good faith and fair dealing, because the franchisor had not acted to destroy the fruits of the franchise contract.<sup>233</sup> The Court of Appeals for the Eleventh Circuit disagreed:

The evidence, viewed in the light most favorable to Camp Creek, shows that [franchisor] ITT Sheraton's representatives did not [conduct their on-site study in Atlanta] to evaluate whether the new hotel would compete against the Inn [franchisee Camp Creek]; similarly, ITT Sheraton's internal evaluations of the project did not seriously consider the competitive harm that might befall the Inn if the property converted to the Sheraton flag.<sup>234</sup>

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230. The Court noted that a summary judgment favoring the defendant franchisor might have made sense if the franchise agreement had been clearer:

This is not to say, however, that Sheraton can never avoid a trial on the issue of its good faith when it seeks to open a new hotel near any of its franchisees; Sheraton need only include (or refrain from limiting and deleting) clear language reserving its right to compete against its franchisees in its License Agreements.

*Id.* at 1405 n.12. The implied covenant, of course, may not be used to rewrite the express terms of a contract. *See id.*

231. *See* Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp., Bus. Franchise Guide (CCH) ¶ 10,775 (N.D. Ga. 1995) (entering summary judgment for the defendant franchisor) [hereinafter *Camp Creek I*].

232. *Id.*

233. *Id.*

234. *Camp Creek II*, 139 F.3d at 1401. Instead, franchisor Sheraton's representatives apparently just looked at the Atlanta Hyatt property that it ultimately acquired and compared that property to others it might acquire instead. *Id.* ("Various members of ITT Sheraton's staff evaluated the proposal [to acquire the Hyatt hotel near the Atlanta airport], both at their corporate headquarters in Boston, Massachusetts and in Atlanta, where they traveled to study competitive properties. . . . [Franchisor Sheraton] maintain[s] that [it] never viewed the Hyatt property as a threat to the Inn because Sheraton expected the property's connection to the Georgia International Convention Center to attract predominately group business.").

The Eleventh Circuit determined that summary judgment was inappropriate on the good faith claim and reversed the lower court.<sup>235</sup>

On remand, the trial court still had to decide whether Sheraton had denied Camp Creek the fruits of its contract. A key issue before the court was the franchisee's allegation that Sheraton engaged in reverse passing off (RPO), a classic form of unfair competition and perhaps also of trademark infringement.<sup>236</sup> RPO occurs when A sells B's product under A's name.<sup>237</sup> The franchisee claimed an interest in the franchisor's name, "Sheraton," used along with the term "Atlanta Airport."<sup>238</sup> The franchisee further alleged that the goodwill it had developed in using those two terms together gave it a property interest for which the franchisor owed a duty to the franchisee.<sup>239</sup> Although it found no evidence of RPO, the court stated that there may have been "passing off," which occurs when A sells A's product under B's name.<sup>240</sup> Such a tort, also called "palming off,"<sup>241</sup> is a concern in all common law jurisdictions.<sup>242</sup> The court affirmed that the evidence might show that the franchisor sold its rooms using the goodwill that the franchisee created.<sup>243</sup> Consequently, the court left the door open for the franchisee to claim an interest in the franchisor's goodwill, finding that the franchisee may have purchased goodwill as part of the franchise package and thereby helped develop that goodwill in the course of business.<sup>244</sup>

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235. *Id.* at 1414.

236. *Id.* at 1413 n.28.

237. *Id.* See also BLACK'S LAW DICTIONARY 1233 (9th ed. 2009) (defining RPO as "falsely representing another's product as one's own in an attempt to deceive potential buyers").

238. *Camp Creek II*, 139 F.3d at 1412.

239. *See id.*

240. *Id.* at 1413 n.28. For definitions of passing off and reverse passing off, see BLACK'S LAW DICTIONARY 1233 (9th ed. 2009).

241. *Id.* at 1219, 1233.

242. *See, e.g.,* Andrea Fong, *Hong Kong*, in INTERNATIONAL FRANCHISING LAW, *supra* note 169, at H.K.-1, -13 (noting that "[t]he goodwill of a business is a Common Law concept and is protected by the law of passing off" and that the first party to establish a reputation in the franchisor's name will hold the business goodwill and be protected from passing off); Andreas Neocleous et al., *Cyprus*, in INTERNATIONAL FRANCHISING LAW, *supra* note 169, at CYP-1, -24, -29 (delineating the Cyprus law on passing off—derived from the English common law—and discussing how a Cypriot franchised business's goodwill is protected by that passing-off law).

243. *Camp Creek II*, 139 F.3d at 1413 n.28.

244. Fong, *supra* note 242, at H.K.-13 (discussing instances when a prospective franchisee may have the goodwill, and recommending that the franchisor acquire that party's business and goodwill). Logic indicates that for the more entrepreneurial franchisees, franchisee businesspersons built goodwill that they had an interest in, not that they increased the goodwill that they bought from the franchisor.

*D. Noncompete Covenants*

Noncompete covenant cases offer dueling assessments of franchising, similar to those furnished in trademark infringement cases.<sup>245</sup> In *DAR & Associates v. Uniforce Services, Inc.*,<sup>246</sup> the franchisee, DAR, sought a declaration that a signed covenant not to compete was void. The franchisor, Uniforce, argued that without the noncompete covenant, the franchisee would be free to siphon customers and goodwill from the franchisor.<sup>247</sup> Uniforce further asserted that the noncompete covenant was necessary to protect that goodwill.<sup>248</sup>

The court denied the franchisee's motion for summary judgment.<sup>249</sup> The franchisor had argued that the franchisee had not obtained any specific rights in the franchise agreement pertaining to goodwill. Like the court in *Bray*,<sup>250</sup> the court bifurcated the goodwill into (1) that which Uniforce had at the time DAR became a licensee,<sup>251</sup> and (2) the overall "business goodwill" or "community goodwill" developed separately by DAR (thanks in part to the franchisor's established systemic goodwill). Ultimately, the franchisor was concerned that the franchisee's failure to comply with the noncompete agreement would somehow taint the integrity of its goodwill.<sup>252</sup> The franchisor therefore argued that enforcing the noncompete agreement would prevent that from occurring, and the court agreed.<sup>253</sup>

In *Bandag, Inc. v. Jack's Tire & Oil, Inc.*,<sup>254</sup> the franchisor contended that it would be irreparably harmed if the court did not

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245. For a comprehensive discussion of noncompete covenants in the franchising context, see Emerson, *Franchising Covenants Against Competition*, *supra* note 5.

246. 37 F. Supp. 2d 192, 195-96 (E.D.N.Y. 1999).

247. *See id.* at 198.

248. *Id.* In effect, the noncompete agreement was supposed to act as a placeholder for the safekeeping of its goodwill, to prevent it from being further taken by DAR and being out-competed in the Maryland market.

249. *Id.* at 204.

250. *See Bray v. QFA Royalties LLC*, 486 F. Supp. 2d 1237, 1237 (D. Colo. 2007), discussed *supra* notes 78-82 and accompanying text.

251. This refers to the goodwill associated with the franchised system's trademark, which Uniforce retained as licensor and which DAR did not legally acquire as part of the license.

252. *DAR & Assocs. v. Uniforce Servs., Inc.*, 37 F. Supp. 2d 192, 198 (E.D.N.Y. 1999). Franchisor Uniforce's fear was that DAR would use the goodwill it developed, which overlapped and was inextricably linked with Uniforce's goodwill, to pull Uniforce's goodwill unto itself (appropriate Uniforce's goodwill). The effect would be to reinforce franchisee DAR's own goodwill and undermine Uniforce's. *Id.*

253. *Id.* at 198, 200.

254. 190 F.3d 924 (8th Cir. 1999).

uphold the noncompete covenant; otherwise, the former franchisee would be able to convert the franchisor's goodwill into goodwill for the ex-franchisee's new enterprise as a manufacturer using competitor Michelin's premolded method.<sup>255</sup> Unlike the court in *DAR & Associates*, the *Bandag* court found for the franchisee.<sup>256</sup> The court stated that because the franchisor could not distinguish between goodwill stemming from the franchisor and goodwill created by the franchisee, the franchisor could not establish irreparable harm.<sup>257</sup> Thus, the *Bandag* court recognized that the franchisee obtained, with respect to the franchise agreement, some rights to the franchisor's goodwill.<sup>258</sup>

This pro-franchisee reasoning is also found in a Canadian case where a noncompetition provision was held to be too uncertain and therefore unenforceable.<sup>259</sup> A high-speed photocopy franchisee sought rescission of its franchise agreement, and while the court found that the franchisee had obtained substantially what it had bargained for and that there was no fundamental breach of contract, the court also concluded that the franchisor's inadequate support services were equivalent to outstanding royalty and advertising fee arrears.<sup>260</sup> The franchisee thus did not owe royalties or fees to the franchisor and, in fact, was entitled to a claim of constructive trust for the business premises.<sup>261</sup> The court even ruled that the franchisee should be paid for the goodwill it built at the business site:

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255. *See id.* at 925–26.

256. *Id.* at 926.

257. *See id.*

258. The same interpretation is evident in holdings in other jurisdictions. *See, e.g.,* *Jiffy Lube Int'l, Inc. v. Weiss Bros.*, 834 F. Supp. 683 (D.N.J. 1993). The court in *Weiss Bros.* found that a particular covenant not to compete was closer to an agreement ancillary to a business sale than to a covenant accompanying an employment contract. *Id.* at 691. It declared that in essence, the franchise contract was a conveyance of the franchisor's goodwill to the franchisee. *Id.* Therefore, when the franchisee terminates the franchise relationship, the goodwill is reconveyed to the franchisor, and the noncompete covenant is required to protect the goodwill after the reconveyance. *Id.*

259. *See* *Magnetic Mktg. Ltd. v. Print Three Franchising Corp.*, 1991 CanLII 1, 55, 57 (Can. B.C. S.C.). The noncompetition clause stated that the franchisee must not

operate or do business under any name or in any manner, either as an individual, agent, partner or as a shareholder, officer or director of a corporation, that *might tend to give the public the impression* that it is operating a printing service, a Print Three Centre or a business similar thereto.

*Id.* at 55 (emphasis added). This language was far too broad and uncertain for enforcement to occur.

260. *Id.* at 49.

261. *Id.* at 52 (“The landlord . . . is content to have [the franchisee] as its tenant.”).

Given the failings of [the franchisor] and the hard work of [the franchisees] to become associated with [the] location, it would constitute unjust enrichment for [the franchisor] to regain control of those premises, cause the eviction of [the franchisee] and obtain for itself whatever locational goodwill may have been built up over the years.<sup>262</sup>

The line of reasoning used in noncompete covenant cases considers a fundamental question: what exactly is a franchisor *selling* when it grants a franchise? The franchisor in *Employee Leasing Ass'n v. Snelling & Snelling, Inc.*<sup>263</sup> argued that the sale of a franchise is the same as the sale of goodwill.<sup>264</sup> There, the franchisee had informed the franchisor that it intended to terminate the franchise agreement and compete with the franchisor despite a noncompete covenant.<sup>265</sup> The franchisor went to court to enforce the agreement, arguing that goodwill attaches to the franchisor's name and was a major element of the sale of the franchise.<sup>266</sup> Throwing the franchisor's very words back at it,<sup>267</sup> the court noted that the franchisor's own franchise agreement proclaimed that all goodwill belongs exclusively to the franchisor.<sup>268</sup> Thus, the court rejected the contention that goodwill had been sold to the franchisee. Seizing upon the fact that under the franchise agreement, the goodwill could be revoked at any time, the court concluded that goodwill had been, instead, *leased* to the franchisee.<sup>269</sup> Although ruling for the franchisee,<sup>270</sup> the *Snelling & Snelling* court held that goodwill

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262. *Id.* at 51–52.

263. 732 F. Supp. 1034 (N.D. Cal. 1990).

264. *Id.* at 1041.

265. *Id.* at 1037.

266. *Id.* at 1041.

267. Presumably, the franchisor drafted the franchise contract. See Postal Instant Press, Inc. v. Sealy, 51 Cal. Rptr. 365, 373 (Cal. Ct. App. 1996) (citing Robert W. Emerson, *Franchising and the Collective Rights of Franchisees*, 43 VAND. L. REV. 1503, 1509 n.21 (1990)) (“Usually [franchise agreements] are form contracts the franchisor prepared and offered to franchisees on a take-or-leave-it [sic] basis.”). Indeed, regardless of whether there is the possibility for negotiation, the worldwide norm is for the franchisor to draft and present the contract to the franchisee. See, e.g., Robert W. Emerson, *Franchise Contracts and Territoriality: A French Comparison*, 3 ENTREPRENEURIAL BUS. L.J. 315, 336 (2009) (noting that the French franchisor, like its American counterpart, is responsible for drafting the franchise agreement).

268. *Snelling & Snelling*, 732 F. Supp. at 1041 n.9.

269. *Id.* at 1041.

270. The court appears to have founded its opinion, at least in part, on both statutory and public policy grounds:

Since the plaintiffs have prevailed on the choice of law issue and demonstrated that the covenant restraining competition in their franchise agreements with Snelling do not fit into any of the statutorily or judicially created exceptions to section 16600 [of the California Business and Professions Code], the Court hereby grants summary

was severable from the trademark and that the franchisee had not purchased the goodwill in the franchise agreement.<sup>271</sup>

### E. Antitrust Tying

Franchisor contentions remain consistent in antitrust tying cases.<sup>272</sup> Franchisors reason that the trademark is inseverable from the allegedly tied product,<sup>273</sup> and because of this inviolable link, there can be no tying.<sup>274</sup> If the court nonetheless found tying, then

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judgment to plaintiffs, denies Snelling's cross-motion for summary judgment and holds that the restrictive covenants in this case are not enforceable against the plaintiffs. Even though the parties agreed to include such a covenant in their agreements, enforcement of such covenants would violate a strong public policy in the state of California of encouraging free competition in business endeavors.

*Id.* at 1045

271. *Id.* at 1041. See generally Robert W. Emerson, *Franchising Covenants Against Competition*, *supra* note 5.

272. See BLACK'S LAW DICTIONARY 1660 (9th ed. 2009) (defining tying as "an arrangement whereby a seller sells a product to a buyer only if the buyer purchases another product from the seller").

273. Courts usually accept the franchisors' contentions. JAMES A. GONIEA & PETER R. SILVERMAN, ANNUAL FRANCHISE AND DISTRIBUTION LAW DEVELOPMENTS 233 (2012) ("Without much success, franchisees and dealers have tried to raise tying claims under the Sherman Act against franchisors."). In most cases, the franchisees cannot show that the franchisor has the necessary market power to coerce franchisees to buy other items (the tied product) in order to obtain the desired item (the tying product). See, e.g., *BP W. Coast Prods., LLC v. Shalabi*, No. C11-1341MJP, 2012 U.S. Dist. LEXIS 82879, at \*26 (W.D. Wash., June 14, 2012) (citing *Illinois Tool Works Inc. v. Indep. Ink*, 547 U.S. 28, 46 (2006) regarding the need for market power, noting that market power is not demonstrated by a franchisor's being an "important player" in its industry, *Rick-Mik Enters. v. Equilon Enters., LLC*, 532 F.3d 963, 977 (9th Cir. 2008), and relying upon the basic proposition that a franchisor's power to make someone buy a franchise cannot be based on power derived from a franchisor-franchisee contract rather than the overall market for the franchise, *Queen City Pizza, Inc., v. Domino's Pizza, Inc.*, 124 F.3d 430, 443 (9th Cir. 1997)).

274. See Emerson, *Franchising and Consumers' Beliefs About "Tied" Product*, *supra* note 115. See, e.g., *Cal. Glazed Prods., Inc. v. Burns & Russell Co. of Balt. City*, 708 F.2d 1423, 1428 (9th Cir. 1983) (finding that glazed masonry block producer's trademark and its component parts were so interrelated in the consumer's mind as to be considered one product); *Hamro v. Shell Oil Co.*, 674 F.2d 784 (9th Cir. 1982) (finding that the nexus between the Shell trademark and the gasoline product was sufficiently close to treat them as one product); *Krehl v. Baskin-Robbins Ice Cream Co.*, 664 F.2d 1348, 1354 (9th Cir. 1982) (finding that ice cream producer and retailer's trademark and products were "so inextricably interrelated in the mind of the consumer as to preclude any finding that the trademark is a separate item for tie-in purposes."); *B-Dry Sys. of Kansas City, Inc. v. B-Dry Sys., Inc.*, No. 88-0653-CV-W-6, 1990 U.S. Dist. LEXIS 17012, at \*12 (W.D. Mo. Dec. 12, 1990) (finding too many unresolved issues of fact and law to grant a summary-judgment order against defendant-franchisor for allegedly tying its trademark to the equipment comprising its waterproofing system); *Smith v. Mobil Oil Corp.*, 667 F. Supp. 1314, 1317 (W.D. Mo. 1987) (finding that defendant Mobil's gasoline product is not separate from its trademark).

the franchisor's fallback position would be that any such restrictions on the franchisee are essential to maintain a level of quality throughout the franchise system.<sup>275</sup>

In *California Glazed Products, Inc. v. Burns & Russell Co. of Baltimore City*, the franchisor insisted that consumers bought the finished product (masonry bricks) because of positive attitudes toward the franchisor and its products.<sup>276</sup> The court determined that the trademark and the products, including the tied products, were so interconnected in the minds of the consumers<sup>277</sup> that they were parts of a total franchise package and could not be considered two products in terms of antitrust tying.<sup>278</sup> The trademark identifies the origin of, and attaches goodwill to, the total product.<sup>279</sup> Thus, goodwill is inseparable from the franchise package that is sold to the franchisee.

In *Mozart Co. v. Mercedes-Benz of North America, Inc.*, the franchisor defended a tying arrangement by arguing that the tie-in was necessary to maintain the quality expected by consumers.<sup>280</sup> The court agreed and stated that when one franchise is below the standard, the franchisor and the entire franchise chain suffer a loss of consumer goodwill.<sup>281</sup> Specifically, the consumer views one franchise unit's lack of quality as a failure by the franchisor to police its franchisees, and the consumer thereby generalizes his perception and applies it to all other franchise locations.<sup>282</sup> On numerous occasions, a franchisor, and subsequently a court, has recognized this phenomenon and therefore tied together the trademark, the system, and the goodwill. In *California Glazed Products, Inc.*, for example, the court concluded that the franchise package includes the

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275. See, e.g., *Metrix Warehouse, Inc. v. Daimler-Benz Aktiengesellschaft*, 828 F.2d 1033, 1040 (4th Cir. 1987) (ruling against appellant's business justification defense because less restrictive measures were available to ensure quality control than requiring franchisees to exclusively purchase replacement parts from the franchisor-distributor); *Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342, 1349-50 (9th Cir. 1987) (finding that defendant-franchisor had a business justification to tie together Mercedes cars and their replacement parts to assure quality control); *Mobile Soft Ice Cream Truck Franchisees of Mister Softee, Inc. v. Mister Softee, Inc.*, 106 F. Supp. 2d 423, 428 (E.D.N.Y. 1999) (finding insufficient evidence showing defendant-franchisor impermissibly required its Mister Softee franchisees to purchase soft-ice-cream mix and other goods from franchisor).

276. *Cal. Glazed Prods., Inc.*, 708 F.2d at 1429-30.

277. *Id.* at 1430.

278. *Id.*

279. *Id.*

280. *Mozart*, 833 F.2d at 1349.

281. See *id.*

282. See *id.* For a brief discussion of what constitutes franchisee free-riding, see *supra* note 23 and accompanying text; see also *infra* note 387 and accompanying text (discussing how the franchisor and franchisee can, in their contract, restructure their relationship to meet concerns such as free-riding).

trademark, the underlying products, and the goodwill.<sup>283</sup> A trademark and goodwill thus become inseparable because the trademark exemplifies the franchise's goodwill.<sup>284</sup>

### F. Vicarious Liability

Inconsistent arguments also arise when franchisees raise the issue of vicarious liability in litigation. A court may hold a franchisor vicariously liable for damage or injury caused by a franchisee if the franchisor had the right to control the day-to-day operations of the franchisee,<sup>285</sup> or if the franchisor represented to the third party that it was in control and the third party relied on that representation to its detriment.<sup>286</sup> Franchisors are vulnerable to claims of vicarious liability because, to avoid losing their trademark rights, they have to exert some degree of control over franchisees' operations. Trademark rights can be lost through a naked license arrangement<sup>287</sup> or due to improper licensing, such as when the trademark owner fails to exert adequate quality control or to supervise the trademark's use by a licensee.<sup>288</sup> Because there is no clear line of supervision beyond which a franchisor's measures of control will subject it to vicarious liability,<sup>289</sup> franchisors and franchisees alike will manipulate the facts to support their respective arguments on vicarious liability.

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283. See, e.g., *Tserpelis v. Mister Softee, Inc.*, 106 F. Supp. 2d 423, 427 (E.D.N.Y. 1999) (holding that the trademark and the product are inseparable).

284. See *id.* (citing *Indus. Rayon Corp. v. Dutchess Underwear Corp.*, 92 F.2d 33, 35 (2d Cir. 1937)) ("Trademark epitomizes the goodwill of a business.").

285. See, e.g., *Nichols v. Arthur Murray, Inc.*, 56 Cal. Rptr. 728 (Cal. Ct. App. 1967); *Manis v. Gulf Oil Corp.*, 185 S.E.2d 589 (Ga. Ct. App. 1971).

286. See *Mobil Oil Corp. v. Bransford*, 648 So. 2d 119, 124 (Fla. 1995).

287. Also called a bare license, a naked license is revocable at will and does not cause a property interest to pass to the licensee. BLACK'S LAW DICTIONARY 1002 (9th ed. 2009). In effect, there are no controls over a naked license. *Id.* at 1004 (a naked license permits the "licensee to use a trademark on any goods and services the licensee chooses"). See Finkelstein & Bussert, *supra* note 192, at 39 (noting that a franchisor must not only have a right to control but must exercise that right, or else the license might be a naked—hence invalid—license, leaving the franchisor with an abandoned and unprotectable trademark).

288. *Dawn Donut, Inc. v. Hart's Food Stores, Inc.*, 267 F.2d 358, 367 (2d Cir. 1959) ("[U]nless the licensor exercises supervision and control over the operations of its licensees the risk that the public will be unwittingly deceived will be increased and this is precisely what the [Lanham] Act is in part designed to prevent. . . . Clearly the only effective way to protect the public where a trademark is used by licensees is to place on the licensor the affirmative duty of policing in a reasonable manner the activities of his licensees.").

289. See Philip F. Zeidman, *Franchising and Other Methods of Distribution: Regulatory Pattern and Judicial Trends*, 1714 PLI/CORP 443, 712 (2009).

In stark contrast to the antitrust cases,<sup>290</sup> the franchisor in *Drexel v. Union Prescription Centers, Inc.*<sup>291</sup> defended a vicarious liability suit by claiming that the franchisee was an independent contractor. Here, the franchisee accidentally gave a lethal drug to the appellant's husband.<sup>292</sup> The appellant claimed that the franchisor was vicariously liable as "owner" of the franchise and argued that the franchisor left itself open to liability as operator of the franchisee's store.<sup>293</sup> The appellant further claimed that the franchisor had led the public to believe that it was dealing with a large national chain or, at the very least, the employees and agents of that chain.<sup>294</sup> The franchisor countered that it did not maintain sufficient control over the franchise to be held vicariously liable for the franchisee's acts.<sup>295</sup> The franchisor further asserted that the franchise agreement only created an independent contractor relationship and not an employer/employee one.<sup>296</sup> Agreeing with the appellant, the U.S. Court of Appeals for the Third Circuit found that there was evidence that the franchisor had made representations of agency or authority to the public.<sup>297</sup>

Unlike the antitrust cases, where franchisors usually emphasize that a franchisee obtains goodwill through the trademark and consumers buy products because of the franchisor's goodwill, the franchisor in *Drexel* declared that it made no representations to the public regarding the franchisee's product and attempted to disassociate its goodwill from the franchisee.<sup>298</sup> In contrast, the franchisors in the antitrust cases avowed that goodwill could not be separated from the trademark and thus attempted to associate the goodwill with the franchisees. These contrary, internally conflicting viewpoints leave franchisees in the dark as to what specific rights they

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290. See *supra* notes 272–284 and accompanying text.

291. 582 F.2d 781, 785 (3d Cir. 1978).

292. *Id.* at 783.

293. *Id.* at 784.

294. *Id.* See Emerson, *Franchisors' Liability when Franchisees Are Apparent Agents*, *supra* note 116 (discussing these beliefs and franchisors' vicarious liability for the acts of their franchisees).

295. *Drexel*, 582 F.2d at 786–87. The franchisor argued on appeal that that the franchisee bore the risk of litigation and that an independent contractor relationship was formed via the franchise agreement. *Id.*

296. *Id.* Numerous commentators and courts have outlined the difference between an independent contractor relationship and an employer/employee relationship in terms of liability. See, e.g., Robert W. Emerson, *Franchise Independence: Awaiting Public Recognition* (Jan. 13, 2012) (unpublished manuscript) (on file with author); King, *supra* note 116, at 461. For further clarification on the employer/employee relationship in the context of liability, see RESTATEMENT (THIRD) OF AGENCY § 7.07 (2006).

297. *Drexel*, 582 F.2d at 795–96.

298. *Id.* at 788.

obtain in franchise agreements or, at least, what rights the franchisor might concede were bestowed upon the franchisee along with the franchise itself.

### G. Tax Cases

In cases involving the Commissioner of Internal Revenue (Commissioner), franchisors often offer arguments inconsistent with the arguments discussed previously.<sup>299</sup> In *Lieb v. Commissioner*, the Internal Revenue Service (IRS) alleged that the franchisor was deficient on its tax filing.<sup>300</sup> The IRS's claim stemmed from a \$300,000 credit that the franchisor gave to the franchisee.<sup>301</sup> The franchisor argued that the credit was in exchange for the franchisee's promise to terminate litigation and to pay the remaining balance on a debt that the franchisee owed to the franchisor.<sup>302</sup> The franchisor claimed that this credit was payment for the franchisee's goodwill and reasoned that by returning customer phone numbers and accounts receivable in exchange, among other things, the franchisee was really selling goodwill, not returning what had always been owned by the franchisor.<sup>303</sup> The court held that the franchisee had no goodwill to sell because all goodwill remains possessed by the franchisor.<sup>304</sup> Following reasoning similar to *Snelling & Snelling*,<sup>305</sup> the court found that goodwill was not part of the franchise package.<sup>306</sup>

In *International Multifoods Corp.*, the franchisor, a U.S. corporation, sold its ownership interest in its foreign franchise operations to a Japanese corporation, Duskin Company,<sup>307</sup> allocating \$1,110,000 of the sale price to goodwill.<sup>308</sup> On its tax return, Duskin

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299. See *Jefferson-Pilot Corp. & Subsidiaries v. Comm'r*, 995 F.2d 530 (4th Cir. 1993); *Int'l Multifoods Corp. & Affiliated Cos. v. Comm'r*, 108 T.C. 25 (1997); *Canterbury v. Comm'r*, 99 T.C. 223 (1992); *Lieb v. Comm'r*, 33 T.C.M. (CCH) 1231 (1974).

300. *Lieb*, 33 T.C.M. (CCH) at 1232 ("Respondent [IRS] determined corporate income tax deficiencies and transferee liabilities in these cases as follows . . .").

301. *Id.*

302. *Id.*

303. *Id.* The \$300,000 credit did correspond to the debt of the franchisor. *Id.* at 1238. Because of conflicting information at different stages of the negotiation—franchisor-franchisee talks, the board meeting, and final settlement—both sides simply differed about that for which the credit was in consideration. *Id.* at 1237–38. Only during the board meeting did the representatives of the franchise parties discuss whether the \$300,000 would be in exchange for the "goodwill" as encapsulated in the clientele information. *Id.* Goodwill was not explicitly mentioned in the talks or in the settlement agreement. *Id.*

304. *Id.* at 1238.

305. See *supra* notes 263–271 and accompanying text.

306. *Lieb*, 33 T.C.M. (CCH) at 1238.

307. *Int'l Multifoods Corp. & Affiliated Cos. v. Comm'r*, 108 T.C. 25 (1997).

308. *Id.* at 36.

listed the monies received for the goodwill as foreign source income for purposes of receiving a foreign tax credit.<sup>309</sup> The IRS challenged this listing.<sup>310</sup> At Tax Court, Duskin posited that the goodwill was severable from the franchise and that any separate monies received for goodwill from the franchisor should be considered foreign, rather than U.S., source income for tax purposes.<sup>311</sup> The IRS contended that goodwill was inherent and not severable from the franchise and that any sale of the franchisor's interest and trademarks already included goodwill for purposes of U.S. source income.<sup>312</sup> The court agreed, finding that the goodwill was "inextricably related" to the franchise,<sup>313</sup> and, therefore, the former franchisees had purchased a franchise package that *already* included goodwill.<sup>314</sup>

Traditionally, goodwill is considered a nonamortizable intangible asset.<sup>315</sup> Under I.R.C. § 1253(d)(2)(A), however, the costs of the trademark and the trade name are amortizable.<sup>316</sup> Still, some courts have held that a portion of the purchase price paid by franchisees should be allocated to goodwill as an additional intangible asset not encompassed in the trademark.<sup>317</sup> In *Canterbury*, however, the Tax Court rejected this contention and held that there was no goodwill separate from the franchisor's trademark.<sup>318</sup> The franchisees in that case had purchased a McDonald's and allocated a portion of the purchase price to the franchise rather than to a separate goodwill.<sup>319</sup> By doing so, the franchisees could write off, or amortize, that allocated amount as an expenditure. The issue before the court was whether the amount attributable to goodwill was also amortizable.<sup>320</sup> The IRS argued that the franchisees should have allocated more to goodwill as a nonamortizable good, implying that goodwill was a cost separate from the purchase price of the franchise.<sup>321</sup>

The franchisees provided an expert, Patrick J. Kaufman, Ph.D., then an associate professor of marketing at Georgia State University, who concluded that "in the McDonald's system of restaurants,

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309. *Id.*

310. *Id.* at 36–38.

311. *Id.*

312. *Id.* at 38–39.

313. *Id.* at 37.

314. *Id.*

315. *See Canterbury v. Comm'r*, 99 T.C. 223, 247–48 (1992).

316. *Id.*

317. For a discussion of this argument (and a rebuttal of it), see *id.* at 248–49.

318. *Id.* at 249.

319. *Id.* at 224.

320. *Id.* at 245.

321. *Id.* at 247.

there is no such thing as franchisee goodwill.”<sup>322</sup> The court agreed with the franchisees and said that the “goodwill inheres in the McDonald’s trade name and trademarks,”<sup>323</sup> thus implying there was no goodwill independent of the franchise.<sup>324</sup> These franchisees adopted a stance incompatible with the franchisee interest in cases where franchisees usually attempt to sell the franchise for a price that *includes* goodwill.

#### H. Equitable Estoppel

Collateral estoppel and judicial estoppel are venerable principles regularly subject to judicial delineation.<sup>325</sup> To estop means that the judge forecloses the supposed contradictions in legal proceedings, with courts sometimes bringing into play quasi-estoppel and its usual precursor, unconscionability. In most cases, the parties fail to raise the issue of whether unconscionability is “fact” or “law,” making the court’s treatment of it difficult to discern.<sup>326</sup> Indeed, creating the contours of estoppel in a way that balances the countervailing policies raised in a claim is a query particularly within the court’s competence.<sup>327</sup> Courts sometimes use estoppel as a self-protective measure, invoking it even where it has not been

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322. *Id.* at 251.

323. *Id.* at 249.

324. *Id.* (quoting *Montgomery Coca-Cola Bottling Co. v. United States*, 615 F.2d 1318, 1331–32 (1980)) (“Anything resembling goodwill attaches solely to the national company and the name of the product . . . the value of goodwill, and the franchise are so interrelated as to be indistinguishable, all the value should then be assigned to the franchise.”).

325. *See, e.g., New Hampshire v. Maine*, 532 U.S. 742 (2001) (ruling that judicial estoppel bars contradictory positions taken on boundary interpretation); *Roxas v. Marcos*, 969 P.2d 1209, 1242 (Haw. 1998) (considering judicial estoppel to preclude inconsistent positions on standing to sue); *see also Payne v. Cartee*, 676 N.E.2d 946, 950 (Ohio Ct. App. 1996) (res judicata). If a court cannot determine inconsistencies from the record, it should deny a pretrial motion for dismissal, but more evidentiary materials can be garnered to support the defense. *See Meeks v. Dashiell*, 890 A.2d 779 (Md. Ct. Spec. App. 2006) (affirming denial of summary judgment based on judicial estoppel).

326. *See Willard v. Ward*, 875 P.2d 441, 443–44 (Okla. Civ. App. 1994) (determining judicial and quasi-estoppel as a matter of law); *Stimpson v. Plano Indep. Sch. Dist.*, 743 S.W.2d 944, 946 (Tex. Ct. App. 1987). *See also USH Ventures v. Global Telesystems Group, Inc.*, 796 A.2d 7, 19 (Del. Super. Ct. 2000) (discussing the defense of unconscionability under the UCC and in other contract actions as based on precepts that are equitable in nature). For the purpose of determining a standard of review, at least one court has called unconscionability a factual matter. *See Jamison v. Consol. Utils., Inc.*, 576 P.2d 97, 102 (Alaska 1978).

327. *Cf. Romero v. Bank of the Sw.*, 83 P.3d 288, 297 (N.M. 2003) (ruling that the application of clean hands in the interests of justice is for judicial decision). *See also Pavel Enters., Inc. v. A.S. Johnson Co., Inc.*, 674 A.2d 521, 533–34 (Md. 1996) (equating the promissory estoppel element of the prevention of injustice with unclean hands, a determination that is a legal question for the court). The “law” versus “fact” inquiry should be informed by consideration of whether judge and jury are each performing those functions that the judge or jury is

raised as a defense.<sup>328</sup> Equitable estoppel<sup>329</sup> preserves the integrity of the courts<sup>330</sup> by precluding inconsistent results in litigation, thereby making precedent more predictable while deterring repetitive litigation.<sup>331</sup>

Equitable estoppel is also intended to promote fair play<sup>332</sup> and protect weaker parties.<sup>333</sup> In furtherance of these goals, some courts will deny the defense of estoppel to parties that have “unclean hands,”<sup>334</sup> as in *SunAmerica Corp. v. Sun Life Assurance Co. of*

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thought best to handle. See T. Leigh Anenson, *Creating Conflicts of Interest: Litigation as Interference with the Attorney-Client Relationship*, 43 AM. BUS. L.J. 173 (2006) (proposing greater judicial cognizance of certain policy issues within a claim for litigious interference with the attorney-client relationship, and further stating that elaborating on which standards of conduct govern in a particular set of circumstances is a question for the judge and determining what relevant events have occurred is normally a function of the jury).

328. *Sartain v. Dixie Coal & Iron Co.*, 266 S.W. 313, 317 (Tenn. 1924); MELVILLE M. BIGELOW, A TREATISE ON THE LAW OF ESTOPPEL, OR OF INCONTESTABLE RIGHTS 763 (James N. Carter ed., 6th ed. 1913); T. Leigh Anenson, *From Theory to Practice: Analyzing Equitable Estoppel Under a Pluralistic Model of Law*, 11 LEWIS & CLARK L. REV. 633, 666–67 (2007) (citing AFSCME Int'l Union v. Bank One, NA, 705 N.W.2d 355, 362 n.3 (Mich. Ct. App. 2005)); Rosalind Poll, Note, *He Who Comes into Equity Must Come with Clean Hands*, 32 B.U. L. REV. 66 (1952)).

329. The Connecticut Supreme Court set forth a basic definition: “Equitable estoppel is a doctrine that operates in many contexts to bar a party from asserting a right that it otherwise would have but for its own conduct.” *Glazer v. Dress Barn*, 873 A.2d 929, 947 (Conn. 2005). See also Eugene R. Anderson & Nadia V. Holober, *Preventing Inconsistencies in Litigation with a Spotlight on Insurance Coverage Litigation: The Doctrines of Judicial Estoppel, Equitable Estoppel, Quasi-Estoppel, Collateral Estoppel, “Mend the Hold,” “Fraud on the Court” and Judicial and Evidentiary Admissions*, 4 CONN. INS. L.J. 589, 633 (1998) (stating that “privity of the parties, reliance, and prejudice, [are] generally recognized elements of equitable estoppel” (footnotes omitted)). See generally Anenson, *supra* note 328; T. Leigh Anenson, *The Triumph of Equity: Equitable Estoppel in Modern Litigation*, 27 REV. LITIG. 377 (2008).

330. Anenson, *supra* note 328, at 663 (citing Zechariah Chafee, Jr., *Foreword to EDWARD D. RE, SELECTED ESSAYS ON EQUITY* (1955)).

331. Anenson, *supra* note 328, at 666 (citing *Decker v. Vt. Educ. Television, Inc.*, 13 F. Supp. 2d 569, 573 (D. Vt. 1998)); *Davis v. B & S, Inc.*, 38 F. Supp. 2d 707, 711 (N.D. Ind. 1998)).

332. Anenson, *supra* note 328, at 663 (citing *In re Lyon*, 882 A.2d 1143, 1151 (Vt. 2005)). French law also provides for the notion of equitable estoppel. In 2010, France’s highest civil court considered the appeal of an arbitration case concerning the contract between a French company and a German company for the packaging of veterinary products. The Cour de cassation clarified the concept of estoppel by noting that estoppel prohibits a party from invoking an argument that is inconsistent with the party’s own behavior and upon which another party has thereby altered its position. That is, a party must raise arguments which are consistent with, or at least not contradictory to, the party’s own actions. Cour de cassation [Cass.] [supreme court for judicial matters] 1e civ., Feb. 3, 2010, Bull. civ. I, No. 08-21288 (Fr.). See also Olivier Vibert, *Précisions sur la Notion d’Estoppel à la Française*, FINYEAR (Apr. 8, 2010), [http://www.cfo-news.com/Precisions-sur-la-notion-d-estoppel-a-la-francaise\\_a14266.html](http://www.cfo-news.com/Precisions-sur-la-notion-d-estoppel-a-la-francaise_a14266.html).

333. Anenson, *supra* note 328, at 663 (citing *B.C. Rogers Poultry, Inc. v. Wedgeworth*, 911 So. 2d 483, 493 (Miss. 2005)).

334. See, e.g., *Haynes Trane Serv. Agency, Inc. v. Am. Standard, Inc.*, 573 F.3d 947, 958 (10th Cir. 2009) (holding that the district court did not abuse its discretion in denying the franchisee relief under the equitable-estoppel doctrine based on the theory of unclean

Canada.<sup>335</sup> In *SunAmerica*, a senior user of a trademark wrongfully sought to appropriate the goodwill that a junior user had established.<sup>336</sup> The senior user of the trademark countersued the junior user for infringement. The junior user argued that the senior user's counterclaim should be estopped because the senior user had acquiesced to the use of its mark by the junior user.<sup>337</sup> The court held that the existence of customer confusion<sup>338</sup> revived the senior user's counterclaim from estoppel.<sup>339</sup> The court noted, however, that this mechanism of revival should be denied in future cases to senior users who come to the court with unclean hands, "wrongfully seeking to appropriate the goodwill of the junior user's mark."<sup>340</sup>

In *Pinnacle Pizza Co. v. Little Caesar Enterprises, Inc.*,<sup>341</sup> franchisee Pinnacle and franchisor Little Caesar each accused the other of poaching goodwill in the way foreshadowed by the *SunAmerica* court. Pinnacle alleged that during its time as a franchisee of Little Caesar, it developed an advertising concept using the phrase "Hot N' Ready" that was highly successful with customers.<sup>342</sup> Pinnacle also alleged that, after allowing Pinnacle to develop and strengthen the "Hot N' Ready" concept for three years, Little Caesar wrongfully began using the concept without Pinnacle's consent.<sup>343</sup> Invoking laches, Little Caesar insisted that Pinnacle should be estopped from objecting to its use of the "Hot N' Ready" concept because Pinnacle "chose to sit on its hands and watch without protest as [Little Caesar] spent millions of dollars promoting" the concept.<sup>344</sup> The court held that questions of material fact existed as to whether equitable

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hands, where a franchisee demonstrated untrustworthiness by his misrepresentations and omissions).

335. 77 F.3d 1325, 1336 n.4 (11th Cir. 1996).

336. *Id.* See also *Iowa Health Sys. v. Trinity Health Corp.*, 177 F. Supp. 2d 897, 925–26 (N.D. Iowa 2001).

337. *SunAmerica Corp.*, 77 F.3d at 1334.

338. *SunAmerica* brought federal unfair-competition and trademark-infringement claims and related state-law claims against Sun Life of Canada, alleging that Sun Life of Canada's use of the marks SUN LIFE (U.S.) and SUN LIFE, without any reference to the geographic modifier "of Canada," was causing unacceptable marketplace confusion. See *id.* at 1330.

339. *Id.* at 1329–30.

340. *Id.* at 1336 n.4 (noting that courts are "able to fashion injunctive relief that avoids the unjust enrichment of a predatory senior user"). See also *Iowa Health Sys.*, 177 F. Supp. 2d at 925–26.

341. 598 F.3d 970 (8th Cir. 2010).

342. *Id.* at 972.

343. *Id.* at 975.

344. *Pinnacle Pizza Co. v. Little Caesar Enters., Inc.*, 560 F. Supp. 2d 786, 798 (D.S.D. 2008), *aff'd*, 598 F.3d 970 (8th Cir. 2010). The laches and limitations arguments of Little Caesar were upheld, as Pinnacle's October 2004 suit against Little Caesar was found to have been filed more than six years after the South Dakota franchise law's six-year period for bringing an action under that Act or for breach of contract. *Little Caesar*, 598 F.3d at 974–79.

estoppel applied and accordingly denied both parties' motions for summary judgment on Little Caesar's equitable defense.<sup>345</sup>

In some equitable estoppel cases, a viable argument persists that some franchisors, because of their contradictory claims, may be estopped from denying to franchisees their own portion of the goodwill. As noted, the franchisor typically asserts exclusive ownership of the franchise's goodwill. Yet when tort plaintiffs aver that the goodwill or trademark has led them to patronize and detrimentally rely on the product or services of a particular franchise, the franchisor denies any vicarious liability, often leaving the franchisee solely responsible for any injuries resulting from the franchise system.<sup>346</sup>

Thus, a contradiction in logic arises. When a franchisee performs well, the franchisor claims the exclusive benefit inuring to the goodwill of the franchise; when a franchisee performs otherwise, the franchisor accepts no responsibility for the ensuing bad will.<sup>347</sup> Tort plaintiffs have contended that franchisors should be estopped from denying responsibility for franchisee negligence,<sup>348</sup> a doctrine known as agency by estoppel.<sup>349</sup>

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345. *Little Caesar*, 560 F. Supp. 2d at 798. Franchisor Little Caesar, however, won the case both at the federal district court on summary judgment and then on appeal. The estoppel argument it advanced was merely an alternative defense, and the appeals court upheld the lower court's grant of Little Caesar's counterclaim for breach of the franchise agreement and concluded that Pinnacle had no claim for a Little Caesar breach of contract, for a franchisor violation of the South Dakota Franchise Act, or for cancellation of Little Caesar's federal trademark for the phrase "Hot N' Ready." *Little Caesar*, 598 F.3d at 978-82 (citing S.D. CODIFIED LAWS § 37-5A-66(7) (2004) (repealed 2008)).

346. For more on vicarious liability cases, see *supra* notes 285-298 and accompanying text. A fair distinction must be drawn between negligent acts associated with the franchise system and those that are not. See, e.g., *Wilson v. Good Humor Corp.*, 757 F.2d 1293 (D.C. Cir. 1985) (affirming a directed verdict in the plaintiffs' suit against Good Humor franchisor after a plaintiff's child was struck and killed by a motorist while crossing the street for ice cream); *Fitz v. Days Inns Worldwide, Inc.*, 147 S.W.3d 467 (Tex. Ct. App. 2004) (affirming the dismissal of the plaintiff's suit against the franchisor for a hit-and-run accident on the sidewalk of a franchisee's hotel).

347. See, e.g., *Allen v. Choice Hotels Int'l*, 942 So. 2d 817 (Miss. Ct. App. 2006) (assigning no liability to the franchisor in a wrongful death action where the franchise agreement was merely the means by which uniform service and public goodwill toward the franchise system was maintained).

348. See, e.g., *Butler v. McDonald's Corp.*, 110 F. Supp. 2d 62 (D.R.I. 2000) (allowing plaintiff's suit against franchisor McDonald's for hand injuries sustained after a franchisee's cracked door shattered while plaintiff entered a restaurant); *Reagin v. Terry*, 675 F. Supp. 297 (M.D.N.C. 1986) (overruling a jury verdict in favor of a plaintiff suing a franchisor for a robber's assault on the plaintiff in a franchisee-owned service station); *Hayman v. Ramada Inn, Inc.*, 357 S.E.2d 394 (N.C. Ct. App. 1987) (rejecting plaintiff's suit against franchisor Ramada Inn, Inc. for failure of the franchisee to provide adequate security or notify plaintiff of the crime rate in the hotel's vicinity).

349. Agency by estoppel

In *Brook v. Nutri/System, Inc.*, the defendant franchisor denied any liability in a wrongful death lawsuit when a woman died after participating in a diet program operated by one of its franchisees.<sup>350</sup> The franchisee's telephone directory listing, advertising, sign frontage, and products were listed under the name of or supplied by Nutri/System as required by a franchise agreement.<sup>351</sup> Moreover, the decedent's husband testified that she had not sought out the franchisee, Thin, Inc., but rather Nutri/System because of the latter's guarantee of weight loss.<sup>352</sup> In fact, a franchisee co-owner testified that 99 percent of the franchise's clients were unfamiliar with the Thin, Inc. name.<sup>353</sup> As a result, the district court denied a summary judgment motion by Nutri/System, finding that a jury may find for the plaintiff on an agency by estoppel theory.<sup>354</sup>

By denying that it bore responsibility for the products sold under its trade name, the franchisor implicitly recognized that the franchisee plays a role in the franchise system independent of the franchisor, its trademarks, and its goodwill. In tort cases such as *Nutri/System*, the franchisor takes an advantageous position, for purposes of agency and tort law, which denies liability<sup>355</sup> but in doing so unwittingly acknowledges that there may be goodwill owned by the franchisee and distinct from the franchisor's interest in the trademark.

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protects third parties who justifiably rely on a belief that an actor is an agent and who act on that belief to their detriment. The doctrine is applicable when the person against whom estoppel is asserted has made no manifestation that an actor has authority as an agent but is responsible for the third party's belief that an actor is an agent and the third party has justifiably been induced by that belief to undergo a detrimental change in position. Most often the person estopped will be responsible for the third party's erroneous belief as the consequence of a failure to use reasonable care, either to prevent circumstances that foreseeably led to the belief, or to correct the belief once on notice of it . . . . The operative question is whether a reasonable person in the position of the third party would believe such an agent, as the actor appears to be, to have authority to do a particular act.

RESTATEMENT (THIRD) OF AGENCY § 2.05 cmt. c (2006) (further noting that a person's scope of power to bind the allegedly estopped party is determined according to the doctrine of apparent authority, as provided in the RESTATEMENT (THIRD) OF AGENCY § 2.03 (2006)).

350. *Brook v. Nutri/System, Inc.*, 654 F. Supp. 7, 7–8 (S.D. Ohio 1986).

351. *Id.* at 9, 11.

352. *Id.* at 11.

353. *Id.* He testified in his deposition: "If you ask [ninety-nine] percent of the clients if they have ever heard of Thin, Inc. [the franchise owner], they would say no." *Id.* Nothing in the record indicates how the deponent came to that conclusion; presumably, it was simply his business experience in owning and operating the franchise.

354. *Id.*

355. See generally Jennifer Arlen & W. Bentley MacLeod, *Beyond Master-Servant: A Critique of Vicarious Liability*, in *EXPLORING TORT LAW 111*, 126 (Stuart Madden ed., 2005) (discussing how vicarious liability, in many cases, can discourage a principal from asserting control over an agent).

Like most estoppel claims, reliance is a key factor. The reliance must be detrimental<sup>356</sup> and reasonable.<sup>357</sup> The great lengths to which franchisors go to create uniformity in both services and appearance likely aid in reliance claims since customers often cannot differentiate between company-operated<sup>358</sup> and franchisee-run locations.<sup>359</sup> Arguably, the same uniformity builds the goodwill associated with the franchise, as customers link their satisfaction to the trademark or other aspects of the system, instead of to individual franchisees.

To aid in the application of vicarious liability claims in agency by estoppel cases, Joseph H. King, Jr., an eminent professor on tort law, proposed that such liability should be limited, in part, to franchisors who do not take reasonable steps to post clear notices that a location is in fact operated by a franchisee, not the franchisor.<sup>360</sup> Such notification would deflate third-party plaintiffs' arguments that they were ignorant of the independent operation of the franchised location, eliminating any basis for showing a detrimental reliance.<sup>361</sup>

Likewise, such disclaimers would likely dispel franchisor contentions that all goodwill benefits only the franchisor and its trademarks, because customers could draw a distinction between franchisor and independent contractors, allocating some goodwill

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356. See Sean Obermeyer, Note, *Resolving the Catch 22: Franchisor Vicarious Liability for Employee Sexual Harassment Claims Against Franchisees*, 40 IND. L. REV. 611, 623 (2007).

357. See John L. Hanks, *Franchisor Liability for the Torts of Its Franchisees: The Case for Substituting Liability as a Guarantor for the Current Vicarious Liability*, 24 OKLA. CITY U.L. REV. 1, 14 (1999).

358. "Company-operated" denotes units directly owned and controlled by the franchisor. Most franchisors have a comparatively small percentage of units that they themselves own and operate. BLAIR & LAFONTAINE, *supra* note 165, at 87–88, 90 (estimating that franchisors retain, as owner-operators, an average of about 15 percent of the units; the percentage can vary depending on the franchisor and its own sense of what is an optimal division between the number of franchisor-run and franchisee-run units). In practice, the percentage of corporate-owned units can vary from none to well over 50 percent. *Id.* at 89–90 (noting, from a dataset of 1,158 franchisors, that 28 percent of the franchisors owned no units although—as indicated in the data—over 10 percent of the franchisors owned more than half of their networks' units). See, e.g., Emerson, *supra* note 10. Of course, if a company controlled all its units (e.g., bought all franchises back), then as a definitional matter, it is no longer a franchisor. Some brands are often erroneously presumed to be franchised. Starbucks Coffee International, for instance, "does not franchise operations and has no plans to franchise in the foreseeable future." *Starbucks Investor Relations: Investor FAQ*, STARBUCKS, <http://investor.starbucks.com/phoenix.zhtml?c=99518&p=irol-faq#26956> (last visited July 3, 2012) (noting, however, that it does have some franchises under the name "Seattle's Best Coffee").

359. Obermeyer, *supra* note 356, at 611, 625; Emerson, *supra* note 10 (discussing nearly fifty questions that collectively demonstrate the public's continuing lack of knowledge about franchising and indicate that people are no more informed about franchising now than they were ten or twenty years ago).

360. King, *supra* note 116, at 461.

361. *Id.* at 463–64.

to the franchisee. Again, this highlights the correlation between franchise goodwill and consumer reliance at the heart of agency by estoppel cases. Typically, plaintiffs claim that they relied on the goodwill of the franchisor in patronizing a franchisee. Franchisors only claim the exclusive benefit of that reliance, however, when a purchase results in a positive sale—as expressed in further goodwill—but not when the result is a negligence lawsuit. Again, equitable estoppel arises.

### III. PROPOSAL

*Grace is given of God, but knowledge is bought in the market.*<sup>362</sup>

Surveys show that consumers are often confused about the control that a franchisor has over its franchisees and whether a particular business even involves a franchisee.<sup>363</sup> With all of the uncertainty that persists in consumer perceptions, it naturally follows that, in many if not most situations, consumers frequent franchised businesses not because of the particular franchisee but because of the trademark and what that trademark represents.<sup>364</sup> One can imagine a sliding scale where the stronger a franchisor's established goodwill is—say, that of McDonald's—the less likely it is that the franchisee will build his own goodwill. If the franchisee does generate his own goodwill in these cases, it is probably because he built upon<sup>365</sup> the already-established goodwill of the franchisor.<sup>366</sup>

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362. ARTHUR HUGH CLOUGH, POEMS OF ARTHUR HUGH CLOUGH 229 (Forgotten Books 2010). (from his 1848 poem, "The Bothie of Tober-na-Vuolich").

363. See Emerson, *Franchising and Consumers' Beliefs About "Tied" Products*, *supra* note 115; Emerson, *Franchisors' Liability When Franchisees Are Apparent Agents*, *supra* note 116. The author conducted similar research in 2000 and in 2008 that confirmed the previous results—most people do not understand the distinction between franchises and company-owned businesses. Of those who do, many still do not know the legal consequences of franchise status, such as limited or no franchisor liability for most contract breaches or torts committed by the local franchisee. Emerson, *supra* note 10.

364. Finkelstein & Bussert, *supra* note 192, at 3–4 ("Goodwill in a trademark develops as a result of favorable consumer recognition and association.").

365. For less established trademarks, the franchisee may justifiably claim that it had little to build from and that its goodwill is largely a product of its own efforts as opposed to the franchisor's efforts. This is discussed *infra* notes 372, 374–376 and accompanying text.

366. Of course, a franchisee may contend that the reverse has happened: the franchisee has built goodwill and is thus entitled to compensation for having to give up the franchise. Commentators have noted that "the corporate franchisor can capture the goodwill of the small business [the franchisee] who got the customer in the first place." Paul Steinberg & Gerald Lescatre, *Beguiling Heresy: Regulating the Franchise Relationship*, 109 PENN ST. L. REV. 105, 223 (2004). See also *Gen. Motors Corp. v. Gallo GMC Truck Sales, Inc.*, 711 F. Supp. 810, 814 (D.N.J. 1989) ("Once a franchisee has succeeded, through the expenditure of his own efforts and capital, to establish a local reputation for the franchise name, his franchise is

It can therefore be argued that, in paying fees to a franchisor, a franchisee is paying to use the goodwill.<sup>367</sup> It is therefore a logical assumption that a more experienced, long-lived franchise with established goodwill requires higher franchise fees than a start-up franchise that has yet to develop much goodwill.<sup>368</sup> Indeed, as the *Trevisan* case portends in French law,<sup>369</sup> one may find that in the United States, the local clientele, which belongs to the franchisee, is composed of consumers, while the national clientele, which belongs to the franchisor, comprises all of the franchisees themselves.<sup>370</sup>

On the other end of the scale, the less established the franchisor's goodwill—such as for many small, start-up franchises—the more one could expect franchisees to build their own goodwill, which, if managed properly, will concurrently reinforce that of the franchisor.<sup>371</sup> Although there are circumstances where customers associate their goodwill toward a franchised business with the specifics of an individual franchisee,<sup>372</sup> those instances are atypical,

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vulnerable to termination.”); *Magnetic Mktg. Ltd. v. Print Three Franchising Corp.*, 1991 CanLII 1, 52 (Can. B.C. S.C.) (holding that a franchisee should be paid for the goodwill it created at its franchised store location), discussed *supra* notes 259–262 and accompanying text; Steinberg & Lescatre, *supra*, at 223–24 (“The nature of a franchise/dealership agreement is such that the upfront costs of acquiring the customer may be borne by the small business, but the gains accrue to the corporate giant.”).

367. *In re Floan & Copperart Pty Ltd.*, slip op. at 56 (Fed. Ct. New South Wales Dist., Aug. 9, 1990) (LEXIS, Commonwealth & Irish Cases Combined File).

368. See Mathewson & Winter, *supra* note 26, at 517. See also Kabir C. Sen, *The Use of Initial Fees and Royalties in Business-Format Franchising*, 14 *MANAGERIAL & DECISION ECON.* 175, 180 (1993). But see Tarique Hossain & Sijun Wang, *Franchisor's Cumulative Franchising Experience and Its Impact on Franchising Management Strategies*, 15 *J. MARKETING CHANNELS* 43 (2008) (concluding that fast-food and restaurant industry data suggest that as a franchisor's cumulative franchising experience rises, the franchisor is more likely to (1) offer less support to franchisees, (2) charge lower royalty and franchise fees, (3) sign longer-term contracts with franchisees, (4) mandate stricter start-up training for franchisee employees, and (5) display decreased propensity to expand franchise networks).

369. Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Mar. 27, 2002, Bull. civ. III, No. 00-20732 (Fr.).

370. See SIMON, *supra* note 49, at 264 n.599.

371. See Rajiv P. Dant et al., *Ownership Redirection in Franchised Channels*, 11 *J. PUB. POL'Y & MARKETING* 33, 36 (1992).

372. Imagine that a new corporation with little goodwill starts franchising. In year one, it allows a franchisee to open a location in a new part of the country. This location is wildly successful and acquires many new and frequent customers in the metropolitan area where it is located. Customers appreciate the local staff and the charisma of the franchised location's owner. The owner is also a philanthropist who is very involved in the local community, which also brings in more business. Before the new location opened, customers in that metropolitan area were unfamiliar with the company. Now, a few years later, the franchisor has decided to terminate the franchise agreement or not renew it, and thus the franchisee sues for customer goodwill. Should that franchisee not be entitled to any of that goodwill? That is the singular difficulty with my proposal, described *infra*, but I believe these circumstances are

especially in larger, standardized franchise systems.<sup>373</sup> For example, assume that a customer lives in Gainesville, Florida and always goes to a certain franchise chain store there but then moves to Jacksonville, Florida and tries the same franchise chain. Assume further that the customer finds the individual franchised business in Jacksonville to be horrible; he might still have goodwill toward the franchised outlet in Gainesville, but obviously not for the one in Jacksonville. How discerning is that customer? In the evidently infrequent case where the customer really comes to see key differences between superficially identical stores,<sup>374</sup> the franchisor goodwill is also derived from a franchisee's activities rather than just the franchise trademark.

Indeed, the franchise trademark does not always matter. There likely are some instances, albeit perhaps uncommon in the franchising context, where the customer only goes to a specific franchisee because of, for example, the friendly, efficient employees of that franchisee or the site of that franchisee's business. For example, the customer knows a regular café that she would visit regardless of the owner or operator so long as the coffee was good, or a hairdresser that she would patronize no matter where or for whom the hairdresser worked. In either of those situations—visiting a franchised enterprise because of its employees or its location<sup>375</sup>—the customer patronizes the franchised business for reasons completely apart from the system's overall reputation, its trademark, or other connotations associated with the franchisor or its chain-style business as a whole. A franchise chain may have multiple franchisees in one town, all of them offering the same product, but consumers tend to patronize one of the franchisees more than the others because that specific franchisee offers something better—be it superior, safer service; more knowledgeable and helpful employees; or simply the

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relatively rare, and any resulting injustice could be averted, for the most part, via strong disclosures to prospective franchisees.

373. See generally Emerson, *Franchising and Consumers' Beliefs About 'Tied' Products*, *supra* note 115.

374. See *infra* notes 375–376 and accompanying text.

375. Courts have addressed how the goodwill associated with a business site the franchisee operates may be severable and separately valuable to the goodwill that attaches to the system's trademark. See *Atl. Richfield Co. v. Razumic*, 390 A.2d 736 (Pa. 1978) (noting that the franchisee built up the goodwill at its franchise site), discussed *supra* notes 73–77 and accompanying text; *Magnetic Mktg. Ltd. v. Print Three Franchising Corp.*, 1991 CanLII 1, 52 (Can. B.C. S.C.) (holding that a franchisee should be paid for the goodwill it created at its franchised store location), discussed *supra* notes 259–262 and accompanying text; *supra* notes 29–33, 47–50, and accompanying text (discussing the French law effective grant of local goodwill rights to franchisees).

very basic accommodation of easier entrance and egress.<sup>376</sup> Even if the franchisee were not accorded rights to goodwill in a future sale or termination of the business, the superior franchisee still benefits from higher revenues compared to its intrabrand rivals. That itself can be an incentive toward, and reward for, franchisee productivity.

This Article proposes that courts apply a single standard for all franchise cases, one that takes consumer perceptions into account. Because of consumers' existing confusion between franchisee-run businesses and company-owned businesses, courts should adopt the position that goodwill cannot be separated from the trademark and that it is purchased by the franchisee as part of a franchise package. This position more accurately portrays the franchisor-franchisee relationship in the minds of consumers and accords with how franchisors market business-format establishments.

A consumer who is unable to decipher what products are regulated by the franchisor and what products are left to the discretion of the franchisee will more easily associate any goodwill with the trademark that adorns the structure of the franchise. By adopting a standard that holds goodwill inseparable from the trademark, similar to the view of most tax courts,<sup>377</sup> court decisions will more accurately reflect the perceptions of consumers and produce more regularity and efficiency in the marketing of franchises themselves. Advisory materials for franchisors have suggested ways to implement such a standard.<sup>378</sup> For example, if it is explicitly stated that all

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376. An example would be a customer's choice to frequent a closer store with smoother traffic patterns and more parking spaces. But this process of choosing between units may occur more often and perhaps in a more idiosyncratic fashion than one might imagine. Surely some consumers prize factors in intra-brand competition besides just proximity. A law student shared with the author how his mother, in California, will visit different locations of the same fast-food system to determine which is better. Once she determines which unit provides her the best service, including the tastiest food and the largest portions, that unit becomes the only one she frequents, even if she must go miles out of her way (sometimes twenty-five miles or more) to visit that particular store. The student's mother has turned what for others may simply be last-minute, one-at-a-time decisions into what for her constitutes an ironclad commitment (a calculated assessment of a meal choice for life); surely she is unusual, but likely not unique.

377. See *supra* Part III.G.

378. One commentator has proposed the following:

*Acknowledge who owns the goodwill.* Expressly state that the phone number, operations manual, confidential information, and business goodwill are owned by the franchisor. Specify that all manuals be returned upon termination of the agreement. Specify that the phone number be transferred to the franchisor upon termination. An argument that all parties contemplated that the goodwill (which the franchisor is seeking to protect through non-compete litigation) belonged to the franchisor will resonate with a judge.

goodwill is associated with the trademark and not the franchisor, a franchisee may feel less manipulated when a relationship ends and he is not compensated for goodwill.<sup>379</sup> That would especially be the case if disclosures to prospective franchisees explicitly state that the franchisee will own *no* goodwill related to the business, at least with respect to the franchisor or any other owner of trademark rights related to the business.

The proposed treatment of goodwill likely would lead parties to make adjustments and would ultimately improve the franchise relationship. For franchisors who do not actually own the trademark,<sup>380</sup> a franchisor would be free to adjust its contract with the trademark owner, as this Article's proposal only governs the franchisor-franchisee relationship. The risk that a franchisee would not work to build the business in the final months or years of the franchise term acts as a counterweight to the proposal's pro-franchisor (or other licensor) characteristics. Surely franchisors could structure franchise agreements and operations manuals to provide incentives for franchisees to continue working hard for the franchise system. Moreover, if a franchise merits renewal, the parties' shaping of a renewed relationship could occur sooner.

For those who argue that goodwill is made up of three components—the site, the brand (which is more than just the trademark), and the guarantee of repeat business attributable to the operator—this approach to goodwill as a matter of *business* reality has faced serious practical problems in terms of its legal application. A rule about ownership of franchise goodwill may, in fact, create incentives for the parties either to pattern their relationship in line with this new, simple legal principle, or—more likely—to take this clearly delineated line of “title” to the goodwill and make practical adjustments reflecting the parties' needs. The parties presently have a number of expectations about goodwill, which—given the breadth, vagueness, or elasticity of the relevant law—may well lead to false assumptions and inefficient behavior. With a clear, firm

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379. Franchise disclosure rules could require the franchisor to inform potential franchisees that any trademark is owned and controlled by the franchisor and that the goodwill goes with that trademark. Such regulation would likely be unnecessary, however, as typical franchisors want to assert such ownership in most situations, and thus already have an incentive to admonish franchisees about the franchise's intellectual property rights and use of the goodwill resting with the franchisor. Other mechanisms may better serve the franchisees' long-term interests, such as a consent clause in which the franchisee—in return for acknowledging the franchisor's control over the goodwill—obtains the franchisor's agreement that it must have the franchisee's consent to any assignment of the franchisor's interest in the franchise-related trademarks. See *infra* notes 401–403 and accompanying text.

380. These franchisors are licensees with the right to grant sublicenses to franchisees.

standard, the parties can, if they so choose, simply adapt their behavior to that benchmark or reach contractual adjustments in line with the parties' own views of what constitutes an optimal arrangement.

These efficiencies could be furthered by a very strong disclosure regime. The Federal Trade Commission rule on franchising mandates numerous disclosures to potential franchisees, but nothing about goodwill.<sup>381</sup> Even without such mandatory disclosures, warnings could come from the franchisor to would-be franchisees either in the contract form itself or in other voluntary disclosures.<sup>382</sup> But a warning would certainly be more meaningful if accompanied by a statement from the Federal Trade Commission that the franchisor is entitled to precondition the grant of a franchise on the franchisor's complete ownership of all goodwill generated by the franchised business. The franchisee would have to sign separately the franchisor's stipulation about goodwill, with that proviso including a declaration that any exception to absolute franchisor ownership must be specified in writing and be separately signed or initialed by both parties. To avoid the problems that would occur if a small, territorially limited franchisor pocketed the goodwill created by pioneer franchisees,<sup>383</sup> the good faith underlying a contractual proviso reserving all goodwill to the franchisor could be judged by these standards: it cannot bind franchisees for a business brand that (1) is still new (e.g., under eighteen months old), or (2) is expanding into virgin territory without survey evidence indicating that the brand is widely recognized there.<sup>384</sup> In other nations, the

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381. 16 C.F.R. §§ 436–437 (2007) (entitled “Disclosure Requirements and Prohibitions Concerning Franchising”). Federal regulations used to require certain disclosures related to goodwill and business opportunities in franchising. 16 CFR § 437.1(a)(15)(viii) (2008) (providing, until this provision was revised in 2010, that when “advertising, offering, licensing, contracting,” selling or otherwise promoting a business opportunity, the seller or broker of that opportunity would commit an unfair or deceptive act if it did not disclose “the conditions under which the business opportunity seller may repurchase, whether by right of first refusal or at the option of the business opportunity seller (and if the business opportunity seller has the option to repurchase . . . whether the repurchase price will be determined by a predetermined formula and whether there will be a recognition of goodwill or other intangibles associated therewith”).

382. *Supra* note 378 and accompanying text.

383. *Supra* note 372 and accompanying text.

384. For example, the survey could show that a significant percentage of the population in that territory were customers of that brand elsewhere. This survey would not be an onerous burden—indeed, likely not even an extra expense—because it is presumably something an expanding franchisor would conduct as part of its marketing plans.

regulatory environment recognizes that franchising simply should not occur until pilot operations have succeeded.<sup>385</sup>

Franchises should always benefit both the franchisee and franchisor, and placing all of the goodwill in the trademark lessens tensions and encourages cooperation and a more successful franchise as a whole. Indeed, if the courts attach goodwill to the trademark, rather than to the franchisor or the franchisee, both parties might benefit. For example, a Quizno's franchisee gains from having a nationally recognized, high-quality trademark. The franchisee also profits from the cooperation and assistance of other Quizno's franchisees. After all, in this scenario, it is in the interest of all Quizno's franchisees to help one another and continue to add to the goodwill of the franchise system as a whole. The franchisor also reaps rewards: the franchise's goodwill will likely be enhanced and franchise and company stock prices will likely increase if individual franchisees work together to achieve the goal of a successful franchise system. This system could even help the judicial system and future litigants because the application of a uniform standard in attaching goodwill to the trademark would lead to consistent results. This, in turn, could bring greater predictability and reduce the likelihood of lawsuits and backlog in the courts.<sup>386</sup>

If goodwill were consistently held inseverable from the trademark, judicial decisions in franchise disputes would become more consistent, with similar fact patterns leading to similar results. For example, in both *Bandag, Inc. v. Jack's Tire & Oil, Inc.*<sup>387</sup> and *DAR & Associates v. Uniforce Services, Inc.*,<sup>388</sup> discussed previously, the franchisor maintained that failing to enforce a covenant not to compete against a former franchisee would harm the franchisor's goodwill.<sup>389</sup> In both cases, the franchisor was essentially arguing

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385. In France, for example, an essential element of franchising is *savoir-faire*, which requires the franchisor to first operate successfully in order to be assured of having the continuous transmission of know-how that is a required element of the franchise relationship. Robert W. Emerson, Franchise Savoir-Faire: Clueless in America? (Dec. 15, 2012) (unpublished manuscript) (on file with author). Moreover, a number of other nations specify testing requirements. Italy requires a franchisor to test its formula on the market before selling to franchisees, and Romanian franchisors "must operate the business for an unspecified period of time prior to expansion." ELIZABETH CRAWFORD SPENCER, THE REGULATION OF FRANCHISING IN THE NEW GLOBAL ECONOMY 259 (2010). China's franchise laws include a "two plus one" rule that a franchisor must operate two stores for at least one year before selling any franchises. *Id.* This rule is also found in some trade association codes of conduct, such as those in Egypt and Malaysia as well as for the European Franchise Federation. *Id.* at 259–60.

386. Other examples could easily be imagined. See *infra* text accompanying note 403.

387. 190 F.3d 924 (8th Cir. 1999). See also *supra* notes 263–268 and accompanying text.

388. 37 F. Supp. 2d 192 (E.D.N.Y. 1999). See also *supra* notes 246–252 and accompanying text.

389. See *Bandag*, 190 F.3d at 926; *DAR & Assocs.*, 37 F. Supp. 2d at 198.

that the franchisee had never obtained any rights to goodwill in the first place. Though the facts in these cases were similar, the court in *DAR & Associates* held in favor of the franchisor<sup>390</sup> and the court in *Bandag* held in favor of the franchisee. In the latter case, the franchisor had not distinguished its goodwill from that retained by the franchisee and therefore could not establish irreparable harm.<sup>391</sup> The *Bandag* court implied that the franchisee might have developed goodwill during his employment and, if he had, that goodwill would belong to him and not to the franchisor. If the court in *Bandag* had before it a clear rule or precedent that goodwill is inseverable and always retained by the franchisor, it would have reached the same result as the court in *DAR & Associates*.

Two other cases with similar facts but different outcomes are *Pappan Enterprises, Inc. v. Hardee's Food System, Inc.*<sup>392</sup> and *Computer Currents Publishing Corp. v. Jaye Communications*,<sup>393</sup> both discussed above. In both cases, the franchisor contended that its goodwill would be irreparably harmed if the franchisee were permitted to continue unauthorized use of the franchisor's trademark.<sup>394</sup> The court in *Pappan Enterprises* held in favor of the franchisor.<sup>395</sup> In rejecting the franchisee's assertion that he would suffer the loss of customer goodwill if enjoined, the court held that "[t]he concept of customers' goodwill in the context of trademark law is goodwill for the mark, not for the specific restaurant."<sup>396</sup> The court in *Computer Currents* held in favor of the franchisee, finding that an injunction would irreparably harm the franchisee because it would cause the franchisee to lose "the good will [the franchisee] has cultivated."<sup>397</sup> Under the rule that goodwill is inseverable from the trademark and remains with the franchisor, the result in *Computer Currents* would have been the same as that in *Pappan Enterprises*, because the court in *Computer Currents* could not have found that the franchisee developed its own goodwill or retained any goodwill after the franchise relationship was terminated.

Some franchisees might worry that vesting all goodwill in the trademark would put them at a disadvantage should the franchisor assign its rights to a new franchisor with a bad or poorly established

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390. *DAR & Assocs.*, 37 F. Supp. 2d at 204.

391. *See Bandag*, 190 F.3d at 926.

392. 143 F.3d 800 (3d Cir. 1998). *See supra* notes 119, 195, 210–213 and accompanying text.

393. 968 F. Supp. 684 (N.D. Ga. 1997). *See supra* notes 215–219 and accompanying text.

394. *See Pappan Enters.*, 143 F.3d at 803; *Computer Currents*, 968 F. Supp. at 689.

395. *Pappan Enters.*, 143 F.3d at 806–07.

396. *Id.* at 806.

397. *Computer Currents*, 968 F. Supp. at 690.

reputation; indeed, the new franchisor's identity could have extremely deleterious effects on the franchisee's ability to attract and retain customers. Where the risk to them is so high, franchisees would argue that they should be given some measure of control. Under a typical franchise agreement, however, the franchisee has little to no power over whether or to whom the franchisor may assign its rights as franchisor; indeed, about three-fourths of franchise agreements expressly state that the franchisor is entitled to assign that agreement to another party,<sup>398</sup> while franchisees almost never have a corresponding right to assign.<sup>399</sup> The franchisor is free to sell the business to a party whose name, reputation, conduct, location, or business practices could negatively affect the trademark.

The franchising parties' own contract clauses can resolve this concern over a new franchisor's identity and reputation.<sup>400</sup> Franchisees could be given a stake in the trademark in the form of a consent clause—either in the original franchise agreement or in a purchase agreement with the new franchisor—which would require the franchisor to obtain franchisees' consent to any assignment of the franchisor's interest. In *International Multifoods Corp. v. Commissioner*, the franchisor assigned its rights to a Japanese company and, in response to concerns that franchisees would be unwilling to work with a foreign franchisor, made the sale subject to franchisees' approval.<sup>401</sup> The purchase agreement included a clause requiring the franchisor to obtain franchisees' consent to the assignment of franchisor's interest.<sup>402</sup> Making the sale of the franchise and its goodwill to a new franchisor subject to approval by some share of the franchisees (or at least subject to a right, upon notice, for franchisees to object) gives the franchisee a stake in the trademark and thus in the business's goodwill.<sup>403</sup> If, for purposes of legal interpretation, legal goodwill were placed within the McDonald's or Dunkin' Donuts trademarks, franchisee owners would presumably

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398. Emerson, *Franchise Contract Clauses*, *supra* note 37, at 970 (66 percent of franchise contracts examined in 1993); Emerson, *supra* note 10 (77 percent of franchise contracts examined in 2011).

399. Emerson, *Franchise Contract Clauses*, *supra* note 37, at 969–70 (95 percent of franchise contracts examined in 1993 involved a franchisor's right to first refusal over a franchisee's proposed transfer of the franchise, and 93 percent of those contracts required that franchisees get franchisor approval before selling or assigning the franchise); Emerson, *supra* note 10 (100 percent and 99 percent respectively of franchise contracts examined in 2011).

400. See *supra* note 380 and accompanying text (a paragraph dealing with how the franchisor and franchisee can, in their contract, restructure the relationship to meet concerns such as free riding).

401. *Int'l Multifoods Corp. v. Comm'r*, 108 T.C. 25, 32 (1997). See *supra* note 119; *infra* note 406; *supra* notes 315–320 and accompanying text.

402. *Id.*

403. See *supra* text accompanying note 393.

have one more reason to work hard to meet the standards that McDonald's or Dunkin' Donuts is known to have, and the franchisors would benefit by having their franchisees cooperate. The increased value of the trademark increases both the value of the individual franchised units and of the system as a whole.

## CONCLUSION

The franchise relationship originates in a contractually imposed demarcation of rights and responsibilities, all ostensibly arrived at with knowledge, consent, and—sometimes—negotiations.<sup>404</sup> Surely, in most cases, franchisors and franchisees are capable of continuing in that vein—resolving difficulties through private dialogue, not a litigated debate. As problems arise, the parties can harness their already-demonstrated abilities to reach a consensus and continue their business relationship, if for no other reason than pecuniary self-interest; at least that is the case most of the time.<sup>405</sup> Franchisors and franchisees do frequently disagree, however, with one common point of contention being the ownership of goodwill.

The courts also render inconsistent decisions, which offer parties little insight into (1) whether goodwill is severable from the franchise and therefore not necessarily sold to the franchisee, or (2) whether goodwill is inseverable from the franchise (in effect, from the trademark accompanying the franchise),<sup>406</sup> and thus is part of a franchise package that the franchisee purchases. Inconsistencies in arguments about goodwill ownership produce incoherent judicial and administrative holdings and sometimes foster inefficient, or even disingenuous, decision making by franchisors

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404. Emerson, *supra* note 91.

405. See Kevin Adler, *Getting Ahead of the Legal Curve*, LJN'S FRANCHISING BUS. & L. ALERT, Feb. 2007, at 1 (recommending that franchisors and franchisees work together, anticipating new laws and developing procedures to implement changes in a cost-effective, goodwill-maximizing fashion rather than waiting until legislation, regulation, or adjudication forces their hands). For an apparently successful exercise of franchise system-wide negotiations, see Davis, *supra* note 107.

406. See *Int'l Multifoods Corp. v. Comm'r*, 108 T.C. 25 (1997) (holding that goodwill in a Mister Donut business in Asia and the Pacific was inseverable from the franchisor's trademarks, discussed *supra* notes 307–312); *Canterbury v. Comm'r*, 99 T.C. 223, 247, 248 (1992) (finding that the expectancy that customers would return for repeat business—or goodwill—is created by and derives from McDonald's name and trademark, also discussed *supra* text accompanying notes 318–328). There are also cases stating the proposition that goodwill is embodied in the trademark, although this may not be considered synonymous with the idea that the two are inseverable.

and franchisees.<sup>407</sup> By taking into account the actual attitudes and perceptions of the key party in the relationship<sup>408</sup>—the franchised business's customers—the franchisors, the franchisees and, most importantly, the courts can focus on the factors to invoke when resolving franchise disputes about goodwill.

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407. See, e.g., *Gorenstein Enters., Inc. v. Quality Care-USA, Inc.*, 874 F.2d 431 (7th Cir. 1989). The court disparaged the franchisees' failure to abide by the franchise agreement, which led to their termination, followed by a wasteful, frivolous, protracted lawsuit; the franchisees wrongfully tried to use the franchisor's trademark (and its goodwill) as a bargaining tactic. See *supra* notes 151–158 and accompanying text. The franchisees were rebuked for taking the trademark hostage, and their termination was upheld. *Id.* Another example is that of *Sparks Tune-Up Centers, Inc. v. Strong*, No. 92 C 5902, 1995 WL 153277, at \*1 (N.D. Ill. Apr. 6, 1995), discussed *supra* note 213.

408. This includes, for example, having goodwill attached to the trademark. See *supra* text accompanying note 386.